

BOARD OF DIRECTORS' REPORT

PLAINTIFF'S  
EXHIBIT  
4211 G  
Comes v. Microsoft

*Raikes*

Finance & Administration  
Q92-2

PLAINTIFF'S  
EXHIBIT  
1186  
A. No. 2:96CV645E

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# Finance and Administration Report

## Contents

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### Finance

<b>Results of Operations</b>	
Comparison with Plan (Quarter) .....	1
Comparison with Plan (YTD) .....	7
Sequential Quarters.....	11
Comparison with Competition .....	15
Comparison with Prior Year (Quarter) .....	23
Comparison with Prior Year (YTD).....	27
<b>Financial Condition</b>	
Balance Sheets and Cash Flows .....	33
Cash and Short-Term Investments .....	37
Accounts Receivable .....	41
Inventories.....	43
Property, Plant and Equipment .....	45
Other Assets .....	47
Current Liabilities / Stockholders' Equity .....	51
<b>Channel Reporting</b>	
Channel Reporting.....	55
International Finished Goods - Europe.....	57
International Finished Goods - ROW .....	65
USSMD .....	75
Worldwide OEM .....	85
PSS.....	91
Other Channels .....	97
US MCS.....	99
<b>Product Group / Business Unit Reporting</b>	
Product Group Reporting.....	105
Applications .....	107
Office.....	111
Analysis .....	117
Entry .....	123
Data Access .....	129
Graphics.....	133

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### Finance (cont.)

Systems.....	137
MS-DOS.....	141
Windows .....	145
Networks.....	151
Languages.....	157
SPAG.....	161
Other Product Groups.....	167
Books .....	169
International R&D.....	175
<b>Tax Matters .....</b>	<b>179</b>
<b>Corporate Risk Management and Audit.....</b>	<b>183</b>

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### Administration

Manufacturing.....	187
Facilities .....	191
Investor Relations / Stock Activity.....	199
Human Resources .....	205
Information Technology .....	211

See page 215 for a list of acronyms that are used throughout this book.

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## COMPARISON WITH PLAN (QUARTER)

	Actual Q92-2		Plan Q92-2		Variance
Net revenues	\$ 682	100.0%	\$ 627	100.0%	9%
Cost of revenues	115	16.9	111	17.8	3
Gross profit	567	83.1	516	82.2	10
Operating expenses:					
Research and development	86	12.6	93	14.8	(8)
Sales and marketing	213	31.1	211	33.6	1
General and administrative	22	3.3	22	3.5	2
Total operating expenses	321	47.0	326	51.9	(2)
Operating income	246	36.1	190	30.3	30
Interest income - net	14	2.0	9	1.5	49
Nonoperating expense	(2)	(0.3)	(4)	(0.7)	(52)
	12	1.7	5	0.8	124
Income before income taxes	258	37.8	195	31.1	32
Provision for income taxes	83	12.1	62	9.9	32
Net income	\$ 175	25.7%	\$ 133	21.2%	32
Average shares outstanding	195.6		192.0		
Net income per share	\$ 0.90		\$ 0.69		30

Windows applications sales helped drive quarterly net revenues \$55 million over plan. The strong domestic introduction of version 2.0 led Win Word sales to \$85 million which was \$18 million over plan and a quarterly record for a Windows applications product. Exceptional worldwide demand for Win Office resulted in quarterly revenues of \$35 million, a \$22 million favorable variance.

Cost of revenues as a percent of net revenues were .9% below plan. Net product costs of 12.8% were essentially as planned while non-product costs were 1.2% below plan. Efficiencies associated with high volumes led to the favorable non-product variance.

Operating expenses of \$321 million were \$5 million below plan. Of note in the research and development variance was payroll which was \$2 million below plan and third party product development which was \$6 million below plan. Sales and marketing was above plan as the \$10 million marketing accrual brought total marketing to \$7 million over plan. A weak dollar caused sales and marketing expenses to be approximately \$7 million more than they would have been if translated at budgeted rates. The marketing accrual and actual exchange versus budget exchange rates offset underspending in headcount related expenses. General and administrative expenses were as planned.

We continued to invest for the future. Q92-2 investments in Systems included \$17 million in the Networks BU (\$17 million plan) and \$4 million in Multimedia (\$5 million plan). Applications investments were \$4 million in Data Access BU (\$6 million plan), \$3 million in Pen (\$3 million plan), and \$6 million in Workgroup (\$3 million plan). Product Support costs were \$36 million (\$43 million plan).

**COMPARISON WITH PLAN (QUARTER)**

**Net Revenues (in millions)**

Channel	Actual Q92-2		Plan Q92-2		Variance
	\$	%	\$	%	
International FG - Europe	\$ 270	40%	\$ 252	40%	7%
International FG - ROW	79	11	73	12	6
<b>Total IFG</b>	<b>349</b>	<b>51</b>	<b>325</b>	<b>52</b>	<b>7</b>
USSMD	215	32	193	31	12
OEM	108	16	95	15	13
Other	10	1	14	2	(27)
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 627</u>	<u>100%</u>	<u>9</u>
<b>Product Group</b>					
Systems	\$ 234	34%	\$ 230	37%	2
Applications	371	54	317	51	17
SPAG	71	10	67	11	5
Other	6	2	13	1	(55)
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 627</u>	<u>100%</u>	<u>9</u>

Worldwide demand for Windows applications and favorable exchange rates led to favorable variances in the reseller channels. In IFG Europe, Windows applications sales were \$118 million, or \$22 million over plan, while finished goods Windows revenues of \$22 million were \$10 million below plan. Local currency IFG-Europe revenues translated into \$29 million more than planned due to the weaker dollar. The favorable exchange variance was partially offset by reserving \$11 million for exchange rate fluctuations. IFG-ROW revenues were modestly above plan. In USSMD, record sales of Windows Office (\$17 million over plan) and Win Word (\$15 million over plan) offset shortfalls in Workgroup Applications and Word for the MAC which were both \$4 million below plan.

**Fifteen Leading Products (units in thousands, revenue in millions)**

Product	Q92-2			Q92-2 Plan			Variance				
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	\$/Unit	Volume	Price	Total
MS-DOS/GW Basic	4,630	\$85	\$18	4,374	\$74	\$17	256	\$1	\$4	\$7	\$11
Win Word	274	69	251	240	65	270	34	(19)	9	(5)	4
Win Excel	211	67	317	246	70	285	(35)	32	(10)	7	(3)
Windows	1,504	66	44	1,685	77	46	(181)	(2)	(8)	(3)	(11)
Ser/Bus Mouse	669	63	93	821	63	77	(152)	16	(11)	11	0
Win Office	85	35	411	30	13	439	55	(28)	24	(2)	22
PC Word	121	34	284	124	30	241	(3)	43	(1)	5	4
MS-DOS 5 Upgrade	602	33	54	434	27	62	168	(8)	11	(5)	6
Mac Excel	76	19	252	59	15	264	17	(12)	5	(1)	4
PC Works	418	16	39	320	18	57	98	(18)	6	(8)	(2)
Mac Word	80	16	200	88	17	196	(8)	4	(1)	0	(1)
Win Word Upd/Upg	156	16	102	22	2	105	134	(3)	14	0	14
LAN Manager	57	12	217	49	13	261	8	(44)	2	(3)	(1)
Win Project	28	11	400	28	11	408	0	(8)	0	0	0
Win Works	79	9	120	32	3	106	47	14	5	1	6
		<u>\$551</u>			<u>\$498</u>				<u>\$49</u>	<u>\$4</u>	<u>\$53</u>
Percent net revenues		<u>81%</u>			<u>79%</u>						

Small percentage variances in units and price had a big impact on our high volume systems products. MS-DOS/GW Basic product was \$11 million over plan primarily from a \$1 per unit price variance. A 10% volume variance for Windows resulted in the large unfavorable variance. Windows shipments to resellers were soft in IFG - Europe. Sales of the OEM Bus Mouse were below plan which caused the volume and price variances. MS-DOS 5 Upgrade volumes ran above plan in all three reseller channels.

The record demand for Windows applications is apparent in the leading products table. Three of the top six products were Windows applications. The strong domestic launch of Win Word 2.0 caused that product's volume

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**COMPARISON WITH PLAN (QUARTER)**

and price variances. The volume variance in Win Excel reflects the shift from standard product to competitive upgrade sales. Win Excel pricing was favorable in Europe, in part due to exchange rates. The large volume variance in Win Office was primarily due to bullish sales in USSMD. High volumes of competitive upgrades, particularly in the USSMD, caused the volume variance in Win Word Upd/Ugd.

**Cost of Revenues**

	Actual Q92-2			Plan Q92-2		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Channel						
International FG - Europe	40.0	12.0%	4.8%	39.6	12.0%	4.8%
International FG - ROW	11.3	16.5	1.9	11.8	18.4	2.2
USSMD	32.4	14.8	4.8	31.7	14.8	4.7
OEM	14.8	4.8	0.7	14.8	2.4	0.4
Other	1.5	13.3	0.1	2.1	7.3	-
	<u>100.0%</u>		<u>12.3%</u>	<u>100.0%</u>		<u>12.1%</u>
Effect of revenue adjustments			x 103.7%			x 102.5%
Product cost - net			12.8			12.5
Non-product costs			4.1			5.3
			<u>16.9%</u>			<u>17.8%</u>

	Actual Q92-2			Plan Q92-2		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Product Group						
Systems	32.6%	8.4%	2.8%	36.0%	9.5%	3.4%
Applications	54.9	10.3	5.6	50.7	9.7	4.9
SPAG	10.5	34.9	3.7	10.8	33.3	3.6
Other	2.0	14.3	0.2	2.5	8.4	0.2
	<u>100.0%</u>		<u>12.3%</u>	<u>100.0%</u>		<u>12.1%</u>

As a percentage of net revenues, net product costs were slightly over plan. Applications sales were a larger portion of the sales mix than planned which pushed net product costs higher than plan. OEM sales included higher than planned Mouse shipments which increased net product costs.

Manufacturing efficiencies associated with greater throughput led to the large favorable variance in non-product costs. Non-product costs included an unplanned \$3 million provision for inventory obsolescence.

**Operating Expenses (in millions)**

	Actual Q92-2	Plan Q92-2	Variance	
Payroll	\$ 109	\$ 113	\$ (4)	(4)%
Marketing	58	61	(3)	(4)
Marketing accrual	10	-	10	-
Depreciation	18	19	(1)	(6)
Employee fringes	17	18	(1)	(8)
Supplies and equipment	16	18	(2)	(9)
Travel and entertainment	14	15	(1)	(3)
Product development	11	17	(6)	(36)
All other	68	65	3	4
	<u>\$ 321</u>	<u>\$ 326</u>	<u>\$ (5)</u>	<u>(2)</u>

Operating expenses were below plan in absolute dollars and as a percentage of net revenues (47.0% actual vs. 57.5% plan). Operating expenses that were impacted by the headcount shortfall were under plan. During Q92-2 \$20-million of additional FY92 incremental marketing spending was approved. The marketing accrual covers the variance between actual and planned marketing spending and a pro-rata portion of the approved incremental marketing.

**COMPARISON WITH PLAN (QUARTER)**

**Headcount**

**Total Headcount**

	<u>Actual</u>	<u>Plan</u>	<u>Variance</u>
December 31, 1991	10,041	10,970	929
September 30, 1991	9,213	10,148	935
June 30, 1991	8,226	7,985	(241)
March 31, 1991	7,341	7,850	509
December 31, 1990	6,769	7,439	670

**Operating Headcount (total above less Manufacturing)**

Actual	Product				Product			
	<u>Channels</u>	<u>Groups</u>	<u>G&amp;A</u>	<u>Total</u>	<u>Channels</u>	<u>Groups</u>	<u>G&amp;A</u>	<u>Total</u>
December 31, 1991	4,860	3,410	801	9,071	53%	38%	9%	100%
September 30, 1991	4,390	3,238	708	8,336	53	39	8	100
June 30, 1991	3,864	2,933	630	7,427	53	39	8	100
March 31, 1991	3,392	2,605	577	6,574	51	40	9	100
December 31, 1990	3,045	2,451	534	6,030	50	41	9	100
<b>Plan</b>								
December 31, 1991	5,299	3,845	807	9,951	53%	39%	8%	100%
September 30, 1991	5,053	3,379	767	9,199	55	37	8	100
June 30, 1991	3,571	2,964	578	7,113	50	42	8	100
March 31, 1991	3,486	2,920	574	6,980	50	42	8	100
December 31, 1990	3,265	2,752	557	6,574	50	42	8	100
<b>Variance</b>								
December 31, 1991	439	435	6	880				
September 30, 1991	663	141	59	863				
June 30, 1991	(293)	31	(52)	(314)				
March 31, 1991	94	315	(3)	406				
December 31, 1990	220	301	23	544				

**Interest and Nonoperating Expense (in millions)**

	<u>Actual</u>	<u>Plan</u>	<u>Variance</u>	
	<u>Q92-2</u>	<u>Q92-2</u>		
Interest income-net				
Interest income	\$ 14	\$ 11	\$ 3	28%
Interest expense	<u>-</u>	<u>(2)</u>	<u>2</u>	(72)
	<u>\$ 14</u>	<u>\$ 9</u>	<u>\$ 5</u>	49
Nonoperating expense				
Financial asset allowance	\$ (3)	\$ (2)	\$ (1)	50
Foreign currency transactions	2	(1)	3	(251)
All other	<u>(1)</u>	<u>(1)</u>	<u>-</u>	(19)
	<u>\$ (2)</u>	<u>\$ (4)</u>	<u>\$ 2</u>	(52)

The size of the portfolio was larger than planned during Q92-2. Cash flow was strong as FY92 profitability exceeded that planned. In addition, yields were better than planned in part due to high interest rates earned on investments in European instruments. As a result interest income was \$3 million greater than planned.

The favorable variance in interest expense resulted from refinements in our hedging strategy.

Due to the uncertain outlook for SCO the financial asset allowance was increased during Q92-2.

During the quarter we held foreign currencies which increased in value relative to the dollar resulting in a \$1.5 million gain.

**COMPARISON WITH PLAN (QUARTER)**

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**Tax Rate**

The tax rate for Q92-2 was 32%, which is the budgeted rate for FY92.

**Net Income**

Net income was \$175 million (25.7% of net revenues) compared to a plan of \$133 million (21.2%). The \$43 million variance resulted from the favorable variances in net revenues, cost of revenues and operating expenses.

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*Results of Operations*

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## COMPARISON WITH PLAN (YTD)

	Actual FY92		Plan FY92		Variance
Net revenues	\$ 1,262	100.0%	\$ 1,090	100.0%	16%
Cost of revenues	219	17.4	195	17.9	13
Gross profit	1,043	82.6	895	82.1	17
Operating expenses:					
Research and development	160	12.7	181	16.6	(12)
Sales and marketing	391	30.9	402	36.9	(3)
General and administrative	43	3.4	43	3.9	1
Total operating expenses	594	47.0	626	57.4	(5)
Operating income	449	35.6	269	24.7	67
Interest income - net	26	2.0	17	1.6	50
Nonoperating expense	(6)	(0.4)	(8)	(0.8)	(35)
	20	1.6	9	0.8	121
Income before income taxes	469	37.2	278	25.5	69
Provision for income taxes	150	11.9	89	8.1	69
Net income	\$ 319	25.3%	\$ 189	17.4%	69
Average shares outstanding	194.0		191.9		
Net income per share	\$ 1.65		\$ 0.98		68

The Company's year to date net revenues were \$172 million over plan. The MS-DOS 5 Upgrade and Windows applications were major contributors to this variance. Year to date MS-DOS 5 Upgrade gross revenues were \$93 million or \$54 million over plan. Our suite of Windows applications generated gross revenues of \$404 million, \$80 million over plan.

Cost of revenues of 17.4% were below plan by .5%. Net product costs were 13.3%, a full percentage point above plan. Conversely, non-product costs were 4.1% or 1.5% less than plan.

Operating expenses were below plan by \$32 million. The \$21 million underspending in research and development was primarily due to a \$14 million variance in third party product development and underspending in payroll (\$5 million) and other headcount related expenditures. In sales and marketing, large variances in headcount related costs more than offset marketing spending. General and administrative expenses were as planned despite an unplanned \$2 million litigation accrual.

Year to date Systems investments were \$28 million in Networks BU (\$34 million plan) and \$8 million in Multimedia (\$10 million plan). Applications investments were \$6 million in Data Access (\$13 million plan), \$13 million in Workgroup (\$7 million plan), and \$5 million in Pen (\$5 million plan). Year to date Product Support costs were \$62 million (\$72 million plan).

Results of Operations

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**COMPARISON WITH PLAN (YTD)**

**Net Revenues (In millions)**

Channel	Actual FY92		Plan FY92		Variance
	\$	%	\$	%	
International FG - Europe	\$ 457	36%	\$ 407	37%	12%
International FG - ROW	143	12	127	12	13
Total IFG	<u>600</u>	<u>48</u>	<u>534</u>	<u>49</u>	12
USSMD	416	33	346	32	20
OEM	226	18	185	17	22
Other	20	1	25	2	(21)
	<u>\$1,262</u>	<u>100%</u>	<u>\$1,090</u>	<u>100%</u>	16
Product Group					
Systems	\$ 490	39%	\$ 407	37%	20
Applications	630	50	539	49	17
SPAG	130	10	121	11	7
Other	12	1	23	3	(42)
	<u>\$1,262</u>	<u>100%</u>	<u>\$1,090</u>	<u>100%</u>	16

Strong MS-DOS 5 Upgrade channel fill in the first quarter and demand for Windows applications in the second quarter were the primary causes of the net revenue variances in the reseller channels. Another factor was exchange rates which increased IFG-Europe net revenues by \$37 million and IFG-ROW net revenues by \$5 million. Conservative reserves for exchange rate fluctuations reduced IFG-Europe revenues by \$11 million.

**Fifteen Leading Products (units in thousands, revenue in millions)**

Product	FY92 YTD			FY92 YTD Plan			Variance				
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	\$/Unit	Volume	Price	Total
MS-DOS/GW Basic	8,491	\$158	\$19	8,079	\$138	\$17	412	\$2	\$7	\$13	\$20
Windows	2,752	122	44	3,071	133	43	(319)	1	(13)	2	(11)
Win Excel	388	116	299	415	115	278	(27)	21	(7)	8	1
Win Word	454	115	253	412	111	269	42	(16)	11	(7)	4
Set/Bus Mouse	1,177	109	93	1,497	114	76	(320)	17	(24)	19	(5)
MS-DOS 5 Upgrade	1,615	93	58	650	39	60	965	(2)	58	(4)	54
PC Word	209	58	275	217	52	242	(8)	33	(2)	8	6
Win Office	124	50	405	56	25	435	68	30	29	(4)	25
Mac Excel	150	37	245	106	28	258	44	(13)	11	(2)	9
Mac Word	173	31	178	165	30	184	8	(6)	2	(1)	1
PC Works	656	29	44	616	33	54	40	(10)	2	(6)	(4)
LAN Manager	159	24	149	96	22	231	63	(82)	15	(13)	2
Win Project	55	21	384	51	21	405	4	(21)	1	(1)	0
Win Word Upd/Upg	202	21	104	36	4	106	166	(2)	17	0	17
Ma- Office	41	16	400	27	12	458	14	(58)	6	(2)	4
		<u>\$1,000</u>			<u>\$877</u>				<u>\$113</u>	<u>\$10</u>	<u>\$123</u>
Percent net revenues		<u>79%</u>			<u>81%</u>						

MS-DOS/GW Basic and MS-DOS 5 Upgrade accounted for the majority of the favorable variance in leading products. MS-DOS/GW Basic was bolstered by better than planned sales of packaged MS-DOS in the international reseller channels. Year to date shipments of MS-DOS 5 Upgrade units were equivalent to the entire FY92 plan. Windows shipments were below plan largely due to IFG-Europe where reseller shipments lagged plan by 150 thousand. Sales of the OEM Bus Mouse were below plan which caused the volume and price variances.

Strong demand for Windows applications led to favorable variances from plan. The volume variance in Win Office was principally domestic as the product is not broadly distributed in the International FG channels. The unit variance in Win Word Upd/Upg was from strong competitive upgrade shipments, primarily in USSMD.

MAC Excel shipments surpassed planned levels in the reseller channels. Conversely, prices were below plan in all reseller channels.

COMPARISON WITH PLAN (YTD)

Cost of Revenues

	Actual FY92			Plan FY92		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Channel						
International FG - Europe	36.3	12.9%	4.7%	36.8	12.1%	4.4%
International FG - ROW	11.3	18.9	2.1	11.7	18.6	2.2
USSMD	34.7	15.0	5.2	32.7	14.8	4.8
OEM	16.2	4.6	0.7	16.5	2.5	0.4
Other	1.5	14.0	0.3	2.3	7.3	0.2
	<u>100.0%</u>		<u>13.0%</u>	<u>100.0%</u>		<u>12.0%</u>
Effect of revenue adjustments			x 102.8%			x 102.6%
Product cost - net			13.3			12.3
Non-product costs			4.1			5.6
			<u>17.4%</u>			<u>17.9%</u>

	Actual FY92			Plan FY92		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Product Group						
Systems	36.6%	10.2%	3.7%	36.6%	9.0%	3.3%
Applications	50.9	10.3	5.2	49.7	9.6	4.8
SPAG	10.5	35.3	3.7	11.2	33.4	3.7
Other	2.0	15.5	0.4	2.5	8.6	0.2
	<u>100.0%</u>		<u>13.0%</u>	<u>100.0%</u>		<u>12.0%</u>

Year to date cost of revenues as a percent of net revenues was below plan. Net product costs were one percent higher than plan. Factors which increased product cost include the high volumes of the MS-DOS 5 Upgrade and higher than planned revenue adjustments (returns reserve). Cost percentages were higher than planned for Systems, Applications and SPAG. The strength of the MS-DOS 5 Upgrade coupled with lower than planned Windows revenues increased Systems product cost. The variance in SPAG was attributable to higher than planned sales of lower margin OEM Mouse and Ballpoint Mouse.

Non-product costs were below plan primarily due to manufacturing efficiencies. Non-product costs include a \$6.4 million unbudgeted provision for inventory obsolescence.

Operating Expenses (in millions)

	Actual FY92	Plan FY92	Variance	
Payroll	\$ 204	\$ 216	\$ (12)	(5)%
Marketing	98	115	(17)	(15)
Marketing accrual	24	-	24	-
Depreciation	33	35	(2)	(6)
Employee fringes	31	35	(4)	(10)
Supplies and equipment	31	35	(4)	(11)
Travel and entertainment	24	29	(5)	(16)
Product development	20	34	(14)	(42)
All other	129	127	2	1
	<u>\$ 594</u>	<u>\$ 626</u>	<u>\$ (32)</u>	<u>(5)</u>

COMPARISON WITH PLAN (YTD)

Actual operating expenses were below planned levels and as a percent of net revenues were 47.0% compared with a plan of 57.4%. The year to date underspending was primarily due to the slower than planned growth in headcount and product development underspending.

The \$24 million marketing accrual covers year to date underspending and a pro-rata portion of the \$30.5 million approved incremental marketing. Actual marketing expenditures were 15% below plan.

Operating expenses also reflect an unplanned litigation provision of \$2 million.

**Interest and Nonoperating Expense (in millions)**

	<u>Actual FY92</u>	<u>Plan FY92</u>	<u>Variance</u>	
Interest income-net				
Interest income	\$ 27	\$ 21	\$ 6	28%
Interest expense	<u>(1)</u>	<u>(4)</u>	<u>3</u>	(72)
	<u>\$ 26</u>	<u>\$ 17</u>	<u>\$ 9</u>	50
Nonoperating expense				
Financial asset allowance	\$ (5)	\$ (4)	\$ (1)	25
Foreign currency transactions	2	(2)	4	(169)
All other	<u>(3)</u>	<u>(2)</u>	<u>(1)</u>	7
	<u>\$ (6)</u>	<u>\$ (8)</u>	<u>\$ 2</u>	(35)

Strong cash flow caused the portfolio to be larger than planned. In addition, yields were better than planned from holding foreign currencies which earned higher interest rates than those prevailing in the United States. As a result, interest income was 28% better than planned.

The favorable variance in interest expense resulted from refinements in our hedging strategies.

During the quarter, we realized a foreign currency gain of \$1.5 million from our hedging strategies.

**Tax Rate**

The year-to-date tax rate was 32%, the same as the budgeted rate.

**Net Income**

Net income was \$319 million (25.3% of net revenues) compared to a plan of \$189 million (17.4%). The \$130 million variance in net income resulted from the large favorable variances in net revenues and operating expenses.

## SEQUENTIAL QUARTERS

### Net Revenues (In millions)

	Q92-2		Q92-1		Q91-4		Q91-3		Q91-2	
<b>Channel</b>										
International FG - Europe	\$ 270	40%	\$ 187	32%	\$ 161	31%	\$ 200	41%	\$ 203	44%
International FG - ROW	79	11	64	11	65	12	53	11	49	11
Total IFG	<u>349</u>	<u>51</u>	<u>251</u>	<u>43</u>	<u>226</u>	<u>43</u>	<u>253</u>	<u>52</u>	<u>252</u>	<u>55</u>
USSMD	215	32	201	35	177	34	130	27	128	28
OEM	108	16	119	20	110	21	90	18	69	15
Other	10	1	9	2	14	2	14	3	11	2
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 580</u>	<u>100%</u>	<u>\$ 527</u>	<u>100%</u>	<u>\$ 487</u>	<u>100%</u>	<u>\$ 460</u>	<u>100%</u>
<b>Product Group</b>										
Systems	\$ 234	34%	\$ 256	44%	\$ 215	41%	\$ 168	34%	\$ 150	33%
Applications	371	54	258	44	257	49	256	52	244	53
SPAG	71	10	59	10	47	9	57	12	59	13
Other	6	2	7	2	8	1	6	2	7	1
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 580</u>	<u>100%</u>	<u>\$ 527</u>	<u>100%</u>	<u>\$ 487</u>	<u>100%</u>	<u>\$ 460</u>	<u>100%</u>

IFG-Europe Windows applications were especially strong and increased \$49 million to \$118 million.

IFG-Europe net revenues were subject to exchange rate changes in each of the last three quarters. For Q92-2 \$17 million and for Q91-2 \$11 million of the sequential *increase* in net revenues was due to a weakening dollar. For Q91-4, \$22 million of the sequential *decrease* in IFG-Europe net revenues was from the strengthening dollar.

The increase in Q92-2 IFG-ROW net revenues was led by a \$8 million sequential increase in Canada's net revenues. The weakening dollar added \$4 million to Q92-2. The increase in IFG-ROW's Q91-4 net revenues was largely in Australia where net revenues increased \$8 million from Q91-3.

In Q92-2, strong Windows applications sales enabled USSMD to post a sequential gain despite a sharp falloff of MS-DOS 5 Upgrade revenues. The MS-DOS 5 Upgrade contributed \$34 million in revenues to Q92-1 and \$42 million to Q91-4 but only \$14 million to Q92-2.

Q92-2 OEM net revenues, although down sequentially, remained at an impressive level. The shift in distribution of Windows to the OEM channel favorably impacted Q92-1 and Q91-4 revenues. During Q91-4, IBM revenues totaled \$16 million, \$14 million more than plan. A significant portion of the IBM revenues were from previously unreported OS/2 and LAN Manager sales. Prepaid balance reserves decreased OEM revenues by \$9 million in Q91-3 and \$8 million in Q91-2.

### Fifteen Leading Products (units in thousands, revenue in millions)

Product	Q92-2		Q92-1		Q91-4		Q91-3		Q91-2	
	Units	Revs	Units	Revs	Units	Revs	Units	Revs	Units	Revs
MS-DOS/GW Basic	4,630	\$85	3,861	\$73	4,295	\$67	3,990	\$70	4,336	\$71
Win Word	274	69	180	46	147	37	153	44	137	43
Win Excel	211	67	177	49	194	55	163	51	135	45
Windows	1,504	66	1,247	56	1,199	49	869	45	728	45
Set/Bus Mouse	669	63	508	46	404	39	518	51	584	54
Win Office	85	35	38	15	32	14	11	6	11	6
PC Word	121	34	88	23	96	26	90	29	140	40
MS-DOS 5 Upgrade	602	33	1,013	60	928	51	--	--	--	--
Mac Excel	76	19	74	18	77	18	50	12	55	13
PC Works	418	16	238	12	239	13	279	17	254	19
Mac Word	80	16	92	15	73	13	73	15	76	15
Win Word Upd/Upg	156	16	45	5	80	9	79	8	52	3
Ln Manager	57	12	101	11	102	17	56	9	44	6
Win Project	28	11	28	10	24	8	24	10	25	9
Win Works	79	9	19	2	--	--	--	--	--	--
		<u>\$551</u>		<u>\$441</u>		<u>\$416</u>		<u>\$367</u>		<u>\$369</u>
Percent net revenues		<u>81%</u>		<u>76%</u>		<u>79%</u>		<u>75%</u>		<u>80%</u>

Results of Operations

MS7029207  
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11

MS-PCA 1189774  
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MS-PCA1189774

## SEQUENTIAL QUARTERS

With the exception of the MS-DOS 5 Upgrade, the Company's Systems products achieved strong sequential increases during Q92-2. The increase in MS-DOS/GW Basic units and revenues was due to a strong uptick in the business of our ROW OEMs. Windows units increased 21% sequentially as IFG-Europe and OEM shipments accelerated. MS-DOS 5 Upgrade revenues were down sharply in each of the reseller channels. Serial Mouse shipments were strong, particularly in Europe-FG.

Life to date Windows distributed (shipments recorded through December 31, 1991 plus a conservative estimate of unreported Q92-2 OEM shipments) totaled 9 million.

Windows applications had strong sequential increases during Q92-2. The introduction of Win Word 2.0 fueled an 86% increase in standard product shipments and a 76% increase in update/upgrade shipments. The 19% sequential increase in Win Excel was primarily caused by Europe-FG shipments. Standard product USSMD Win Excel shipments were down on a sequential basis. The popularity of Win Office in USSMD channel accounted for most of the 24% increase in shipments.

### Cost of Revenues - Product Costs as a Percent of Gross Sales

	<u>Q92-2</u>	<u>Q92-1</u>	<u>Q91-4</u>	<u>Q91-3</u>	<u>Q91-2</u>
Consolidated	12.3%	13.7%	12.7%	12.8%	14.2%
<b>Channel</b>					
International FG - Europe	12.0%	14.3%	12.6%	13.2%	15.6%
International FG - ROW	16.5	21.9	21.5	22.6	22.1
USSMD	14.8	15.2	14.5	15.2	14.9
OEM	4.8	4.4	4.7	3.6	4.5
Other	13.3	14.8	17.5	9.9	12.4
<b>Product Group</b>					
Systems	8.4	11.8	9.9	9.9	10.7
Applications	10.3	10.3	10.2	10.1	11.7
SPAG	34.9	35.8	36.4	33.4	33.5
Other	14.3	17.0	21.4	10.8	15.5

For the periods presented, consolidated product costs trended downward until Q92-1 when product mix shifted to large volumes of the MS-DOS 5 Upgrade. MS-DOS 5 Upgrade product cost percentages are greater than those of Windows applications sold through the reseller channels, and MS-DOS and Win 3.0 licensed to OEMs. During Q92-2 product mix shifted back towards Windows applications, and product costs percentages again declined. Adoption of a more precise method of eliminating markup in intercompany sales also reduced product cost percentages during Q92-2.

### Operating Expenses (in millions)

	<u>Q92-2</u>	<u>Q92-1</u>	<u>Q91-4</u>	<u>Q91-3</u>	<u>Q91-2</u>
Payroll	\$ 109	\$ 96	\$ 83	\$ 75	\$ 68
Marketing	58	40	53	37	37
Marketing accrual	10	14	(18)	-	12
Depreciation	18	15	14	13	11
Employee fringes	17	15	13	12	9
Supplies and equipment	16	15	12	13	10
Travel and entertainment	14	10	13	9	9
Product development	11	9	11	6	7
All other	68	59	54	53	45
	<u>\$ 321</u>	<u>\$ 273</u>	<u>\$ 235</u>	<u>\$ 218</u>	<u>\$ 208</u>
Sequential increase	17%	16%	8%	5%	9%
Seq increase without marketing	15	10	10	14	5

SEQUENTIAL QUARTERS

The sequential growth in operating expenses is attributable to numerous factors including marketing spending, headcount growth, our fourth quarter "budget" spending pattern, and quarter end reserves. Q92-2 expenses with the largest absolute increases were payroll (\$13 million), and marketing and marketing accrual (\$14 million). The sequential increase in depreciation resulted in part from placing Building 16 in service.

**Interest and Nonoperating Expense** (in millions)

	<u>Q92-2</u>	<u>Q92-1</u>	<u>Q91-4</u>	<u>Q91-3</u>	<u>Q91-2</u>
Interest income-net					
Interest income	\$ 14	\$ 13	\$ 12	\$ 11	\$ 10
Interest expense	<u>-</u>	<u>(1)</u>	<u>(2)</u>	<u>(2)</u>	<u>(1)</u>
	<u>\$ 14</u>	<u>\$ 12</u>	<u>\$ 10</u>	<u>\$ 9</u>	<u>\$ 9</u>
Nonoperating expense					
Financial asset allowance	\$ (3)	\$ (2)	\$ (2)	\$ (2)	\$ (3)
Foreign currency transactions	2	-	(1)	-	-
All other	<u>(1)</u>	<u>(1)</u>	<u>-</u>	<u>(1)</u>	<u>(2)</u>
	<u>\$ (2)</u>	<u>\$ (3)</u>	<u>\$ (3)</u>	<u>\$ (3)</u>	<u>\$ (5)</u>

Interest income grew along with the investment portfolio, in spite of generally declining interest rates. Refinements in our hedging program resulted in a Q92-2 decrease in interest expense and a foreign currency gain.

## COMPARISON WITH COMPETITION

Most recent quarter	Microsoft		Novell		Lotus		Borland	
Net revenues	\$ 682	100.0%	\$ 187	100.0%	\$ 219	100.0%	\$ 115	100.0%
Cost of revenues	115	16.9	34	18.1	45	20.3	24	20.7
Gross profit	567	83.1	153	81.9	174	79.7	91	79.3
Operating expenses:								
Research and development	86	12.6	21	11.3	29	13.1	14	12.2
Sales and marketing	213	31.1	52	27.7	94	43.3	72	63.1
General and administrative	22	3.3	9	5.0	18	8.2	--	--
Special charges	--	--	--	--	--	--	6	5.2
Total operating expenses	321	47.0	82	44.0	141	64.6	92	80.5
Operating income (loss)	246	36.1	71	37.9	33	15.1	(1)	(1.2)
Interest income (expense) - net	14	2.0	6	3.0	(1)	(0.3)	2	1.8
Nonoperating expense	(2)	(0.3)	(1)	(0.3)	--	(0.3)	--	(0.1)
Income before income taxes	258	37.8	76	40.6	32	14.5	1	0.5
Provision for income taxes	83	12.1	25	13.6	11	4.7	(7)	(6.1)
Net income	\$ 175	25.7%	\$ 51	27.0%	\$ 21	9.8%	\$ 8	6.6%
Average shares outstanding	196		149		45		27	
Net income per share	\$ 0.90		\$ 0.34		\$ 0.48		\$ 0.28	

Trailing twelve months	Microsoft		Novell		Lotus		Borland	
Net revenues	\$ 2,276	100.0%	\$ 640	100.0%	\$ 766	100.0%	\$ 502	100.0%
Cost of revenues	413	18.1	123	19.3	155	20.3	122	24.3
Gross profit	1,863	81.9	517	80.7	611	79.7	380	75.7
Operating expenses:								
Research and development	290	12.8	78	12.2	174	22.8	79	15.7
Sales and marketing	679	29.8	178	27.7	335	43.5	284	56.6
General and administrative	78	3.4	35	5.5	68	8.9	--	--
Special charges	--	--	--	--	--	--	116	23.1
Total operating expenses	1,047	46.0	291	45.4	577	75.2	479	95.4
Operating income (loss)	816	35.9	226	35.3	34	4.5	(99)	(19.7)
Interest income - net	45	2.0	23	3.6	1	0.1	10	2.0
Nonoperating expense	(12)	(0.5)	(1)	(0.2)	(4)	(0.5)	(2)	(0.3)
Income (loss) before income taxes	849	37.4	248	38.7	31	4.1	(91)	(18.0)
Provision for income taxes	268	11.9	86	13.3	25	3.4	(10)	(1.9)
Net income (loss)	\$ 581	25.5%	\$ 162	25.4%	\$ 6	0.7%	\$ (81)	(16.1)%
Average shares outstanding	192		148		44		24	
Net income (loss) per share	\$ 3.02		\$ 1.10		\$ 0.09		\$ (3.36)	

Results of Operations

MS7029210  
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15

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COMPARISON WITH COMPETITION

**MICROSOFT**  
(consecutive quarters)

	Dec. 31, 1991	Sep. 30, 1991	Jun. 30, 1991	Mar. 31, 1991	Trailing 12 months
Net revenues	\$ 682	\$ 580	\$ 527	\$ 487	\$ 2,276
Cost of revenues	<u>115</u>	<u>104</u>	<u>98</u>	<u>96</u>	<u>413</u>
Gross profit	<u>567</u>	<u>476</u>	<u>429</u>	<u>391</u>	<u>1,863</u>
Operating expenses:					
Research and development	86	74	70	60	290
Sales and marketing	213	178	147	141	679
General and administrative	<u>22</u>	<u>21</u>	<u>18</u>	<u>17</u>	<u>78</u>
Total operating expenses	<u>321</u>	<u>273</u>	<u>235</u>	<u>218</u>	<u>1,047</u>
Operating income	246	203	194	173	816
Interest income - net	14	12	10	9	45
Nonoperating expense	<u>(2)</u>	<u>(3)</u>	<u>(3)</u>	<u>(3)</u>	<u>(12)</u>
Income before income taxes	258	212	201	179	849
Provision for income taxes	<u>83</u>	<u>68</u>	<u>63</u>	<u>55</u>	<u>268</u>
Net income	<u>\$ 175</u>	<u>\$ 144</u>	<u>\$ 138</u>	<u>\$ 124</u>	<u>\$ 581</u>
Average shares outstanding	<u>195.6</u>	<u>192.3</u>	<u>190.8</u>	<u>189.5</u>	<u>192.1</u>
Net income per share	<u>\$ 0.90</u>	<u>\$ 0.75</u>	<u>\$ 0.73</u>	<u>\$ 0.65</u>	<u>\$ 3.02</u>
Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	<u>16.9</u>	<u>18.0</u>	<u>18.5</u>	<u>19.6</u>	<u>18.1</u>
Gross profit	<u>83.1</u>	<u>82.0</u>	<u>81.5</u>	<u>80.4</u>	<u>81.9</u>
Operating expenses:					
Research and development	12.6	12.8	13.3	12.4	12.8
Sales and marketing	31.1	30.7	27.9	28.9	29.8
General and administrative	<u>3.3</u>	<u>3.6</u>	<u>3.4</u>	<u>3.5</u>	<u>3.4</u>
Total operating expenses	<u>47.0</u>	<u>47.1</u>	<u>44.6</u>	<u>44.8</u>	<u>46.0</u>
Operating income	36.1	34.9	36.9	35.6	35.9
Interest income - net	2.0	2.1	2.0	1.9	2.0
Nonoperating expense	<u>(0.3)</u>	<u>(0.6)</u>	<u>(0.8)</u>	<u>(0.7)</u>	<u>(0.5)</u>
Income before income taxes	37.8	36.4	38.1	36.8	37.4
Provision for income taxes	<u>12.1</u>	<u>11.6</u>	<u>11.8</u>	<u>11.4</u>	<u>11.9</u>
Net income	<u>25.7%</u>	<u>24.8%</u>	<u>26.3%</u>	<u>25.4%</u>	<u>25.5%</u>

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COMPARISON WITH COMPETITION

NOVELL  
(consecutive quarters)

	Oct. 26, 1991	Jul. 27, 1991	Apr. 27, 1991	Jan. 26, 1991	Trailing 12 months
Net revenues	\$ 187	\$ 168	\$ 150	\$ 135	\$ 640
Cost of revenues	<u>34</u>	<u>33</u>	<u>27</u>	<u>29</u>	<u>123</u>
Gross profit	<u>153</u>	<u>135</u>	<u>123</u>	<u>106</u>	<u>517</u>
Operating expenses:					
Research and development	21	21	19	17	78
Sales and marketing	52	43	44	39	178
General and administrative	<u>9</u>	<u>9</u>	<u>8</u>	<u>8</u>	<u>35</u>
Total operating expenses	<u>82</u>	<u>73</u>	<u>71</u>	<u>64</u>	<u>291</u>
Operating income	71	62	52	42	226
Nonoperating income	<u>5</u>	<u>4</u>	<u>7</u>	<u>5</u>	<u>22</u>
Income before income taxes	76	66	59	47	248
Provision for income taxes	<u>25</u>	<u>23</u>	<u>21</u>	<u>17</u>	<u>86</u>
Net income	<u>\$ 51</u>	<u>\$ 43</u>	<u>\$ 38</u>	<u>\$ 30</u>	<u>\$ 162</u>
Average shares outstanding	<u>149.4</u>	<u>148.5</u>	<u>148.0</u>	<u>146.0</u>	<u>148.0</u>
Net income per share	<u>\$ 0.34</u>	<u>\$ 0.29</u>	<u>\$ 0.26</u>	<u>\$ 0.21</u>	<u>\$ 1.10</u>
Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	<u>18.1</u>	<u>19.8</u>	<u>18.1</u>	<u>21.5</u>	<u>19.3</u>
Gross profit	<u>81.9</u>	<u>80.2</u>	<u>81.9</u>	<u>78.5</u>	<u>80.7</u>
Operating expenses:					
Research and development	11.3	12.4	12.8	12.4	12.2
Sales and marketing	27.7	25.4	29.2	29.2	27.7
General and administrative	<u>5.0</u>	<u>5.5</u>	<u>5.5</u>	<u>6.0</u>	<u>5.5</u>
Total operating expenses	<u>44.0</u>	<u>43.3</u>	<u>47.5</u>	<u>47.6</u>	<u>45.4</u>
Operating income	37.9	36.9	34.4	30.9	35.3
Nonoperating income	<u>2.7</u>	<u>2.5</u>	<u>4.9</u>	<u>3.9</u>	<u>3.4</u>
Income before income taxes	40.6	39.4	39.3	34.8	38.7
Provision for income taxes	<u>13.6</u>	<u>13.8</u>	<u>13.7</u>	<u>12.2</u>	<u>13.3</u>
Net income	<u>27.0%</u>	<u>25.6%</u>	<u>25.6%</u>	<u>22.6%</u>	<u>25.4%</u>

Results of Operations

MS7029212  
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17

MS-PCA 1189779  
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MS-PCA1189779

COMPARISON WITH COMPETITION

**LOTUS**  
(consecutive quarters)

	Sep. 30, 1991	Jun. 30, 1991	Mar. 31, 1991	Dec. 31, 1990	Trailing 12 months
Net revenues	\$ 219	\$ 186	\$ 174	\$ 186	\$ 766
Cost of revenues	<u>45</u>	<u>39</u>	<u>36</u>	<u>34</u>	<u>155</u>
Gross profit	<u>174</u>	<u>147</u>	<u>138</u>	<u>152</u>	<u>611</u>
Operating expenses:					
Research and development	29	30	27	89	174
Sales and marketing	94	84	82	73	335
General and administrative	<u>18</u>	<u>17</u>	<u>17</u>	<u>16</u>	<u>68</u>
Total operating expenses	<u>141</u>	<u>131</u>	<u>126</u>	<u>178</u>	<u>577</u>
Operating income (loss)	33	16	12	(26)	34
Nonoperating income (expense)	<u>(1)</u>	<u>(2)</u>	<u>(2)</u>	<u>3</u>	<u>(3)</u>
Income before income taxes	32	14	10	(23)	31
Provision for income taxes	<u>11</u>	<u>5</u>	<u>3</u>	<u>9</u>	<u>25</u>
Net income (loss)	<u>\$ 21</u>	<u>\$ 9</u>	<u>\$ 7</u>	<u>\$ (32)</u>	<u>\$ 6</u>
Average shares outstanding	<u>45.2</u>	<u>44.4</u>	<u>42.8</u>	<u>42.6</u>	<u>43.8</u>
Net income per share	<u>\$ 0.48</u>	<u>\$ 0.21</u>	<u>\$ 0.15</u>	<u>\$ (0.74)</u>	<u>\$ 0.09</u>
Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	<u>20.3</u>	<u>21.0</u>	<u>21.1</u>	<u>18.6</u>	<u>20.3</u>
Gross profit	<u>79.7</u>	<u>79.0</u>	<u>78.9</u>	<u>81.4</u>	<u>79.7</u>
Operating expenses:					
Research and development	13.1	16.1	15.5	47.6	22.8
Sales and marketing	43.3	45.3	46.8	39.5	43.5
General and administrative	<u>8.2</u>	<u>9.3</u>	<u>9.7</u>	<u>8.4</u>	<u>8.9</u>
Total operating expenses	<u>64.6</u>	<u>70.7</u>	<u>72.0</u>	<u>95.5</u>	<u>75.2</u>
Operating income (loss)	15.1	8.3	6.9	(14.1)	4.5
Nonoperating income (expense)	<u>(0.6)</u>	<u>(1.1)</u>	<u>(1.3)</u>	<u>1.6</u>	<u>(0.4)</u>
Income before income taxes	14.5	7.2	5.6	(12.5)	4.1
Provision for income taxes	<u>4.7</u>	<u>2.3</u>	<u>1.8</u>	<u>4.5</u>	<u>3.4</u>
Net income (loss)	<u>9.8%</u>	<u>4.9%</u>	<u>3.8%</u>	<u>(17.0)%</u>	<u>0.7%</u>

COMPARISON WITH COMPETITION

**BORLAND<sup>(1)</sup>**  
(consecutive quarters)

	Dec. 31, 1991	Sep. 30, 1991	Jun. 30, 1991	Mar. 31, 1991	Trailing 12 months
Net revenues	\$ 115	\$ 114	\$ 137	\$ 136	\$ 502
Cost of revenues	<u>24</u>	<u>27</u>	<u>29</u>	<u>43</u>	<u>122</u>
Gross profit	<u>91</u>	<u>87</u>	<u>108</u>	<u>93</u>	<u>380</u>
Operating expenses:					
Research and development	14	15	14	36	79
Sales, general and administrative	72	81	78	52	284
Restructuring and pooling costs	<u>6</u>	<u>110</u>	<u>-</u>	<u>-</u>	<u>116</u>
Total operating expenses	<u>92</u>	<u>206</u>	<u>92</u>	<u>88</u>	<u>479</u>
Operating income (loss)	(1)	(119)	16	5	(99)
Nonoperating income	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>	<u>8</u>
Income (loss) before income taxes	1	(117)	18	7	(91)
Provision (benefit) for income taxes	<u>(7)</u>	<u>(14)</u>	<u>6</u>	<u>4</u>	<u>(10)</u>
Net income (loss)	<u>\$ 8</u>	<u>\$ (103)</u>	<u>\$ 12</u>	<u>\$ 3</u>	<u>\$ (81)</u>
Average shares outstanding	<u>27.2</u>	<u>24.4</u>	<u>25.6</u>	<u>24.0</u>	<u>24.0</u>
Net income (loss) per share	<u>\$ 0.28</u>	<u>\$ (4.21)</u>	<u>\$ 0.47</u>	<u>\$ 0.12</u>	<u>\$ (3.36)</u>
Net revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenues	<u>20.7</u>	<u>23.4</u>	<u>21.0</u>	<u>31.6</u>	<u>24.3</u>
Gross profit	<u>79.3</u>	<u>76.6</u>	<u>79.0</u>	<u>68.4</u>	<u>75.7</u>
Operating expenses:					
Research and development	12.2	13.1	10.2	26.4	15.7
Sales, general and administrative	63.1	71.1	56.9	38.5	56.6
Restructuring and pooling costs	<u>5.2</u>	<u>96.6</u>	<u>-</u>	<u>-</u>	<u>23.1</u>
Total operating expenses	<u>80.5</u>	<u>180.8</u>	<u>67.1</u>	<u>64.9</u>	<u>95.4</u>
Operating income (loss)	(1.2)	(104.2)	11.9	3.5	(19.7)
Nonoperating income	<u>1.7</u>	<u>1.8</u>	<u>1.5</u>	<u>1.7</u>	<u>1.7</u>
Income (loss) before income taxes	0.5	(102.4)	13.4	5.2	(18.0)
Provision (benefit) for income taxes	<u>(6.1)</u>	<u>(12.0)</u>	<u>4.7</u>	<u>3.1</u>	<u>(1.9)</u>
Net income (loss)	<u>6.6%</u>	<u>(90.4)%</u>	<u>8.7%</u>	<u>2.1%</u>	<u>(16.1)%</u>

(1) Results of operations combine Borland and Ashton-Tate. Borland has incurred a total of \$116 million in pre-tax transaction and restructuring costs related to the acquisition of Ashton-Tate.

Results of Operations

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19

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**COMPARISON WITH COMPETITION**

**Other Data**

	Microsoft		Novell		Lotus		Borland	
	Dec. 31, 1991		Oct. 26, 1991		Sep. 30, 1991		Dec. 31, 1991	
<b>Current assets:</b>								
Cash and short-term investments	\$ 976	46%	\$ 347	48%	\$ 229	32%	\$ 125	32%
Accounts receivable - net	259	12	164	23	166	23	81	21
Inventories	58	3	12	2	26	4	19	5
Other	59	2	30	3	14	2	39	10
<b>Total current assets</b>	<b>1,352</b>	<b>63</b>	<b>553</b>	<b>76</b>	<b>435</b>	<b>61</b>	<b>264</b>	<b>68</b>
Property, plant and equipment - net	695	33	142	20	148	21	107	28
Other assets	81	4	31	4	133	18	15	4
	<u>\$ 2,128</u>	<u>100%</u>	<u>\$ 726</u>	<u>100%</u>	<u>\$ 716</u>	<u>100%</u>	<u>\$ 386</u>	<u>100%</u>
<b>Current liabilities</b>	<b>\$ 357</b>	<b>16%</b>	<b>\$ 118</b>	<b>16%</b>	<b>\$ 185</b>	<b>26%</b>	<b>\$ 132</b>	<b>34%</b>
Long-term liabilities	--	--	9	1	164	23	14	4
Stockholders' equity	1,771	84	599	83	367	51	240	62
	<u>\$ 2,128</u>	<u>100%</u>	<u>\$ 726</u>	<u>100%</u>	<u>\$ 716</u>	<u>100%</u>	<u>\$ 386</u>	<u>100%</u>

**Other data**

	Microsoft		Novell		Lotus		Borland	
	1991	1990	1991	1990	1991	1990	1991	1990
Closing stock price (12/31)	\$111.25	\$50.17	\$60.00	\$16.50	\$26.25	\$20.00	\$82.25	\$31.75
Common shares outstanding (in millions)	177	172	144	141	44	42	26	14
Market value (in millions)	\$19,691	\$8,629	\$8,640	\$2,327	\$1,155	\$840	\$2,139	\$445
Trailing twelve months revenues (in millions)	\$2,276	\$1,478	\$640	\$498	\$766	\$685	\$502	\$191
Price/revenues ratio	8.7x	5.8x	13.5x	4.7x	1.5x	1.2x	4.3x	2.3x
Trailing twelve months EPS	\$3.02	\$1.93	\$1.10	\$0.68	\$0.09	\$0.54	\$(3.36)	\$1.56
Price/earnings ratio	36.8x	26.0x	54.5x	24.3x	*	37.0x	*	20.4x
Cash (in millions)	\$976	\$540	\$347	\$255	\$229	\$298	\$125	\$45
Cash per share	\$5.51	\$3.14	\$2.41	\$1.81	\$5.20	\$7.10	\$4.81	\$3.21
Book value (in millions)	\$1,771	\$1,119	\$599	\$398	\$367	\$349	\$240	\$75
Book value per share	\$10.01	\$6.51	\$4.16	\$2.82	\$8.34	\$8.31	\$9.23	\$5.36
Price/book value ratio	11.1x	7.7x	14.4x	5.9x	3.1x	2.4x	8.9x	5.9x

\* Not Meaningful

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**COMPARISON WITH COMPETITION**

**Other Competitors**

	IBM	Apple Computer	Son	Oracle	Software Publishing	Computer Assoc
	12/31/91	12/27/91	9/27/91	11/30/91	12/31/91	12/31/91
<b>Income statement (in millions)</b>						
Net revenues	\$22,082	\$1,860	\$755	\$284	\$41	\$455
Net income (loss)	(1,382)	166	27	14	4	76
Net income per share	(2.42)	1.36	0.27	0.10	0.33	0.43
<b>Trailing twelve months (in millions)</b>						
Net revenues	\$64,792	\$6,496	\$3,299	\$1,085	\$141	\$1,438
Net income (loss)	(2,827)	325	191	34	(21)	173
Net income (loss) per share	(0.99) (1)	2.68	1.85	0.25	(1.71)	0.96
<b>Balance sheet</b>						
Cash	4,562 (2)	604 (2)	638	44	53	39 (2)
Other current assets	33,289	2,260	1,155	408	26	885
Other assets	49,473	630	525	307	32	916
	<u>\$87,324</u>	<u>\$3,494</u>	<u>\$2,318</u>	<u>\$759</u>	<u>\$111</u>	<u>\$1,840</u>
Liabilities	49,133	1,727	1,046	341	29	765
Equity	38,191	1,767	1,272	418	82	1,075
	<u>\$87,324</u>	<u>\$3,494</u>	<u>\$2,318</u>	<u>\$759</u>	<u>\$111</u>	<u>\$1,840</u>
<b>Other data</b>						
Closing stock price (December 31, 1991)	\$89.00	\$56.38	\$28.38	\$14.50	\$16.00	\$11.38
Common shares outstanding (in millions)	571	119	98	137	12	177
Market value (in millions)	\$50,819	\$6,709	\$2,781	\$1,987	\$192	\$2,013
Price/revenues ratio	0.8x	1.0x	0.8x	1.8x	1.4x	1.4x
Price/earnings ratio	*	21.0x	15.3x	57.4x	*	11.8x
Cash per share	\$7.99	\$5.08	\$6.51	\$0.32	\$4.42	\$0.22
Book value per share	\$66.88	\$14.85	\$12.98	\$3.05	\$6.83	\$6.07
Price/book value ratio	1.3x	3.8x	2.2x	4.8x	2.3x	1.9x

(1) Excludes a \$3.96 charge to implement a new pension accounting standard.

(2) Balance sheet was not disclosed with December results. The September balance sheet is presented.

\* Not Meaningful

## COMPARISON WITH PRIOR YEAR (QUARTER)

	Q92-2		Q91-2		Variance
Net revenues	\$ 682	100.0%	\$ 460	100.0%	48%
Cost of revenues	<u>115</u>	<u>16.9</u>	<u>93</u>	<u>20.3</u>	23
Gross profit	<u>567</u>	<u>83.1</u>	<u>367</u>	<u>79.7</u>	55
Operating expenses:					
Research and development	86	12.6	54	11.7	59
Sales and marketing	213	31.1	140	30.3	53
General and administrative	<u>22</u>	<u>3.3</u>	<u>14</u>	<u>3.1</u>	55
Total operating expenses	<u>321</u>	<u>47.0</u>	<u>208</u>	<u>45.1</u>	55
Operating income	<u>246</u>	<u>36.1</u>	<u>159</u>	<u>34.6</u>	54
Interest income - net	14	2.0	9	2.0	45
Nonoperating expense	<u>(2)</u>	<u>(0.3)</u>	<u>(5)</u>	<u>(1.1)</u>	(63)
	<u>12</u>	<u>1.7</u>	<u>4</u>	<u>0.9</u>	176
Income before income taxes	258	37.8	163	35.5	58
Provision for income taxes	<u>83</u>	<u>12.1</u>	<u>50</u>	<u>11.0</u>	63
Net income	<u>\$ 175</u>	<u>25.7%</u>	<u>\$ 113</u>	<u>24.5%</u>	55
Average shares outstanding	<u>195.6</u>		<u>185.5</u>		
Net income per share	<u>\$ 0.90</u>		<u>\$ 0.61</u>		48

Net revenues increased \$222 million from the comparable quarter of last year. Sales of the MS-DOS 5 Upgrade of \$33 million, Windows Office (\$35 million, up \$31 million), Win Word (up \$26 million or 60%) and Win Excel (up \$22 million or 49%) contributed to overall growth.

Windows applications represented a larger portion of total applications revenues. Windows applications accounted for 64% of applications revenue during Q92-2, up from 47% in the corresponding quarter a year ago. The MS-DOS applications sales mix declined from 35% last year to 18% during Q92-2, and Macintosh applications declined slightly from 18% to 16% of total applications revenue.

Windows applications revenues during Q92-2 of \$248 million were more than double Q91-2 sales of \$119 million. MS-DOS applications revenues declined to \$71 million, down 19% from a year ago.

Cost of revenues as a percent of net revenues were down sharply from a year ago. Factors in the decrease include increased sales of higher margin Windows applications, operational improvements, reductions in product costs, and increased sales of MLPs.

Operating expenses for the quarter increased \$113 million. Growth in headcount and increased spending in International Research and Development of \$10 million contributed to the increase in research and development expense as a percent of net revenues. IFG sales and marketing expenses grew \$37 million or 69% and USSMD expenses grew \$30 million or 57%, which contributed to the increase in sales and marketing expenses as a percent of net revenue. The increase in general and administrative expenses was in line with the growth in revenues.

**COMPARISON WITH PRIOR YEAR (QUARTER)**

**Net Revenues (in millions)**

Channel	Q92-2		Q91-2		Growth
	\$	%	\$	%	
International FG - Europe	\$ 270	40%	\$ 203	44%	33%
International FG - ROW	79	11	49	11	61
Total IFG	349	51	252	55	39
USSMD	215	32	128	28	68
OEM	108	16	69	15	55
Other	10	1	11	2	(8)
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 460</u>	<u>100%</u>	48
<b>Product Group</b>					
Systems	\$ 234	34%	\$ 150	33%	55
Applications	371	54	244	53	52
SPAG	71	10	59	13	20
Other	6	2	7	1	(18)
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 460</u>	<u>100%</u>	48

All major channels showed strong year over year revenue growth. IFG-Europe growth of \$67 million results principally from strong growth in England (up \$15 million or 82%) and increases in Germany (up \$25 million or 39%) and France (up \$14 million or 21%). Growth in IFG-ROW of 61% is attributable to growth at Canada (up 95%), Australia (up 49%) and Japan (up 33%). USSMD growth resulted from very strong sales of the Win Office and Win Word 2.0 (launched in December). OEM revenues grew \$39 million or 55%, reflecting growth in Windows bundling by OEMs and higher revenue per unit for MS-DOS.

Systems revenue increased \$84 million year over year, from increased MS-DOS license revenue (up \$14 million or 20%), sales of MS-DOS 5 Upgrade (\$33 million, new this year) and Windows (up \$21 million or 47%). Networks revenue more than doubled to \$18 million, but Languages revenue declined 4% to \$15 million.

Applications revenue increased \$127 million. Virtually all the growth is attributable to Windows applications which increased \$129 million or 108%. The introduction of Win Word 2.0, an aggressive competitive upgrade program and a price reduction in the Win Office contributed to the increase.

**Fifteen Leading Products (units in thousands, revenue in millions)**

Product	Q92-2			Q91-2			Change				
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	\$/Unit	Volume	Price	Total
MS-DOS/GW Basic	4,630	\$85	\$18	4,336	\$71	\$16	294	\$2	\$5	\$9	\$14
Win Word	274	69	251	137	43	313	137	(62)	43	(17)	26
Win Excel	211	67	317	135	45	335	76	(18)	26	(4)	22
Windows	1,504	66	44	728	45	62	776	(18)	49	(28)	21
Ser/Bus Mouse	669	63	93	584	54	93	85	0	9	0	9
Win Office	85	35	411	9	4	468	76	(57)	36	(5)	31
PC Word	121	34	284	140	40	282	(19)	2	(6)	0	(6)
MS-DOS 5 Upgrade	602	33	54	--	--	--	602	54	33	0	33
Mac Excel	76	19	252	55	13	236	21	16	5	1	6
PC Works	418	16	39	254	19	76	164	(37)	13	(16)	(3)
Mac Word	80	16	200	76	15	198	4	2	1	0	1
Win Word Upd/Upg	156	16	102	52	3	67	104	35	7	6	13
LAN Manager	57	12	217	44	6	145	13	72	2	4	6
Win Project	28	11	400	25	9	379	3	21	1	1	2
Win Works	79	9	120	--	--	--	79	120	9	0	9
		<u>\$551</u>			<u>\$367</u>				<u>\$233</u>	<u>(\$49)</u>	<u>\$184</u>
% of Consolidated net revenues		<u>81%</u>			<u>80%</u>						

Systems products shipments were up sharply from the prior comparable quarter. A combination of higher MS-DOS unit volumes (up 7%) and revenue per unit (up \$2) resulted in a 20% increase in MS-DOS revenues. Windows unit sales during Q92-2 exceeded 1.5 million, more than double a year ago. Revenues grew at a slower



**COMPARISON WITH PRIOR YEAR (QUARTER)**

rate than units due to a tripling in OEM unit sales. The MS-DOS 5 Upgrade, introduced in June 1991, added \$33 million to revenues.

The growth in applications products was led by Windows applications. Win Word revenues were up \$26 million or 60%. Revenue per unit was down \$62 or 20% due to high volumes of academic product. Win Excel revenues were up \$22 million or 49%, reflecting strong growth in international revenues (up \$20 million or 64%). IFG generated 77% of Win Excel revenues during Q92-2, up from 64% a year ago. Win Office shipments generated revenue of \$35 million compared with \$4 million a year ago. USSMD accounted for 66% of Win Office revenues and 70% of unit sales. An aggressive Win Word upgrade program resulted in a tripling of unit sales and revenue of more than 5 times last year.

**Cost of Revenues**

	Q92-2			Q91-2		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Channel						
International FG - Europe	40.0	12.0%	4.8%	42.8	15.6%	6.7%
International FG - ROW	11.3	16.5	1.9	10.2	22.1	2.3
USSMD	32.4	14.8	4.8	28.5	14.9	4.2
OEM	14.8	4.8	0.7	16.4	4.5	0.7
Other	1.5	13.3	0.1	2.1	12.4	0.3
	<u>100.0%</u>		<u>12.3%</u>	<u>100.0%</u>		<u>14.2%</u>
Effect of revenue adjustments			x 103.7%			x 104.8%
Product cost - net			12.8			14.9
Non-product costs			4.1			5.4
			<u>16.9%</u>			<u>20.3%</u>

	Q92-2			Q91-2		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Product Group						
Systems	32.6%	8.4%	2.8%	33.2%	10.7%	3.5%
Applications	54.9	10.3	5.6	52.2	11.7	6.1
SPAG	10.5	34.9	3.7	12.6	33.5	4.2
Other	2.0	14.3	0.2	2.0	15.5	0.4
	<u>100.0%</u>		<u>12.3%</u>	<u>100.0%</u>		<u>14.2%</u>

Net product COGS as a percent of net revenues declined 2.1%. The decline resulted from a shift in sales mix to higher-margin Windows applications and product cost reductions.

**Operating Expenses (in millions)**

	Q92-2	Q91-2	Change	
Payroll	\$ 109	\$ 68	\$ 41	59%
Marketing	58	37	21	59
Marketing accrual	10	12	(2)	(13)
Depreciation	18	11	7	64
Employee fringes	17	9	8	80
Supplies and equipment	16	10	6	66
Travel and entertainment	14	9	5	54
Product development	11	7	4	66
All other	68	45	23	49
	<u>\$ 321</u>	<u>\$ 208</u>	<u>\$ 113</u>	55

Results of Operations

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25

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COMPARISON WITH PRIOR YEAR (QUARTER)

Growth in headcount and marketing were the primary causes of the \$113 million increase in operating expenses. Operating headcount increased by 3,040 or 50% from the comparable quarter.

**Interest and Nonoperating Expense (in millions)**

	<u>Q92-2</u>	<u>Q91-2</u>	<u>Change</u>	
Interest income-net				
Interest income	\$ 14	\$ 10	\$ 4	38%
Interest expense	-	(1)	1	(38)
	<u>\$ 14</u>	<u>\$ 9</u>	<u>\$ 5</u>	45
Nonoperating expense				
Financial asset allowance	\$ (3)	\$ (3)	\$ -	4
Foreign currency transactions	2	-	2	(652)
All other	(1)	(2)	1	(67)
	<u>\$ (2)</u>	<u>\$ (5)</u>	<u>\$ 3</u>	(63)

Interest income increased due to growth in the investment portfolio, partly offset by lower interest rates.

## COMPARISON WITH PRIOR YEAR (YTD)

	FY92		FY91		Variance
Net revenues	\$ 1,262	100.0%	\$ 830	100.0%	52%
Cost of revenues	<u>219</u>	<u>17.4</u>	<u>170</u>	<u>20.4</u>	29
Gross profit	<u>1,043</u>	<u>82.6</u>	<u>660</u>	<u>79.6</u>	58
Operating expenses:					
Research and development	160	12.7	105	12.6	52
Sales and marketing	391	30.9	246	29.7	59
General and administrative	43	3.4	27	3.3	59
Total operating expenses	<u>594</u>	<u>47.0</u>	<u>378</u>	<u>45.6</u>	57
Operating income	<u>449</u>	<u>35.6</u>	<u>282</u>	<u>34.0</u>	59
Interest income - net	26	2.0	18	2.1	44
Nonoperating expense	<u>(6)</u>	<u>(0.4)</u>	<u>(10)</u>	<u>(1.1)</u>	(46)
	<u>20</u>	<u>1.6</u>	<u>8</u>	<u>1.0</u>	149
Income before income taxes	469	37.2	290	35.0	62
Provision for income taxes	<u>150</u>	<u>11.9</u>	<u>90</u>	<u>10.8</u>	67
Net income	<u>\$ 319</u>	<u>25.3%</u>	<u>\$ 200</u>	<u>24.2%</u>	59
Average shares outstanding	<u>194.0</u>		<u>185.2</u>		
Net income per share	<u>\$ 1.65</u>		<u>\$ 1.08</u>		53

Net revenues for FY92 YTD increased \$432 million over FY91 YTD. The principal factors in the growth were Windows applications which doubled to \$404 million, and the MS-DOS 5 Upgrade which added \$93 million in revenues.

Windows applications accounted for 61% of total applications revenues, up from 44% last year. Revenues from MS-DOS applications decreased by \$26 million and accounted for 19% of total applications revenue compared with 33% last year. Mac applications revenues increased by \$39 million and generated 18% of applications revenue, the same as last year.

Cost of revenues decreased by three percentage points. The reduction reflects manufacturing efficiencies and growth in sales of higher margin application products.

Operating expenses were \$594 million, up \$216 million or 57% from last year. As a percent of net revenue, operating expenses were 47.0%, up 1.4% from last year. Research and development expenses grew \$55 million or 52%, principally due to headcount growth. Sales and marketing expenses increased \$145 million to \$391 million or 30.9% of net revenue, an increase of 1.2 percentage points. Growth in payroll costs of 67% account for most of the growth. General and administrative expense was up \$16 million.

**COMPARISON WITH PRIOR YEAR (YTD)**

**Net Revenues (in millions)**

Channel	FY92		FY91		Growth
	\$	%	\$	%	
International FG - Europe	\$ 457	36%	\$ 327	39%	40%
International FG - ROW	143	12	90	11	59
Total IFG	600	48	417	50	44
USSMD	416	33	256	31	62
OEM	226	18	137	17	65
Other	20	1	20	2	(1)
	<u>\$ 1,262</u>	<u>100%</u>	<u>\$ 830</u>	<u>100%</u>	52
<b>Product Group</b>					
Systems	\$ 490	39%	\$ 286	34%	72
Applications	630	50	422	51	49
SPAG	130	10	108	12	20
Other	12	1	14	3	(9)
	<u>\$ 1,262</u>	<u>100%</u>	<u>\$ 830</u>	<u>100%</u>	52

Revenues in Europe increased \$130 million or 40%. Growth in England (up \$24 million or 66%), Germany (up \$51 million or 49%) and France (up \$26 million or 24%) accounted for most of the growth. Revenues in ROW were up \$53 million or 59%, reflecting strong growth in Australia (up \$17 million or 70%) and Canada (up \$18 million or 75%). Revenue growth of \$160 million or 62% in USSMD reflected introduction of the MS-DOS 5 Upgrade and Win Word 2.0, and increased sales of Win Office.

Spurred by the MS-DOS 5 Upgrade and a 63% increase in Windows revenues, Systems revenues grew \$204 million. Languages revenues declined 10%. Applications revenue grew \$208 million, mainly due to increases in Windows applications.

**Fifteen Leading Products (units in thousands, revenue in millions)**

Product	FY92 YTD			FY91 YTD			Change				
	Units	Revs		Units	Revs		Units	\$/Unit	Revenues		
		\$/Unit	Total		Volume	Price			Total		
MS-DOS/GW Basic	8,491	\$158	\$19	8,227	\$131	\$16	264	\$3	\$4	\$23	\$27
Windows	2,752	122	44	1,166	75	65	1,586	(21)	103	(56)	47
Win Excel	388	116	299	260	79	303	128	(4)	39	(2)	37
Win Word	454	115	253	261	73	279	193	(26)	54	(12)	42
Ser/Bus Mouse	1,177	109	93	1,080	101	93	97	0	9	(1)	8
MS-DOS 5 Upgrade	1,615	93	58	--	--	--	1,615	58	93	0	93
PC Word	209	58	275	238	68	285	(29)	(10)	(8)	(2)	(10)
Win Office	124	50	405	13	6	490	111	(85)	54	(10)	44
Mac Excel	150	37	245	105	24	226	45	19	10	3	13
Mac Word	173	31	178	152	29	188	21	(10)	4	(2)	2
PC Works	656	29	44	473	35	73	183	(29)	13	(19)	(6)
LAN Manager	159	24	149	83	10	118	76	31	9	5	14
Win Project	55	21	384	40	15	388	15	(4)	6	0	6
Win Word Upd/Upg	202	21	104	76	6	76	126	28	9	6	15
Mac Office	41	16	400	21	9	449	20	(49)	9	(2)	7
		<u>\$1,000</u>			<u>\$661</u>				<u>\$408</u>	<u>(569)</u>	<u>\$339</u>
Percent net revenues		<u>79%</u>			<u>80%</u>						

MS-DOS unit sales increased 3% and revenue per unit increased \$3, resulting in a 21% increase in MS-DOS revenues. Windows unit sales increased 136% but revenue per unit declined \$21 or 32% because of a shift in Windows volume to the OEM channel. Sales of the MS-DOS 5 Upgrade, introduced in June 1991, generated revenues of \$93 million.

Win Excel revenues increased \$37 million or 47%, primarily from strong shipments in IFG-Europe. Win Word unit volume was up 74% but revenue was up only 57%, reflecting reduction in revenue per unit due to heavy academic sales. Win Office generated \$50 million in revenues compared with \$6 million last year. Unit sales

**COMPARISON WITH PRIOR YEAR (YTD)**

increased more than nine-fold, but revenue per unit declined due to a reduction in SRP. Sales of PC Word and PC Works declined from last year by 15% and 17% respectively.

**Cost of Revenues**

	FY92			FY91		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Channel						
International FG - Europe	36.3	12.9%	4.7%	38.1	15.5%	5.9%
International FG - ROW	11.3	18.9	2.1	10.5	24.1	2.5
USSMD	34.7	15.0	5.2	31.4	16.4	5.1
OEM	16.2	4.6	0.7	17.8	4.0	0.7
Other	1.5	14.0	0.3	2.2	13.7	0.4
	<u>100.0%</u>		<u>13.0%</u>	<u>100.0%</u>		<u>14.6%</u>
Effect of revenue adjustments			x 102.8%			x 104.7%
Product cost - net			13.3			15.3
Non-product costs			4.1			5.1
			<u>17.4%</u>			<u>20.4%</u>

Product Group	FY92			FY91		
	Gross Sales Mix	Cost	Weighted Cost	Gross Sales Mix	Cost	Weighted Cost
Systems	36.6%	10.2%	3.7%	35.0%	10.9%	3.8%
Applications	50.9	10.3	5.2	50.1	11.9	6.0
SPAG	10.5	35.3	3.7	12.8	34.7	4.5
Other	2.0	15.5	0.4	2.1	16.6	0.3
	<u>100.0%</u>		<u>13.0%</u>	<u>100.0%</u>		<u>14.6%</u>

Lower product costs in the reseller channels added 1.5% to gross margins. The improvement was greatest in ROW, where product cost percentages declined by almost a fifth to 18.9% of revenue. Higher product costs in the OEM and other channels reduced gross margins slightly.

Non-product costs as a percent of revenue declined 1.0% due mainly to favorable manufacturing variances.

**Operating Expenses (In millions)**

	FY92	FY91	Change	
Payroll	\$ 204	\$ 130	\$ 74	58%
Marketing	98	60	38	62
Marketing accrual	24	18	6	36
Depreciation	33	21	12	58
Employee fringes	31	19	12	67
Supplies and equipment	31	18	13	77
Travel and entertainment	24	16	8	55
Product development	20	12	8	64
All other	129	84	45	50
	<u>\$ 594</u>	<u>\$ 378</u>	<u>\$ 216</u>	57

Operating expenses grew 57% over last year, compared with revenue growth of 52%. Headcount related expenses were the overriding factor in the increase. Operating headcount grew by 3,041 (50%) from the prior period.

COMPARISON WITH PRIOR YEAR (YTD)

Interest and Nonoperating Expense (in millions)

	<u>FY92</u>	<u>FY91</u>	<u>Change</u>	
Interest income-net				
Interest income	\$ 27	\$ 19	\$ 8	38%
Interest expense	<u>(1)</u>	<u>(1)</u>	<u>-</u>	<u>(31)</u>
	<u>\$ 26</u>	<u>\$ 18</u>	<u>\$ 8</u>	<u>44</u>
Nonoperating expense				
Financial asset allowance	\$ (5)	\$ (6)	\$ 1	(21)
Foreign currency transactions	2	1	1	174
All other	<u>(3)</u>	<u>(5)</u>	<u>2</u>	<u>(56)</u>
	<u>\$ (6)</u>	<u>\$ (10)</u>	<u>\$ 4</u>	<u>(46)</u>

The increase in interest income resulted from a much larger portfolio. Cash and investments were \$976 million at December 31, 1990 versus \$540 million at December 31, 1991, a \$436 million increase.

Net Income

Net income was \$319 million, up 59% from last year. As a percent of revenue, net income increased from 24.2% to 25.3%. The 1.1% increase is attributable to a 3.0% improvement in gross margin and a 0.7% improvement in nonoperating expenses, partly offset by an increase in operating expenses by 1.4% and an increase in income tax provision of 1.1%.

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## BALANCE SHEETS AND CASH FLOWS

	Dec. 31, 1991		Sep. 30, 1991		Quarter Change	
<b>Assets</b>						
<b>Current assets</b>						
Cash and short-term investments	\$ 976	46%	\$ 859	46%	\$ 117	14%
Accounts receivable - net	299	12	238	13	21	9
Inventories	58	3	58	3	-	-
Other	59	2	46	3	13	28
Total current assets	<u>1,352</u>	<u>63</u>	<u>1,201</u>	<u>65</u>	<u>151</u>	<u>13</u>
Property, plant, and equipment - net	695	33	588	31	107	18
Other assets	81	4	81	4	-	-
Total assets	<u>\$ 2,128</u>	<u>100%</u>	<u>\$ 1,870</u>	<u>100%</u>	<u>\$ 258</u>	<u>14</u>
<b>Liabilities and Stockholders' Equity</b>						
<b>Current liabilities</b>						
Accounts payable	\$ 138	6%	\$ 104	5%	\$ 34	33%
Customer deposits	13	1	17	1	(4)	(24)
Accrued compensation	49	2	34	2	15	44
Notes payable	18	1	19	1	(1)	(5)
Income taxes payable	46	2	48	3	(2)	(4)
Other	93	4	93	5	-	-
Total current liabilities	<u>357</u>	<u>16</u>	<u>315</u>	<u>17</u>	<u>42</u>	<u>13</u>
<b>Stockholders' equity</b>						
Common stock and paid-in capital	522	25	460	25	62	13
Retained earnings	1,227	58	1,089	58	138	13
Translation adjustment	22	1	6	-	16	267
Total stockholders' equity	<u>1,771</u>	<u>84</u>	<u>1,555</u>	<u>83</u>	<u>216</u>	<u>14</u>
Total liabilities and stockholders' equity	<u>\$ 2,128</u>	<u>100%</u>	<u>\$ 1,870</u>	<u>100%</u>	<u>\$ 258</u>	<u>14</u>

	Q92-2	Q92-1
<b>Cash flows from operations</b>		
Net income	\$ 175	\$ 144
Depreciation and amortization	26	21
Current liabilities, excluding notes payable	43	22
Accounts receivable	(21)	5
Inventories	-	(11)
Other current assets	(13)	6
Translation adjustment	16	9
Net cash from operations	<u>226</u>	<u>196</u>
<b>Cash flows from financing</b>		
Notes payable	(1)	(1)
Common stock issued	28	39
Common stock repurchased	(37)	(15)
Stock option income tax benefits	34	28
Net cash from financing	<u>24</u>	<u>51</u>
<b>Cash flows used for investments</b>		
Additions to property, plant and equipment	(126)	(73)
Other assets	(7)	(1)
Net cash used for investments	<u>(133)</u>	<u>(74)</u>
<b>Net change in cash and short-term investments</b>		
	117	173
Cash and short-term investments, beginning of period	859	686
Cash and short-term investments, end of period	<u>\$ 976</u>	<u>\$ 859</u>

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**BALANCE SHEETS AND CASH FLOWS**

	<u>Dec. 31, 1991</u>		<u>Jun. 30, 1991</u>		<u>YTD Change</u>	
<b>Assets</b>						
<b>Current assets</b>						
Cash and short-term investments	\$ 976	46 %	\$ 686	42 %	\$290	42 %
Accounts receivable - net	259	12	243	15	16	7
Inventories	58	3	47	3	11	23
Other	59	3	52	3	7	13
Total current assets	<u>1,352</u>	<u>64</u>	<u>1,028</u>	<u>63</u>	<u>324</u>	<u>32</u>
Property, plant, and equipment - net	695	33	530	32	165	31
Other assets	81	4	86	5	(5)	(6)
Total assets	<u>\$2,128</u>	<u>100 %</u>	<u>\$1,644</u>	<u>100 %</u>	<u>\$484</u>	<u>29</u>
<b>Liabilities and Stockholders' Equity</b>						
<b>Current liabilities</b>						
Accounts payable	\$ 138	6 %	\$ 86	5 %	\$ 52	60 %
Customer deposits	13	1	26	2	(13)	(50)
Accrued compensation	49	2	42	3	7	17
Notes payable	18	1	20	1	(2)	(10)
Income taxes payable	46	2	44	3	2	5
Other	93	4	76	5	17	22
Total current liabilities	<u>357</u>	<u>17</u>	<u>294</u>	<u>18</u>	<u>63</u>	<u>21</u>
<b>Stockholders' equity</b>						
Common stock and paid-in capital	522	25	394	24	128	32
Retained earnings	1,227	58	959	58	268	28
Translation adjustment	22	1	(3)	0	25	(833)
Total stockholders' equity	<u>1,771</u>	<u>83</u>	<u>1,350</u>	<u>82</u>	<u>421</u>	<u>31</u>
Total liabilities and stockholders' equity	<u>\$2,128</u>	<u>100 %</u>	<u>\$1,644</u>	<u>100 %</u>	<u>\$484</u>	<u>29</u>

	<u>FY92 YTD</u>	<u>FY91 YTD</u>
<b>Cash flows from operations</b>		
Net income	\$319	\$200
Depreciation and amortization	46	29
Current liabilities, excluding notes payable	65	50
Accounts receivable	(16)	(46)
Inventories	(11)	(8)
Other current assets	(7)	(12)
Translation adjustment	25	12
Net cash from operations	<u>421</u>	<u>225</u>
<b>Cash flows from financing</b>		
Notes payable	(2)	11
Common stock issued	67	32
Common stock repurchased	(52)	(85)
Stock option income tax benefits	62	40
Net cash from financing	<u>75</u>	<u>(2)</u>
<b>Cash flows used for investments</b>		
Additions to property, plant and equipment	(199)	(131)
Other assets	(7)	(1)
Net cash used for investments	<u>(206)</u>	<u>(132)</u>
Net change in cash and short-term investments	290	91
Cash and short-term investments, beginning of period	686	449
Cash and short-term investments, end of period	<u>\$976</u>	<u>\$540</u>

**BALANCE SHEETS AND CASH FLOWS**

**Measures of Financial Strength (in millions)**

	Dec. 31, 1991	Sep. 30, 1991
Cash and short-term investments	\$ 976	\$ 859
Total assets	2,128	1,870
Stockholders' equity	1,771	1,555

**Rate of Return Indicators (annualized)**

	Q92-2	Q92-1
Net Income Return On Equity (average)	42.1%	39.7%
Assets (average)	35.0	32.8
Net revenues	25.7	24.8

As shown in the Q92-2 statement of cash flows on the preceding page, net income plus non-cash depreciation and amortization generated cash of \$201 million, compared to \$165 in the prior quarter. Cash flow provided by operations was \$226 million.

An additional \$62 million in cash was provided by stock option exercise proceeds and the related tax benefits. Stock repurchases were \$37 million. During Q92-2, Buildings 1 - 4 on the Corporate Campus were purchased for \$47 million. Other purchases of property, plant and equipment were similar in scope to the prior quarter.

Cash and short-term investments increased \$117 million in Q92-1 to \$976 million.

**Stock Repurchases**

To provide shares for its stock option plan and reduce its dilutive effect, the Company purchases its own stock in the open market. Purchases are made during a window that begins several days after we have released earnings and extends through the end of the second month in the quarter. Purchases are made by Goldman Sachs at our direction. During Q92-2, we repurchased 415,000 shares at an average price of \$90.19 per share for a total of \$37 million. A table of stock repurchases follows.

	Shares adjusted for 3:2 split	Amount (millions)	Quarterly Avg Cost	12 Mo Avg Cost*	LTD
Q90-3	504,000	\$ 16	\$ 32.42	\$ 32.42	
Q90-4	686,250	30	44.19	39.21	
FY90	<u>1,190,250</u>	<u>\$ 46</u>	39.21	39.21	
Q91-1	1,086,000	\$ 45	41.54	39.94	
Q91-2	892,500	40	44.32	40.83	
Q91-3	649,500	43	66.83	45.52	
Q91-4	1,018,500	69	67.39	53.95	
FY91	<u>3,646,500</u>	<u>\$ 197</u>	53.95	53.95	
Q92-1	187,500	\$ 15	79.98	60.63	
Q92-2	415,000	37	90.19	72.44	
FY92	<u>602,500</u>	<u>\$ 52</u>	87.01	72.44	
LTD	<u>5,439,250</u>	<u>295</u>			54.38

\* Average cost for the trailing twelve months.

At December 31, 1991, we have a cumulative unused buyback authorization (based on proceeds from prior quarters' stock option exercises) of \$113 million. These funds are available if the price of the stock reaches a point where a higher level of repurchase activity is warranted. As can be seen by the above table, our stock repurchase program has been successful, in acquiring shares for stock option exercises at favorable prices. The average cost of the repurchase during the last four quarters of \$72 compares favorably with the current price of the stock. Going forward, equities traders at Goldman Sachs are optimistic about stock prices, based upon three key factors: 1) A moderate *economic and profit recovery* is expected later this year, 2) Their models point to a current *undervaluation of the equities market* in the range of 3 - 5 percent, with historical bull market peaks in the range of overvaluations of 15 - 20%, and 3) In the current scenario of low interest rates, an *individual investor movement* from short-term fixed income investments towards long-term fixed income securities and equities, particularly technology stocks.

## CASH AND SHORT-TERM INVESTMENTS

Cash and short-term investments increased \$117 million in Q92-2 to \$976 million at quarter-end. These liquid assets comprise 72% of current assets, 46% of total assets, and 55% of stockholders' equity.

During Q92-2, the "Microdollar" strategy was implemented. This strategy focuses on accumulating a global basket of currencies to carry out MS global business plans. As a result, total cash and investments at the end of Q92-2 consisted of 14% foreign currency balances.

### Cash and Investment Portfolio Balances (in millions)

	Dec. 31, 1991		Sep. 30, 1991
MS portfolio			
US\$ investments	\$ 708	73%	81%
MS Puerto Rico investments	77	8	7
Foreign currency investments	133	14	-
Worldwide cash and money market accounts	58	6	12
	<u>\$ 976</u>	<u>100%</u>	<u>100%</u>

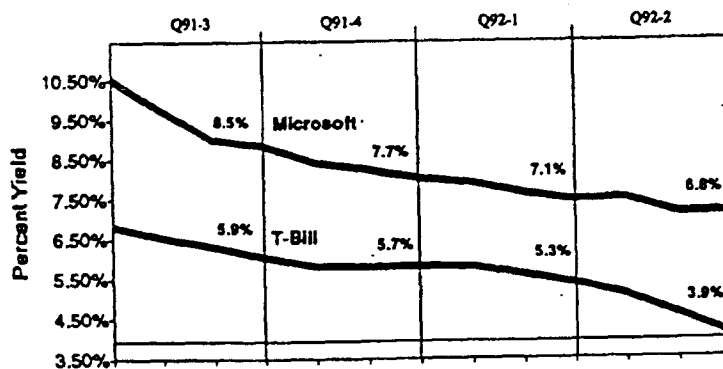
### US\$ Portfolio Characteristics

Short term domestic rates continued to decline quite dramatically during Q92-2, falling by an additional 150 basis points to 15-year historical lows. In contrast, the MS portfolio yield remained relatively stable, declining only 30 basis points. The MS portfolio yield at the end of Q92-2 was about 3% above that of the benchmark 90-day U.S. Treasury Bill.

Market sentiment is that domestic rates will remain low over the next six months and that the low interest rates will spur economic recovery, with the eventual rebound in growth applying upward pressure on rates in the second half of calendar 1992.

The following table compares the MS portfolio pre-tax yield with that of the benchmark 90-day T-Bill during the trailing twelve months:

MS US\$ Portfolio Pre-Tax Yield vs. 90-Day T-Bill



At December 31, 1991, the portfolio was in compliance with all investment guidelines. We continue to emphasize diversification among security types, industry groups, and individual issuers. At December 31, 1991, the US\$ portfolio contained 205 positions, with an average holding of \$3.4 million. The average maturity at

**CASH AND SHORT-TERM INVESTMENTS**

December 31, 1991 was 155 days compared to 148 days at September 30, 1991. The following tables summarize certain portfolio characteristics ("yield" represent the weighted average yield to maturity on a *pre-tax* basis).

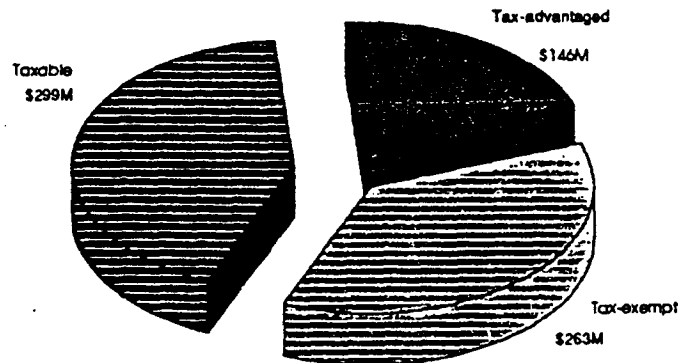
**US\$ Portfolio Diversification by Security Type (In millions)**

Security Type	Dec. 31, 1991			Sep. 30, 1991		
	Cost	Percent	Yield	Cost	Percent	Yield
Municipal Bonds	\$ 263	37%	7.9%	\$ 253	33%	8.1%
Commercial Paper	176	25	5.3	169	22	5.6
Money Market Preferred	102	14	6.1	84	11	6.6
Corporate Bonds	69	10	7.7	77	10	8.4
Loan Participations	36	5	5.1	93	12	5.8
U.K. Preferred Stock	27	4	5.8	21	3	6.3
Fixed Rate Auction Preferred	18	3	13.0	24	3	13.0
Discount Notes	14	2	4.5	0	-	-
Floating Rate Notes	3	0	4.8	11	1	6.3
Treasury Securities	0	-	-	26	3	5.6
	<u>\$ 708</u>	<u>100%</u>	6.8	<u>\$ 758</u>	<u>100%</u>	7.1

The portfolios continue to include both taxable and tax-advantaged securities, and are diversified across a broad group of money market and short-term fixed income security types. Approximately 42% are taxable, 37% are tax-exempt, and 21% are tax-advantaged. The various tax categories earned pre-tax equivalent yields as follows:

Tax exempt municipals	7.9%
Tax advantaged preferred stock securities	6.9
Taxable securities	5.8

**US\$ Portfolio Diversification**  
December 31, 1991



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**CASH AND SHORT-TERM INVESTMENTS****US\$ Portfolio Diversification by Credit Rating (in millions)**

Credit Rating	Dec. 31, 1991		Sep. 30, 1991	
	Amount	Percent	Amount	Percent
AAA	\$ 121	17%	\$ 149	20%
AA	212	30	175	23
A	274	39	244	32
BBB	96	13	169	22
MS Rated	7	1	21	3
	<u>\$ 708</u>	<u>100%</u>	<u>\$ 758</u>	<u>100%</u>

**Credit Rating Definitions****Investment Grade**

- AAA Capacity to pay interest and principal extremely strong.
- AA Capacity to pay interest and principal very strong.
- A Capacity to pay interest and principal strong.
- BBB Capacity to pay interest and principal adequate.
- MS Rated This category consists of securities which may not carry a published rating but for which MS Treasury has conducted credit research and assigned an implied investment grade rating. An example is City of Redmond LID bond anticipation notes.

**US\$ Portfolio Diversification by Industry (in millions)**

Industry	Dec. 31, 1991		Sep. 30, 1991	
	Amount	Percent	Amount	Percent
Municipalities	\$ 263	37%	\$ 253	33%
Industrial	59	8	56	7
Food/Beverage	59	8	70	9
Natural Resources	44	6	37	5
Banking	39	6	30	4
Securities	38	5	25	3
Medical	37	5	15	2
Utilities	30	4	44	6
Services	29	4	25	3
Automotive	25	4	5	1
Transportation	13	2	7	1
Insurance	8	1	13	2
Retailing	6	1	16	2
Chemical	6	1	46	6
Other	51	7	116	15
	<u>\$ 708</u>	<u>100%</u>	<u>\$ 758</u>	<u>100%</u>

**Foreign Currency Management**

The dollar continued to weaken against most currencies during Q92-2. The European benchmark currency, the Deutschmark, rose an additional 9% during the quarter to a total increase of 16% against the dollar during the first half of FY92.

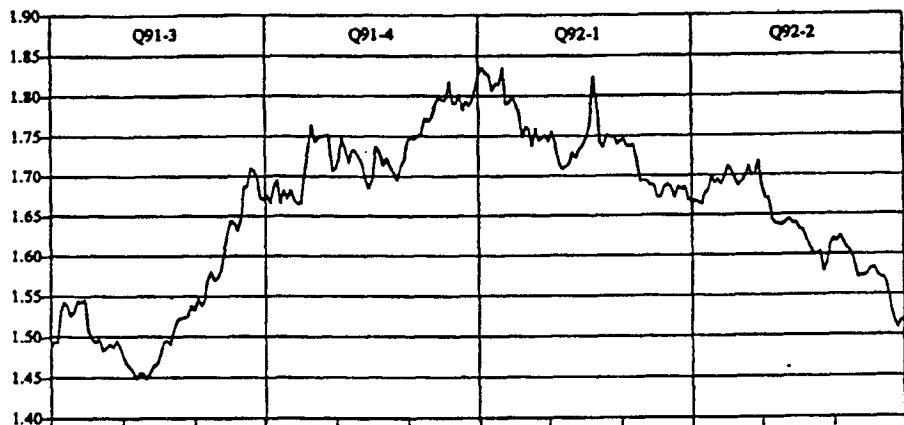
During Q92-2, the implementation of the "Microdollar" strategy significantly altered hedging activities. The emphasis now is to carefully forecast natural foreign currency inflows from the subsidiaries, and maintain levels of specific currencies for anticipated near-term business plans (i.e., international facilities, intercompany loans, capital infusions, etc.) As a result, forward contracts were purchased on a limited basis during Q92-2. Instead,

**CASH AND SHORT-TERM INVESTMENTS**

certain foreign currencies were accumulated and held in anticipation of forecasted foreign currency requirements. The portfolio totaled \$133 million, translated into US dollars at the foreign exchange rates on December 31, 1991. Foreign currencies in the portfolio include British Pounds Sterling, Irish Punts, German Deutschemarks, French Francs, and Japanese Yen.

The foreign currency portfolio is currently invested in short-term money market securities. The average yield for these investments at December 31, 1991 was 8.8%.

**Deutschemark vs. Dollar**



**MS Puerto Rico Investments**

MS Treasury also manages the portfolio of MS Puerto Rico, which is invested in local tax exempt securities. The funds from the profits of the Puerto Rican manufacturing operation are invested in certificates of deposit and earn a pre-tax yield of 5.6%

**Non-Performing Securities**

At December 31, 1991, the only non-performing security was \$10.4 million of Tucson Electric Power Co. money market preferred stock. The utility was recently granted a permanent rate increase that should improve their cash flow situation. Present Microsoft reserves appear more than adequate to cover this investment.

## ACCOUNTS RECEIVABLE

Consolidated Amounts (dollars in millions)

	Net Receivables	DSO	Allowance	
			Dollars	% of AR
Q92-2	\$ 259	50	\$ 50	19%
Q92-1	238	52	43	18
Q91-4	243	57	36	15
Q91-3	223	54	37	17
Q91-2	227	57	34	15

Net receivables increased \$21 million from Q92-1 to Q92-2 reflecting the increase in sales. DSO decreased 2 days from Q92-1 to Q92-2, primarily because of decreases in the IFG Europe channel. In particular, the DSO in Germany dropped to 30 days from 38 days. As a precautionary measure, reserves for uncollectible accounts were strengthened in terms of both absolute dollars and as a percentage of gross accounts receivable. The consolidated allowance was \$50 million or 19% of accounts receivable at December 31, 1991.

World-Wide Accounts Receivable (dollars in millions)

	DSO		Total	Aging Summary			
	Q92-2	Q92-1		Current	1-30	31-60	Over 60
<b>Retail</b>							
USSMD	38	40	\$ 97	\$ 63	\$ 30	\$ 2	\$ 2
International	54	58	217	159	33	8	17
			314	222	63	10	19
<b>OEM</b>							
Domestic	28	26	19	4	9	2	4
International	100	96	51	26	5	-	20
			70	30	14	2	24
<b>Other</b>	94	92	10	7	1	-	2
<b>Total accts receivable-billed</b>	50	52	394	\$ 299	\$ 78	\$ 12	\$ 45
<b>Aging percentages</b>				66%	20%	3%	11%
OEM GAAP adjustments			21				
Sales returns reserve			(80)				
Reseller rebates			(26)				
Allowance for doubtful accounts			(30)				
			(135)				
<b>Accounts receivable-net</b>			\$ 259				

In the International Finished Goods channel, the over-60-days receivable balance primarily represented reseller payment delays in Germany (\$5 million), Brazil (\$3 million), Italy (\$3 million), and Spain (\$2 million). In Brazil, the local software law does not allow distributors to pay software companies until sales are made to end users. Brazil is currently experiencing both a recessionary and inflationary economy.

We are closely monitoring receivables in Spain and France. The over-60-days balance in Spain represents 25% of Spain's total accounts receivable. These past due amounts are primarily from one distributor. An addition of \$800 thousand to the allowance for uncollectible accounts was provided in December, so the account is fully reserved. In France, receivables doubled during the quarter and an additional \$550 thousand was added to the allowance for uncollectible accounts.

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41

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**ACCOUNTS RECEIVABLE**

Slow payments, amendment delays and payment schedules affect OEM customers in Korea (\$5 million), Italy (\$5 million), Taiwan (\$4 million), and Germany (\$2 million). OEM payments of \$3.7 million were received shortly after the Q92-2 close, due to holiday banking delays.

**Ten Largest World-Wide Accounts Receivable Customers (dollars in millions)**

	Total	Aging Summary			
		Current	1-30	31-60	Over 60
Ingram Micro	\$ 53.9	\$ 37.0	\$ 16.4	\$ 0.3	\$ 0.2
Merisel	25.2	15.0	9.9	0.1	0.2
Olivetti	13.2	8.1	0.7	0.1	4.3
Access GMBH	8.9	8.7	0.1	-	0.1
Computer 2000	8.9	4.7	3.0	0.6	0.6
Egghead	7.9	7.7	0.1	-	0.1
Feeder	5.6	5.0	0.6	-	-
Software Spectrum	5.5	4.7	0.8	-	-
Corporate Software	4.5	2.9	1.3	0.3	-
CompUSA	4.4	2.1	1.7	0.4	0.2
	<u>\$ 138.0</u>	<u>\$ 95.9</u>	<u>\$ 34.6</u>	<u>\$ 1.8</u>	<u>\$ 5.7</u>
Percentage of total		69.5%	25.1%	1.3%	4.1%

Ten large worldwide customer account balances represent 35% of the \$394 million accounts receivable billed, a 1% increase from Q92-1. The over-60-days receivable balance decreased 28% from \$8 million in Q92-1. A payment of \$3 million was received from Olivetti after the Q92-2 close further reducing the over-60-day balance.



## INVENTORIES

### Day's Sales (in millions)

	Inventories	Days' Sales
Q92-2	\$58	60
Q92-1	58	65
Q91-4	47	59
Q91-3	53	74
Q91-2	63	83

Inventories remain unchanged for Q92-2. Consolidated days inventory on hand (calculated based on the past three months product costs) decreased 8% to 60 days. The decrease was primarily due to an 8% increase in finished goods inventory.

### Inventories (in millions)

	Dec. 31, 1991	Sep. 30, 1991	Change
<b>Location</b>			
Sub Warehouses	\$ 39	\$ 37	\$ 2
Campus North	15	16	(1)
Ireland	3	4	(1)
Puerto Rico	1	1	-
	<u>\$ 58</u>	<u>\$ 58</u>	<u>\$ -</u>
<b>Subsidiary</b>			
France	\$ 7	\$ 6	\$ 1
Germany	6	4	2
Australia	5	5	-
Canada	4	4	-
England	1	1	-
Other	16	17	(1)
	<u>\$ 39</u>	<u>\$ 37</u>	<u>\$ 2</u>

### Raw Materials, Finished Goods and Allowances (in millions)

	Dec. 31, 1991	Sep. 30, 1991	Change
<b>Domestic Inventories</b>			
Raw materials	\$ 23	\$ 20	\$ 3
Finished goods	14	16	(2)
Allowances	(27)	(23)	(4)
	<u>10</u>	<u>13</u>	<u>(3)</u>
<b>IFF Inventories</b>			
Raw materials	4	3	1
Finished goods	6	5	1
Allowances	(4)	(4)	-
	<u>6</u>	<u>4</u>	<u>2</u>
<b>Subsidiary and Ireland Inventories</b>			
Raw materials	6	8	(2)
Finished goods	47	41	6
Allowances	(11)	(8)	(3)
	<u>42</u>	<u>41</u>	<u>1</u>
	<u>\$ 58</u>	<u>\$ 58</u>	<u>\$ -</u>
<b>Consolidated Inventories</b>			
Raw materials	\$ 33	\$ 31	\$ 2
Finished goods	67	62	5
Allowances	(42)	(35)	(7)
	<u>\$ 58</u>	<u>\$ 58</u>	<u>\$ -</u>

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43

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## INVENTORIES

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The domestic raw materials increase was primarily due to a \$2 million growth in Mice inventory as a result of an overly optimistic marketing forecast. The domestic finished goods inventory decrease was attributable to a 50% decrease in MS-DOS Retail upgrade inventory. The MS-DOS Retail upgrade decrease is a result of the anticipated release of a silent upgrade.

The subsidiary inventory increase resulted from a build-up of stock levels in anticipation of the peak sales period, the continued weakening of the dollar, and poor forecasting in Australia and France. The increase in the reserve for obsolescence at most subsidiaries is based upon the increasing inventory levels. Additional provisions were recorded in Australia and France to cover obsolete stock.

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## PROPERTY, PLANT AND EQUIPMENT

### Property, Plant and Equipment (in millions)

	Dec. 31, 1991	Sep. 30, 1991	Change
Land	\$ 134	\$ 125	\$ 9
Buildings	306	233	73
Computer equipment	272	248	24
Other	141	118	23
	<u>853</u>	<u>724</u>	<u>129</u>
Accumulated depreciation	(158)	(136)	(22)
	<u>\$ 695</u>	<u>\$ 588</u>	<u>\$ 107</u>

During Q92-2, Buildings 1-4 were purchased for \$47 million. Of this amount, \$8 million was allocated to land and \$39 million to the buildings. Additionally, existing leasehold improvements to these buildings of \$7 million were reclassified to buildings. Capitalized costs of construction totaled \$16 million for Buildings 16, 17, and 18 and \$5 million for the new facility in England. Construction in progress costs are classified as buildings.

Buildings 1-4 are the original core of the Corporate Campus. The land and buildings were leased at a cost of \$720 thousand per quarter, and the lease was subject to rent escalation provisions. Future depreciation will be \$380 thousand per quarter, based upon a 30-year life.

Other property, plant and equipment additions include \$10 million of leasehold improvements at various domestic offsite sales locations, \$9 million of domestic telecommunications equipment, and \$3 million of domestic furniture and equipment. Subsidiary furniture and equipment additions totaled \$4 million, and were concentrated in England and Germany (\$1 million each).

	Quantity Purchased	Cost (millions)	Avg Price (thousands)
Domestic personal computers *			
Clone 386 computers	269	\$ 1.0	\$ 3.7
Clone 486 computers	270	1.5	5.4
Compaq 386 computers			
Desktop	174	0.8	4.9
Portable	123	0.7	5.8
Compaq 486 computers	115	0.8	7.3
Apple computers	137	0.7	4.8
IBM computers	39	0.4	10.6
Servers			
Compaq 486	60	1.0	17.0
Other	7	0.2	30.8
RISC workstations	24	0.4	15.5
	<u>1,218</u>	<u>7.5</u>	
Other computer equipment			
Subsidiary computer equipment		8.0	
Networking equipment		2.5	
PC peripherals		1.9	
VAX equipment upgrades		-	
Net A/P accrual and other		4.9	
Retirements		(0.8)	
Net change		<u>\$ 24.0</u>	

\* A Microsoft PC SKU typically includes the following components: CPU, VGA monitor, keyboard, 8 MB RAM, floppy drives, 120 - 200MB HD, 8 to 10% sales tax, freight, and installation charges.

The large price reductions by PC manufacturers will result in a significant decrease in the Company's FY92 PC spending. During Q92-2, a "PC price adjustment" was made to reduce the domestic PC budget by 30%.

Clones became popular during Q92-2. During the quarter, clone purchases increased by 75% over the prior quarter. For the month of December, clones represented approximately 70% of domestic PC purchases.

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45

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## OTHER ASSETS

Other Assets (in millions)

	Dec. 31, 1991	Sep. 30, 1991	Change
<b>Financial Assets</b>			
Santa Cruz Operation	\$ 20	\$ 20	\$ --
Dorling Kindersley	16	16	--
Non-performing securities	10	10	--
Other	<u>2</u>	<u>2</u>	<u>--</u>
	48	48	--
Valuation allowance	<u>(13)</u>	<u>(10)</u>	<u>(3)</u>
	<u>35</u>	<u>38</u>	<u>(3)</u>
<b>Intellectual Property Rights</b>			
Consumer Software, Inc.	13	13	--
Other	<u>19</u>	<u>16</u>	<u>3</u>
	32	29	3
Accumulated amortization	<u>(15)</u>	<u>(12)</u>	<u>(3)</u>
	<u>17</u>	<u>17</u>	<u>--</u>
<b>Miscellaneous</b>			
	<u>29</u>	<u>26</u>	<u>3</u>
	<u>\$ 81</u>	<u>\$ 81</u>	<u>\$ --</u>

Financial assets represent our minority investments in companies with strategic technology together with any non-performing securities that have been removed from the Treasury portfolio. Minority investments are carried at cost less amortization, which we call a valuation allowance, for the excess of cost over our share of the pro-rata book value of the investment. As investees earn income, the need for future valuation provisions for these investments is therefore reduced. Non-performing securities are carried at cost. The valuation provision that is made each quarter covers any potential losses on the disposition of non-performing securities as well as an allowance for the other financial assets. The valuation provision is charged to non-operating income in the financial statements.

Intellectual property rights represent purchased code or other intellectual property and rights. Their cost is amortized over periods of up to five years. Amortization is generally charged to research and development expense.

Miscellaneous assets include other long-term assets, primarily lease and other deposits.

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47

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**OTHER ASSETS****Santa Cruz Operation**

## Results of Operations (in millions, unaudited)

	Year Ended Sep. 30, 1991	Year Ended Sep. 30, 1990	Change
Net revenues	\$ 136	\$ 107	27 %
Cost of revenues	54	42	29
Gross profit	82	65	25
Operating expenses	93	69	35
Net loss	\$ (11)	\$ (4)	220

## Financial Condition (in millions, unaudited)

	Sep. 30, 1991	Sep. 30, 1990	Change	Change
Cash	\$ 5	\$ 11	\$ (6)	(51) %
Other current assets	34	28	6	20
Property and other	14	13	1	5
Total assets	\$ 53	\$ 52	\$ 1	2
Short-term borrowings	\$ -	\$ 8	\$ (8)	NA %
Other current liabilities	43	25	18	67
Long-term liabilities	4	5	(1)	(19)
Stockholders' equity	6	14	(8)	(54)
Total liabilities and equity	\$ 53	\$ 52	\$ 1	2

## Cash Flows (in millions, unaudited)

	Year Ended Sep. 30, 1991	Year Ended Sep. 30, 1990
Cash used in operations	\$ (6)	\$ 1
Cash from financing - net	7	5
Cash used for investments	(6)	(4)
Foreign exchange gain (loss)	(1)	--
Net change in cash and short-term investments	(6)	2
Cash, beginning of period	11	9
Cash, end of period	\$ 5	\$ 11

SCO's unaudited book value at September 30, 1991 was \$6 million, of which Microsoft's 18.1% share is \$1 million. The cost of Microsoft's investment was \$20 million, so cost in excess of our pro-rata share book value was \$19 million.

SCO restructured its operations to reduce costs and improve operational efficiencies. As a result a \$3.9 million restructuring charge was recorded in the September 30, 1991 results. The charge was for severance costs, consolidation of facilities, and writeoff of certain assets.

The Company's restructuring and attrition resulted in a 14% decrease in headcount to 1,190 at December 31, 1991.

For the quarter ended December 31, 1991, management estimates that SCO will record net revenues of \$36.3 million and operating income of \$1 million. These results will exceed planned net revenues (\$36.2) and operating income (\$400 thousand). Quarterly net revenues will be flat on a sequential basis.

The business highlight for SCO's December quarter is participation in a large government contract. SCO will act as a subcontractor in Boeing's development of systems to manage materials for U.S. Army reserve troops. SCO will provide its operating system, ODT, for the systems. The contract will provide revenues of \$24 million over fifteen months. The Company expects to earn favorable gross margins on the contract revenues.

Cash flow remains very tight for SCO. At December 31, 1991, the balance in their line of credit was \$10 million and the company had accounts payable and held checks totaling \$7 million. SCO plans profits in the March

## OTHER ASSETS

quarter and beyond which would provide a modest degree of relief. The Company continues to pursue financing but presently has no concrete alternatives.

The Company's line of credit is effective through February 28, 1992. Management believes the bank is pleased with the recent financial performance and expects the line to be extended to at least the end of May.

### Dorling Kindersley

#### Results of Operations (in millions, unaudited)

	Quarter Ended Sep. 30, 1991	Year Ended Jun. 30, 1991
Net revenues	\$ 30	\$ 75
Cost of sales	17	39
Gross margin	13	36
Operating expense	9	30
Operating income	4	6
Taxation	-	2
Net income	\$ 4	\$ 4

#### Financial Condition (in millions, unaudited)

	Sep. 30, 1991	Jun. 30, 1991
Current assets	\$ 60	\$ 44
Fixed assets	3	3
Total assets	\$ 63	\$ 47
Current liabilities	\$ 44	\$ 33
Long-term liabilities	3	3
Stockholders' equity	16	11
Total liabilities and equity	\$ 63	\$ 47

#### Cash Flows (in millions, unaudited)

	Quarter Ended Sep. 30, 1991	Year Ended Jun. 30, 1991
Net income	\$ 4	\$ 4
Increase in inventories	(4)	(8)
Increase in A/R	(11)	(4)
Other	7	10
Cash from operations	(4)	2
Purchase of RD stock	-	(10)
Issuance of stock to MS	-	13
Proceeds from MS loan	-	4
Cash from financing	-	7
Net additions to PP&E	(1)	(2)
Cash used for investments	(1)	(2)
Net change in cash	(5)	7
Cash, beginning of period	7	-
Cash, end of period	\$ 2	\$ 7

Dorling Kindersley's book value at September 30, 1991 was \$16 million of which Microsoft's 26% share represents \$4 million. The cost of Microsoft's 26% investment was \$16 million, so cost in excess of our pro-rata share of book value is now approximately \$12 million.

DK also has both an outstanding \$3 million long-term loan and an unused \$5 million line of credit with Microsoft. The cash flow forecast for FY92 projects that DK may need to borrow \$5 million on their line of credit with Microsoft due to the seasonality of their sales.

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49

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## OTHER ASSETS

The Company currently projects FY92 net revenues of 72 million BPS (\$126 million). For the five months ended November 30, 1991, *profit before tax* was 12.5% of revenues (versus a 13% forecast for the year). For the first half of the year, this translates into profits before tax of 4.5 million BPS (\$7.9 million) on net revenue of 36.3 million BPS (\$63.5 million). DK capitalizes the cost of new publications and amortizes them over periods of up to two years.

Microsoft and DK have agreed in principle to commercial terms for the development of two multimedia products, "Inside the Human Body" and "Multimedia Musical Instruments."

Negotiations are also under way as to the possibility of increasing Microsoft's equity interest from 26% to 75% in a stock for stock exchange. Goldman Sachs is presently completing a valuation study.

### **Intellectual Property Rights**

#### **Citrix Systems**

In December, Microsoft made a \$2 million equity investment in, and entered a \$750 thousand development agreement with, Citrix Systems, Inc. The \$2 million equity purchase gave Microsoft ownership of 14.5% of Citrix and was part of a \$5 million financing. Under the terms of the development agreement, Citrix will allocate three people full time for 2 1/2 years to support OS/2 development and the port of Multiuser to NT.

Citrix has thirty people, primarily ex-IBM staff. Its product is Multiuser, a modified OS/2 product which enables buyers to use their PCs to function as both PCs and dumb UNIX terminals.

Microsoft has two primary objectives in investing in Citrix. The first is to contract out OS/2 development. Citrix has a more complete OS/2 development team than does Microsoft and Citrix's work will free up internal development and test resources currently assigned to OS/2. The second objective is to port Multiuser to NT and Win32 to gain entry to the UNIX world.

For the year ended September 30, 1991 the Company's revenues were \$269 thousand, operating expenses were \$4.1 million, and net loss was \$3.9 million. The Company had \$500 thousand in assets and \$825 thousand negative equity at September 30, 1991 (pre-financing).

#### **Natural Language Incorporated**

In October Microsoft invested \$323 thousand in Natural Language Incorporated (NLI). Microsoft has been an investor in NLI since 1987 and owns 10.1% of the company's equity. The most recent investment is part of a \$2 million 6-month 6.14% Convertible Promissory Note. It is anticipated that this note will roll over once and then will convert to equity at a future equity financing at the same price as other participants in that financing. As consideration for participating in the loan, Microsoft was granted a 3-year warrant to purchase 967,744 common shares of NLI at \$0.01 per share. Microsoft's ownership would increase to 11.03% if the note was converted to equity, at the same price as the last round of financing, and the warrants were exercised.

NLI is a Berkeley, California, software firm which sells a natural language interface which allows non-technical users to make English language queries of relational database systems. NLI's product is believed to be the best of its type and is well received by customers.

Current NLI products are expensive and require a great deal of processing power. However, a broader use of natural language processing in a number of products may be possible as computing power increases and as the natural language software is refined.

For the year ended December 31, 1991, NLI had revenues of \$2.8 million, operating expenses of \$4.3 million, and a net loss of \$2.4 million. NLI's total assets, including \$1.9 million in cash, were \$3.5 million at December 31, 1991. Equity was a negative \$489 thousand.

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## CURRENT LIABILITIES

Current liabilities increased \$42 million to \$357 million at December 31, 1991. Accounts payable were up \$34 million with the rise in operating expense levels, the additional marketing accrual of \$10 million, and reclassifications of \$17 million of stock benefit and claims reserves. Customer deposits decreased primarily due to a decrease in OEM International-Europe customer deposits of \$3 million. Accrued compensation increased \$15 million, due to provisions for yearly bonuses. Subsidiary short-term borrowings decreased slightly and income taxes payable decreased \$2 million to \$46 million at December 31, 1991. Other current liabilities were flat, with a \$2 million accrual for business taxes plus additions to the litigation reserve (\$3 million), the stock benefit reserve (\$9 million), and reserve for marketing funds (\$3 million) offset by the claims and stock benefit reserve reclassifications.

## STOCKHOLDERS' EQUITY

Stockholders' equity increased \$216 million in Q92-2, from \$1.6 billion at September 30, 1991 to \$1.8 billion at December 31, 1991. Net income (\$175 million), stock option exercises (\$28 million), income tax benefits related to stock options (\$34 million), and translation adjustment (\$16 million) were offset by common stock repurchases (\$37 million).

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## CHANNEL REPORTING

Net revenues	Q92-2		Q92-3 Plan		Q92-1		Variance	Change
IPG - Europe	\$ 270	40%	\$ 252	40%	\$ 187	32%	\$ 18	\$ 83
IPG - ROW	79	11	73	12	64	11	6	15
Total IPG	349	51	325	52	251	43	24	98
USSMD	215	32	193	31	201	35	22	14
Domestic OEM	39	9	51	8	61	11	8	(2)
OEM - Europe	21	3	16	3	14	2	5	7
OEM - ROW	28	4	28	4	44	7	-	(16)
Total OEM	108	16	95	15	119	20	13	(11)
Other	10	1	14	2	9	2	(4)	1
	\$ 682	100%	\$ 627	100%	\$ 580	100%	\$ 55	\$ 102

Net revenues	FY 92 YTD		FY 92 YTD Plan		Variance
IPG - Europe	\$ 457	36%	\$ 407	37%	\$ 50
IPG - ROW	143	12	127	12	16
Total IPG	600	48	534	49	66
USSMD	416	33	346	32	70
Domestic OEM	120	9	100	9	20
OEM - Europe	34	3	31	3	3
OEM - ROW	72	6	54	5	18
Total OEM	226	18	185	17	41
Other	20	1	25	2	(5)
	\$ 1,262	100%	\$ 1,090	100%	\$ 172

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Channel Reporting

55

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**CHANNEL REPORTING**

Operating Income (Loss)	Q92-3		Q92-3 Plan		Q92-1		Variance	Change
	Revenue		Revenue		Revenue			
IFG - Europe	\$ 119	43.9%	\$ 100	39.7%	\$ 73	39.0%	\$ 19	\$ 46
IFG - ROW	19	24.5	14	18.7	9	14.9	5	10
Total IFG	138	39.5	114	35.0	82	32.5	24	56
USSMD	54	24.9	31	16.2	48	23.9	23	6
Domestic OEM	32	53.2	24	47.8	37	60.7	8	(5)
OEM - Europe	11	55.2	6	37.9	6	77.3	5	5
OEM - ROW	16	56.9	15	52.7	34	42.9	1	(18)
Total OEM	59	54.5	45	47.6	77	64.1	14	(18)
Other	(5)	(30.1)	-	(7.4)	(4)	-	(5)	(1)
	\$ 246	36.1%	\$ 190	30.3%	\$ 203	34.9%	\$ 56	\$ 43

Operating Income (Loss)	FY 92 YTD		FY 92 YTD Plan		Variance
	Revenue		Revenue		
IFG - Europe	\$ 191	41.9%	\$ 134	32.9%	\$ 57
IFG - ROW	29	20.2	14	11.0	15
Total IFG	220	36.7	148	27.7	72
USSMD	102	24.4	33	9.7	69
Domestic OEM	68	56.6	49	48.5	19
OEM - Europe	17	50.8	12	38.8	5
OEM - ROW	50	68.6	29	53.9	21
Total OEM	135	59.5	90	48.4	45
Other	(8)	(45.2)	(2)	(16.9)	(6)
	\$ 449	35.6%	\$ 269	24.6%	\$ 180

Headcount	Dec. 31, 1991		Sept. 30, 1991		Jan. 30, 1991		Mar. 31, 1991		Dec. 31, 1990	
IFG - Europe	1,333	27%	1,136	26%	1,044	27%	891	26%	799	26%
IFG - ROW	656	13	384	13	529	14	489	15	459	15
USSMD	1,263	26	1,176	27	1,001	21	926	23	862	23
OEM (Redmond)	67	1	65	1	57	1	57	2	55	2
PSS	1,107	23	1,035	24	897	23	740	22	632	21
Other	232	6	212	5	184	10	151	8	119	7
Sales Support	202	4	182	4	152	4	135	4	119	4
	4,860	100%	4,390	100%	3,864	100%	3,392	100%	3,045	100%

**Notes:**

IFG includes: All Non-R&D subsidiary headcount. International OEM, PSS, MSU and MCS headcount imbedded in the IFG Channel are not specifically identified.

OEM (Redmond) includes: Domestic OEM plus International OEM support personnel located in Redmond.

Other includes: US MSU, US MCS, and Press.

Sales support includes: Corpcom, PR & Tradeshow, US Networks, and SMSD Management

## INTERNATIONAL FINISHED GOODS - EUROPE

### Q92-2

Revenue growth from Q92-1 was largely due to increased sales of Windows applications. Total Windows applications revenues were \$118 million, an increase of \$49 million from the prior quarter.

Revenue growth was positively impacted by the weakening of the US dollar. The foreign exchange effect was a \$17 million increase in revenues over the prior quarter and a \$29 million increase over plan, before an \$11 million accrual.

Sales of the MS-DOS 5 Upgrade product have trended downward since the initial filling of the channel in July. Both units shipped and revenues were below plan in December.

### YTD

Strong sales of Windows applications led to European revenues of almost a half billion dollars. Growth has also been bolstered by the weak dollar (\$26 million) and earlier than planned sales of the MS-DOS 5 Upgrade (\$19 million). However, absent these two items, revenues were only \$5 million more than plan.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 270	100.0%	\$ 252	100.0%	\$ 187	100.0%	\$ 18	\$ 83
Cost of revenues	46	17.1	44	17.6	33	17.8	(2)	(13)
Operating expense	68	25.1	66	25.9	47	25.3	(2)	(21)
Allocations	38	13.9	42	16.8	34	17.9	4	(4)
Burdened operating income	\$ 118	43.9%	\$ 100	39.7%	\$ 73	39.0%	\$ 18	\$ 45

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 457	100.0%	\$ 407	100.0%	\$ 50
Cost of revenues	80	17.4	73	17.9	(7)
Operating expense	115	25.2	119	29.3	4
Allocations	71	15.5	81	19.9	10
Burdened operating income	\$ 191	41.9%	\$ 134	32.9%	\$ 57

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	109	\$ 43	\$ 400	108	\$ 38	\$ 355	1	\$ 5	\$ 45
Win Word	105	39	369	108	38	352	(3)	1	17
PC Word	79	27	342	77	22	283	2	5	59
Mouse	212	22	106	228	20	90	(16)	2	16
Windows	197	22	112	298	32	107	(101)	(10)	5
MS-DOS	224	18	82	171	13	74	53	5	8
MS-DOS 5 Upgrade	218	14	64	173	13	75	45	1	(11)
Mac Excel	24	7	298	18	6	318	6	1	(20)
Win Office	10	7	639	5	3	602	5	4	37
PC Works	51	6	124	71	9	122	(20)	(3)	2
		\$ 205			\$ 194			\$ 11	
Percentage of net revenues		76%			77%				

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57

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**INTERNATIONAL FINISHED GOODS - EUROPE**

Win Excel, Win Word and Win Office (standard products) together represented 33% of net revenues and were \$10 million over plan. However, sales of Windows were below plan by \$10 million (101,000 units). This variance was caused by a budget based on the release of Windows 3.1 during Q92-2 and OEMs bundling a higher number of PCs with Windows. Bundling revenues flow through the OEM channel.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	109	\$ 43	\$ 400	74	\$ 28	\$ 373	35	\$ 15	\$ 27
Win Word	105	39	369	63	25	392	42	14	(23)
PC Word	79	27	342	56	17	309	23	10	33
Mouse	212	22	106	125	13	100	87	9	6
Windows	197	22	112	129	13	100	68	9	12
MS-DOS	224	18	82	182	14	77	42	4	5
MS-DOS 5 Upgrade	218	14	64	291	21	73	(73)	(7)	(9)
Mac Excel	24	7	298	13	4	315	11	3	(17)
Win Office	10	7	639	1	1	554	9	6	85
PC Works	51	6	124	31	4	135	20	2	(11)
		<u>\$ 205</u>			<u>\$ 140</u>			<u>\$ 65</u>	
Percentage of net revenues		<u>76%</u>			<u>74%</u>				

Net revenues ramped up \$83 million (44%) from Q92-1. Specifically, revenues for Win Excel grew \$15 million and Win Word \$14 million, and did not appear to be negatively impacted by increased sales of Win Office, which grew \$6 million. Per unit revenues of Win Word decreased due to higher discounts granted to reduce stocks in anticipation of shipment of localized versions of Word for Windows 2.0 in Q92-3. Sales of PC Word were also strong, increasing \$10 million. Revenues and revenues per unit were positively impacted by the foreign exchange bump of about 9% over Q92-1.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	183	\$ 71	\$ 389	175	\$ 62	\$ 357	8	\$ 9	\$ 32
Win Word	168	64	378	179	64	356	(11)	-	22
PC Word	135	45	329	127	37	293	8	8	36
Windows	327	35	107	477	51	107	(150)	(16)	-
MS-DOS 5 Upgrade	509	35	69	213	16	74	296	19	(5)
Mouse	337	35	104	389	35	89	(52)	-	15
MS-DOS	405	32	80	280	21	74	125	11	6
Win Excel Upd/Upg	96	14	141	45	6	135	51	8	6
Mac Excel	37	11	304	29	9	317	8	2	(13)
PC Works	82	11	128	114	14	122	(32)	(3)	6
		<u>\$ 353</u>			<u>\$ 315</u>			<u>\$ 38</u>	
Percentage of net revenues		<u>77%</u>			<u>77%</u>				

On a year to date basis, revenue growth over plan has been lead by Win Excel and MS-DOS 5.0. Win Excel product has exceeded budgeted revenues and units in virtually all categories, including standard product, upgrades, updates, licenses and academic versions. The positive variance for the MS-DOS 5 Upgrade of \$19 million was caused by a very strong channel fill in July (and subsequent declining shipment rate) versus the planned gradual revenue growth over the first five months after introduction and then level sales for the remainder of the fiscal year. Sales of Packaged MS-DOS have been strong in Europe, leading to a positive variance of \$11 million over plan. Although Windows sales growth has been steady, finished goods revenues are substantially under plan during the first half of the year (\$16 million).

**INTERNATIONAL FINISHED GOODS - EUROPE**

**Product Group Revenues (In millions)**

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
Applications	\$ 186	\$ 152	\$ 113	\$ 34	\$ 73
MS-DOS & Windows	61	64	52	(3)	9
SPAG	26	24	16	2	10
Languages	4	6	3	(2)	1
Networks	4	8	3	(4)	1
Adjustments	(11)	(2)	—	(9)	(11)
Net revenues	<u>\$ 270</u>	<u>\$ 252</u>	<u>\$ 187</u>	<u>\$ 18</u>	<u>\$ 83</u>

Net revenues from Applications were 22% (\$34 million) over plan for the quarter, predominantly driven by Windows applications. Win Works exceeded plan by \$5 million because localized versions were not expected to be available until Q92-3. DOS & Windows products finished under plan, with the MS-DOS 5 Upgrade and MS-DOS ahead of plan offset by the shortfall in Windows sales. In Europe, all other product groups were below plan, after taking into account the FX effects. Adjustments included \$11 million of reserve for the subsequent reversal (strengthening) of the US dollar in relation to European currencies.

Net revenues increased 44% from Q92-1 as a result of strong applications sales. Strengthening sales of Packaged MS-DOS and Windows were offset by slower sales of the MS-DOS 5 Upgrade. Shipments of Mice were also strong, increasing \$9 million over the prior quarter.

	FY92 YTD	FY92 YTD Plan	Variance
Applications	\$ 298	\$ 251	\$ 47
MS-DOS & Windows	113	97	16
SPAG	42	40	2
Languages	7	10	(3)
Networks	7	12	(5)
Adjustments	(10)	(3)	(7)
Net revenues	<u>\$ 457</u>	<u>\$ 407</u>	<u>\$ 50</u>

Applications led the way over the first half of the year, exceeding plan by 19%. Excel and Word product units were both over plan in each environment (Win, PC, Mac, and PM). Within MS-DOS & Windows, sales of MS-DOS 5.0 (both the packaged version and the retail upgrade) were well above plan, offset by the shortfall of Windows revenues. Revenues from Languages and Networks products were weak across the board.

INTERNATIONAL FINISHED GOODS - EUROPE

	Q92-2		Q92-2 Plan		Net Variance	Operations Variance	Exchange Rate Variance
Germany	\$ 90	33%	\$ 87	35%	\$ 3	\$ (7)	\$ 10
France	83	31	72	29	11	3	8
England	34	13	26	10	8	5	3
Nordic Region	26	10	25	10	1	(2)	3
Benelux	14	5	14	6	-	(2)	2
Italy	11	4	11	4	-	(1)	1
Switzerland	11	4	9	4	2	1	1
Austria	5	2	3	1	2	1	1
Spain	6	2	5	2	1	1	-
Redmond	(10)	(4)	-	-	(10)	1	(11)
	<u>\$ 270</u>	<u>100%</u>	<u>\$ 252</u>	<u>100%</u>	<u>\$ 18</u>	<u>\$ -</u>	<u>\$ 18</u>

Compared to plan, the quarter's favorable revenue variance was caused entirely by the \$29 million favorable exchange rate variance, offset by an \$11 million FX rate accrual. England and France posted positive volume variances over plan, in addition to the translation bump. However, Germany, the Nordic Region, the Netherlands, and Italy were all below planned volumes.

**INTERNATIONAL FINISHED GOODS - EUROPE**

	FY92 YTD		FY92 Plan		Net Variance	Operations Variance	Exchange Rate Variance
Germany	\$ 154	34%	\$ 141	35%	\$ 13	\$ -	\$ 13
France	134	29	112	28	-22	11	11
England	60	13	47	12	13	10	3
Nordic Region	42	9	39	10	3	-	3
Benelux	22	5	22	5	-	(2)	2
Italy	17	4	17	4	-	(2)	2
Switzerland	17	4	14	3	3	2	1
Austria	10	2	6	1	4	3	1
Spain	10	2	9	2	1	-	1
Redmond	(9)	(2)	-	-	(9)	2	(11)
	<u>\$ 457</u>	<u>100%</u>	<u>\$ 407</u>	<u>100%</u>	<u>\$ 50</u>	<u>\$ 24</u>	<u>\$ 26</u>

The favorable revenue variance was composed of a \$24 million favorable operations variance and a \$26 million favorable exchange rate variance. France and England accounted for 85% of the favorable operations variance for the first half of the year, while representing 42% of net revenues. Volume was equal to an aggressive plan in Germany. (Budgeted growth for FY92 over FY91 is 43% in Germany, compared to 14% in France, 36% in England, and 33% for all of Europe.) Switzerland and Austria have positive operational variances, while volumes are below plan in Italy, Belgium, and the Netherlands.

	Q92-2		Q92-1		Net Change	Operations Change	Exchange Rate Change
Germany	\$ 90	33%	\$ 64	34%	\$ 26	\$ 20	\$ 6
France	83	31	51	27	32	27	5
England	34	13	26	14	8	6	2
Nordic Region	26	10	16	8	10	8	2
Benelux	14	5	9	5	5	4	1
Italy	11	4	6	3	5	4	1
Switzerland	11	4	7	4	4	4	-
Austria	5	2	5	3	-	-	-
Spain	6	2	3	2	3	3	-
Redmond	(10)	(4)	-	0	(10)	1	(11)
	<u>\$ 270</u>	<u>100%</u>	<u>\$ 187</u>	<u>100%</u>	<u>\$ 83</u>	<u>\$ 77</u>	<u>\$ 6</u>

The first quarter is typically slow in Europe, with vacations impacting other activity. In FY92, second quarter volumes grew 41% over the first quarter, compared to 56% in FY91. Q92-1 was positively impacted by the channel fill of the MS-DOS 5 Upgrade. Sales of this product in Germany were \$9 million and \$3 million in the first two quarters, respectively. Sales of the MS-DOS 5 Upgrade in France, however, were flat at \$2 million each quarter, thus the higher percentage increase. Volumes increased 50% in the Nordic Region, which ended the quarter with strong December sales, despite a deep recession.



**INTERNATIONAL FINISHED GOODS - EUROPE**

**Cost of Revenues (in millions)**

	Q92-2			Q92-2 Plan		
	Sales		Weighted	Sales		Weighted
	Mix	Cost	Cost	Mix	Cost	Cost
Applications	65.7%	9.3%	6.1%	59.9%	8.4%	5.0%
SPAG	9.1	32.6	3.0	9.3	32.5	3.0
MS-DOS & Win	21.5	12.2	2.6	25.2	13.5	3.4
Languages	1.5	(4.1)	(0.1)	2.3	11.5	0.3
Networks	1.5	8.5	0.1	3.1	6.7	0.2
Other	0.7	2.6	0.3	0.2	3.6	0.1
Product cost - gross	100.0%		12.0%	100.0%		12.0%
Effect of adjustments			x 1.05			x 1.01
Product cost - net			12.5%			12.2%

Product costs, as a percentage of gross revenue, were right on plan at 12.0%. The shift in mix away from sales of Systems products such as MS-DOS, Windows, and various Language and Network products was toward a higher percentage of Applications products, which carry higher margins. This was offset by the mix within Applications (higher than planned percentage of Windows applications) and within MS-DOS & Win (higher percentage of MS-DOS and lower percentage of Windows). In addition, there was a favorable variance in non-product costs, which was brought about by lower than planned inventory adjustments, royalties and freight costs.

**Operating Expenses (in millions)**

	Q92-2	Q92-2 Plan	Net Variance	Operations Variance	Exchange Rate Variance
Germany	\$ 17	\$ 18	\$ 1	\$ 3	\$ (2)
France	16	17	1	3	(2)
England	10	8	(2)	(1)	(1)
Nordic Region	7	8	1	1	--
Benelux	4	4	--	--	--
Italy	3	3	--	--	--
Spain	3	2	(1)	--	(1)
Switzerland	2	2	--	--	--
Austria	1	1	--	--	--
Redmond	5	2	(3)	(3)	--
	<u>\$ 68</u>	<u>\$ 65</u>	<u>\$ (3)</u>	<u>\$ 3</u>	<u>\$ (6)</u>

	Q92-2	Q92-2 Plan	Variance
Marketing	\$ 20	\$ 20	\$ --
Marketing accrual	4	--	(4)
Product support services	7	8	1
Payroll & payroll taxes	15	14	(1)
Other	22	23	1
	<u>\$ 68</u>	<u>\$ 65</u>	<u>\$ (3)</u>

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**INTERNATIONAL FINISHED GOODS - EUROPE**

Spending for operating expenses in local currencies was 6% under plan. Marketing expense, after being below plan in the first quarter, was equal to plan in Q92-2. The marketing accrual is for underspending on a business unit basis, plus an accrual for recently approved incremental marketing programs. The underspending in PSS was broadly distributed among all European subsidiaries. Excluding the foreign exchange impact, payroll was under plan because of the lag in hiring. An exception was Germany, where payroll spending was over plan by 9%.

	FY92 YTD	FY92 YTD Plan	Net Variance	Operations Variance	Exchange Rate Variance
Germany	\$ 30	\$ 35	\$ 5	\$ 8	\$ (3)
France	28	29	1	3	(2)
England	17	16	(1)	-	(1)
Nordic Region	12	13	1	2	(1)
Benclux	7	8	1	1	-
Italy	5	6	1	1	-
Switzerland	4	4	-	-	-
Spain	4	3	(1)	-	(1)
Austria	1	1	-	-	-
Redmond	7	4	(3)	(3)	-
	<u>\$ 115</u>	<u>\$ 119</u>	<u>\$ 4</u>	<u>\$ 12</u>	<u>\$ (8)</u>

	FY92 YTD	FY92 YTD Plan	Variance
Marketing	\$ 32	\$ 35	\$ 3
Marketing accrual	6	--	(6)
Product support services	12	15	3
Payroll & payroll taxes	25	25	--
Bad debt expense	3	2	(1)
Other	37	42	5
	<u>\$ 115</u>	<u>\$ 119</u>	<u>\$ 4</u>

Strong cost control has kept operating expenses below plan (\$12 million excluding the effect of exchange rates). Across all business units, local currency spending for marketing was under plan primarily in Germany (18%) and in France (15%). However, underspending in the MS-DOS product unit and approved incremental marketing programs led to the establishment of a marketing accrual of \$6 million. Product support services expense was under plan in all subsidiaries. Recessionary trends have led to larger provisions for bad debts in some countries. Spain recorded an unbudgeted accrual for \$800 thousand in December, although this particular provision is thought more attributable to credit management issues than to local economic conditions.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channels
December 31, 1991	1,333	1,525	192	197	15%	27%
September 30, 1991	1,136	1,332	196	92	14	26
June 30, 1991	1,044	1,015	(29)	153	14	27
March 31, 1991	891	983	92	92	14	26
December 31, 1990	799	922	123	167	13	26

Net revenues per headcount was \$203,000 in Q92-2 versus \$165,000 in Q92-1.

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63

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## **INTERNATIONAL FINISHED GOODS - EUROPE**

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### **Allocations**

#### **Q92-2**

The favorable allocation variance was primarily due to lower than expected allocations for research and development from International R&D (\$3 million), with smaller positive variances from most other research and development and sales and marketing cost centers.

#### **YTD**

Allocations were below plan in absolute dollars and as a percentage of revenues for all development, marketing, and management functions, except Legal and Corporate Affairs.

### **Burdened Operating Income**

#### **Q92-2**

Burdened operating income exceeded plan by 19%. Revenues were positively affected by the weaker dollar, and cost of revenues, at 17.1% of revenues, were below plan. Spending in local currencies for operating expenses were below plan, and allocations were also under budget.

### **Quarterly Growth**

The Q92-2 burdened operating income of \$118 million, was 63% higher than in Q92-1. This improvement was caused by a 45% increase in revenues (\$83 million) and, as a percentage of net revenues, lower costs of revenues, operating expenses, and allocations.

#### **YTD**

The weak US dollar supported record revenues, and its impact on cost of revenues and operating expenses was offset by efficiencies in non-product costs and controlled local currency spending. Headcounts below plan in the European channel and in product development also had positive influences.

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## INTERNATIONAL FINISHED GOODS - ROW

### Q92-2

Driven largely by Windows and Windows applications products, revenue grew 21% from Q92-1.

Sales of the MS-DOS 5 upgrade were flat with Q92-1 at \$5 million.

Burdened operating income more than doubled over Q92-1 to \$19 million, 36% over plan.

### YTD

Net revenues of \$143 million exceeded plan by \$16 million. Strong packaged MS-DOS sales accounted for 44% of this variance.

Windows and Windows application products represented 40% of gross revenues.

Burdened operating income, \$29 million, was \$15 million over plan.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 79	100.0%	\$ 73	100.0%	\$ 64	100.0%	\$ 6	\$ 15
Cost of revenues	18	23.6	20	26.9	21	32.3	2	3
Operating expense	22	27.5	21	29.0	19	28.7	(1)	(3)
Allocations	20	24.4	18	25.4	15	24.1	(2)	(5)
Burdened operating income	\$ 19	24.5%	\$ 14	18.7%	\$ 9	14.9%	\$ 5	\$ 10

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 143	100.0%	\$ 127	100.0%	\$ 16
Cost of revenues	39	27.5	35	27.7	(4)
Operating expense	40	28.1	40	31.9	-
Allocations	35	24.2	38	29.4	3
Burdened operating income	\$ 29	20.2%	\$ 14	11.0%	\$ 15

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	30	\$ 8	\$ 275	39	\$ 11	\$ 288	(9)	\$ (3)	\$ (13)
Mouse	84	8	94	87	7	84	(3)	1	10
MS-DOS	127	7	55	67	4	64	60	3	(9)
Win Word	28	6	223	34	7	212	(6)	(1)	11
Windows	73	6	75	71	5	74	2	1	1
Win Office	16	5	335	9	4	424	7	1	(89)
MS DOS 5 Upgrade	99	5	47	76	4	52	23	1	(5)
Win Excel Upd/Upg	24	4	161	14	2	128	10	2	33
PC Works	29	3	93	47	5	103	(18)	(2)	(10)
Mac Excel	12	2	202	10	3	242	2	(1)	(40)
		\$ 54			\$ 52			\$ 2	
Percentage of net revenues		69%			71%				

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65

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**INTERNATIONAL FINISHED GOODS - ROW**

Revenues across the top ten products showed mixed results versus plan. A positive volume variance of \$4 million was offset by a \$2 million negative price variance. Volume gains were strongest in MS-DOS, particularly in the ICON region. The negative price variance of \$2 million was composed of \$1 million in MS-DOS and \$1 million in Win Office. Win Excel sales, \$8 million, were significantly below plan due to a \$3 million negative variance in sales of standard product in MS Japan. However, Japan had a \$2.5 million positive variance in upgrades. The MS-DOS 5 upgrade continued to show strong sales. PC Works is below plan due to significant shortfall of localized product in Japan. The new release of Kanji Works is due at the end of Q92-3.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	30	\$ 8	\$ 275	21	\$ 4	\$ 209	9	\$ 4	\$ 66
Mouse	84	8	94	74	7	91	10	1	3
MS-DOS	127	7	55	143	8	55	(16)	(1)	-
Win Word	28	6	223	17	4	221	11	2	2
Windows	73	6	75	63	5	82	10	1	(7)
Win Office	16	5	335	10	4	434	6	1	(99)
MS-DOS 5 Upgrade	99	5	47	92	5	59	7	-	(12)
Win Excel Upd/Upg	24	4	161	8	1	97	16	3	64
PC Works	29	3	93	28	3	95	1	-	(2)
Mac Excel	12	2	202	11	3	233	1	(1)	(31)
		<u>\$ 54</u>			<u>\$ 44</u>			<u>\$ 10</u>	
Percentage of net revenues		<u>69%</u>			<u>67%</u>				

Net revenues increased \$15 million (21%) from Q92-1. Nearly half of this growth came from sales of Win Excel (including updates/upgrades) with sales evenly split between the English International version and the Kanji version. Driven by strong sales of the English International version in the ICON region, Win Word revenues were \$2 million over plan. MS-DOS 5 upgrade sales were flat versus the prior quarter. Win Excel's average unit price increased \$66 from Q92-1 due to discounted sales to the Australian government in the first quarter.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	269	\$ 15	\$ 55	121	\$ 8	\$ 65	148	\$ 7	\$ (10)
Mouse	158	15	92	156	13	85	2	2	7
Win Excel	51	13	248	57	16	276	(6)	(3)	(28)
Windows	137	11	79	130	9	73	7	2	6
Win Word	46	10	222	45	10	215	1	-	7
MS-DOS 5 Upgrade	190	10	53	152	8	50	38	2	3
Win Office	25	9	373	18	7	425	7	2	(52)
PC Works	58	5	94	90	9	101	(32)	(4)	(7)
Win Excel Upd/Upg	36	5	141	23	3	118	13	2	23
Mac Excel	23	5	217	20	5	243	3	-	(26)
		<u>\$ 98</u>			<u>\$ 88</u>			<u>\$ 10</u>	
Percentage of net revenues		<u>68%</u>			<u>69%</u>				

Net revenues were \$16 million ahead of plan on a year-to-date basis. MS-DOS accounted for 57% of this favorable variance. PC Works revenues lag budget by \$4 million due to lower than expected sales in Japan. The unfavorable Win Excel variance was nearly offset by the favorable variance in Win Excel updates/upgrades. The unfavorable unit price variance on Win Excel and Win Office resulted from the Australian government sales mentioned above.

**INTERNATIONAL FINISHED GOODS - ROW**

**Product Group Revenues (in millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Q92-1</u>	<u>Variance</u>	<u>Change</u>
Applications	\$ 45	\$ 45	\$ 32	\$ --	\$ 13
MS-DOS & Windows	20	16	20	4	--
SPAG	9	8	7	1	2
Languages	4	4	4	--	--
Networks	2	2	2	--	--
Other	--	1	1	(1)	(1)
Adjustments	(1)	(3)	(2)	2	1
Net revenues	<u>\$ 79</u>	<u>\$ 73</u>	<u>\$ 64</u>	<u>\$ 6</u>	<u>\$ 15</u>

Net revenues were \$6 million over plan for the quarter. The majority of the variance was in Systems products with MS-DOS and the MS-DOS 5 upgrade contributing a \$4 million positive variance. Applications products revenues were on plan with negative variances in Win Excel (\$3.1 million) and PC Works (\$2.1 million) offset by positive variances in Win Excel updates/upgrades (\$2.1 million), Win Works (\$1.3 million), Mac Excel updates (\$0.8 million), and Win Publisher (\$0.5 million). Strong Mouse sales resulted in a \$1 million positive variance in SPAG.

Net revenues increased 21% from Q92-1. Applications products represented nearly the entire increase with strong growth in the major Windows applications: Win Excel (\$4 million), Win Excel updates/upgrades (\$3 million), Win Word (\$2 million), and Win Office (\$1 million). The remainder of the net revenue increase is due to continued strong sales of Mouse products.

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Applications	\$ 76	\$ 75	\$ 1
MS-DOS & Windows	40	30	10
SPAG	16	14	2
Languages	8	6	2
Networks	4	4	--
Other	2	1	1
Adjustments	(3)	(3)	--
Net revenues	<u>\$ 143</u>	<u>\$ 127</u>	<u>\$ 16</u>

On a year-to-date basis, net revenues were \$16 million over plan with strong sales in Systems products (MS-DOS and the MS-DOS 5 upgrade) being a contributing factor. All other product categories are slightly above plan with the exception of Networks which is on plan.

**INTERNATIONAL FINISHED GOODS - ROW**

**Net Revenues (in millions)**

	Q92-2		Q92-2 Plan		Net Variance	Operations Variance	Exchange Rate Variance
<b>ICON</b>							
Canada	\$ 24	30.5%	\$ 19	26.5%	\$ 5	\$ 4	\$ 1
Australia	16	20.4	16	22.1	--	(1)	1
Singapore	4	4.7	2	2.7	2	2	--
	<u>44</u>	<u>55.6</u>	<u>37</u>	<u>51.3</u>	<u>7</u>	<u>5</u>	<u>2</u>
<b>EAR EAST</b>							
Japan	21	25.9	24	32.8	(3)	(5)	2
Korea	2	2.1	2	2.0	--	--	--
Taiwan	1	1.6	1	1.9	--	--	--
Hong Kong	1	1.4	1	1.3	--	--	--
	<u>25</u>	<u>31.0</u>	<u>28</u>	<u>38.0</u>	<u>(3)</u>	<u>(5)</u>	<u>2</u>
<b>LATIN AMERICA</b>							
Mexico	3	4.0	2	3.2	1	1	--
Brazil	1	1.9	2	2.3	(1)	(1)	--
Argentina	1	1.3	1	1.0	--	--	--
Venezuela	1	1.3	1	0.9	--	--	--
	<u>6</u>	<u>8.5</u>	<u>6</u>	<u>7.4</u>	<u>--</u>	<u>--</u>	<u>--</u>
<b>AIME</b>							
Aime	3	4.4	2	3.1	1	1	--
Israel	1	0.5	--	0.2	1	1	--
	<u>4</u>	<u>4.9</u>	<u>2</u>	<u>3.3</u>	<u>2</u>	<u>2</u>	<u>--</u>
Redmond Operations	--	--	--	--	--	--	--
	<u>\$ 79</u>	<u>100.0%</u>	<u>\$ 73</u>	<u>100.0%</u>	<u>\$ 6</u>	<u>\$ 2</u>	<u>\$ 4</u>

The positive revenue variance of \$6 million was due almost entirely to strong performance in the ICON region. Canada had a particularly strong quarter with a \$5 million positive variance. The major products contributing to these results were the MS-DOS 5 upgrade and Win Works (which was not budgeted). Japan suffered a \$5 million operations variance, primarily due to slippage of Win Word (from October to December) and Win Works sales lagging plan. This was offset somewhat by a positive foreign exchange variance of \$2 million. The AIME region posted slight gains to plan due to positive performance in Win Office, Win Word and the MS-DOS 5 upgrade.

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**INTERNATIONAL FINISHED GOODS - ROW**

	Q92-2		Q92-1		Net Change	Operations Change	Exchange Rate Change
<b>ICON</b>							
Canada	\$ 24	30.5%	\$ 16	24.4%	\$ 8	\$ 8	\$ --
Australia	16	20.4	23	36.0	(7)	(7)	--
Singapore	4	4.7	2	3.8	2	2	--
	<u>44</u>	<u>55.6</u>	<u>41</u>	<u>64.2</u>	<u>3</u>	<u>3</u>	<u>--</u>
<b>FAR EAST</b>							
Japan	21	25.9	12	17.9	9	8	1
Korea	2	2.1	1	1.5	1	1	--
Taiwan	1	1.6	1	2.2	--	--	--
Hong Kong	1	1.4	1	1.5	--	--	--
	<u>25</u>	<u>31.0</u>	<u>15</u>	<u>23.1</u>	<u>10</u>	<u>9</u>	<u>1</u>
<b>LATIN AMERICA</b>							
Mexico	3	4.0	2	3.0	1	1	--
Brazil	1	1.9	1	2.1	--	--	--
Argentina	1	1.3	1	1.3	--	--	--
Venezuela	1	1.3	1	1.3	--	--	--
	<u>6</u>	<u>8.5</u>	<u>5</u>	<u>7.7</u>	<u>1</u>	<u>1</u>	<u>--</u>
<b>AIME</b>							
Aime	3	4.4	2	4.1	1	1	--
Israel	1	0.5	1	0.6	--	--	--
	<u>4</u>	<u>4.9</u>	<u>3</u>	<u>4.7</u>	<u>1</u>	<u>1</u>	<u>--</u>
Redmond Operations	--	--	--	0.3	--	--	--
	<u>\$ 79</u>	<u>100.0%</u>	<u>\$ 64</u>	<u>100.0%</u>	<u>\$ 15</u>	<u>\$ 14</u>	<u>\$ 1</u>

Revenue growth versus the prior quarter was strong in both Canada and Japan. Canadian sales were particularly strong in Win Word, Win Office and the MS-DOS 5 upgrade. Sales growth in MS Japan was primarily in Win Excel and Win Word. Revenues in MS Australia lagged Q92-1 in nearly all categories since the Q92-1 figures were boosted by the one-time effects of filling backorders and the completion of the per system sales to the Australian Tax Authority. There were no significant foreign exchange impacts from quarter to quarter.

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**INTERNATIONAL FINISHED GOODS - ROW**

	FY92 YTD		FY92 Plan		Net Variance	Operations Variance	Exchange Rate Variance
<b>ICON</b>							
Canada	\$ 40	27.8%	\$ 33.0	25.7%	\$ 7	\$ 6	\$ 1
Australia	39	27.5	33	25.8	6	5	1
Singapore	6	4.3	3	2.9	3	3	--
	<u>85</u>	<u>59.6</u>	<u>69</u>	<u>54.4</u>	<u>16</u>	<u>14</u>	<u>2</u>
<b>FAR EAST</b>							
Japan	32	22.3	36	28.4	(4)	(7)	3
Korea	3	1.9	3	2.1	--	--	--
Taiwan	2	1.8	2	2.1	--	--	--
Hong Kong	2	1.4	2	1.4	--	--	--
	<u>39</u>	<u>27.4</u>	<u>43</u>	<u>34.0</u>	<u>(4)</u>	<u>(7)</u>	<u>3</u>
<b>LATIN AMERICA</b>							
Mexico	5	3.5	4	3.3	1	1	--
Brazil	3	2.0	3	2.6	--	--	--
Argentina	2	1.3	1	1.1	1	1	--
Venezuela	2	1.3	1	0.9	1	1	--
	<u>12</u>	<u>8.1</u>	<u>9</u>	<u>7.9</u>	<u>3</u>	<u>3</u>	<u>--</u>
<b>AIME</b>							
Aime	6	4.3	4	3.4	2	2	--
Israel	1	0.6	1	0.3	--	--	--
	<u>7</u>	<u>4.9</u>	<u>5</u>	<u>3.7</u>	<u>2</u>	<u>2</u>	<u>--</u>
Redmond Operations	--	--	1	--	(1)	(1)	--
	<u>\$ 143</u>	<u>100.0%</u>	<u>\$ 127</u>	<u>100.0%</u>	<u>\$ 16</u>	<u>\$ 11</u>	<u>\$ 5</u>

The \$16 million favorable variance in net revenues on a year-to-date basis was virtually all from the ICON region where sales were strong across the board. Unfavorable variances in the Far East were offset by gains in the Latin America and AIME regions.

	Q92-2			Q92-2 Plan		
	Sales Mix	Cost	Weighted Cost	Sales Mix	Cost	Weighted Cost
Applications	56.2%	12.1%	6.8%	60.0%	13.3%	8.0%
SPAG	10.8	32.5	3.5	10.8	34.6	3.7
MS-DOS & Win	25.0	16.5	4.1	21.3	24.6	5.2
Languages	5.5	17.5	1.0	4.6	18.9	0.9
Networks	2.2	48.6	1.1	3.1	17.3	0.5
Other	0.3	20.5	0.1	0.2	21.1	--
Product cost - gross	100.0%		16.6%	100.0%		18.3%
Effect of adjustments			x 1.02			x 1.04
Product cost - net			<u>16.9%</u>			<u>19.0%</u>

Product costs, as a percentage of revenue, were significantly below plan in all categories except Networks. Non-product costs were favorable to plan with gains in freight, royalties and allocations more than offsetting higher than planned inventory adjustments.

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**INTERNATIONAL FINISHED GOODS - ROW**

**Operating Expenses (In millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Net Variance</u>	<u>Operations Variance</u>	<u>Exchange Rate Variance</u>
<b>ICON</b>					
Canada	\$ 4.5	\$ 4.5	\$ --	\$ 0.1	\$ (0.1)
Australia	5.0	5.1	0.1	0.3	(0.2)
Singapore	0.7	0.5	(0.2)	(0.2)	--
	<u>10.2</u>	<u>10.1</u>	<u>(0.1)</u>	<u>0.2</u>	<u>(0.3)</u>
<b>FAR EAST</b>					
Japan	6.2	6.0	(0.2)	0.4	(0.6)
Korea	0.5	0.5	--	--	--
Taiwan	0.5	0.5	--	--	--
Hong Kong	0.2	0.4	0.2	0.2	--
	<u>7.4</u>	<u>7.4</u>	<u>--</u>	<u>0.6</u>	<u>(0.6)</u>
<b>LATIN AMERICA</b>					
Mexico	0.9	1.2	0.3	0.3	--
Brazil	0.6	0.9	0.3	0.3	--
Argentina	0.4	0.3	(0.1)	(0.1)	--
Venezuela	0.2	0.2	--	--	--
	<u>2.1</u>	<u>2.6</u>	<u>0.5</u>	<u>0.5</u>	<u>--</u>
<b>AIME</b>					
Aime	0.3	0.5	0.2	0.2	--
Israel	0.1	0.1	--	--	--
	<u>0.4</u>	<u>0.6</u>	<u>0.2</u>	<u>0.2</u>	<u>--</u>
Redmond Operations	1.4	0.6	(0.8)	(0.8)	--
	<u>\$ 21.5</u>	<u>\$ 21.3</u>	<u>\$ (0.2)</u>	<u>\$ 0.7</u>	<u>\$ (0.9)</u>

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Variance</u>
Settlements, lic, ins, tax	\$ 1.4	\$ 0.5	\$ (0.9)
Marketing	6.6	5.8	(0.8)
Payroll & payroll taxes	4.0	4.6	0.6
Product Support Services	3.0	3.4	0.4
Other	6.5	7.0	0.5
	<u>\$ 21.5</u>	<u>\$ 21.3</u>	<u>\$ (0.2)</u>

Operating expenses were slightly above plan during the quarter. The negative variance in settlements, licenses, insurance and taxes was the result of unplanned B&O taxes recorded in the Redmond international department. This was nearly offset by slight gains to plan across the subsidiaries and territories. The negative marketing variance reflects spending that was planned in Q92-1, but delayed until Q92-2.

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**INTERNATIONAL FINISHED GOODS - ROW**

	<u>FY92 YTD</u>	<u>FY92 Plan</u>	<u>Net Variance</u>	<u>Operations Variance</u>	<u>Exchange Rate Variance</u>
<b>ICON</b>					
Canada	\$ 8.5	\$ 8.4	\$ (0.1)	\$ 0.1	\$ (0.2)
Australia	9.8	10.0	0.2	0.7	(0.5)
Singapore	1.0	1.0	--	--	--
	<u>19.3</u>	<u>19.4</u>	<u>0.1</u>	<u>0.8</u>	<u>(0.7)</u>
<b>FAREAST</b>					
Japan	9.8	10.9	1.1	2.0	(0.9)
Korea	0.8	0.9	0.1	0.1	--
Taiwan	1.1	1.1	--	--	--
Hong Kong	0.3	0.7	0.4	0.4	--
	<u>12.0</u>	<u>13.6</u>	<u>1.6</u>	<u>2.5</u>	<u>(0.9)</u>
<b>LATIN AMERICA</b>					
Mexico	1.7	2.3	0.6	0.6	--
Brazil	1.3	1.9	0.6	0.6	--
Argentina	0.6	0.7	0.1	0.1	--
Venezuela	0.3	0.4	0.1	0.1	--
	<u>3.9</u>	<u>5.3</u>	<u>1.4</u>	<u>1.4</u>	<u>--</u>
<b>AIME</b>					
Aime	0.7	0.9	0.2	0.2	--
Israel	0.1	0.2	0.1	0.1	--
	<u>0.8</u>	<u>1.1</u>	<u>0.3</u>	<u>0.3</u>	<u>--</u>
Redmond Operations	4.1	1.0	(3.1)	(3.1)	--
	<u>\$ 40.1</u>	<u>\$ 40.4</u>	<u>\$ 0.3</u>	<u>\$ 1.9</u>	<u>\$ (1.6)</u>

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Marketing accrual	\$ 1.8	\$ --	\$ (1.8)
Settlements, lic, ins, tax	2.3	0.9	(1.4)
Payroll & payroll taxes	7.7	8.8	1.1
Marketing	9.9	10.7	0.8
Other	18.4	20.0	1.6
	<u>\$ 40.1</u>	<u>\$ 40.4</u>	<u>\$ 0.3</u>

Operating expenses were 99% of plan on a year-to-date basis. The marketing accrual reflects a corporate level accrual for planned marketing expenditures. This negative variance was partially offset by a delay in planned marketing spending. The negative variance in settlements, licenses, insurance and taxes resulted from unplanned B&O taxes recorded in the Redmond international department. The positive payroll variance was caused by slippage of planned headcount additions.

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**INTERNATIONAL FINISHED GOODS - ROW**

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channels
December 31, 1991	656	664	8	72	7%	13%
September 30, 1991	584	737	153	55	7	13
June 30, 1991	529	516	(13)	40	7	14
March 31, 1991	489	510	21	30	7	14
December 31, 1990	459	479	20	28	8	15

Net revenues per headcount was \$119,000 in Q92-2 versus \$111,000 in Q92-1.

**Allocations****Q92-2**

Allocations were \$500,000 higher than plan. The primary factors were higher than expected expenses in International R&D and International management.

**YTD**

Allocations were \$2.6 million below plan, nearly all of which was in research and development. The International R&D component was \$1.4 million below plan.

**Burdened Operating Income****Q92-2**

Burdened operating income exceeded plan by 39%. This variance was the result of higher than planned revenues (\$6 million) and gross margin (\$8 million). This was reduced slightly by higher than planned operating expenses and allocations (\$3 million).

**Quarterly Growth**

Burdened operating income growth was driven by strong revenue growth, \$15 million, and gains in cost of revenues of \$3 million. Increases in operating expenses, \$3 million, and allocations, \$5 million, somewhat offset the gross margin gain.

**YTD**

Revenue, \$16 million over plan, drove burdened operating income gains of \$15 million over plan on a year-to-date basis. Revenues have been at or above plan in all product categories with Systems products being particularly strong due to MS-DOS and the MS-DOS 5 upgrade.

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## USSMD

### Q92-2

Continued demand for Windows and Windows applications pulled net revenues past the \$200 million mark for the second consecutive quarter. Windows and Windows applications revenues accounted for 51% of USSMD's gross revenues.

Demand for the MS-DOS 5 Upgrade declined sharply. MS-DOS 5 Upgrade Q92-2 revenues declined 60% from Q92-1, although they surpassed plan by \$4 million.

Win-Word 2.0 was introduced two months earlier than planned and contributed to the \$15 million favorable variance for Win Word (all SKUs). WordPerfect for Windows shipped in December. With both products experiencing large channel filling shipments, results to date are inconclusive as to what impact, if any, WordPerfect for Windows will have on demand for Win Word.

### YTD

MS-DOS 5 Upgrade revenues exceeded plan by \$32 million. Channel filling demand was explosive during Q92-1, but declined sharply during Q92-2.

Applications revenues were \$52 million (24%) above plan. Windows applications revenue was 36% above plan.

Demand for Win Excel has not been adversely impacted by the Lotus123/W product. Reports from the channel indicate that the character based version of Lotus 123 continues to sell surprisingly well.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 215	100.0%	\$ 193	100.0%	\$ 201	100.0%	\$ 22	\$ 14
Cost of revenues	41	19.0	40	21.0	42	20.7	(1)	1
Operating expense	83	38.5	82	42.7	76	37.7	(1)	(7)
Allocations	37	17.6	40	20.1	35	17.7	3	(2)
Burdened operating income	\$ 54	24.9%	\$ 31	16.2%	\$ 48	23.9%	\$ 23	\$ 6

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 416	100.0%	\$ 346	100.0%	\$ 70
Cost of revenues	83	19.8	73	21.2	(10)
Operating expense	158	38.1	161	46.5	3
Allocations	73	17.7	79	22.6	6
Burdened operating income	\$ 102	24.4%	\$ 33	9.7%	\$ 69

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Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Mouse	372	\$ 32	\$ 87	372	\$ 33	\$ 89	-	\$ (1)	\$ (2)
Win Office	59	23	392	16	6	398	43	17	(6)
Win Word	131	23	176	87	19	221	44	4	(45)
Windows	272	19	71	241	18	75	31	1	(4)
Win Excel	67	15	222	84	20	233	(17)	(5)	(11)
MS-DOS 5 Upgrade	278	14	49	185	10	54	93	4	(5)
Win Word Upd/Upg	108	11	98	-	-	-	108	11	98
Mac Word	55	10	186	58	11	183	(3)	(1)	3
Mac Excel	41	10	238	31	7	240	10	3	(2)
Mac Office	18	7	399	15	7	456	3	-	(57)
		<u>\$ 164</u>			<u>\$ 131</u>			<u>\$ 33</u>	
Percentage of net revenues		<u>76%</u>			<u>68%</u>				

Stimulated by the "Buy 8, get 10" promotion, revenue for the Win/Mouse bundle was 6% ahead of plan. The positive revenue variance from Win/Mouse (\$1.0 million) was offset by below plan shipments and revenues for the Paintbrush/Mouse (28,800 units, \$2.4 million, respectively).

Windows and Windows applications dominated the USSMD sales charts, representing five of the top 10 products and 51% of gross revenues. Win Office, Win Word and Windows exceeded plan by 259%, 20% and 6%, respectively.

Increased penetration of the Windows platform, combined with the attractiveness of the Office bundle as an economical means of obtaining a full suite of Windows compatible applications, pushed Win Office revenues to over three times planned amounts.

Win Word 2.0 shipped during the quarter, generating favorable unit variances as distributors placed large orders to fill the channel. Win Word academic version revenues exceeded plan by 144%, comprising 44% of the unit sales mix and driving the \$/unit below plan. Unplanned Win Word 2.0 update revenues, combined with the extension of the \$129 competitive upgrade program, contributed \$11 million to revenues. Win Excel suffered a \$5 million revenue shortfall primarily due to the shift in sales mix from full packaged product to the Win Office bundle and upgrades. The shortfall in standard product units shipped was entirely offset by above plan \$129 competitive upgrade program shipments.

Strong revenues posted by Mac standard products were offset by lower than planned Mac Word upgrade revenues (\$4 million), resulting in overall Mac applications revenues equal to plan. Mac Excel standard product revenues exceeded plan by 32%, while upgrades exceeded plan by 199%. Mac Office \$/unit variance resulted from the unplanned reduction of the SRP from \$849 to \$750 and a special price promotion offered to Franchisers to bundle Mac Office with their computer hardware sales.

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	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Mouse	372	\$ 32	\$ 87	309	\$ 27	\$ 88	63	\$ 5	\$ (1)
Win Office	59	23	392	28	10	370	31	13	22
Win Word	131	23	176	91	17	188	40	6	(12)
Windows	272	19	71	276	20	71	(4)	(1)	-
Win Excel	67	15	222	73	16	223	(6)	(1)	(1)
MS-DOS 5 Upgrade	274	14	50	629	34	54	(355)	(20)	(4)
Win Word Upd/Upg	108	11	98	29	3	108	79	8	(10)
Mac Word	55	10	186	66	9	138	(11)	1	48
Mac Excel	41	10	238	50	11	218	(9)	(1)	20
Mac Office	18	7	399	16	7	410	2	-	(11)
		<u>\$ 164</u>			<u>\$ 154</u>			<u>\$ 10</u>	
Percentage of net revenues		<u>76%</u>			<u>77%</u>				

Substantial increases in shipments of Mice and Windows applications boosted Leading Product revenues to a 7% increase over the prior quarter despite a 60% decline in MS-DOS 5 Upgrade revenues. Excluding MS-DOS 5 Upgrade revenues, Leading Products increased 25%. End user demand for MS-DOS 5 Upgrade softened during Q92-2, causing decreased shipments to resellers as their sell-through rate fell dramatically. Mouse sales, stimulated by the "Buy 8, get 10" promotion, increased 18% over the prior quarter.

Windows applications revenue increased by 43%, reflecting a 83% increase in update/upgrade revenues and a 36% increase in standard product revenues. Increases in Win Word update/upgrade, Win Office, and Win Word of 237%, 129%, and 35%, respectively, offset the 9% decline in Win Excel revenues. The Win Word (all SKUs) increase reflected the introduction of Win Word 2.0 and the continuation of the \$129 competitive upgrade program. Win Office gains reflected the accelerating popularity of the Windows platform and the attractiveness of Win Office as a means of economically acquiring a full-suite of Windows applications.

Mac applications showed mixed results; Word and Office revenues increased 13% and 10%, respectively, while Excel revenues declined by 10%. Word and Excel shipped fewer units at a higher \$/unit pursuant to the shift in the sales mix to higher SRP standard product from academic versions. Following the seasonally high Q92-1 selling season, Word and Excel academic version unit shipments declined by 54% and 57%, respectively. Office unit penetration increased as end users responded to the reduced SRP.

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	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Mouse	681	\$ 59	\$ 100	688	\$ 61	\$ 98	(7)	\$ (2)	\$ 2
MS-DOS 5 Upgrade	903	47	52	285	15	54	618	32	(2)
Win Word	222	40	181	166	37	221	56	3	(40)
Windows	547	39	71	431	32	75	116	7	(4)
Win Office	87	33	385	31	12	398	56	21	(13)
Win Excel	141	31	222	155	36	233	(14)	(5)	(11)
Mac Excel	90	20	227	58	14	235	32	6	(8)
Mac Word	122	19	160	114	19	168	8	-	(8)
Mac Office	34	14	404	23	10	456	11	4	(52)
Win Word Upd/Upg	137	14	100	-	-	-	137	14	100
		<u>\$ 316</u>			<u>\$ 236</u>			<u>\$ 80</u>	
Percentage of net revenues		<u>76%</u>			<u>69%</u>				

Leading Products contributed 76% of net revenue versus plan of 69%. Overall, these products exceeded plan by 34%. MS-DOS 5 Upgrade, Win Office, Mac Excel and Win Word (all SKUs) were the primary drivers of the favorable variance. Excluding the MS-DOS 5 Upgrade, revenues from Leading Products surpassed plan by \$48 million, a 22% favorable variance.

Windows and Windows applications accounted for 46% of gross revenues versus plan of 42%. Windows continued to achieve penetration in the retail channel, surpassing plan by 21%. Windows applications revenues exceed plan by 36%, including a 21% (\$24 million) favorable variance in standard products and a 365% (\$20 million) favorable variance in updates/upgrades. The favorable standard products variance results primarily from the success of Win Office and Win Word which exceeded plan by 171% and 10%, respectively. Continuation of the Win Excel and Win Word \$129 competitive upgrade programs contributed revenues of \$16 million. The \$/unit variances resulted from the shift in the planned sales mix from full packaged product to steeply discounted academic products and the Win Office.

Mac applications exceeded plan by 21%, driven by the strength in shipments of Excel and Office. Excel 3.0 revenues were 50% ahead of plan. The reduction in the SRP of Office from \$849 to \$750 stimulated demand, resulting in a 33% favorable variance.

Product Group Revenues (in millions)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
Applications	\$ 151	\$ 125	\$ 124	\$ 26	\$ 27
MS-DOS & Windows	34	29	55	5	(21)
SPAG	33	35	33	(2)	-
Languages	6	10	6	(4)	-
Networks	4	4	3	-	1
Adjustments	(13)	(10)	(20)	(3)	7
Net revenues	<u>\$ 215</u>	<u>\$ 193</u>	<u>\$ 201</u>	<u>\$ 22</u>	<u>\$ 14</u>

Q92-2

Strong shipments of Applications and MS-DOS & Windows pushed net revenues over the \$215 million mark. Gross revenues were \$26 million over plan, a 13% variance. Applications revenues exceeded plan by 21%. Windows applications revenues were above plan by \$30 million. DOS applications were \$4 million below plan while Mac applications revenues approximated budget. MS-DOS & Windows revenues surpassed plan by 16%, reflecting favorable variances in the MS-DOS 5 Upgrade (\$4 million) and Windows (\$1 million). Hardware revenues were 5% below plan. A favorable variance for Win/Mouse (\$1 million) was offset by unfavorable variances for Paintbrush (\$2 million) and the Ballpoint Mouse (\$1 million). Language revenues were 38% below



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plan due to the slippage of Windows Professional C (\$2 million, all SKUs) and lower than planned revenues from DOS Professional C (\$600,000, all SKUs) and Pro COBOL (\$500,000). Revenue adjustments exceeded plan due to the volume driven rebates. As a percentage of Qualified Purchases, actual rebates (6.4%) exceeded plan (5.1%) by 1.3% due to a shift in the planned sales mix from Distributors to Major Chains, which receive a higher rebate percentage.

**Quarterly Growth**

Gross revenues increased 4% over Q92-1, setting a new high for the channel. Excluding the MS-DOS 5 Upgrade, revenues increased 15%. All product groups contributed higher revenues, except MS-DOS & Windows, which declined by 39% due to the 60% drop in the MS-DOS 5 Upgrade. Windows revenues declined by 2%. Applications revenues increased by 22%, including increases of 43% (\$29 million) and 7% (\$1 million) in Windows and DOS applications, respectively. Mac applications declined 4% primarily due to a decrease in Mac Excel sales (\$2 million). Networks, Languages and SPAG posted gains of 33%, 6% and 2%, respectively, over the prior quarter. The increase in Networks related to the release of LAN Manager 2.1 during Q92-2. Increased SPAG sales can be attributed to the "Buy 8, get 10" promotion that ran during Q92-2. Revenue adjustments declined by \$7 million, reflecting the \$6 million returns reserve recorded in Q92-1. Rebates, as a percentage of Qualified Purchases, declined from 6.8% to 6.4%, reflecting a shift in the actual sales mix from Major Chains to Distributors.

	FY92 YTD	FY92 YTD Plan	Variance
Applications	\$ 275	\$ 223	\$ 52
MS-DOS & Windows	89	50	39
SPAG	66	65	1
Languages	12	20	(8)
Networks	8	8	-
Adjustments	(34)	(20)	(14)
Netrevenues	<u>\$ 416</u>	<u>\$ 346</u>	<u>\$ 70</u>

**YTD**

Gross revenues exceeded plan by 23%. Excluding the MS-DOS 5 Upgrade, revenues were favorable to plan by 15%. Applications revenues surpassed plan by 24%, fueled by above plan variances from Win and Mac applications of 36% and 21%, respectively. DOS applications trailed plan by 20%. The MS-DOS 5 Upgrade and Windows revenues exceeded plan by 207% and 20%, respectively. Languages trailed plan by 37%, primarily due to the slippage of Windows Professional C (\$3 million, all SKUs).

**Customer Classification Revenues (in millions)**

	Q92-2			Q92-1		
	Sales	Percent	Discount	Sales	Percent	Discount
Distributors/Franchisors	\$ 133	58%	46%	\$ 113	51%	46%
Contracted Dealers	59	26	44	67	30	44
End User	10	4	25	9	4	22
Government	8	4	51	10	5	48
Value Added Resellers	8	3	60	6	3	63
Corporate Accounts	7	3	61	6	3	58
Education	4	2	49	7	3	49
Other	-	-	-	3	1	39
Gross revenues	<u>\$ 229</u>	<u>100%</u>	46%	<u>\$ 221</u>	<u>100%</u>	46%

Seasonal purchasing patterns and sharply reduced MS-DOS 5 Upgrade purchases shifted the sales mix. Distributors/Franchisors revenues increased 18%, while Education, Government, and Contracted Dealers posted declines of 43%, 20%, and 12%, respectively. Distributors/Franchisors increased purchases to meet seasonal

**USSMD**

demand, to take advantage of the "Buy 8, get 10" promotional offer and to stock the rapidly selling Windows applications. Contracted Dealers revenues declined 12%, reflecting the 44% decline in Egghead purchases pursuant to their reduced purchases of the MS-DOS 5 Upgrade. End User sales jumped 11%, largely in response to Win Word 2.0 upgrades (\$3 million). End User discounts increased due to free updates for Win Word 2.0 and Mac Excel 3.0. Government purchases declined by 20% following the ramp-up in Q92-1 sales in response to heavy fiscal year-end government reseller purchases. Increased Government discounts resulted from companion pricing agreements with GTSI on sales of products to the U.S. Navy. Education revenues (from direct sales to educational institutions) declined 43% due to seasonality factors. Total Education Channel revenues, including AED shipments sold through distribution and IBM-ACIS, totaled \$14 million, a 18% decline from the \$17 million sold in Q92-1.

**Significant Customers (in millions)**

	<u>Q92-2</u>	<u>Q92-1</u>	<u>Q91-4</u>	<u>Q91-3</u>	<u>Q91-2</u>
Ingram	\$ 84	\$ 53	\$ 46	\$ 32	\$ 39
Merisel	38	47	37	18	19
Egghead	22	39	33	27	25
Corporate Software	10	5	4	5	5
Software Spectrum	10	6	7	4	3
IBM	7	6	4	2	3
Comp USA	7	7	9	5	5
Computerland	6	7	9	5	3
Intelligent Electronics	4	4	4	3	1
800 Software	4	4	3	2	2
	<u>\$ 192</u>	<u>\$ 178</u>	<u>\$ 156</u>	<u>\$ 103</u>	<u>\$ 105</u>
Percent of Gross Revenue	<u>84%</u>	<u>81%</u>	<u>78%</u>	<u>74%</u>	<u>77%</u>

Sales to USSMD's top three customers were 63% of gross revenues, consistent with Q92-1. Ingram purchases increased 58% while Merisel and Egghead registered declines of 19% and 44%, respectively. The growth in Ingram's Q92-2 purchases related to incremental shipments of Applications and Hardware products of 74% and 47%, respectively. Windows applications accounted for the majority of the increase with Win Office, Win Word and Win Excel increasing by 391% (\$8 million), 157% (\$3 million) and 49% (\$2 million), respectively. Merisel purchases declined by 19%, due to a conservative inventory management strategy. The Egghead reduction in volume was due to discontinued purchases of the MS-DOS 5 Upgrade. Excluding the impact of the MS-DOS 5 Upgrade, Egghead purchases increased by \$1 million. Corporate Software purchases increased by 100% due to sharp increases in their purchases of Windows applications.

**Cost of Revenues**

Q92-2	19.0%
Q92-1	20.7%
Q91-4	21.1%
Q91-3	21.9%
Q91-2	23.0%

	Actual			Plan		
	Sales Mix	Cost	Weighted Cost	Sales Mix	Cost	Weighted Cost
Applications	65.9%	11.1%	7.3%	61.2%	10.2%	6.2%
SPAG	14.5	32.4	4.7	17.1	31.4	5.4
Languages	2.8	15.5	0.4	5.1	17.5	0.9
Multimedia	0.2	9.8	--	0.2	8.2	--
Networks	1.9	6.6	0.1	2.1	8.1	0.2
DOS & Windows	14.7	14.5	2.1	14.3	15.1	2.1
Product cost - gross	<u>100.0%</u>		<u>14.6%</u>	<u>100.0%</u>		<u>14.8%</u>
Effect of revenue adjustments			<u>x 107.5%</u>			<u>x 105.8%</u>
Product cost - net			<u>15.7</u>			<u>15.7</u>
Non-product costs			<u>3.3</u>			<u>5.3</u>
			<u>19.0%</u>			<u>21.0%</u>

**Q92-2**

Cost of revenues, as a percentage of net revenues, was below plan due to a \$3 million favorable shortfall in manufacturing & distribution allocations as a result of favorable purchase price variances and higher than planned throughput. Overall, product costs were equal to plan. The increase in product costs associated with a shift in the sales mix to Office and higher than planned product costs for Word products was offset by lower than planned product costs for SPAG, Languages, Networks, and Systems products.

**YTD**

Cost of revenues, as a percentage of net revenues, was below plan due to a \$2 million shortfall in the manufacturing & distribution allocation resulting from higher than planned throughput. Product costs were slightly higher than plan due to a shift in the sales mix to the MS-DOS 5 Upgrade and higher than planned product costs for Applications and SPAG products.

Operating Expenses (In millions)

	Q92-2	Q92-2 Plan	Variance
Marketing accrual	\$ 5	\$ -	\$ (5)
PSS	15	17	2
Marketing	28	30	2
Payroll & payroll taxes	15	15	-
Other	20	20	-
	<u>\$ 83</u>	<u>\$ 82</u>	<u>\$ (1)</u>

A \$5 million unplanned marketing accrual was recorded in Q92-2 to offset the impact when the marketing variance turns around and incrementally approved spending is incurred in the second half. Marketing spending was 6% below plan due to the deferral of spending by Product Marketing. Significant variances were attributed to below plan spending on Win Project and Windows resource kits (\$1 million each), offset by above plan spending by MS-DOS (\$1 million). PSS costs were 14% below plan due to lower product support costs associated with Windows (\$700,000), MS-DOS (\$600,000) and Client Server Applications (\$600,000), partially offset by above plan spending on Word (\$200,000). Overall PSS spending variances related primarily to a slower than planned headcount ramp.

	FY92 YTD	FY92 YTD Plan	Variance
Marketing accrual	\$ 14	\$ -	\$ (14)
Marketing	50	61	11
PSS	28	31	3
Payroll & payroll taxes	29	30	1
Other	37	39	2
	<u>\$ 158</u>	<u>\$ 161</u>	<u>\$ 3</u>

Marketing expenses were \$11 million below plan. All product groups except Data Access, Entry and Windows were below plan. Significant positive marketing variances were attributed to Product Marketing (\$7 million), Channel Marketing (\$5 million), and Education Marketing (\$1 million). A \$14 million marketing accrual was recorded to offset the impact when the marketing variance turns around and incrementally approved expenditures are incurred. Payroll & payroll taxes were below plan due to the timing differences between planned and actual hire dates. PSS expenses were below plan primarily due to differences between planned and actual support costs by product group. Product groups with significant variances included positive variances in Windows (\$2 million), Client Server (\$900,000) and Project (\$500,000), partially offset by a negative Word variance (\$500,000).

Incremental Marketing

During Q92-2, approximately \$23 million of incremental marketing funding was approved, bringing the total marketing pool approved for the six-months ended June 30, 1992 to approximately \$90 million. Expected uses of these funds include: Applications \$44 million, Systems \$22 million, US Marketing \$10 million, Corporate Marketing \$4 million and Networks \$2 million. Applications spending includes Excel \$15 million, Word \$12 million, EBU \$2 million and Project \$2 million. Systems spending includes Windows \$12 million, MS-DOS 5 Upgrade \$2 million and SPAG \$2 million.

Year-to-date incremental funding by product unit includes: Excel \$11 million, Word \$7 million, Entry \$1 million, Windows \$6 million and MS-DOS \$2 million. Corporate Marketing anticipates spending \$2 million. The majority of the marketing blitz will be focused on Windows and Windows applications including the launch of Win 3.1 and Win Excel 4.0.

## USSMD

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channels
December 31, 1991	1,263	1,326	63	87	14%	26%
September 30, 1991	1,176	1,297	121	175	14	27
June 30, 1991	1,001	1,037	36	75	13	26
March 31, 1991	926	1,003	77	64	14	27
December 31, 1990	862	894	32	71	14	28

Headcount varied from plan by 5% due to a slower than planned ramp rate. Field Sales and Sales Operations headcount were 10 heads (1%) and 53 heads (5%) below plan, respectively. The significant increase in USSMD headcount from Q91-4 to Q92-1 resulted from the absorption of the Network Channel into USSMD. Net revenue per head was \$170,000 and \$171,000 in Q92-2 and Q92-1, respectively.

### Allocations

#### Q92-2

Allocations were below plan in absolute dollars and as a percentage of revenue. The variance was primarily due to lower than planned charges from DOS & Windows development, Corpcom and SPAG.

#### YTD

All allocations were favorable to plan in absolute dollars and as a percentage of revenues. The variance was due to lower allocations from DOS & Windows, Corpcom, SPAG and F&A.

### Burdened Operating Income

#### Q92-2

Record revenues led the way to a \$23 million positive burdened operating income variance. The introduction of Win Word 2.0 and the success of the Win Office bundle were the primary contributors to this above plan performance.

#### Quarterly Growth

Burdened operating income increased by \$6 million, based primarily on the continued strength of Windows applications. The Win Office bundle, Win Word and Mouse overcame the sharp reduction in the MS-DOS 5 Upgrade revenues and increased operating expenses.

#### YTD

Burdened operating income was an impressive \$69 million over plan, primarily due to strong Applications and Systems revenues. As a percentage of net revenue, product costs, operating expenses and allocations were below plan. BOI was 24% compared to a planned 10%.

## Worldwide OEM

### Q92-2

The increasing commoditization of the PC is creating a shift in distribution channels in the U.S. and Europe from traditional reseller sales to direct response (telemarketing and mail order) sales and sales through superstores and mass merchandisers. This shift has resulted in growth in market share for OEMs using these channels (e.g., Gateway, Dell, EMI, Packard Bell) at the expense of companies using the traditional reseller channel (e.g., Compaq, IBM, Tandy). It has also increased price competition and resulted in significant price cuts by many OEMs during the quarter.

Domestically, 35 OEMs who previously purchased MS packaged product converted to 2 - 3 year "per system" royalty agreements. Of the 35 licenses, 17 also include a per system Windows agreement. The MS-DOS Easy Distribution program facilitated these conversions and will be used by approximately 30 of these licensees.

### YTD

Gray market sales of unbundled MS-DOS and piracy are increasing in California and Europe.

Competition from DR DOS continues. Although MS signed agreements with several DR DOS OEMs, such as EMI and ALR, competing bids from DRI are putting downward pressure on MS-DOS royalty rates.

The U.S. signed a trade agreement with the People's Republic of China (PRC) in January that established copyright protection, opening the way to potential trade with that country. OEM has begun negotiations with the PRC and established an OEM Account Manager in Hong Kong.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 108	100.0%	\$ 95	100.0%	\$ 119	100.0%	\$ 13	\$ (11)
Cost of revenues	6	5.9	5	5.0	6	5.1	(1)	-
Operating expense	14	12.7	14	14.7	12	10.0	-	(2)
Allocations	29	26.9	31	32.7	24	20.8	2	(5)
Burdened operating income	\$ 59	54.5%	\$ 45	47.6%	\$ 77	64.1%	\$ 14	\$ (18)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 226	100.0%	\$ 185	100.0%	\$ 41
Cost of revenues	12	5.5	9	5.1	(3)
Operating expense	26	11.3	26	14.0	-
Allocations	53	23.7	60	32.5	7
Burdened operating income	\$ 135	59.5%	\$ 90	48.4%	\$ 45

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	4,280	\$ 59	\$ 14	4,136	\$ 58	\$ 14	144	\$ 1	\$ -
Windows	983	19	19	1,075	22	20	(92)	(3)	(1)
Mouse	498	7	14	258	3	12	240	4	2
LAN Manager	35	5	143	69	3	43	(34)	2	100
Works	305	4	13	163	2	12	142	2	1
		\$ 94			\$ 88			\$ 6	
Percentage of net revenues		87%			93%				

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85

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**WORLDWIDE OEM**

Despite many OEMs reporting lower than planned royalties, MS-DOS revenues were over plan due to out-of-period reporting by Sanyo (\$5.4 million favorable variance) and Acer (\$2.2 million favorable variance). In the Far East, Toshiba was \$711,000 below plan due to competition with its export and laptop machines. Windows revenues were below plan primarily because of a budgeted but unbilled flat fee payment from IBM (\$2.5 million) and a missing royalty report from Unisys (\$750,000). Mouse sales were \$4 million over the planned \$3 million as a result of strong sales by Gateway 2000 (\$1.7 million over plan), Dell, Unisys, and Zeos. LAN Manager royalties were the primary revenue component of the Networks product group. Effective royalty rates for LAN Manager were distorted by the mix of Client (low royalty rate) and Server (higher royalty rate) due to a late royalty report from DEC. Because DEC is licensed for client workstations rather than servers, they would normally report a high number of units at a low royalty rate. Vobis reported 4 quarters of Works shipments, resulting in the entire \$2 million Works variance.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	4,280	\$ 59	\$ 14	3,535	\$ 51	\$ 14	745	\$ 8	\$ -
Windows	983	19	19	851	16	19	132	3	-
Mouse	498	7	14	437	6	14	61	1	-
LAN Manager	35	5	143	88	6	68	(53)	(1)	75
Works	305	4	13	131	2	15	174	2	(2)
	<u>\$ 94</u>			<u>\$ 81</u>			<u>\$ 13</u>		
Percentage of net revenues	<u>87%</u>			<u>68%</u>					

All leading products except LAN Manager outperformed Q92-1 in both units and revenues. LAN Manager \$/Unit was skewed by DEC's failure to report in Q92-2. In Q92-1, DEC reported 65,000 units for \$2 million in revenue.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	7,815	\$ 110	\$ 14	7,652	\$ 109	\$ 14	163	\$ 1	\$ -
Windows	1,834	35	19	2,033	40	20	(199)	(5)	(1)
Mouse	935	13	14	505	6	12	430	7	2
LAN Manager	123	11	89	74	5	68	49	6	21
Works	436	6	14	328	4	12	108	2	2
	<u>\$ 175</u>			<u>\$ 164</u>			<u>\$ 11</u>		
Percentage of net revenues	<u>77%</u>			<u>89%</u>					

Year-to-date, the \$5 million shortfall in Windows revenue results domestically from late reports from IBM and Unisys and internationally from below planned shipments for Europe, Korea, and Japan. In the U.S., Windows shipments continue to ramp, particularly in the direct response and mass merchandising channels.

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WORLDWIDE OEM

Net Revenues (in millions)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
Domestic					
Licensing	\$ 47.8	\$ 44.9	\$ 45.2	\$ 2.9	\$ 2.6
Packaged Goods	11.3	6.4	11.4	4.9	(0.1)
Gross domestic revenue	59.1	51.3	56.6	7.8	2.5
Domestic revenue adjustments					
GAAP accrual	0.1	-	4.4	0.1	(4.3)
Prepaid reserve accrual	-	-	-	-	-
Total adjustments	0.1	-	4.4	0.1	(4.3)
Net domestic revenue	59.2	51.3	61.0	7.9	(1.8)
International Europe					
Germany	6.6	5.0	5.9	1.6	0.7
Italy	3.4	3.6	3.8	(0.2)	(0.4)
United Kingdom	2.8	2.5	3.3	0.3	(0.5)
Nordic Region	1.0	1.6	2.6	(0.6)	(1.6)
Holland	0.9	0.9	0.8	-	0.1
Spain	0.4	-	-	0.4	0.4
Other	1.3	2.1	1.3	(0.8)	-
Gross European revenue	16.4	15.7	17.7	0.7	(1.3)
Int'l - Europe revenue adjustments					
GAAP accrual	3.9	-	(4.3)	3.9	8.2
Prepaid reserve accrual	-	-	-	-	-
Total adjustments	3.9	-	(4.3)	3.9	8.2
Net Int'l Europe revenue	20.3	15.7	13.4	4.6	6.9
International ROW					
Japan	12.9	13.4	13.5	(0.5)	(0.6)
Taiwan	9.3	6.1	7.1	3.2	2.2
Korea	4.2	5.6	7.8	(1.4)	(3.6)
Hong Kong	1.0	0.9	0.8	0.1	0.2
Canada	0.6	0.7	0.8	(0.1)	(0.2)
Latin America	0.6	0.5	0.1	0.1	0.5
Australia	0.4	0.3	0.5	0.1	(0.1)
Aime	0.2	0.1	0.2	0.1	-
Other	-	0.2	0.6	(0.2)	(0.6)
Gross ROW revenue	29.2	27.8	31.4	1.4	(2.2)
Int'l ROW revenue adjustments					
GAAP accrual	(1.2)	-	12.9	(1.2)	(14.4)
Prepaid reserve accrual	-	-	-	-	-
Total adjustments	(1.2)	-	12.9	(1.2)	(14.4)
Net Int'l ROW revenue	28.0	27.8	44.3	0.2	(16.3)
Net worldwide revenue	\$ 107.5	\$ 94.8	\$ 118.7	\$ 12.7	\$ (11.2)

Q92-2 net revenues were 13% greater than plan but 9% less than Q92-1. Q92-1 revenue included a \$13 million GAAP accrual versus a \$2.8 million accrual in Q92-2. Absent this adjustment, gross revenue of \$105 million was 10% above plan, but 1% below Q92-1 gross revenue.

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87

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WORLDWIDE OEM

Significant Customers (in millions)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IBM	\$ 5.6	\$ 5.3	\$ 6.2	\$ 0.3	\$ (0.6)
Gateway 2000	4.6	1.8	3.2	2.8	1.4
NEC	4.3	4.5	4.9	(0.2)	(0.6)
Unisys	3.4	2.7	3.2	0.7	0.2
Acer	3.4	1.3	1.2	2.1	2.2
Compaq	3.4	4.3	4.0	(0.9)	(0.6)
Olivetti	3.0	2.9	3.1	0.1	(0.1)
Dell	2.5	1.2	1.9	1.3	0.6
Fujitsu	2.5	2.5	2.5	--	--
American Tel. & Tel.	2.5	1.3	2.2	1.2	0.3
Zenith	2.3	2.6	2.5	(0.3)	(0.2)
Vobis	2.1	0.6	0.7	1.5	1.4
AST	2.0	2.0	1.9	--	0.1
Packard Bell	1.9	1.7	1.3	0.2	0.6
Digital Equipment	1.9	1.0	2.0	0.9	(0.1)
Phoenix Computer	1.8	1.0	1.0	0.8	0.8
Sanyo Electric	1.7	--	--	1.7	1.7
Toshiba	1.7	2.5	2.1	(0.8)	(0.4)
CompuAdd	1.3	1.0	1.3	0.3	--
Siemens Nixdorf	1.3	1.4	1.4	(0.1)	(0.1)
Other customers	51.5	53.2	59.1	(1.7)	(7.6)
Gross Revenue	104.7	94.8	105.7	9.9	(1.0)
Revenue adjustments	2.8	--	13.0	2.8	(10.2)
Net revenue	\$ 107.5	\$ 94.8	\$ 118.7	\$ 12.7	\$ (11.2)

In the Domestic channel, Q92-2 revenues of \$59 million were \$8 million over a planned \$51 million but \$2 million less than prior quarter. The decrease from Q92-1 was primarily due to late royalty reports from DEC and IBM. OEMs using direct response channels (mail order and telemarketing), selling through mass merchandisers (e.g., Price Club), or superstores (e.g., CompUSA) have gained market share at the expense of traditional resellers. Gateway 2000 and Dell (direct response) together had a favorable variance of \$4 million versus Compaq and Tandy (reseller), who together had an unfavorable variance of \$2 million. With a five-year compounded growth rate of 26,469%, Gateway 2000 was named Inc. magazine's fastest growing company for 1991. Companies, such as Gateway, who preinstall MS-DOS and Windows are beginning to express interest in also being able to offer applications to customers. Tandy licensed Windows, displacing DeskMate on its machines, and began opening superstores. EMI, previously a DR DOS OEM, signed a per system MS-DOS and Windows license. Thirty-five Finished Goods MS-DOS customers were converted to 2-3 year per system royalty agreements. Of the 35, 17 also licensed Windows per system, and approximately 30 anticipate using the MS-DOS Easy Distribution program. The Easy Distribution program also resulted in 13 new business licenses signed during the quarter. This new business consists of OEMs who previously purchased through the gray market, shipped naked systems, purchased DR DOS, or pirated MS software. Nevertheless, competition from DRI and Logitech during a time when OEMs' margins are shrinking is putting downward pressure on MS-DOS and Mouse pricing.

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**WORLDWIDE OEM**

Revenues of \$20 million in the Int'l - Europe channel were \$4 million greater than the plan of \$16 million primarily as a result of a positive GAAP accrual (\$4 million) and four quarters of royalties reported by Vobis at one time. Competition from U.S. and Far Eastern OEMs impacted sales of European OEMs. Europe also experienced a shift in channels from traditional reseller to direct response (Viglen, Elonex) and superstores (PC World).

In the Int'l - ROW channel, revenues of \$28 million were at plan but \$16 million less than Q92-1. Absent the GAAP accrual, the change would have been \$2 million. In the Far East, Taiwan was 51% above plan, whereas Korea was 25% below plan and Japan was 4% below plan. Taking advantage of cheaper labor, Taiwan gained market share at Korea's expense in both the U.S. and European markets. Sanyo's \$1.7 million favorable variance resulted from out-of-period reporting under a new agreement. Toshiba's \$800,000 unfavorable variance resulted from a decrease in export machines, particularly laptops. Although Acer's run rate continued to ramp, the \$2.1 million variance resulted from two periods of reporting in Q92-2. In the remainder of ROW, another interesting Q92-2 event was the first receipt of royalty payments from India.

The gross Prepaid Balance (PPB) for worldwide OEM was \$176 million at the end of Q92-2, a decrease of \$5 million from Q92-1. This decrease results from positive UPB (\$1 million) net of approximately \$6 million that is no longer available for recoupment (e.g., license agreements that have expired).

**Prepaid Balances (in millions)**

	<u>December 31, 1991</u>	<u>September 30, 1991</u>
Fujitsu LTD	\$ 20	\$ 20
Unisys	5	3
Samsung Electronics	5	5
Olivetti	5	5
Hyundai	5	3
3 COM	5	5
Schneider Rundfunkwerke	4	4
Hitachi	4	4
Epson	3	4
Gold Star Co.	3	2
Acer	3	4
Sun Microsystems	3	3
Zenith	3	3
Mitsubishi	3	3
Daewoo Electronics	3	1
Other	<u>102</u>	<u>112</u>
Gross	176	181
Reserve	<u>(41)</u>	<u>(41)</u>
Net prepaid balance	<u>\$ 135</u>	<u>\$ 140</u>

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Since prepaid balances can be recouped with royalties from products shipped in succeeding quarters, prepaids reduce the amount of revenue we will recognize related to future customer shipments. On the other hand, minimum commitments smooth the revenue stream and make it costly for a customer to move to a competitor. When a sizable prepaid builds up, an OEM may request concessions. Normally, any concessions are prospective.

In analyzing the risk of future concessions, Joachim Kempin, Vice President OEM Sales, defined categories of risk and categorized OEM customers as of December 31, 1991 as follows:

The Negligible Risk category is defined as those OEMs for which concessions have already been made, such as NCR and 3COM, or for which no concessions are anticipated; the Low Risk category; as those having the potential of concessions affecting up to 20% of the PPB amount; and the Greater Risk category, as those having the potential of up to 50%. For Q92-2, 49% of the prepaid balance was designated as negligible risk; 44% as low

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89

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## WORLDWIDE OEM

risk; and 7% as being of Greater risk. This assessment suggests a potential revenue exposure of \$16 million, against a reserve for such concessions of \$41 million. The potential exposure in Q92-1 was assessed at \$22 million. The \$41 million reserve appears appropriately conservative.

Unspecified Product Billings (UPB) of \$1 million for Q92-2 reflect due on signing and minimum commitment billings in excess of recoupment by product-specific revenue. Missing royalty reports in the Domestic channel (Unisys, DEC, IBM) contributed to the positive UPB and, conversely, out of period reporting in the Int'l - ROW channel increased the recoupment for the period.

This quarter's GAAP accrual of \$2.8 million reflects a decrease from Q92-1 in the accrual for earned but unreported royalties (\$1.4 million) offset by a reduction in deferred revenue (\$4.2 million). The reduction in deferred revenue was primarily related to localized product that shipped during the quarter.

### Operating Expenses and Allocations.

#### Q92-2

Q92-2 operating expenses and allocations approximated plan.

#### YTD

Year-to-date operating expenses approximated plan. Favorable variances in marketing (\$3 million) and PSS (\$1 million) were offset by a \$2 million marketing accrual and higher than planned headcount related costs. Allocations were 11% under plan. The primary variances occurred in MS-DOS and Windows and International R&D allocations.

#### Redmond Based Headcount \*

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channels
December 31, 1991	67	64	(3)	2	1%	1%
September 30, 1991	65	63	(2)	8	1	2
June 30, 1991	57	60	3	--	2	2
March 31, 1991	57	59	2	2	1	2
December 31, 1990	55	57	2	5	1	2

\*The headcount totals represent Redmond-based people only. Subsidiary personnel dedicated to International OEM are included in the IFG Channel

### Burdened Operating Income

#### Q92-2

Q92-2 burdened operating income was \$14 million greater than plan. The variance was primarily the result of higher than planned Mice, Works, and LAN Manager revenues and a positive GAAP accrual.

#### Quarterly Growth

Q92-2 burdened operating income was \$18 million less than prior quarter due to a \$10.2 million reduction in the GAAP accrual coupled with increased allocated expenses.

#### YTD

Year-to-date burdened operating income was \$45 million, 50%, greater than plan. Strong revenue performance and lower than planned allocations, were only slightly offset by higher cost of revenues related to Mouse and packaged applications sales.

## PSS

### Q92-2

A third support site was opened in Dallas on October 1. As of December 31, a staff of 47 was in place supporting MS-DOS, Windows and LAN Man.

PSS support hours were extended on October 1 to provide coverage from 6 a.m. to 6 p.m. for all Microsoft products.

Lower than planned headcount and cost per head resulted in a favorable operating expense variance. Total operating expenses were 16% less than plan.

The top four products, measured in total support cost, were Windows, Win Word, Windows SDK, and Win Excel. These four products represented 50% of domestic PSS cost.

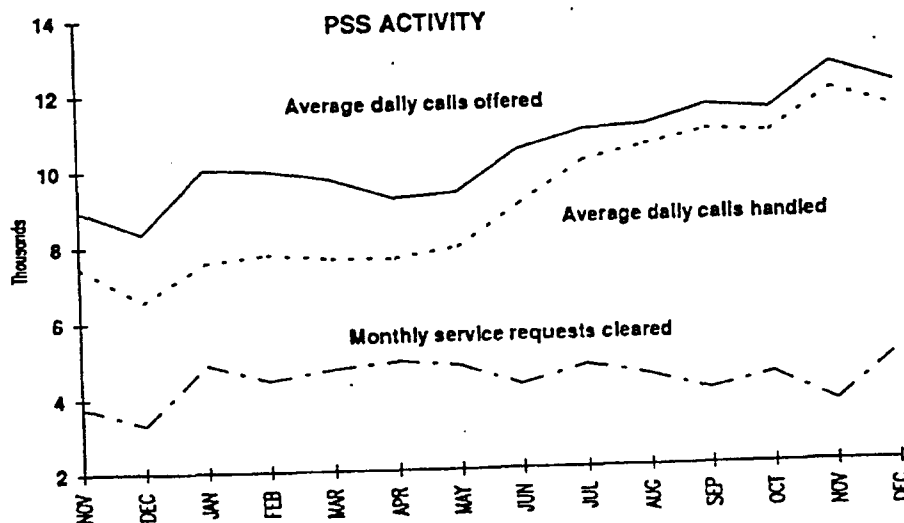
### YTD

Beginning in July, domestic product support costs were distributed to product units and channels based upon actual labor activity. Because of this improved tracking, PSS expenses were moved from the allocations to the operating expense section of product unit and channel P&L's. Detailed results from this activity-based costing system (ABC) are presented below.

Total PSS operating expenses of \$33.6 million were favorable to plan by \$5.0 million, or 13%.

### PSS Activity

As illustrated in the following chart, average daily calls offered and handled continued to increase in Q92-2.



Total average daily calls offered and handled increased 7.4% and 7.8% respectively over Q92-1 volumes. Calls offered represents the total calls received by PSS, however, the total calls made by customers may be higher due to the use of "all trunks busy" as a means of handling volume. The handling percentage increased slightly from Q92-1 to 95%.

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91

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**Average Daily Calls**

	Offered			Handled			Handle Ratio		Average Call Time	
	Q92-2	Q92-1	Change	Q92-2	Q92-1	Change	Q92-2	Q92-1	Q92-2	Q92-1
Windows	2,953	2,494	18.4%	2,840	2,395	18.6%	96 %	96 %	11.93	11.56
OBU	2,854	2,473	15.4	2,713	2,354	15.3	95	95	9.84	9.60
ABU	2,027	1,922	5.5	1,919	1,809	6.1	95	94	8.83	9.45
MS-DOS	754	1,225	(38.4)	719	1,153	(37.6)	95	94	12.70	13.60
EBU	1,005	746	34.7	959	698	37.4	95	94	7.63	6.47
IVR*	729	669	9.0	639	581	10.0	88	87	4.57	3.71
Languages	479	474	1.1	450	451	(0.2)	94	95	8.96	8.65
DABU	320	341	(6.2)	295	317	(6.9)	92	93	7.71	7.74
Strategic support	239	200	19.5	213	185	15.1	89	93	7.45	6.66
SPAG	175	172	1.7	163	158	3.2	93	92	6.88	7.08
GBU	176	171	2.9	163	158	3.2	93	92	7.55	7.64
Other	166	176	(5.7)	158	161	(1.9)	95	91	5.68	5.42
	<u>11,877</u>	<u>11,063</u>	<u>7.4%</u>	<u>11,231</u>	<u>10,420</u>	<u>7.8%</u>	<u>95 %</u>	<u>94 %</u>	<u>9.93</u>	<u>9.67</u>

\* IVR = Interactive Voice Response system; a fully-recorded system that handles very basic support questions.

Due to limited 90-day free service and tapering off of sales for the MS-DOS 5 upgrade, calls offered for MS-DOS decreased 38% over Q92-1. Calls offered for EBU increased 35% over Q92-1 due to the new product offerings Win Works, Win Publisher, and Money. These three products accounted for 90% of the increased calls in EBU. Calls offered for Windows increased 18%. The average call length of 11.93 minutes for Windows, increased 3% over Q92-1 and is 2 minutes longer than the all product average. Calls offered for OBU increased 15% due to the release of Win Word 2.0, which resulted in a 33% increase in Win Word calls.

**Activity-Based Costing Results**

With the implementation of activity-based costing, domestic support costs were charged to product units based on actual labor expended. Existing labor-tracking systems were enhanced to provide a data feed into the general ledger for cost distribution. Each product unit receives a "burdened" support cost distribution which includes the cost of support delivery personnel and an overhead burden of management, facilities, etc. This process provides a more accurate presentation of support costs by product unit than the fixed percentage allocation rules used in prior years.

The following chart illustrates the distribution of PSS cost to product units.

**PSS Cost Distribution by Product Unit (in millions)**

(Domestic only)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Windows	\$ 5.8	34.0%	\$ 6.7	34.0%	\$ 3.8	26.6%	\$ 0.9	\$ 2.0
Word	3.3	20.0	3.1	16.0	2.8	19.6	(0.2)	0.5
Excel	1.8	11.0	1.9	10.0	1.8	12.6	0.1	-
Entry	1.2	7.0	1.2	6.0	0.8	5.6	-	0.4
MS-DOS	1.1	6.0	1.8	9.0	1.9	13.3	0.7	(0.8)
LM2	1.1	6.0	1.1	6.0	0.8	5.6	-	0.3
Language	0.9	5.0	0.9	5.0	0.6	4.2	-	0.3
Data access	0.6	4.0	0.5	2.0	0.5	3.5	(0.1)	0.1
Client server	0.3	2.0	0.9	5.0	0.4	2.8	0.6	(0.1)
Work group apps	0.3	2.0	0.3	1.0	0.2	1.4	-	0.1
Graphics	0.2	1.0	0.3	1.0	0.2	1.4	0.1	-
Hardware	0.2	1.0	0.3	1.0	0.2	1.4	0.1	-
Project	0.2	1.0	0.5	2.0	0.2	1.4	0.3	-
OS/2	0.1	-	0.1	1.0	0.1	0.7	-	-
Multimedia Systems	-	-	0.2	1.0	-	-	0.2	-
	<u>\$ 17.1</u>	<u>100.0%</u>	<u>\$ 19.8</u>	<u>100.0%</u>	<u>\$ 14.3</u>	<u>100.0%</u>	<u>\$ 2.7</u>	<u>\$ 2.8</u>

Total domestic PSS costs were \$2.7 million below plan for the quarter. These costs exclude \$0.9 million in expense incurred in the US to assist the International PSS groups. International costs are distributed to subsidiaries. Windows represented 34% of domestic PSS costs for the quarter, Windows and Windows

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**PSS**

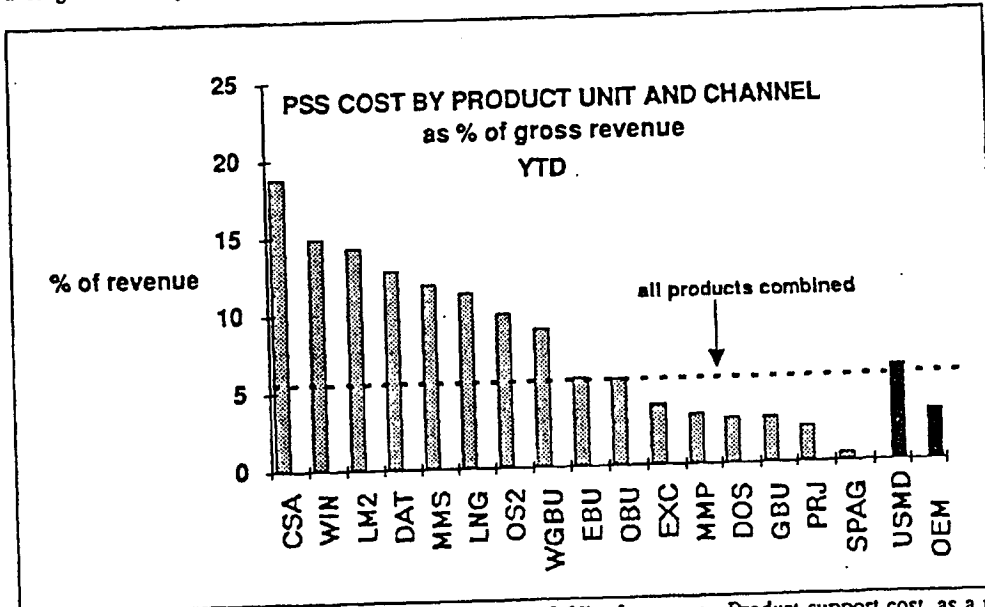
applications combined to represent 54% of total costs. Q92-2 costs were \$2.8 million higher than Q92-1. Significant changes between Q92-2 and Q92-1 are discussed in the Cost by Product section below.

Within the ABC system, product support costs for each product unit are distributed to the USSMD and OEM channels based on the historical sales split between these channels.

**PSS Cost Distribution by Channel (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
USSMD	\$ 15.0	90.0%	\$ 17.2	90.0%	\$ 12.7	89.0%	\$ 2.2	\$ 2.3
Domestic OEM	2.1	10.0	2.6	10.0	1.6	11.0	0.5	0.5
	<u>\$ 17.1</u>	<u>100.0%</u>	<u>\$ 19.8</u>	<u>100.0%</u>	<u>\$ 14.3</u>	<u>100.0%</u>	<u>\$ 2.7</u>	<u>\$ 2.8</u>

Support cost as a percent of revenue is illustrated below by product unit and channel. Since support costs in a specific month correspond to sales in prior months in addition to the current month, the chart below contains YTD averages to best represent the long term trend.



Domestically, the average cost of product support was 5.6% of revenue. Product support cost, as a percent of revenue, was 14.9% for Windows, 9 points above the all product average. Lower sales volumes and higher than average labor costs impacted the percentage for Client Server, Multimedia Systems, and LAN Manager.

With the implementation of ABC, support cost by product is now available. The top 15 products, measured by total support costs are presented below.

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PSS Cost by Product (in millions)

Ranking		Product	Q92-2	Q92-1	% Change
Q92-1	Q92-1		\$	\$	
1	1	Windows	\$ 4.0	\$ 2.2	84.1
2	4	Win Word	1.9	1.6	22.2
3	3	Windows SDK	1.9	1.6	16.8
4	5	Win Excel	1.3	1.1	12.3
5	6	Lan Manager	1.1	0.8	25.0
6	2	MS-DOS	1.0	1.8	(43.9)
7	7	PC Word	0.7	0.7	(1.7)
8	10	PC Works	0.6	0.5	35.6
9	9	Mac Word	0.6	0.5	24.1
10	8	Mac Excel	0.5	0.6	(11.2)
11	12	C Compiler	0.4	0.3	35.8
12	11	SQL Server	0.3	0.3	(12.8)
13	14	Mac Works	0.2	0.1	54.4
14	NR	Win Works	0.2	-	-
15	13	Visual Basic	0.2	0.2	(10.8)
		Total	\$ 14.9	\$ 12.3	21.2

Support costs for Windows increased \$1.8 million over Q92-1. This increase is due to three factors. First, recorded labor time for Windows increased by 34%, which accounted for \$0.7 million of the increase. In addition, the average cost/head in Q92-2 versus Q92-1 increased by 9% in the groups supporting Windows. This increase resulted from one-time charges for co-op employee compensation, increased general distribution charges, and the effects of the August pay increases (which averaged at 9% due to one-time adjustments to line up PSS employees with the corporate standards). The cost/head increase accounted for \$0.6 million of the increased Windows support cost. The remaining \$0.5 million of the increased Windows cost was due to a product mix shift. As call volume on MS-DOS declined, technicians supporting MS-DOS were freed up to support Windows. Since Windows call volume did not increase as quickly as MS-DOS calls dropped, a temporary reduction in technician productivity resulted. This reduction is expected to reverse shortly as Windows calls continue to increase. Currently, these employees are training to handle support calls on Windows 3.1.

Due to declining sales and limited free support for the MS-DOS 5 upgrade, support costs for MS-DOS decreased by \$0.8 million. The release of Win Word 2.0 during Q92-2, resulted in a 33% increase in call activity for Win Word and a 22% increase in support cost.

Domestic Headcount

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channels
December 31, 1991	1,107	1,255	148	72	12%	23%
September 30, 1991	1,035	1,122	87	138	12	24
June 30, 1991	897	691	(206)	154	12	22
March 31, 1991	743	686	(57)	111	11	21
December 31, 1990	632	672	40	73	11	20

Favorable headcount variance was due to increased productivity and lower than planned call volume. Average call time decreased 4% compared to Q91-4. Actual call volume compared to plan was favorable by 10%.

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Domestic Operating Expenses (in millions)

	Q92-2		Q92-2 Plan		Variance
Supplies & equipment	\$ 2.1	11%	\$ 3.8	17%	\$ 1.7
Payroll	9.5	53	10.7	50	1.2
Paid support offset	(1.2)	(6)	(1.6)	(7)	(0.4)
Other	7.6	42	8.6	40	1.0
	<u>\$ 18.0</u>	<u>100%</u>	<u>\$ 21.5</u>	<u>100%</u>	<u>\$ 3.5</u>

Total operating expenses were \$18.0 million, or 16% less than plan. The favorable variance of \$3.5 million was due to lower than planned headcount, which accounted for \$2.3 million and favorable cost per head which accounted for \$1.2 million. Domestic PSS revenue, which is netted against support costs, was \$1.2 million with the major components being \$1.1 million in OnLine revenue and \$0.1 million in 900# calls.

International PSS

Product support is provided in 13 subsidiaries. Support is handled primarily by telephone with a few subsidiaries offering OnLine support. An escalation process is in place which allows the subsidiaries to submit to Redmond those questions which cannot be answered by the subsidiary.

Plans are currently being made to implement activity-based costing for PSS in the subsidiaries by the beginning of FY93.

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95

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## Other Channels

Netrevenues	Q92-2	Q92-2Plan	Q92-1	Variance	Change
Press	\$ 4.2	\$ 5.1	\$ 5.0	\$ (0.9)	\$ (0.8)
USMSU	2.8	3.5	2.5	(0.7)	0.3
USMCS	1.8	3.2	1.4	(1.4)	0.4
Int'lMSU - ROW	0.6	0.5	0.3	0.1	0.3
Int'lMCS - Europe	0.6	0.8	0.1	(0.2)	0.5
Int'lMCS - ROW	0.3	0.4	0.1	(0.1)	0.2
Int'lMSU - Europe	-	0.5	-	(0.5)	-
Eliminations	-	-	-	-	-
	<u>\$ 10.3</u>	<u>\$ 14.0</u>	<u>\$ 9.4</u>	<u>\$ (3.7)</u>	<u>\$ 0.9</u>

Netrevenues	FY92 YTD		
	FY92 YTD	Plan	Variance
Press	\$ 9.2	\$ 9.0	\$ 0.2
USMSU	5.3	6.5	(1.2)
USMCS	3.2	5.3	(2.1)
Int'lMSU - ROW	0.9	1.0	(0.1)
Int'lMCS - Europe	0.7	1.1	(0.4)
Int'lMCS - ROW	0.4	0.6	(0.2)
Int'lMSU - Europe	-	0.9	(0.9)
Eliminations	-	0.1	(0.1)
	<u>\$ 19.7</u>	<u>\$ 24.5</u>	<u>\$ (4.8)</u>

Operating Income (Loss)	Q92-2				
	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
Press	\$ (1.0)	\$ -	\$ -	\$ (1.0)	\$ (1.0)
USMSU	(1.5)	(0.3)	(1.4)	(1.2)	(0.1)
USMCS	(0.9)	(0.3)	(1.3)	(0.6)	0.4
Int'lMSU - ROW	(0.3)	(0.1)	(0.3)	(0.2)	-
Int'lMCS - Europe	(0.3)	(0.5)	(0.5)	0.2	0.2
Int'lMCS - ROW	(0.4)	(0.1)	(0.2)	(0.3)	(0.2)
Int'lMSU - Europe	(0.4)	0.3	(0.5)	(0.7)	0.1
Eliminations	0.8	0.7	0.6	0.1	0.2
	<u>\$ (4.0)</u>	<u>\$ (0.3)</u>	<u>\$ (3.6)</u>	<u>\$ (3.7)</u>	<u>\$ (0.4)</u>

Operating Income (Loss)	FY92 YTD		
	FY92 YTD	Plan	Variance
Press	\$ (0.9)	\$ (0.6)	\$ (0.3)
USMSU	(3.0)	(0.9)	(2.1)
USMCS	(2.1)	(1.2)	(0.9)
Int'lMSU - ROW	(0.6)	(0.2)	(0.4)
Int'lMCS - Europe	(0.9)	(1.3)	0.4
Int'lMCS - ROW	(0.6)	(0.4)	(0.2)
Int'lMSU - Europe	(0.9)	0.5	(1.4)
Eliminations	1.4	1.4	-
	<u>\$ (7.6)</u>	<u>\$ (2.7)</u>	<u>\$ (4.9)</u>

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**OTHER CHANNELS**

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channel
Press	22	22	-	(1)	1.0%	1.0%
US MSU	133	133	-	9	1.0	3.0
US MCS	77	100	23	12	1.0	2.0
	232	255	23	20	3.0%	6.0%

**Press**

Revenues were below plan for the quarter due to "Running MS-DOS 5th Edition." The variance on this traditionally strong title was due to channel filling sales in the prior quarters. An unplanned charge for obsolete inventory was made in the quarter which increased cost of revenues by \$635,000. See additional detail in the Books business unit analysis.

**US MSU**

Revenue variance for the quarter was \$727,000 unfavorable to plan. Management education was \$384,000 unfavorable although a revision in the launch plan of this program accounted for \$139,000 of the variance. Domestic licensing revenue was \$275,000 unfavorable. Reserves were also established in the quarter for doubtful accounts and sales returns. These reserves increased expenses by \$246,000 and decreased revenues by \$154,000, respectively. Other operating expenses were \$78,000 favorable to plan for the quarter, partially offsetting a \$239,000 unfavorable cost of revenues variance in trainer T&E and freight for equipment.

**Int'l MSU-Europe**

Minimal revenue was reported. Unbudgeted cost of revenues, \$120,000, and higher than planned expenses also contributed to the unfavorable operating results. A study to develop strategies for the European channel's business was completed in the quarter. The results of this study are now under review.

**Int'l MSU-ROW**

Revenue for the quarter was \$598,000 and exceeded plan by \$33,000. 59% of the revenue was in Australia with a majority of the balance in Canada. Higher than planned cost of revenues combined with higher than anticipated operating expenses for the unfavorable results.

**US MCS**

Refer to US MCS channel analysis.

**Int'l MCS-Europe**

Revenue for the quarter was \$595,000. Year-to-date revenue increased to \$733,000 with 67% from the U.K. and 33% from Germany. The revenue backlog of committed projects going into Q92-3 was down from the previous quarter to \$133,000 in the U.K. and \$97,000 in Germany.

**Int'l MCS-ROW**

Revenue for the quarter was \$289,000, a \$196,000 increase from the previous quarter, with 63% of the revenue in Australia and the balance in Canada. Operating expenses for the quarter were \$501,000, up \$298,000 from the previous quarter. Year-to-date revenue grew to \$382,000 versus a budget of \$645,000. The revenue backlog of committed projects going into Q92-3 in Australia went down from \$132,000 to \$105,000, while Canada's backlog grew from \$55,000 to \$215,000.

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**US MCS**

**Q92-2**

Sales in the quarter lagged expectations resulting in a \$1.4 million unfavorable revenue variance and lower than planned utilization of consultants.

The following unplanned accounting changes were made to more properly reflect the results of operations.

- A \$500,000 revenue accrual. The accrual reflects the fact that MCS work is invoiced the month after the actual work is performed. This accrual is intended to improve matching of revenue and costs.
- \$279,000 in year-to-date client reimbursable T&E costs were reclassified from revenues to contra expense. This more clearly identifies work sold and actual operating expenses.
- An accrual of \$200,000 for sales returns and bad debt was made. This accrual reflects amounts due from clients which have not been paid due to some type of billing dispute.

New work sold during the quarter of \$5.7 million mirrored the end of quarter backlog. Wins at Bankers Trust, Century 21, and Pacific Gas & Electric accounted for \$4.2 million of new sold work for the quarter.

**YTD**

Practice utilization continued to lag plan and declined from Q92-1 to a year-to-date average of 47% versus a budget of 58%.

Lower than planned headcount and spending provided a \$1.3 million favorable expense variance. Monthly operating expenses per billable head averaged \$13,400 versus a plan of \$14,800.

**Results of Operations (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
	\$	%	\$	%	\$	%		
Net revenues	1.8	100.0%	3.2	100.0%	1.4	100.0%	(1.4)	0.4
Cost of revenues	--	--	--	--	--	--	--	--
Operating expense	2.4	133.2	3.2	100.7	2.4	172.4	0.8	--
Allocations	0.3	15.1	0.3	9.5	0.3	19.2	--	--
Burdened operating income	\$ (0.9)	(48.3)%	\$ (0.3)	(10.2)%	\$ (1.3)	(91.6)%	\$ (0.6)	\$ 0.4

	FY92 YTD		FY92 YTD Plan		Variance
	\$	%	\$	%	
Net revenues	3.2	100.0%	5.3	100.0%	\$ (2.1)
Cost of revenues	--	--	--	--	--
Operating expense	4.7	150.4	6.0	114.2	1.3
Allocations	0.5	16.9	0.5	8.6	--
Burdened operating income	\$ (2.1)	(67.3)%	\$ (1.2)	(22.8)%	\$ (0.9)

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Revenue (in millions)

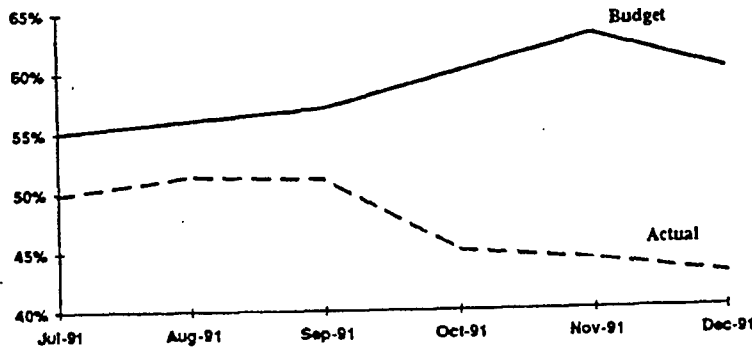
Q92-2

Revenues were \$1.4 million below plan. Utilization of billable heads was 44% for the quarter versus a budget of 63%. This represented a decline of 7% points from Q92-1. Fee's per billable hour climbed to \$142 per hour, from \$111 the previous quarter, but were short of planned revenue per hour of \$155.

YTD

Year-to-date revenue variance was \$2.1 million unfavorable to plan. Practice utilization year-to-date was 47% versus budget of 58%. Fee's per billable hour averaged \$128 versus a plan of \$155. Several large proposals were closed in the month of December and raised the year-to-date monthly average of new sold work to \$1.1 million.

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US Practice Utilization



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Operating Expenses

Q92-2

Operating expenses were \$855,000 below plan due to lower than planned headcount. Actual monthly spending per billable head averaged \$13,200 for the quarter, which compared to a planned \$14,600.

YTD

Operating expenses were \$1.3 million favorable to plan for the first six months. Year-to-date spending per billable head averaged \$13,400 per month versus a plan of \$14,800 per month.

Headcount

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Channels
December 31, 1991	77	100	(23)	12	1 %	2 %
September 30, 1991	65	82	(17)	16	1	2
June 30, 1991	49	40	9	10	1	1
March 31, 1991	39	36	3	17	1	1
December 31, 1990	22	27	(5)	6	1	1

**US MCS**

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US MCS headcount continued to lag plan. As a result of the negative revenue variance, headcount was only increased based upon new work sold. Headcount will continue to grow as new work is sold, but MCS will finish the year well below its plan of 128.

**Allocations**

**Q92-2**

Allocations in the quarter were below plan in absolute dollars, but due to the revenue shortfall, were higher than plan as a percentage of revenues. The allocation of MCS management expenses out to the international subsidiaries provided a \$46,000 favorable variance offset which was partially by a \$14,000 unfavorable variance in the Legal & Corporate Affairs allocation.

**YTD**

Year-to-date allocations were above plan in absolute dollars and as a percentage of revenues. Legal & Corporate Affairs allocations were \$87,000 above plan through the end of Q92-2, accounting for a majority of the unfavorable performance.

**Burdened Operating Income**

**Q92-2**

Operating income variance was \$530,000 below plan. Lower than planned utilization combined with below plan headcount generated the variances.

**Quarterly Growth**

Operating losses for Q92-2 were \$853,000, a \$407,000 improvement over the Q92-1 losses of \$1.3 million. Fee revenue increased \$390,000 to \$1.8 million for the quarter while expenses were down slightly from Q92-1 to Q92-2.

**YTD**

The year-to-date operating loss of \$2.1 million was \$905,000 greater than plan. MCS will not reach its FY92 revenue budget of \$15 million. Heads will only be hired as new work dictates. This should improve utilization during the second half. MCS is currently estimating a FY92 operating loss of \$2.4 million versus a planned loss of \$203,000.

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## PRODUCT GROUP REPORTING

### Net Revenues

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Applications	\$ 371	54%	\$ 317	51%	\$ 258	45%	\$ 54	\$ 113
Systems	234	34	230	37	256	44	4	(22)
SPAG	71	10	67	11	59	10	4	12
Other	6	2	13	1	7	1	(7)	(1)
	<u>\$ 682</u>	<u>100%</u>	<u>\$ 627</u>	<u>100%</u>	<u>\$ 580</u>	<u>100%</u>	<u>\$ 55</u>	<u>\$ 102</u>

	FY92 YTD		FY92 YTD Plan		Variance
Applications	\$ 630	50%	\$ 539	49%	\$ 91
Systems	490	39	407	37	83
SPAG	130	10	121	11	9
Other	12	1	23	3	(11)
	<u>\$ 1,262</u>	<u>100%</u>	<u>\$ 1,090</u>	<u>100%</u>	<u>\$ 172</u>

### Op Inc (Loss)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
	Revenue		Revenue		Revenue			
Applications	\$ 148	39.8%	\$ 101	31.5%	\$ 80	30.8%	\$ 47	\$ 69
Systems	80	34.0	73	31.0	114	44.4	7	(35)
SPAG	24	33.3	24	35.1	19	32.2	-	5
Other	(6)	(74.0)	(8)	(39.4)	(10)	(130.4)	2	4
	<u>\$ 246</u>	<u>36.1</u>	<u>\$ 190</u>	<u>30.3</u>	<u>\$ 203</u>	<u>34.9</u>	<u>\$ 56</u>	<u>\$ 43</u>

	FY92 YTD		FY92 YTD Plan		Variance
	Revenue		Revenue		
Applications	\$ 227	36.1%	\$ 135	24.8%	\$ 92
Systems	192	39.4	107	26.4	85
SPAG	43	32.8	40	32.6	3
Other	(13)	(105.3)	(13)	(54.4)	-
	<u>\$ 449</u>	<u>35.6</u>	<u>\$ 269</u>	<u>24.6</u>	<u>\$ 180</u>

### Headcount (percent is of Product Groups' total)

	December 31, 1991		September 30, 1991		June 30, 1991		March 31, 1991		December 31, 1990	
Applications	1,178	35%	1,137	35%	1,046	36%	891	34%	849	35%
Systems	1,014	30	978	30	870	30	841	32	825	34
SPAG	49	1	41	1	43	1	38	1	38	2
International R&D	1,002	29	919	28	825	28	698	27	604	25
Other	167	5	163	5	149	5	137	5	135	6
	<u>3,410</u>	<u>100%</u>	<u>3,238</u>	<u>100%</u>	<u>2,933</u>	<u>100%</u>	<u>2,605</u>	<u>100%</u>	<u>2,451</u>	<u>100%</u>

Note: Other includes Services, Multimedia, Books and inter-business unit eliminations.

Product Group / Business Unit Reporting

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105

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**PRODUCT GROUP REPORTING**

**Quarterly Revenues (In millions)**

	Q92-1		Q92-2		Q92-3		Q92-4		FY92	
Applications	\$ 258	44%	\$ 371	54%					\$ 630	50%
Systems	256	45	234	34					490	39
SPAG	99	10	71	10					130	10
Other	7	1	6	2					12	1
	<u>\$ 580</u>	<u>100%</u>	<u>\$ 682</u>	<u>100%</u>					<u>\$ 1,262</u>	<u>100%</u>

	Q91-1		Q91-2		Q91-3		Q91-4		FY91	
Applications	\$ 178	48%	\$ 244	53%	\$ 256	53%	\$ 257	49%	\$ 935	51%
Systems	138	37	164	36	166	34	220	42	688	37
SPAG	30	14	59	13	57	12	47	9	213	12
Other	4	1	(6)	(1)	7	1	2	-	7	-
	<u>\$ 370</u>	<u>100%</u>	<u>\$ 461</u>	<u>100%</u>	<u>\$ 486</u>	<u>100%</u>	<u>\$ 526</u>	<u>100%</u>	<u>\$ 1,843</u>	<u>100%</u>

	Q90-1		Q90-2		Q90-3		Q90-4		FY90	
Applications	\$ 106	45%	\$ 153	51%	\$ 138	51%	\$ 145	43%	\$ 562	48%
Systems	98	42	105	35	113	36	148	44	464	39
SPAG	25	11	36	12	33	11	35	10	129	11
Other	6	3	6	2	7	2	9	3	28	2
	<u>\$ 235</u>	<u>100%</u>	<u>\$ 300</u>	<u>100%</u>	<u>\$ 311</u>	<u>100%</u>	<u>\$ 337</u>	<u>100%</u>	<u>\$ 1,183</u>	<u>100%</u>

	Q89-1		Q89-2		Q89-3		Q89-4		FY89	
Applications	\$ 72	41%	\$ 86	41%	\$ 78	40%	\$ 105	48%	\$ 341	42%
Systems	79	45	89	42	89	45	91	41	348	43
SPAG	21	12	30	14	22	11	19	9	92	11
Other	5	3	5	2	8	4	5	2	23	3
	<u>\$ 177</u>	<u>100%</u>	<u>\$ 210</u>	<u>100%</u>	<u>\$ 197</u>	<u>100%</u>	<u>\$ 220</u>	<u>100%</u>	<u>\$ 804</u>	<u>100%</u>

Note: See the following Channel sections for analysis.



**APPLICATIONS**

**Results of Operations (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 371	100.0%	\$ 317	100.0%	\$ 258	100.0%	\$ 54	\$ 113
Cost of revenues	55	14.7	49	15.7	41	15.4	(6)	(14)
Operating expense	89	23.7	81	25.7	63	24.0	(8)	(26)
Allocations	79	21.8	86	2.0	75	29.8	7	(4)
Burdened operating income	\$ 148	39.8%	\$ 101	31.5%	\$ 79	30.8%	\$ 47	\$ 69

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 630	100.0%	\$ 539	100.0%	\$ 91
Cost of revenues	95	15.0	84	15.8	(11)
Operating expense	150	23.8	154	28.5	4
Allocations	158	25.1	166	30.9	8
Burdened operating income	\$ 227	36.1%	\$ 135	24.8%	\$ 92

**Channel Revenues (in millions)**

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IFG-Europe	\$ 186	\$ 152	\$ 113	\$ 34	\$ 73
USSMD	151	125	124	26	27
IFG-ROW	45	45	31	-	14
Domestic OEM	3	2	3	1	-
OEM-Europe	2	1	1	1	1
OEM-ROW	1	-	-	1	1
Adjustments	(17)	(8)	(14)	(9)	(3)
Net revenues	\$ 371	\$ 317	\$ 258	\$ 54	\$ 113

	FY92 YTD	FY92 YTD Plan	Variance
IFG-Europe	\$ 299	\$ 251	\$ 48
USSMD	275	223	52
IFG-ROW	76	75	1
Domestic OEM	6	5	1
OEM-Europe	3	1	2
OEM-ROW	1	-	1
Adjustments	(30)	(16)	(14)
Net revenues	\$ 630	\$ 539	\$ 91

Product Group / Business Unit Reporting

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**APPLICATIONS**

**Leading Products (units in thousands, revenues in millions)**

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Word	274	\$ 69	\$ 251	240	\$ 65	\$ 270	34	\$ 4	\$ (19)
Win Excel	211	67	317	246	70	285	(35)	(3)	32
PC Word	121	34	284	124	30	241	(3)	4	43
Mac Excel	76	19	252	59	15	264	17	4	(12)
Mac Word	80	16	200	88	17	196	(8)	(1)	4
Win Word Upd/Upg	156	16	102	22	2	105	134	14	(3)
PC Works	418	16	39	320	18	57	98	(2)	(18)
Win Excel Upd/Upg	108	14	131	57	7	121	51	7	10
Win Project	28	11	400	28	11	408	-	-	(8)
Win Works	79	9	120	32	3	106	47	6	14
		<u>\$ 271</u>			<u>\$ 238</u>			<u>\$ 33</u>	
Percentage of netrevenues		<u>73%</u>			<u>75%</u>				

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Word	274	\$ 69	\$ 251	180	\$ 46	\$ 257	94	\$ 23	\$ (6)
Win Excel	211	67	317	177	49	276	34	18	41
PC Word	121	34	284	88	23	262	33	11	22
Mac Excel	76	19	252	74	18	238	2	1	14
Mac Word	80	16	200	92	15	159	(12)	1	41
Win Word Upg/Upd	156	16	102	45	5	113	111	11	(11)
PC Works	418	16	39	238	12	52	180	4	(13)
Win Excel Upd/Upg	108	14	131	103	12	121	5	2	10
Win Project	28	11	400	28	10	368	-	1	32
Win Works	79	9	120	19	2	109	60	7	11
		<u>\$ 271</u>			<u>\$ 192</u>			<u>\$ 79</u>	
Percentage of netrevenues		<u>73%</u>			<u>74%</u>				

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	388	\$ 116	\$ 299	415	\$ 115	\$ 278	(27)	\$ 1	\$ 21
Win Word	454	115	253	411	111	269	43	4	(16)
PC Word	209	58	275	217	52	242	(8)	6	33
Mac Excel	150	37	245	106	28	258	44	9	(13)
Mac Word	173	31	178	165	30	184	8	1	(6)
PC Works	656	29	44	616	33	54	40	(4)	(10)
Win Excel Upd/Upg	218	27	126	104	12	120	114	15	6
Win Word Upd/Upg	202	21	104	36	4	106	166	17	(2)
Win Project	55	21	384	51	21	405	4	-	(21)
Mac Excel Upd	130	14	106	67	6	88	63	8	18
		<u>\$ 469</u>			<u>\$ 412</u>			<u>\$ 57</u>	
Percentage of netrevenues		<u>74%</u>			<u>77%</u>				

**APPLICATIONS**

**Environment Revenues (in millions)**

	Q92-2		Plan	Q92-1		Q91-4		Q91-3	
Windows	\$ 248	64%	59%	\$ 156	57%	\$ 154	57%	\$ 149	57%
Mac	63	16	19	58	21	57	21	42	16
DOS	71	18	22	53	20	57	21	68	26
Other	6	2	-	5	2	4	1	4	1
	<u>388</u>	<u>100%</u>	<u>100%</u>	<u>272</u>	<u>100%</u>	<u>272</u>	<u>100%</u>	<u>263</u>	<u>100%</u>
Adjustments	(17)			(14)		(15)		(7)	
Netrevenues	<u>\$ 371</u>			<u>\$ 258</u>		<u>\$ 257</u>		<u>\$ 256</u>	

	FY92 YTD		FY92 YTD Plan	
Windows	\$ 404	61%	\$ 325	59%
Mac	122	18	102	18
DOS	124	19	125	23
Other	10	2	3	1
	<u>660</u>	<u>100%</u>	<u>555</u>	<u>100%</u>
Adjustments	(30)		(16)	
Net revenues	<u>\$ 630</u>		<u>\$ 539</u>	

**Business Unit Results (in millions)**

Netrevenues	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Office	\$ 163	44.0%	\$ 141	44.4%	\$ 105	40.6%	\$ 22	\$ 58
Analysis	142	38.1	119	37.6	110	42.6	23	32
Entry	47	12.7	39	12.2	26	10.2	8	21
Graphics	11	3.0	12	3.7	8	3.1	(1)	3
Data Access	8	2.1	6	2.0	9	3.6	2	(1)
Rounding	-	0.1	-	0.1	-	(0.1)	-	-
	<u>\$ 371</u>	<u>100.0%</u>	<u>\$ 317</u>	<u>100.0%</u>	<u>\$ 258</u>	<u>100.0%</u>	<u>\$ 54</u>	<u>\$ 113</u>

Netrevenues	FY92 YTD		FY92 YTD Plan		Variance
Office	\$ 268	42.6%	\$ 240	44.6%	\$ 28
Analysis	252	40.0	204	37.8	48
Entry	74	11.7	61	11.3	13
Graphics	19	3.1	21	4.0	(2)
Data Access	17	2.7	12	2.3	5
Rounding	-	(0.1)	1	-	(1)
	<u>\$ 630</u>	<u>100.0%</u>	<u>\$ 539</u>	<u>100.0%</u>	<u>\$ 91</u>

**APPLICATIONS**

Operating Income (Loss)	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
	Revenue		Revenue		Revenue			
Office	\$ 66	40.5%	\$ 47	33.7%	\$ 28	26.6%	\$ 19	\$ 38
Analysis	68	48.2	50	41.6	50	45.2	18	18
Entry	16	33.6	9	22.3	4	16.3	7	12
Graphics	2	16.7	1	5.5	(1)	(6.8)	1	3
Dam Access	(4)	(54.3)	(6)	(99.7)	(2)	(18.5)	2	(2)
Rounding	-	-	-	-	-	-	-	-
	<u>\$ 148</u>	<u>39.8</u>	<u>\$ 101</u>	<u>31.5</u>	<u>\$ 79</u>	<u>30.8</u>	<u>\$ 47</u>	<u>\$ 69</u>

Operating Income (Loss)	FY92 YTD		FY92 YTD Plan		Variance
	Revenue		Revenue		
Office	\$ 94	35.1%	\$ 66	27.4%	\$ 28
Analysis	118	46.9	72	35.2	46
Entry	20	27.4	8	13.4	12
Graphics	1	7.1	1	2.8	-
Dam Access	(6)	(35.0)	(13)	(102.0)	7
Rounding	-	-	1	-	(1)
	<u>\$ 227</u>	<u>36.1</u>	<u>\$ 135</u>	<u>24.8</u>	<u>\$ 92</u>

**Headcount (percent is of Product Groups' total)**

	December 31, 1991		September 30, 1991		June 30, 1991		March 31, 1991		December 31, 1990	
Office	427	12%	404	13%	366	13%	272	10%	250	10%
Analysis	205	6	193	6	175	6	158	6	159	7
Entry	173	5	168	5	159	5	142	6	143	6
Dam Access	156	5	154	5	139	5	127	5	123	5
Graphics	57	2	50	1	47	1	46	1	43	2
Support*	160	5	168	5	160	6	146	6	131	5
	<u>1,178</u>	<u>35%</u>	<u>1,137</u>	<u>35%</u>	<u>1,046</u>	<u>36%</u>	<u>891</u>	<u>34%</u>	<u>849</u>	<u>35%</u>

\* Includes Division Management, Marketing and Strategy Management.  
For additional information, see the following analysis for each Business Unit.

**OFFICE**

**Q92-2**

Win Word 2.0 shipped in October 1991. Reaction was extremely favorable, as evidenced by great reviews in the trade publications and sales of \$85 million (full product and updates/upgrades).

Mac Word 5.0 shipped in December 1991.

Competition is increasing as WordPerfect began shipping WordPerfect for Windows during the quarter. Prior to this quarter, Ami Pro was the only serious contender in the Windows word processing market. WordPerfect publicly stated that approximately 360,000 units were sold in their first month. Win Word sold approximately 200,000 units during its first month. WordPerfect's early releases were excessively buggy.

In November 1991, an agreement with DEC was announced whereby Microsoft and DEC will work toward integrating Microsoft applications with DEC's Team Links client server environment. This will allow seamless integration with Microsoft applications and provide users the ability to use Microsoft applications with e-mail, work flow automation, and other Workgroup applications. DEC licensed Microsoft applications and will sell them along with their own products, worldwide.

Six million dollars in incremental marketing was approved in December 1991. This money will be spent on competitive comparisons and increased advertising and direct mail.

**YTD**

Approximately \$7 million in incremental marketing was approved YTD.

Good progress was made on Windows for pen computing. Pen release dates are tied to the Windows 3.1 development schedule. Market interest escalated as PC users became informed of the potential uses and advantages of pen computing.

MS Office demand continued to grow. Win Office shipped 125,000 units and the Mac Office was 150% above plan of 23,000.

**Results of Operations (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 163	100.0%	\$ 141	100.0%	\$ 105	100.0%	\$ 22	\$ 58
Cost of revenues	23	14.0	20	14.6	16	15.2	(3)	(7)
Operating expense	37	22.6	33	23.7	26	24.4	(4)	(11)
Allocations	37	22.9	41	28.0	35	33.8	4	(2)
Burdened operating income	\$ 66	40.5%	\$ 47	33.7%	\$ 28	26.6%	\$ 19	\$ 38

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 268	100.0%	\$ 240	100.0%	\$ 28
Cost of revenues	39	14.5	35	14.5	(4)
Operating expense	63	23.3	63	26.2	-
Allocations	72	27.1	76	31.9	4
Burdened operating income	\$ 94	35.1%	\$ 66	27.4%	\$ 28

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## Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Word	274	\$ 69	\$ 251	240	\$ 65	\$ 270	34	\$ 4	\$ (19)
PC Word	121	34	284	124	30	241	(3)	4	43
Mac Word	80	16	200	88	17	196	(8)	(1)	4
Win Word Upd/Upg	156	16	102	22	2	105	134	14	(3)
PM Word	7	2	342	2	1	265	5	1	77
		<u>\$ 137</u>			<u>\$ 115</u>			<u>\$ 22</u>	
Percentage of net revenues		<u>84%</u>			<u>82%</u>				

Win Word's favorable unit variance was due to a 35,000 unit variance in academic versions. The average academic unit price of \$109, \$35 below plan, drove down the overall \$/unit average. PC Word's favorable unit price variance was due to the IFG-Europe channel which was \$59 over plan. Mac Word's \$1 million unfavorable variance was probably due to users delaying purchase decisions pending the release of Mac Word 5.0. Win Word updates/upgrades' favorable unit and revenue variances were due to 108,000 unplanned units in the USSMD channel.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Word	274	\$ 69	\$ 251	180	\$ 46	\$ 257	94	\$ 23	\$ (6)
PC Word	121	34	284	88	23	262	33	11	22
Mac Word	80	16	200	92	15	159	(12)	1	41
Win Word Upd/Upg	156	16	102	45	5	113	111	11	(11)
PM Word	7	2	342	8	2	298	(1)	-	44
		<u>\$ 137</u>			<u>\$ 91</u>			<u>\$ 46</u>	
Percentage of net revenues		<u>84%</u>			<u>87%</u>				

Win Word sales increased by 49% over the previous quarter, due to the introduction of Win Word 2.0 in October 1991. IFG-Europe saw a 56% increase in Win Word revenues while USSMD experienced 35% growth. PC Word remained popular in Europe. IFG-Europe had a quarterly increase of 23,000 units of PC Word. USSMD had a 6,000 unit increase. An average unit price in IFG-Europe of \$342 compared favorably to last quarter's \$309, and accounted for the favorable price per unit variance. USSMD's Mac Word sales dropped by 11,000 units to 55,000 units. The average unit price, however, was \$49 higher this quarter in USSMD due to an 18,000 unit reduction in academic units. The 250% increase in unit sales of Win Word updates/upgrades was attributable to the release of version 2.0. PM Word's sales in IFG-Europe increased 16% in volume and an average price per unit of \$468 was achieved, compared to last quarter's volume of 3,000 units at an average price of \$387. In contrast, both volume and price per unit in USSMD fell, by 21% and 6%, respectively, ending the quarter with just over 3,000 units sold at an average price of \$231.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Word	454	\$ 115	\$ 253	411	\$ 111	\$ 269	43	\$ 4	\$ (16)
PC Word	209	58	275	217	52	242	(8)	6	33
Mac Word	173	31	178	165	30	184	8	1	(6)
Win Word Upd/Upg	202	21	104	36	4	106	166	17	(2)
PM Word	15	5	319	5	1	265	10	4	54
		<u>\$ 230</u>			<u>\$ 198</u>			<u>\$ 32</u>	
Percentage of net revenues		<u>85%</u>			<u>83%</u>				

Win Word's favorable volume variance was attributable to USSMD selling 53,000 more academic units than planned. These deeply discounted units also explained the unfavorable price per unit variance. PC Word's

**OFFICE**

favorable price per unit variance was due to a shift in sales mix toward IFG-Europe and away from the lower priced USSMD channel. IFG-Europe's PC Word volume was 149% above USSMD's year-to-date. Win Word Updates/Upgrades' favorable unit and revenue variances were primarily due to unplanned sales in the USSMD channel, which sold 137,000 units for a total of \$14 million. Most of the remaining variance was attributable to stronger than planned sales in IFG-Europe. The favorable PM Word volume variance was due to higher than planned sales in USSMD and IFG-Europe of 3,000 and 6,000 units, respectively.

**Channel Revenues (in millions)**

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IFG-Europe	\$ 84	\$ 74	\$ 53	\$ 10	\$ 31
USSMD	54	47	38	7	16
IFG-ROW	12	13	8	(1)	4
Domestic OEM	1	1	1	-	-
Adjustments	12	6	5	6	7
Net revenues	<u>\$ 163</u>	<u>\$ 141</u>	<u>\$ 105</u>	<u>\$ 22</u>	<u>\$ 58</u>

The favorable IFG-Europe revenue variance was primarily due to sales of PC Word (\$5 million) and Win Word Upgrades (\$2 million). The increase over last quarter came from Win Word (\$14 million), PC Word (\$10 million) and Win Word Upgrades (\$2 million). The USSMD revenue variance was due to unplanned Win Word Upgrades of \$11 million and a favorable \$3 million revenue variance from Win Word academic. The favorable variances were offset by a \$4 million variance in the Mac Word Updates and a \$2 million variance for Workgroup's mail products. The increase over last quarter consisted mainly of greater Win Word (\$6 million) and Win Word updates/upgrades (\$7 million). The adjustments included inter business unit royalties from the sales of MS Office, which enjoyed tremendous success in the marketplace.

	FY92 YTD	FY92 YTD Plan	Variance
IFG-Europe	\$ 137	\$ 123	\$ 14
USSMD	92	85	7
IFG-ROW	20	20	-
Domestic OEM	1	1	-
Adjustments	18	11	7
Net revenues	<u>\$ 268</u>	<u>\$ 240</u>	<u>\$ 28</u>

PC Word sales in the IFG-Europe channel were \$7 million above plan. Win Word Upgrades were \$3 million over plan and academic versions accounted for an additional \$1 million variance. PM Word had unplanned revenues of \$3 million. USSMD Win Word full product and update/upgrade revenues were approximately \$17 million above plan. However, below planned revenues from the Mail products (\$7 million) and Mac Word updates (\$4 million) mitigated the favorable variance.

## Product Unit Revenues (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Word	\$ 157	96%	\$ 131	93%	\$ 102	97%	\$ 26	\$ 55
Workgroup	6	4	10	7	3	3	(4)	3
Pen	-	-	-	-	-	-	-	-
	<u>\$ 163</u>	<u>100%</u>	<u>\$ 141</u>	<u>100%</u>	<u>\$ 105</u>	<u>100%</u>	<u>\$ 22</u>	<u>\$ 58</u>

	FY92 YTD		FY92 YTD Plan		Variance
Word	\$ 242	97%	\$ 212	93%	\$ 30
Workgroup	8	3	17	7	(9)
Pen	-	-	-	-	-
	<u>\$ 250</u>	<u>100%</u>	<u>\$ 229</u>	<u>100%</u>	<u>\$ 21</u>

## Cost of Revenues

## Q92-2

Product costs were 8.9% of net revenues, compared to a planned 8.1%. The higher product cost percentage was due to higher than planned volume of lower margin Win Word Upgrades. Non-product costs of revenue were 5.1% versus a 6.5% plan. The lower than planned non-product cost percentage was due to lower than planned manufacturing and distribution allocations and lower royalties. The royalty variance was due to Win Word having surpassed its annual cap on the thesaurus and lower than planned Mac Word revenues.

## YTD

Cost of revenues mirrored plan at 14.5% of net revenues. Product costs were 9.2% of net revenues compared to a planned 7.8%. The variance was due to higher than planned shipments of Updates and academic versions. The product cost variance was offset by lower manufacturing and distribution allocations and Win Word royalties.

## Operating Expenses (in millions)

	Q92-2	Q92-2 Plan	Variance
Marketing	\$ 14	\$ 15	\$ 1
Marketing accrual	3	-	(3)
Payroll & payroll taxes	5	5	-
Other	15	13	(2)
	<u>\$ 37</u>	<u>\$ 33</u>	<u>\$ (4)</u>

Total operating expenses were \$5 million over plan for the Word product unit and \$1 million under plan for the Workgroup product unit. Marketing costs were accrued to approximate budget on a year-to-date basis.

	FY92 YTD	FY92 YTD Plan	Variance
Marketing	\$ 22	\$ 27	\$ 5
Marketing accrual	5	-	(5)
Product development	4	5	1
Payroll & payroll taxes	10	10	-
Other	22	21	(1)
	<u>\$ 63</u>	<u>\$ 63</u>	<u>\$ -</u>

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**OFFICE**

The marketing variance was due to timing differences. The accrual was booked to offset the effects when this underspending turns around. The Word product unit had a \$2 million unfavorable variance while Workgroup was \$2 million under plan.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	427	420	(7)	23	4%	12%
September 30, 1991	404	389	(15)	38	5	12
June 30, 1991	366	261	(105)	94	5	12
March 31, 1991	272	256	(16)	22	4	10
December 31, 1990	250	240	(10)	17	4	10

**Allocations**

**Q92-2**

The favorable allocation variance was primarily due to underspending by IFG-Europe (\$1 million).

**YTD**

The \$4 million favorable variance was due to underspending by IFG-Europe (\$2 million), USSMD (\$1 million) and IPG (\$1 million).

**Burdened Operating Income**

**Q92-2**

Burdened operating income was 39% above plan. This was largely attributable to tremendous sales of Win Word and Win Word Upgrades, particularly in USSMD. Higher than expected average unit prices combined with exceptionally strong sales of PC Word in IFG-Europe also contributed to BOI being above plan. MS Office inter business unit royalties were \$10 million above plan. The revenue variance more than offset a \$4 million unfavorable operating expense variance.

**Quarterly Growth**

Burdened operating income grew 137% over last quarter to \$66 million. The growth was fueled by the introduction of Win Word 2.0 which was responsible for \$34 million of the \$58 million quarterly increase in revenues.

**YTD**

Burdened operating income of \$94 million was 43% above plan. The \$28 million revenue variance was primarily due to the introduction of Win Word 2.0. Operating expenses mirrored plan while allocations were \$4 million favorable.

## ANALYSIS

### Q92-2

Incremental Excel marketing of \$11 million was approved in December. This marketing blitz will focus on the Win Excel 4.0 launch.

Win Excel received top ratings honors from National Software Testing Labs and InfoWorld comparative reviews. Win Excel also received the Editor's Choice Award from PC magazine, and PC Computing's MVP at Comdex.

The \$129 competitive upgrade program continued to stimulate penetration of Win Excel. Demand was not adversely impacted by 123/W, however, reports from the USSMD channel indicate that character based 123 continues to sell well.

Win Excel 3.1J shipped on October 15, 1991.

Win Excel 4.0 is expected to Ship in March 1992.

Project for Windows 3.0 is scheduled to ship February 15, 1992.

Superproject for Windows was released by Computer Associates.

Quattro Pro for Windows' March release slipped, and is now expected in June.

Lotus recently announced plans to layoff 400 employees as part of their overall cost-cutting and restructuring plans. Lotus has already begun laying off international employees.

### YTD

The MS Office continued to divert sales of standard product towards this economical method of acquiring a suite of MS applications. Year-to-date Win office shipments of 125,000 units is 208% of plan while the Mac Office is 150% over its plan of 23,000 units.

Lotus 1-2-3 for the Macintosh and 1-2-3/W shipped.

Borland launched Quattro Pro SE (a low-end, reduced capability spreadsheet).

French and German versions of Mac Excel 3.0 shipped in Q92-1.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 142	100.0%	\$ 119	100.0%	\$ 110	100.0%	\$ 23	\$ 32
Cost of revenues	19	13.7	16	13.7	15	13.4	(3)	(4)
Operating expense	26	18.1	24	19.8	18	16.8	(2)	(8)
Allocations	29	20.0	29	24.9	27	24.6	-	(2)
Burdened operating income	\$ 68	48.2%	\$ 50	41.6%	\$ 50	45.2%	\$ 18	\$ 18

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 252	100.0%	\$ 204	100.0%	\$ 48
Cost of revenues	34	13.6	28	14.0	(6)
Operating expense	44	17.5	46	22.6	2
Allocations	56	22.0	58	28.2	2
Burdened operating income	\$ 118	46.9%	\$ 72	35.2%	\$ 46

ANALYSIS

Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	211	\$ 67	\$ 317	246	\$ 70	\$ 285	(35)	\$ (3)	\$ 32
Mac Excel	76	19	252	59	15	264	17	4	(12)
Win Excel Upd/Upg	108	14	131	57	7	121	51	7	10
Win Project	28	11	400	28	11	408	-	-	(8)
Mac Excel Upd	63	7	105	30	3	93	33	4	12
		<u>\$ 118</u>			<u>\$ 106</u>			<u>\$ 12</u>	
Percentage of net revenues		<u>83%</u>			<u>89%</u>				

USSMD accounted for the Win Excel unit variance as pricing and sales focus stimulated Win Office to the detriment of full product sales. USSMD Excel units were 17,000 below plan, while Win Office unit sales exceed plan by 265%, (59,000 units versus 16,000 plan). Forty-seven percent of Q92-2 Win Excel units were sold via the Win Office Bundle. Additionally, IFG-ROW and WW OEM units were below plan by 9,000 and 12,000, respectively. The negative IFG-ROW variance was due to lower than planned sales in Japan. The WW OEM variance was due to Unisys not reporting royalties related to the Desktop III contract. The Win Excel \$/unit variance was attributed to the weaker than budgeted dollar and below plan OEM business. The favorable Mac Excel unit variance occurred in the USSMD (10,000) and IFG-Europe (6,000) channels. The negative \$/unit variance was due to the fact steeply discounted academic versions represented a higher than planned percentage of the sales mix. The favorable Win Excel update/upgrade unit variance was primarily due to sales of 44,000 units in IFG-Europe versus 21,000 plan, and USSMD's \$129 competitive upgrade program, which generated a positive variance of 18,000 units. The positive Mac Excel update unit variance was widely dispersed through the channels. The \$/unit variance was due to 57% of USSMD's sales being direct to end users at zero discount, compared to the overall 40% discount in the plan.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	211	\$ 67	\$ 317	177	\$ 49	\$ 276	34	\$ 18	\$ 41
Mac Excel	76	19	252	74	18	238	2	1	14
Win Excel Upd/Upg	108	14	131	103	12	121	5	2	10
Win Project	28	11	400	28	10	368	-	1	32
Mac Excel Upd	63	7	105	66	7	107	(3)	-	(2)
		<u>\$ 118</u>			<u>\$ 96</u>			<u>\$ 22</u>	
Percentage of net revenues		<u>83%</u>			<u>87%</u>				

The positive unit increase for Win Excel was primarily due to increased volume of localized French and German versions. The favorable \$/unit variance was due to the price uplift recognized on these localized versions. The quarter-to-quarter increase in IFG-Europe was primarily attributed to the seasonally slow Q92-1. The \$/unit increase for Mac Excel was attributed to a more favorable sales mix, with less academic units sold in Q92-2. The Win Excel update/upgrade increase in \$/unit primarily occurred in the IFG-ROW due to the release of Win Excel 3.1J. The Win Project \$/unit variance was related to deeply discounted unit sales to the Australian Tax Office in Q92-1, versus none in Q92-2.

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**ANALYSIS**

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win Excel	388	\$ 116	\$ 299	415	\$ 115	\$ 278	(27)	\$ 1	\$ 21
Mac Excel	150	37	245	106	28	258	44	9	(13)
Win Excel Upg/Upd	218	27	126	104	12	120	114	15	6
Win Project	55	21	384	51	21	405	4	-	(21)
Mac Excel Upd	130	14	106	67	6	88	63	8	18
	<u>\$ 215</u>			<u>\$ 182</u>			<u>\$ 33</u>		
Percentage of net revenues	<u>85%</u>			<u>89%</u>					

As noted above, the negative Win Excel unit variance occurred in USSMD and was attributed to the success of the Win Office bundle. Year-to-date unit USSMD sales of the Win Office bundle were 88,000 versus 31,000 plan. The Win Excel \$/unit variance was attributed to a weaker dollar versus the budgeted rate. The Mac Excel unit and \$/unit variance was primarily due to above planned sales of lower priced academic units. The Win Excel update/upgrade unit variance was related to the continuation of the unbudgeted \$129 competitive upgrade promotion. The Win Project \$/unit variance was due to higher than planned licensed units in the IFG-ROW channel, specifically to the Austrian Tax department. The Mac Excel update unit variance was due to strong demand for Mac Excel 3.0. The \$/unit variance was due to the deep discount assumed in the USSMD plan.

**Channel Revenues (in millions)**

	Q92-2		Q92-1		Variance	Change
	Q92-2	Q92-2 Plan	Q92-1	Q92-1		
IFG-Europe	\$ 69	\$ 56	\$ 48	\$ 48	\$ 13	\$ 21
USSMD	40	38	45	45	2	(5)
IFG-ROW	18	18	11	11	--	7
Domestic OEM	1	--	1	1	1	--
Adjustments	14	7	5	5	7	9
Net revenues	<u>\$ 142</u>	<u>\$ 119</u>	<u>\$ 110</u>	<u>\$ 110</u>	<u>\$ 23</u>	<u>\$ 32</u>

IFG-Europe revenues were 24% above plan. The positive variance was primarily due to Win Excel (\$43 million versus \$38 million plan) and Win Excel update/upgrade (\$6 million versus \$3 million plan). The 44% quarter-to-quarter growth was the result of the seasonal slow summer in Europe and was helped by a 9% foreign exchange bump. USSMD revenues approximated plan and accounted for 28% of net revenues. The 12% quarter-to-quarter decrease was primarily due to Win Excel (\$2 million), which was impacted by the success of the Office Bundle, and Mac Excel (\$1 million). The IFG-ROW consecutive quarter increase was due to Win Excel (\$4 million) and Win Excel update/upgrade (\$3 million). The favorable adjustments variance was due to higher than planned inter business unit royalties which represent ABU's portion of the revenue generated by the Mac and Win Office bundles.

	FY92 YTD		FY92 YTD Plan		Variance
	FY92 YTD	FY92 YTD	Plan	Plan	
IFG-Europe	\$ 117	\$ 117	\$ 91	\$ 91	\$ 26
USSMD	86	86	72	72	14
IFG-ROW	30	30	28	28	2
Domestic OEM	1	1	1	1	-
Adjustments	18	18	12	12	6
Net revenues	<u>\$ 252</u>	<u>\$ 252</u>	<u>\$ 204</u>	<u>\$ 204</u>	<u>\$ 48</u>

IFG-Europe revenues were 28% above plan and comprised 46% of net revenues. The positive variance was primarily due to strong demand for Win Excel (\$71 million versus \$62 million plan) and Win Excel update/upgrade (\$14 million versus \$7 million plan). USSMD revenues were 18% above plan. The positive variance was comprised of Mac Excel (\$20 million versus \$14 million plan), Win Excel update/upgrade (\$9

**ANALYSIS**

million versus \$4 million plan) and Mac Excel update (\$8 million versus \$3 million plan). Win Excel was 13% below plan due to higher than planned units of the Win Office bundle. The positive adjustments variance was due to higher than planned inter business unit royalties which represent ABU's portion of the revenue generated by the Mac and Win Office bundles.

**Product Unit Net Revenues (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Excel	\$ 129	91%	\$ 105	88%	\$ 99	90%	\$ 24	\$ 30
Project	13	9	14	12	11	10	(1)	2
	<u>\$ 142</u>	<u>100%</u>	<u>\$ 119</u>	<u>100%</u>	<u>\$ 110</u>	<u>100%</u>	<u>\$ 23</u>	<u>\$ 32</u>

	FY92 YTD		FY92 YTD Plan		Variance
Excel	\$ 228	90%	\$ 179	88%	\$ 49
Project	24	10	25	12	(1)
	<u>\$ 252</u>	<u>100%</u>	<u>\$ 204</u>	<u>100%</u>	<u>\$ 48</u>

**Cost of Revenues**

**Q92-2**

Product costs were 8.6% of net revenues, compared to a planned 7.8%. The variance was due to higher than planned product costs in IFG-Europe (9.7% versus 7.3% plan). The product cost variance was partially offset by a favorable non-product cost variance due to lower allocations from manufacturing and distribution.

**YTD**

Product costs were 8.4% of net revenues, compared to a planned 7.9%. The variance was due to Q92-1's sales mix which favored deeply discounted academic versions in the USSMD channel. Additionally, higher than planned IFG-Europe products costs, 8.9% versus a planned 7.4%, contributed to the unfavorable product cost variance. The product cost variance was partially offset by a favorable non-product cost variance due to lower allocations from manufacturing and distribution.

**Operating Expenses (in millions)**

	Q92-2	Q92-2 Plan	Variance
Marketing accrual	\$ 2	\$ -	\$ (2)
Product development	1	2	1
Marketing	11	11	-
Payroll & payroll taxes	2	2	-
Other	10	9	(1)
	<u>\$ 26</u>	<u>\$ 24</u>	<u>\$ (2)</u>

The marketing accrual reflected a partial accrual for the \$11 million incremental marketing which was approved during the quarter. The product development variance was a timing difference that should reverse by year end.

**ANALYSIS**

	FY92 YTD		Variance
	FY92 YTD	Plan	
Marketing accrual	\$ 4	\$ -	\$ (4)
Product development	2	5	3
Marketing	19	21	2
Payroll & payroll taxes	5	5	-
Other	14	15	1
	<u>\$ 44</u>	<u>\$ 46</u>	<u>\$ 2</u>

Operating expenses approximated plan and were consistent with the current headcount position. The marketing accrual variance was made to offset the effects when the current marketing variance reverses. It also represents a partial accrual for the \$11 million incremental marketing which was approved during the quarter. Product development was slightly below plan and reflected a timing difference which should reverse by fiscal year end.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	205	206	1	12	2%	6%
September 30, 1991	193	191	(2)	18	2	6
June 30, 1991	175	179	4	17	2	6
March 31, 1991	158	177	19	(1)	2	6
December 31, 1990	159	173	14	11	3	7

**Allocations**

**Q92-2**

Quarterly allocations approximated plan.

**YTD**

The favorable allocations variance was due to underspending by IFG-Europe (\$1 million) and IFG-ROW (\$601,000).

**Burdened Operating Income**

**Q92-2**

The favorable BOI variance was due to greater than planned Win Excel full product and update/upgrade revenues in IFG-Europe, coupled with strong USSMD sales of the Office bundle.

**Quarterly Growth**

The 37% quarter-to-quarter revenue growth, fueled by Win Excel in IFG-Europe and USSMD's Office bundle, more than offset increased operating expenses and allocations.

**YTD**

Burdened operating income was 65% higher than plan. The variance was due to a \$48 million revenue variance, combined with expenses which were slightly below plan.

**ENTRY**

**Q92-2**

The Solutions Series (Windows Works, Publisher and Money) generated \$17 million in revenues during Q92-2. The unplanned simultaneous shipment of French and German versions of Win Works and Publisher added to the series' success by generating \$9 million in unplanned revenue

Money continued to receive stiff competition, as Quicken tried to protect market share with a price of \$14.95.

Works for Windows Multimedia Edition was released to manufacturing on December 3, 1991. This product did not actually ship until January 13, 1992 due to a delay in receiving the duplicated CDs from our outside duplication vendor.

EBU is aggressively pursuing the mass merchant channel and has developed prototypes of new products for this channel. These plans will be presented to executive management during Q92-3.

An agreement was reached with Jostens Learning Corporation to make the family of Works products available with all Jostens Integrated Learning Systems (ILS) networks. Jostens ILS are currently in place at more than 6,000 schools and accessible to more than three million students nationwide. MS Works' inclusion in Jostens Learning's ILS will be available in the fall of 1992.

**YTD**

The Solutions Series was introduced in Q92-1. Works for Windows, Publisher and Money, target the growing small business and home user market. The series received great press coverage and enthusiastic acceptance from resellers and hardware manufactures. To date the series has generated over 27% (\$21 million) of EBU's gross revenues. Ninety-seven percent (\$14 million) of EBU's favorable gross revenue variance was due to the Solution Series.

The shift in Works' units toward the OEM channel continues as EBU tries to protect market share from competition.

USSMD entered into the mass-merchandise channel by establishing a direct sales relationship with Costco. EBU products are the primary thrust of this emerging channel resulting in \$2 million in revenues year-to-date.

**Product Ship dates**

Mac Flight Simulator 4.0 .....	9/4	Windows Entertainment Pak 2 .....	9/13
Windows Entertainment Pak 3 ...	9/13	Works for Windows .....	9/16
Money .....	9/23	Publisher .....	10/7
Win Works Multimedia Edition	1/13		

**Results of Operations (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 47	100.0%	\$ 39	100.0%	\$ 26	100.0%	\$ 8	\$ 21
Cost of revenues	9	18.6	9	23.2	6	21.9	-	(3)
Operating expense	15	30.8	12	32.2	9	33.1	(3)	(6)
Allocations	7	17.0	9	22.3	7	28.7	2	-
Burdened operating income	\$ 16	33.6%	\$ 9	22.3%	\$ 4	16.3%	\$ 7	\$ 12

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 74	100.0%	\$ 61	100.0%	\$ 13
Cost of revenues	15	19.7	14	23.7	(1)
Operating expense	23	31.6	22	35.5	(1)
Allocations	16	21.3	17	27.4	1
Burdened operating income	\$ 20	27.4%	\$ 8	13.4%	\$ 12

ENTRY

Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
PC Works	418	\$ 16	\$ 39	320	\$ 18	\$ 57	98	\$ (2)	\$ (18)
Win Works	79	9	120	32	3	106	47	6	14
Publisher	45	5	112	18	2	106	27	3	6
Mac Works	33	4	127	47	5	102	(14)	(1)	25
Entertainment Pak	140	3	20	67	1	21	73	2	(1)
		<u>\$ 37</u>			<u>\$ 29</u>			<u>\$ 8</u>	
Percentage of net revenues		<u>80%</u>			<u>77%</u>				

The favorable PC Works unit variance was due to out-of-period reporting by the German OEM, Vobis Data. In Q92-2 Vobis reported 139,000 units (\$2 million) which represented shipments over the prior four quarters. The delayed reporting was due to a pending price amendment on German Works. The unfavorable PC Works unit price variance was due to channel mix. Specifically, WW retail units were 29% of total shipments, compared to a plan of 49%, while the lower per unit revenue WW OEM channel represented 71%, compared to a plan of 51%. Win Works' favorable unit variance was attributed to the unexpected shipment of French and German versions, which generated 27,000 units and a 13,000 unit variance in IFG-ROW. Unplanned Domestic OEM shipments (7,000 units) offset the USSMD shortfall (6,000 units). The favorable Win Works unit price variance was a result of 43% of the sales going through the IFG-Europe channel at an average price of \$158. The plan anticipated IFG Europe (English language versions) would represent 4% of revenues at \$123 per unit. Publisher's favorable unit variance was spread through all the retail channels: USSMD (33,000 versus 16,000), IFG-Europe (5,000 versus 1,000), and IFG-ROW (6,000 versus 900). Mac Works sales were less than planned in all retail channels. However, significant revenue shortfalls were mitigated because USSMD and IFG-Europe unit prices were above plan. Entertainment Paks' favorable unit variance was due to excellent retail sales during the holiday season. USSMD (91,000 versus 48,000), IFG-Europe (14,000 versus 2,000), and IFG-ROW (27,000 versus 16,000) all exceeded plan. Domestic OEM recorded 7,000 units versus no plan.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
PC Works	418	\$ 16	\$ 39	238	\$ 12	\$ 52	180	\$ 4	\$ (13)
Win Works	79	9	120	19	2	109	60	7	11
Publisher	45	5	112	--	--	--	45	5	112
Mac Works	33	4	127	44	5	119	(11)	(1)	8
Entertainment Pak	140	3	20	44	1	22	96	2	(2)
		<u>\$ 37</u>			<u>\$ 20</u>			<u>\$ 17</u>	
Percentage of net revenues		<u>80%</u>			<u>79%</u>				

As noted above, the favorable PC Works unit variance was due to out-of-period reporting by Vobis Data. Domestic OEM experienced a 40% increase in units shipped and IFG-Europe increased by 65%. PC Works' unit price was lower than plan in Domestic OEM (\$12 versus \$16) and IFG-Europe (\$124 versus \$135). The increase in Win Works and Entertainment Pak units were due to the fact that these products did not ship until the last month in Q92-1. Most of Win Works increase in units came from IFG-Europe (34,000 versus five units in Q92-1) and IFG-ROW (13,000 versus 48 units in Q92-1). The favorable Win Works price per unit variance was attributed to the big increase in international sales and their related price uplift. The decline in Mac Works sales is due to the drop in USSMD academic units (6,000 versus 19,000 units in Q92-1). This drop is due to the highly seasonal Q92-1 "back to school" sales.



**ENTRY**

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
PC Works	656	\$ 29	\$ 44	616	\$ 33	\$ 54	40	\$ (4)	\$ (10)
Win Works	98	12	118	32	3	106	66	9	12
Mac Works	77	9	122	80	8	99	(3)	1	23
Publisher	45	5	112	18	2	106	27	3	6
PC Flight Sim	137	4	32	138	4	31	(1)	-	1
		<u>\$ 59</u>			<u>\$ 50</u>			<u>\$ 9</u>	
Percentage of netrevenues		<u>80%</u>			<u>83%</u>				

The favorable PC Works unit variance was the result of Vobis Data. USSMD and OEM-ROW also exceeded plan with USSMD shipping 88,000 units versus a plan of 83,000 and OEM-ROW shipping 47,000 units versus a plan of 21,000. The unfavorable unit price variance in PC Works was due to sales mix. Retail unit sales were 35% of total shipments compared to a plan of 47% while WW OEM represented 65% compared to a plan of 53%. Win Works' favorable unit variance was attributed to the earlier than planned shipment of international versions. International retail generated 48,000 units compared to a plan of 2,000. The favorable Win Works price per unit variance was attributed to the variance in international sales, and their related price uplift, and a favorable foreign exchange variance. Mac Works' favorable unit price variance was due to USSMD and IFG-Europe having a higher than planned unit price. Publisher's positive unit variance occurred in USSMD (33,000 units versus a plan of 16,000). In addition, IFG-Europe was 4,000 units over plan and IFG-ROW shipped 6,000 units versus a plan of 900.

**Channel Revenues (in millions)**

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
USSMD	\$ 19	\$ 18	\$ 14	\$ 1	\$ 5
IFG-Europe	19	13	8	6	11
IFG-ROW	7	7	4	-	3
Domestic OEM	2	1	1	1	1
OEM-Europe	2	1	-	1	2
Adjustments	(2)	(1)	(1)	(1)	(1)
Netrevenues	<u>\$ 47</u>	<u>\$ 39</u>	<u>\$ 26</u>	<u>\$ 8</u>	<u>\$ 21</u>

USSMD highlights included better than expected sales for Publisher (\$2 million over plan) and Entertainment Pak (\$1 million over plan). However, competition from Quicken restricted Money sales (\$1 million below plan) and Mac Works updates sales were less than expected (\$1 million less than plan). The Works variance was a result of the product slipping from November 1991 to May 1992. IFG-Europe's sales were 47% above plan and accounted for 41% of EBU's net revenues. The favorable variance was primarily attributable to higher than planned revenues for Win Works Standard Products and updates (\$6 million) as a result of the early shipment of French and German versions. A portion of this variance was also due to the weak dollar versus plan. The increase in USSMD sales was due to the Q92-2 release of Publisher, which generated \$4 million in revenue. IFG-Europe's increase in sales from Q92-1 was attributed to Win Works standard product and updates (\$5 million), PC Works (\$2 million) and Publisher (\$1 million).

**ENTRY**

	FY92 YTD		
	FY92 YTD	Plan	Variance
USSMD	\$ 33	\$ 26	\$ 7
IFG-Europe	27	21	6
IFG-ROW	11	12	(1)
Domestic OEM	3	2	1
OEM-Europe	3	2	1
OEM-ROW	1	-	1
Adjustments	(4)	(2)	(2)
Netrevenues	<u>\$ 74</u>	<u>\$ 61</u>	<u>\$ 13</u>

USSMD sales were 28% above plan and accounted for 45% of EBU's year-to-date net revenues. The favorable variance was primarily attributable to higher than planned revenues for Publisher (\$2 million), Mac Works (\$1 million), Win Works (\$1 million) and Entertainment Pak (\$1 million). IFG-Europe's sales were 28% above plan and accounted for 36% of EBU's net revenues. The favorable variance was attributable to higher than planned revenues for Win Works (\$5 million) and Win Works upgrades (\$1 million).

**Cost of Revenues**

**Q92-2**

Cost of revenues, as a percent of net revenues, were below plan due to a shift in sales mix and higher than expected unit prices for most products. Specifically, the royalty based OEM business represented a higher percentage of revenue than planned.

**YTD**

Cost of revenues, as a percent of net revenues, were less than plan due to the higher than planned OEM revenues and higher than expected unit prices for most major products. In addition, manufacturing allocations were lower than plan, as a percentage of net revenue, due to a favorable revenue variance compared to a relatively fixed cost base.

**Operating Expenses (in millions)**

	Q92-2		
	Q92-2	Plan	Variance
Marketing	\$ 5	\$ 4	\$ (1)
Marketing accrual	1	-	(1)
Payroll & payroll taxes	2	2	-
Other	7	6	(1)
	<u>\$ 15</u>	<u>\$ 12</u>	<u>\$ (3)</u>

Operating expenses were over plan due to marketing and the marketing accrual. The marketing variance is partially due to \$1 million in incremental marketing which was approved for advertising and direct mail.

	FY92 YTD		
	FY92 YTD	Plan	Variance
Marketing	\$ 7	\$ 7	\$ --
Marketing accrual	1	-	(1)
Payroll & payroll taxes	4	4	--
Other	11	11	--
	<u>\$ 23</u>	<u>\$ 22</u>	<u>\$ (1)</u>

Operating expenses were very close to plan. The marketing accrual will reverse by fiscal year end.

**ENTRY**

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	173	176	3	5	2%	5%
September 30, 1991	168	171	3	9	2	5
June 30, 1991	159	152	(7)	17	2	6
March 31, 1991	142	150	8	(1)	2	6
December 31, 1990	143	145	2	7	2	6

**Allocations****Q92-2**

Underspending by International Research and Development (\$359,000), IFG-Europe (\$106,000) and IFG-ROW (\$77,000) were responsible for the lower than planned allocations.

**YTD**

Underspending by International Research and Development (\$661,000), IFG-Europe (\$182,000), Applications Support (\$179,000) and USSMD (\$107,000) were responsible for the lower than planned allocations.

**Burdened Operating Income****Q92-2**

The favorable burdened operating income variance was due to greater than planned Win Works and Publisher revenues.

**Quarterly Growth**

Burdened operating income improved by \$12 million from Q92-2 due to greater than planned Solutions Series revenues in the international channels. The revenue growth was partially offset by higher marketing (\$3 million) and PSS (\$1 million) costs. Allocations were flat between the two quarters.

**YTD**

The favorable burdened operating income variance was due to greater than planned Win Works and Publisher revenues, while expenses and allocations approximated plan.

## DATA ACCESS

### Q92-2

Visual BASIC received top honors at Fall Comdex, PC Magazine's Technical Excellence award and PC Computing's MVP award.

Cirrus is scheduled to release to manufacturing on June 1, 1992.

Borland's Paradox for Windows is expected to ship in March 1992.

### YTD

Net revenues were 38% above plan primarily due to Visual BASIC. Year-to-date units were 78% above plan (62,000 versus 35,000 plan).

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 8	100.0%	\$ 6	100.0%	\$ 9	100.0%	\$ 2	\$ (1)
Cost of revenues	2	20.3	2	25.6	2	19.6	-	-
Operating expense	7	85.2	7	104.9	6	60.0	-	(1)
Allocations	3	48.8	3	69.2	3	38.9	-	-
Burdened operating income	\$ (4)	(54.3)%	\$ (6)	(99.7)%	\$ (2)	(18.5)%	\$ 2	\$ (2)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 17	100.0%	\$ 12	100.0%	\$ 5
Cost of revenues	3	19.9	3	24.6	-
Operating expense	12	71.6	13	107.3	1
Allocations	8	43.5	9	70.1	1
Burdened operating income	\$ (6)	(35.0)%	\$ (13)	(102.0)%	\$ 7

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Visual BASIC	29	\$ 4	\$ 129	21	\$ 2	\$ 116	8	\$ 2	\$ 13
PC Quick BASIC	22	1	66	29	2	59	(7)	(1)	7
Visual BASIC upgrades	11	1	101	3	-	96	8	1	5
Pro BASIC	4	1	245	6	2	288	(2)	(1)	(43)
Mac Quick BASIC	4	-	60	3	-	56	1	-	4
		\$ 7			\$ 6			\$ 1	
Percentage of net revenues	95%			96%					

The Visual BASIC full product and upgrade unit variances were due to above plan unit sales in the IFG-Europe channel for French, German, and International English versions. The \$/unit variance was due to the price uplift recognized on localized versions and a favorable foreign exchange rate. The unit variance for PC Quick BASIC was due to poor sales in all retail channels. The Pro BASIC unit variance was due to below planned sales in the international retail channels. The \$/unit variance was due to 400 units of Kanji version sold for \$68/unit, and unplanned MLPs.

Product Group / Business Unit Reporting

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129

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	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Visual BASIC	29	\$ 4	\$ 129	33	\$ 4	\$ 114	(4)	\$ -	\$ 15
PC Quick BASIC	22	1	66	21	1	65	1	-	1
Visual BASIC upg	11	1	101	13	1	97	(2)	-	4
Pro BASIC	4	1	245	6	2	310	(2)	(1)	(65)
Mac Quick BASIC	4	-	60	4	-	56	-	-	4
		<u>\$ 7</u>			<u>\$ 8</u>			<u>\$ (1)</u>	
Percentage of net revenues	<u>95%</u>			<u>92%</u>					

USSMD unit sales of Visual BASIC declined substantially (23,000 Q92-2 vs. 9,000 Q92-1), while IFG-Europe sales have more than doubled (17,000 versus 7,000). The mix change resulted in the \$/unit increase due to the price uplift recognized on localized versions. The Pro BASIC unit variance primarily occurred in the IFG-ROW channel. The \$/unit change occurred due to a greater number of lower priced MLPs sold during Q92-2 and the deeply discounted sale of Kanji product.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Visual BASIC	62	\$ 8	\$ 121	35	\$ 4	\$ 115	27	\$ 4	\$ 6
PC Quick BASIC	44	3	65	55	3	59	(11)	-	6
Pro BASIC	10	3	285	10	3	289	-	-	(4)
Visual BASIC upg	24	2	99	15	1	96	9	1	3
Mac Quick BASIC	8	-	58	5	-	56	3	-	2
		<u>\$ 16</u>			<u>\$ 11</u>			<u>\$ 5</u>	
Percentage of net revenues	<u>94%</u>			<u>95%</u>					

The Visual BASIC unit variance was due to above planned unit sales for both USSMD, 82% (31,000 vs. 17,000 plan) and IFG-Europe, 64% (23,000 vs. 14,000 plan). The Visual BASIC upgrade unit variance reflected the fact that no upgrades were budgeted for IFG-Europe. The Mac Quick BASIC unit variance was evenly distributed among the retail channels.

**Channel Revenues (in millions)**

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IFG-Europe	\$ 4	\$ 2	\$ 2	\$ 2	\$ 2
USSMD	3	2	5	1	(2)
IFG-ROW	2	2	2	-	-
Adjustments	(1)	-	-	(1)	(1)
Netrevenues	<u>\$ 8</u>	<u>\$ 6</u>	<u>\$ 9</u>	<u>\$ 2</u>	<u>\$ (1)</u>

The IFG-Europe and USSMD unit variances were due to above planned sales of Visual BASIC. USSMD Visual BASIC sales peaked during the first quarter then decreased 62% in Q92-2. IFG-Europe sales increased 148% during the second quarter due to the introduction of localized product.

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	FY92 YTD		Variance
	FY92 YTD	Plan	
USSMD	\$ 7	\$ 5	\$ 2
IFG-Europe	6	4	2
IFG-ROW	4	3	1
Domestic OEM	1	1	--
Adjustments	(1)	(1)	--
Net revenues	<u>\$ 17</u>	<u>\$ 12</u>	<u>\$ 5</u>

The favorable revenue variances in all retail channels were related to greater than planned demand for Visual BASIC.

**Cost of Revenues**

**Q92-2**

Product costs approximated plan. Non-product costs were 5.3% versus 9.9% plan. The variance was primarily due to lower than expected MS Database (Desktop III) royalties and favorable manufacturing and distribution allocations.

**YTD**

Product costs were slightly below the 14.9% plan. Non-product costs were below plan due to lower than expected royalties and favorable manufacturing and distribution allocations.

**Operating Expenses (in millions)**

	Q92-2		Variance
	Q92-2	Plan	
Payroll & payroll taxes	\$ 2	\$ 2	\$ --
Marketing	1	1	--
Marketing accrual	1	--	(1)
Product development	--	1	1
Other	3	3	--
	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ --</u>

The marketing accrual variance was due to timing differences. Product development was under plan by \$313,000.

	FY92 YTD		Variance
	FY92 YTD	Plan	
Payroll & payroll taxes	\$ 4	\$ 4	\$ --
Marketing	2	2	--
Marketing accrual	1	--	(1)
Product development	1	2	1
Other	4	5	1
	<u>\$ 12</u>	<u>\$ 13</u>	<u>\$ 1</u>

Year-to-date operating expenses approximated plan. The product development variance was primarily due to slippage of third-party product localization costs and is expected to reverse before year end.

**DATA ACCESS**

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Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	156	166	10	2	2%	5%
September 30, 1991	154	161	7	15	2	5
June 30, 1991	139	134	(5)	12	2	5
March 31, 1991	127	134	7	4	2	5
December 31, 1990	123	133	10	5	2	5

**Allocations****Q92-2**

Q92-2 allocated expenses were below plan. Applications support (\$369,000) and International R&D (\$229,000) both underspent budget.

**YTD**

Year-to-date allocated expenses were below plan. The largest variances occurred in Applications support (\$794,000) and International R&D (\$407,000).

**Burdened Operating Income****Q92-2**

The smaller than planned loss was due to higher than expected revenues for Visual BASIC. Operating expenses were at plan, while cost of revenues and allocations were both favorable.

**Quarterly Growth**

The burdened operating loss grew \$2 million over the prior quarter. Lower revenue, due to slowdown of USSMD demand for Visual BASIC, was responsible for the negative change.

**YTD**

The year-to-date burdened operating losses were significantly less than planned. The favorable variance was due to higher than expected revenues for Visual BASIC, lower than planned operating expenses, and favorable allocations.

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## GRAPHICS

### Q92-2

Lotus shipped Freelance for Windows in November 1991 and launched a direct mail campaign combined with a substantial trade advertising promotion.

Harvard Graphics for Windows is expected to ship in February 1992. A large promotional drive is expected.

### YTD

The Menlo Park development group plans to ship Win and Mac PowerPoint version 3.0 in February and June 1992, respectively.

A reseller-focused, \$129 Win PowerPoint competitive upgrade was launched in September 1991.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 11	100.0%	\$ 12	100.0%	\$ 8	100.0%	\$ (1)	\$ 3
Cost of revenues	2	18.3	2	19.3	2	21.0	-	-
Operating expense	4	35.6	5	45.3	4	45.7	1	-
Allocations	3	29.4	4	29.9	3	40.1	1	-
Burdened operating income	\$ 2	16.7%	\$ 1	5.5%	\$ (1)	(6.8)%	\$ 1	\$ 3

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 19	100.0%	\$ 21	100.0%	\$ (2)
Cost of revenues	4	19.4	4	19.3	-
Operating expense	8	39.7	10	45.7	2
Allocations	6	33.8	6	32.2	-
Burdened operating income	\$ 1	7.1%	\$ 1	2.8%	\$ -

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win PowerPoint	16	\$ 4	\$ 274	36	\$ 8	\$ 215	(20)	\$ (4)	\$ 59
Mac PowerPoint	9	2	207	7	2	220	2	-	(13)
		\$ 6			\$ 10			\$ (4)	
Percentage of net revenues		55%			83%				

The Win PowerPoint unit variance was due to a late royalty report from Unisys and a shift in USSMD to the Win Office, which cannibalizes a certain percentage of Win PowerPoint sales. Unisys' report of 5,000 units was received after the close of the quarter. The absence of the lower priced Unisys sales caused the favorable \$/unit variance. USSMD PowerPoint units were 29% below plan, while Win Office Bundle unit sales exceed plan by 265%, (59,000 units vs. 16,000 plan), 85% of Q92-2 Win PowerPoint units were sold via the Win Office Bundle. Mac PowerPoint unit sales approximated plan. The \$/unit variance was due to 700 academic units being sold for \$78 in the USSMD channel versus no budget.



**GRAPHICS**

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win PowerPoint	16	\$ 4	\$ 274	21	\$ 4	\$ 192	(5)	\$ -	\$ 82
Mac PowerPoint	9	2	207	9	2	196	-	-	11
		<u>\$ 6</u>			<u>\$ 6</u>			<u>\$ -</u>	
Percentage of net revenues		<u>55%</u>			<u>75%</u>				

The Win PowerPoint unit and \$/unit changes were primarily due to a late royalty report from Unisys. The Mac PowerPoint \$/unit variance is due from more academic units being sold during Q92-1.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win PowerPoint	37	\$ 8	\$ 228	69	\$ 14	\$ 209	(32)	\$ (6)	\$ 19
Mac PowerPoint	17	4	202	14	3	219	3	1	(17)
		<u>\$ 12</u>			<u>\$ 17</u>			<u>\$ (5)</u>	
Percentage of net revenues		<u>63%</u>			<u>81%</u>				

The Win PowerPoint unit variance is due to sales shifting to the Win Office Bundle, users waiting for Win PowerPoint 3.0 and aggressive competition from Lotus and Harvard Graphics. The \$/unit variance is due to lower than planned OEM business. Mac PowerPoint unit sales approximated year-to-date plan, the \$/unit variance is due to 1,800 academic units being sold in the USSMD channel for \$78 versus no plan.

**Channel Revenues (in millions)**

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
	USSMD	\$ 4	\$ 5	\$ 4	\$ (1)
IFG-Europe	2	4	1	(2)	1
IFG-ROW	--	1	1	(1)	(1)
Adjustments	5	2	2	3	3
Net revenues	<u>\$ 11</u>	<u>\$ 12</u>	<u>\$ 8</u>	<u>\$ (1)</u>	<u>\$ 3</u>

USSMD sales of Win PowerPoint were \$1 million below a \$4 million plan. Mac PowerPoint was \$500,000 above a \$1 million plan. IFG-Europe sales of Win PowerPoint were \$1 million below a \$3 million plan and Mac PowerPoint was \$100,000 below plan. IFG-ROW sales of Win and Mac PowerPoint were \$400,000 and \$200,000 below plan, respectively. The favorable adjustments variance was due to higher than expected sales of the Mac and Win Office bundles.

	FY92 YTD	FY92 YTD Plan	Variance
	USSMD	\$ 8	\$ 10
IFG-ROW	1	2	(1)
IFG-Europe	4	6	(2)
Domestic OEM	--	1	(1)
Adjustments	6	2	4
Net revenues	<u>\$ 19</u>	<u>\$ 21</u>	<u>\$ (2)</u>

USSMD sales of Win PowerPoint were \$3 million below plan of \$8 million. Mac PowerPoint was \$1 million above plan. IFG-Europe sales of Win PowerPoint were \$2 million versus plan of \$5 million and Mac PowerPoint was \$200,000 below a \$700,000 plan. IFG-ROW sales of both Win and Mac PowerPoint were \$200,000 and \$300,000 below plan, respectively. The favorable adjustments variance was due to higher than planned sales for the Mac and Win Office bundles.

**GRAPHICS**

**Cost of Revenues**

**Q92-2**

Product costs were 7.8% of net revenues versus 10.6% plan. All channels had favorable product costs. The product cost variance was partially offset by an unfavorable non-product cost variance resulting from above planned inter business unit royalties related to the Office bundle sales.

**YTD**

Product cost of revenues were 8.5% of net revenues versus 10.7% plan. The product cost variance was partially offset by higher than planned inter business unit royalties related to the Office bundle sales.

**Operating Expenses (in millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Variance</u>
Marketing	\$ 1	\$ 1	\$ --
Product development	--	1	1
Payroll & payroll taxes	1	1	--
Other	2	2	--
	<u>\$ 4</u>	<u>\$ 5</u>	<u>\$ 1</u>

Product development was under plan by \$465,000 due to lower than planned third-party development spending. This timing difference that should reverse by year end.

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Marketing	\$ 2	\$ 3	\$ 1
Product development	1	1	--
Payroll & payroll taxes	2	2	--
Other	3	4	1
	<u>\$ 8</u>	<u>\$ 10</u>	<u>\$ 2</u>

Marketing was under plan by \$1 million. This savings will reverse by year end.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	57	67	10	7	1%	2%
September 30, 1991	50	57	7	3	1	2
June 30, 1991	47	62	15	1	1	2
March 31, 1991	46	59	13	3	1	2
December 31, 1990	43	52	9	3	1	2

**Allocations**

There were no significant allocation variances.

**Burdened Operating Income**

**Q92-2**

BOI was \$1.9 million versus plan of \$646,000. Lower than planned revenues were offset by favorable operating expense and allocations variances.

**GRAPHICS**

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**Quarterly Growth**

The \$3 million growth in BOI was due entirely to increased sales of the Office bundle.

**YTD**

Operating results were at plan thanks to strong sales of the Office bundle and favorable expense variances.

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## SYSTEMS

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 234	100.0%	\$ 230	100.0%	\$ 256	100.0%	\$ 4	\$ (22)
Cost of revenues	30	13.1	34	14.0	37	14.5	4	7
Operating expense	70	29.9	73	31.3	56	21.7	3	(14)
Allocations	54	23.0	50	23.7	48	19.4	(4)	(6)
Burdened operating income	\$ 80	34.0%	\$ 73	31.0%	\$ 115	44.4%	\$ 7	\$ (35)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 490	100.0%	\$ 407	100.0%	\$ 83
Cost of revenues	68	13.8	57	13.7	(11)
Operating expense	126	25.6	138	34.0	12
Allocations	104	21.2	105	25.9	1
Burdened operating income	\$ 192	39.4%	\$ 107	26.4%	\$ 85

### Channel Revenues (in millions)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IFG-Europe	\$ 69	\$ 78	\$ 58	\$ (9)	\$ 11
Domestic OEM	49	45	47	4	2
USSMD	44	44	64	-	(20)
OEM-ROW	28	28	31	-	(3)
IFG-ROW	26	22	26	4	-
OEM-Europe	14	15	17	(1)	(3)
Adjustments	4	(2)	13	6	(9)
Net revenues	\$ 234	\$ 230	\$ 256	\$ 4	\$ (22)

	FY92 YTD	FY92 YTD Plan	Variance
IFG-Europe	\$ 127	\$ 119	\$ 8
Domestic OEM	96	89	7
USSMD	109	77	32
OEM-ROW	59	54	5
IFG-ROW	53	41	12
OEM-Europe	31	29	2
Adjustments	15	(2)	17
	\$ 490	\$ 407	\$ 83

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Product Group / Business Unit Reporting

137

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**SYSTEMS**

**Leading Products (units in thousands, revenues in millions)**

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	4,630	\$ 85	\$ 18	4,374	\$ 74	\$ 17	256	\$ 11	\$ 1
Win 3.0	1,504	66	44	1,685	77	46	(181)	(11)	(2)
MS-DOS 5 Upgrade	602	33	54	434	27	62	168	6	(8)
Pro C	26	5	203	23	6	262	3	(1)	(59)
LAN Manager Server	30	4	126	34	2	64	(4)	2	62
Win 3.0 Upd	58	3	59	102	6	63	(44)	(3)	(4)
Windows Manuals	56	2	32	42	1	20	14	1	12
Quick C for Windows	16	2	109	9	1	107	7	1	2
LAN Manager Unlimited	1	2	3288	1	3	3486	-	(1)	(198)
LAN Manager 1-5 User	3	2	681	7	4	576	(4)	(2)	105
OS/2	100	2	18	57	1	21	43	1	(3)
		<u>\$ 206</u>			<u>\$ 202</u>			<u>\$ 4</u>	
Percentage of netrevenues		<u>88%</u>			<u>88%</u>				

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	4,630	\$ 85	\$ 18	3,861	\$ 73	\$ 19	769	\$ 12	\$ (1)
Win 3.0	1,504	66	44	1,247	56	45	257	10	(1)
MS-DOS 5 Upgrade	602	33	54	1,013	60	60	(411)	(27)	(6)
Pro C	26	5	203	25	5	209	1	-	(6)
LAN Manager Server	30	4	126	21	3	141	9	1	(15)
Win 3.0 Upd	58	3	59	40	2	61	18	1	(2)
Windows Manuals	56	2	32	39	1	20	17	1	12
Quick C for Windows	16	2	109	3	-	108	13	2	1
LAN Manager Unlimited	1	2	3288	-	1	3108	1	1	180
LAN Manager 1-5 User	3	2	681	2	1	597	1	1	84
OS/2	100	2	18	83	3	32	17	(1)	(14)
		<u>\$ 206</u>			<u>\$ 205</u>			<u>\$ 1</u>	
Percentage of netrevenues		<u>88%</u>			<u>80%</u>				

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
MS-DOS	8,491	\$ 158	\$ 19	8,079	\$ 138	\$ 17	412	\$ 20	\$ 2
Win 3.0	2,752	122	44	3,071	133	43	(319)	(11)	1
MS-DOS 5 Upgrade	1,615	93	58	650	39	60	965	54	(2)
Pro C	52	11	206	40	10	261	12	1	(55)
LAN Manager Server	50	7	132	71	5	65	(21)	2	67
Win 3.0 Upd	99	6	61	156	10	61	(57)	(4)	-
OS/2	183	4	24	112	4	32	71	-	(8)
LAN Manager Unlimited	1	4	3221	1	5	3461	-	(1)	(240)
Windows Manuals	95	3	27	80	2	20	15	1	7
LAN Manager Client	71	3	46	2	-	275	69	3	(229)
		<u>\$ 411</u>			<u>\$ 346</u>			<u>\$ 65</u>	
Percentage of netrevenues		<u>84%</u>			<u>85%</u>				

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**SYSTEMS**

**Business Unit Results (in millions)**

Netrevenues	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
	\$	%	\$	%	\$	%		
MS-DOS	118	50.3%	101	44.1%	134	52.5%	17	(16)
Windows	78	33.3	88	38.3	65	25.4	(10)	13
Networks	17	7.2	19	8.2	17	6.5	(2)	-
Languages	14	6.1	19	8.2	12	4.6	(5)	2
UPB	5	2.1	1	0.3	26	10.2	4	(21)
Unix	2	1.0	2	0.9	2	0.8	-	-
	<u>\$ 234</u>	<u>100.0%</u>	<u>\$ 230</u>	<u>100.0%</u>	<u>\$ 256</u>	<u>100.0%</u>	<u>\$ 4</u>	<u>\$ (22)</u>

Netrevenues	FY92 YTD		FY92 YTD Plan		Variance
	\$	%	\$	%	
MS-DOS	253	51.5%	177	43.5%	76
Windows	143	29.2	152	37.3	(9)
Networks	34	6.9	35	8.5	(1)
Languages	26	5.3	35	8.5	(9)
UPB	31	6.3	5	1.2	26
Unix	4	0.9	4	1.0	-
Rounding	(1)	(0.1)	(1)	-	-
	<u>\$ 490</u>	<u>100.0%</u>	<u>\$ 407</u>	<u>100.0%</u>	<u>\$ 83</u>

Operating Income (Loss)	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
	\$	%	\$	%	\$	%		
MS-DOS	83	70.4%	70	68.6%	91	67.6%	13	(8)
Windows	8	9.8	15	16.9	10	14.7	(7)	(2)
Networks	(17)	(97.2)	(17)	(91.9)	(12)	(70.5)	-	(5)
Languages	(1)	(8.7)	3	13.3	(2)	(18.5)	(4)	1
UPB	5	100.0	1	100.0	26	100.0	4	(21)
Unix	2	82.8	1	46.6	2	82.8	1	-
	<u>\$ 80</u>	<u>34.0</u>	<u>\$ 73</u>	<u>31.0</u>	<u>\$ 115</u>	<u>44.4</u>	<u>\$ 7</u>	<u>\$ (35)</u>

Operating Income (Loss)	FY92 YTD		FY92 YTD Plan		Variance
	\$	%	\$	%	
MS-DOS	174	68.9%	118	66.5%	56
Windows	17	12.0	14	9.0	3
Networks	(28)	(84.0)	(34)	(98.2)	6
Languages	(3)	(13.1)	3	9.5	(6)
UPB	30	100.0	5	100.0	25
Unix	3	82.8	2	46.8	1
Rounding	(1)	-	(1)	-	-
	<u>\$ 192</u>	<u>39.4</u>	<u>\$ 107</u>	<u>26.4</u>	<u>\$ 85</u>

**SYSTEMS**

**Headcount (percent is of Product Groups' total)**

	<u>December 31, 1991</u>		<u>September 30, 1991</u>		<u>June 30, 1991</u>		<u>March 31, 1991</u>		<u>December 31, 1990</u>	
DOS	57	2.0%	57	2.0%	52	2.0%	48	2.0%	48	2.0%
Windows	554	15.0	524	15.0	172	6.0	133	5.0	132	5.0
Languages	158	5.0	152	5.0	147	5.0	140	5.0	136	6.0
Networks	191	6.0	194	6.0	192	7.0	239	9.0	235	10.0
Unix	-	-	-	-	2	-	2	-	2	-
OS/2	-	-	-	-	204	7.0	184	7.0	185	8.0
Printer	-	-	-	-	22	1.0	24	1.0	21	1.0
Support*	54	2.0	51	2.0	79	2.0	71	3.0	66	2.0
	<u>1,014</u>	<u>30.0%</u>	<u>978</u>	<u>30.0%</u>	<u>870</u>	<u>30.0%</u>	<u>841</u>	<u>32.0%</u>	<u>825</u>	<u>34.0%</u>

\* Support includes Division Management, Advanced Technical & Business, Systems User Education, Business Operations and MSJ Development.  
See the following Business Unit sections for analysis of the significant Business Units.

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## MS-DOS

### Q92-2

MS-DOS 5 Upgrade shipments of 602,000 units and \$33 million, exceeded plan by 169,000 units and \$6 million. However, Q92-2 represented a decrease of 410,000 units and \$27 million from the 1.0 million units and \$60 million during Q92-1. The decline in shipments resulted in high inventory levels and plans for Q92-3 promotions to regalanize demand.

Pricing and marketing strategies are being considered which may impact gross margins and channel mix in future quarters, most notably the MS-DOS Easy Distribution program. Already, 35 finished goods MS-DOS customers have signed long-term royalty agreements, 32 of which anticipate using the Easy Distribution program. About half are also licensing Windows.

### YTD

Surprising initial response to the MS-DOS 5 Upgrade resulted in significant favorable variances in units (964,000) and revenues (\$54 million).

In Q92-1, \$1.6 million in incremental marketing was approved for advertising in business publications and other promotional programs.

Pricing pressure from competitors, notably Novell's DR DOS, continues. Novell announced intentions to tighten the integration of DR DOS with NetWare.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 118	100.0%	\$ 101	100.0%	\$ 134	100.0%	\$ 17	\$ (16)
Cost of revenues	13	11.1	11	10.4	20	14.7	(2)	(7)
Operating expense	10	8.5	10	9.7	13	9.5	--	(3)
Allocations	12	10.0	10	11.3	10	8.2	(2)	2
Burdened operating income	\$ 83	70.4%	\$ 70	68.6%	\$ 91	67.6%	\$ 13	\$ (8)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 253	100.0%	\$ 177	100.0%	\$ 76
Cost of revenues	33	13.0	17	9.7	(16)
Operating expense	23	9.0	20	11.3	(3)
Allocations	23	9.0	22	12.5	(1)
Burdened operating income	\$ 174	69.0%	\$ 118	66.5%	\$ 56

### Channel Revenues (in millions)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IFG-Europe	\$ 35	\$ 26	\$ 36	\$ 9	\$ (1)
OEM-Domestic	27	27	27	--	--
OEM-ROW	25	23	17	2	8
USSMD	14	10	34	4	(20)
IFG-ROW	12	9	14	3	(2)
OEM-Europe	8	8	8	--	--
Adjustments	(3)	(2)	(2)	(1)	(1)
Net revenues	\$ 118	\$ 101	\$ 134	\$ 17	\$ (16)

Product Group / Business Unit Reporting

MS7029322  
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141

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**MS-DOS**

IFG-Europe MS-DOS shipments of 216,000 exceeded plan of 171,000 and accounted for \$4 million of the favorable variance. The MS-DOS/Windows Bundle shipped 29,000 units compared to plan of only 4,000, contributing an additional \$4 million to the variance, while the MS-DOS 5 Upgrade made up the remaining \$1 million. The USSMD favorable variance was made up entirely of MS-DOS 5 Upgrade shipments, while the IFG-ROW favorable variance was mainly comprised of MS-DOS, which shipped 122,000 units, exceeding plan by 55,000 and creating a variance of \$3 million. OEM-ROW MS-DOS exceeded plan by 207,000 units, resulting in their favorable variance.

	FY92 YTD		
	FY92 YTD	Plan	Variance
IFG-Europe	\$ 71	\$ 37	\$ 34
OEM-Domestic	54	53	1
USSMD	47	15	32
OEM-ROW	42	40	2
IFG-ROW	25	16	9
OEM-Europe	16	18	(2)
Adjustments	(2)	(2)	--
Net revenues	<u>\$ 253</u>	<u>\$ 177</u>	<u>\$ 76</u>

IFG-Europe's sizable favorable variance was led by MS-DOS 5 Upgrade shipments of 506,000 units, which exceeded plan by 293,000, and generated a \$19 million variance. MS-DOS shipments were 405,000, compared to plan of 280,000 and contributed \$9 million to the favorable variance. The MS-DOS/Windows Bundle shipped 39,000 units versus 7,000, resulting in \$5 million in unplanned revenue. USSMD's significant favorable variance was due to the MS-DOS 5 Upgrade which was 213% over plan. The unexpectedly strong results occurred primarily during Q92-1. IFG-ROW's variance was comprised of MS-DOS (\$7 million) and the MS-DOS 5 Upgrade (\$2 million). Worldwide OEM did not vary significantly from plan, however, there was an increasing emphasis on market penetration, favoring a shift toward OEM royalty business in future periods.

**Significant Worldwide OEM Customers**

	Q92-2				
	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
Sanyo	\$ 6.0	\$ 0.6	\$ --	\$ 5.4	\$ 6.0
NEC	3.4	3.4	3.2	--	0.2
Compaq	3.4	4.1	3.2	(.7)	0.2
ACER	3.3	1.2	0.8	2.1	2.5
Packard Bell	2.5	1.7	1.0	0.8	1.5
Phoenix Comp Products	1.9	0.8	1.0	1.1	0.9
Philips Electronics	1.7	1.0	--	0.7	1.7
Olivetti	1.5	1.5	1.8	--	(.3)
AST Research	1.5	1.3	1.8	0.2	(.3)
Toshiba	1.4	2.2	1.9	(.8)	(.5)
Dell	1.3	0.8	1.3	0.5	--
Gateway 2000	1.3	0.8	1.9	0.5	(.6)
Tandy	1.2	1.5	1.0	(.3)	0.2
Hewlett Packard	1.1	0.6	0.5	0.5	0.6
Siemens	1.0	1.0	1.1	--	(.1)
Other Customers	27.7	35.6	31.0	(7.9)	(3.3)
	<u>\$ 60.2</u>	<u>\$ 58.1</u>	<u>\$ 51.5</u>	<u>\$ 2.1</u>	<u>\$ 8.7</u>

Worldwide OEM revenues exceeded plan primarily due to two Far East OEM's: Sanyo and ACER. Sanyo reported 304,000 units versus a plan of only 27,000, while ACER reported 392,000 against a plan of only 70,000. Their variances were due to out-of-period royalty reports which included unit sales for the five quarters and two

## MS-DOS

quarters, respectively. In addition, Dell and Gateway 2000 each had favorable variances due to the increasing market share earned by direct responses and mass merchandising OEMs. Compaq royalties were 17% below plan.

### Cost of Revenues

#### Q92-2

The Q92-2 cost of revenues variance was due to \$2 million in unplanned inter business unit royalties paid to the Windows business unit for the MS-DOS/Win bundle. Product costs were under plan as a percentage of net revenues (6.9% versus 7.9%) due to reductions in the raw material costs for packaged MS-DOS.

#### YTD

The year-to-date variance in cost of revenues was due to the shift in sales mix to packaged products, specifically the MS-DOS 5 Upgrade. As a percentage of gross revenues, actual product costs were 9.7% versus plan of 7.1%. This variance reflected the fact that the predominately royalty based OEM channel represented 44% of net revenues versus plan of 62%. The remainder of the unfavorable variance was due to \$3 million in unplanned inter business unit royalties for the MS-DOS/Win bundle.

#### Operating Expenses (in millions)

	Q92-2	Q92-2 Plan	Variance
Marketing	\$ 4	\$ 3	\$ (1)
Marketing accrual	(1)	--	1
PSS	2	3	1
Payroll & payroll taxes	1	1	--
Other	4	3	(1)
	<u>\$ 10</u>	<u>\$ 10</u>	<u>\$ --</u>

Overspending for marketing was offset by the marketing accrual. PSS was under plan due to lower than planned headcount supporting DOS.

	FY92 YTD	FY92 YTD Plan	Variance
Marketing	\$ 9	\$ 7	\$ (2)
Marketing accrual	1	--	(1)
PSS	4	5	1
Payroll & payroll taxes	1	1	--
Other	8	7	(1)
	<u>\$ 23</u>	<u>\$ 20</u>	<u>\$ (3)</u>

The variance in marketing was largely due to overspending in IFG-Europe, while the marketing accrual was created to partially offset the affects when incremental marketing expenditures are incurred. PSS was under plan, consistent with the favorable average headcount variance in that group.

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**MS-DOS**

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	57	53	(4)	—	1%	2%
September 30, 1991	57	49	(8)	5	1	2
June 30, 1991	52	40	(12)	4	1	2
March 31, 1991	48	36	(12)	—	1	2
December 31, 1990	48	35	(13)	3	1	2

**Allocations**

Allocations were over plan for the quarter and year-to-date due to higher than planned charges from all three OEM channels.

**Burdened Operating Income****Q92-2**

Burdened operating income was 19% higher than planned. The variance was due to a \$17 million revenue variance which offset higher than planned cost of revenue and unfavorable channel allocations.

**Quarterly Growth**

Led by the shrinkage in MS-DOS 5 Upgrade volume, revenues decreased by \$16 million on a quarter-to-quarter basis. However, the decrease was offset by a corresponding reduction in COGS and operating expenses. The shift away from the MS-DOS 5 Upgrade resulted in a higher mix of OEM revenue, giving rise to the 2.8% increase in the BOI percentage as compared to Q92-1.

**YTD**

Burdened operating income exceeded plan by 48%. The variance was due to high initial demand for the MS-DOS 5 Upgrade, compared to a conservative plan, particularly in IFG-Europe. The \$76 million revenue variance more than offset an increase in cost of revenues brought about by the shift in sales mix away from the royalty business and higher than budgeted expenses.

## WINDOWS

### Q92-2

Headcount remained below plan (554 versus plan of 618 as of December 31, 1991). However, the January 1, 1992 reallocation of Networks headcount resulted in an increase of approximately 90 persons to the Windows business unit. This will negatively impact operating expenses over the remainder of FY92.

Win 3.1 is scheduled to be announced at WinWorld on April 6, 1992, with release to manufacturing on March 9, 1992. The enhanced version will incorporate over 1,000 changes based on feedback from the millions of current Win 3.0 users. It will provide better applications support, including Object Linking and Embedding (OLE), true type fonts and support for MS-DOS applications. It will also include OS features which will help it perform faster and more reliable than Win 3.0. Key examples of those features include applications reboot, parameter validation, Smartdrive 4.0, and 32 bit disk access. In addition, a peer-to-peer networking add-on is planned for release during Q92-4.

Win 3.0 Q92-2 shipments and revenues, including updates and all bundles, were 1.8 million and \$77 million, respectively. The Mouse/Windows bundle accounted for 219,000 units and \$5.2 million, the MS-DOS/Windows bundle 35,000 units and \$2.5 million.

Incremental marketing of \$6 million was approved in December.

### YTD

Since July 1, 1991, virtually all activities relating to the development, testing and marketing of Windows have been consolidated in the Windows business unit. Major groups that are part of this "Super" Windows Business Unit include NT, Advanced Windows Services and Win Printing.

Life-to-date shipments including updates and bundles, as of December 31, 1991, plus an estimate of unreported Q92-2 OEM shipments, were 9 million. Life-to-date revenues were \$388 million.

Windows SDK life-to-date shipments were nearly 71,000 through December 31, 1991.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 78	100.0%	\$ 88	100.0%	\$ 65	100.0%	\$ (10)	\$ 13
Cost of revenues	11	14.1	13	14.2	10	15.2	2	(1)
Operating expense	37	47.0	38	42.9	25	38.2	1	(12)
Allocations	22	29.1	22	26.0	20	31.9	--	(2)
Burdened operating income	\$ 8	9.8%	\$ 15	16.9%	\$ 10	14.7%	\$ (7)	\$ (2)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 143	100.0%	\$ 152	100.0%	\$ (9)
Cost of revenues	21	14.6	22	14.3	1
Operating expense	62	43.0	72	47.5	10
Allocations	43	30.4	44	29.2	1
Burdened operating income	\$ 17	12.0%	\$ 14	9.0%	\$ 3

**WINDOWS**

**Leading Products (units in thousands, revenues in millions)**

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win 3.0	1,504	\$ 66	\$ 44	1,685	\$ 77	\$ 46	(181)	\$ (11)	\$ (2)
Win 3.0 Updates	58	3	59	102	6	63	(44)	(3)	(4)
Windows Manuals	56	2	32	42	1	20	14	1	12
Windows SDK	4	1	278	7	2	264	(3)	(1)	14
		<u>\$ 72</u>			<u>\$ 86</u>			<u>\$ (14)</u>	
Percentage of net revenues		<u>92%</u>			<u>98%</u>				

The Win 3.0 unit variance was largely due to IFG-Europe shipping 101,000 units less than planned. The Win 3.0 updates units variance was comprised of unfavorable variances in IFG-Europe (35,000) and IFG-ROW (11,000), less a favorable variance in USSMD (2,000). The Windows Manuals favorable unit variance was attributed to Japanese manuals (11,000), while the unit price variance was due to IFG-Europe shipping 3,000 unplanned units at an average price of \$52. IFG-Europe was responsible for the unfavorable unit variance for the Windows SDK, although pricing exceeded plan within all retail channels.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win 3.0	1,504	\$ 66	\$ 44	1,247	\$ 56	\$ 45	257	\$ 10	\$ (1)
Win 3.0 Updates	58	3	59	40	2	61	18	1	(2)
Windows Manuals	56	2	32	39	1	20	17	1	12
Windows SDK	4	1	278	5	1	281	(1)	--	(3)
		<u>\$ 72</u>			<u>\$ 60</u>			<u>\$ 12</u>	
Percentage of net revenues		<u>92%</u>			<u>93%</u>				

Demand for Win 3.0 continued as shipments grew by 21%. Q92-2 set another record for units shipped, including updates and bundles, of 1.8 million versus 1.4 million during Q92-1. OEM shipments of Win 3.0 continued to increase as a percentage of the total (64% versus 63% in the prior quarter) resulting in the slight price per unit reduction. All retail channels shared in the unit increase for Win 3.0 updates. The growth in Windows Manuals related to MS Japan selling 25,000 more manuals than in Q92-1. The Windows Manual \$/unit change was due to IFG-Europe shipping 3,000 unplanned units at an average price of \$52.

	FY92 YTD			FY92 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Win 3.0	2,752	\$ 122	\$ 44	3,071	\$ 133	\$ 43	(319)	\$ (11)	\$ 1
Win 3.0 Updates	99	6	61	156	10	61	(57)	(4)	--
Windows Manuals	95	3	27	80	2	20	15	1	7
Windows SDK	9	2	280	15	4	264	(6)	(2)	16
		<u>\$ 133</u>			<u>\$ 149</u>			<u>\$ (16)</u>	
Percentage of net revenues		<u>92%</u>			<u>97%</u>				

Windows revenues continued to grow during the first half of FY92, though not enough to keep pace with an aggressive international plan. The Win 3.0 international shortfall occurred primarily in OEM-Europe (354,000) and IFG-Europe (150,000). These were partially offset by favorable variances in USSMD (116,000) and Domestic OEM (107,000). Win 3.0 update units fell short of plan in all retail channels: IFG-Europe (35,000), IFG-ROW (19,000) and USSMD (2,000). Windows Manual units were favorable because of unplanned shipments through Domestic OEM (7,000), IFG-Europe (4,000) and USSMD (3,000). The favorable price per unit variance was due to IFG-Europe pricing which averaged \$44.

WINDOWS

Channel Revenues (in millions)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
IFG-Europe	\$ 26	\$ 38	\$ 16	\$ (12)	\$ 10
USSMD	20	19	21	1	(1)
Domestic OEM	11	12	13	(1)	(2)
IFG-ROW	8	8	7	--	1
OEM-ROW	5	6	4	(1)	1
OEM-Europe	4	4	3	--	1
Adjustments	4	1	1	3	3
Net revenues	<u>\$ 78</u>	<u>\$ 88</u>	<u>\$ 65</u>	<u>\$ (10)</u>	<u>\$ 13</u>

The IFG-Europe unfavorable variance was due to Win 3.0 being under plan by 101,000 units or \$10 million. In addition, IFG-Europe Win 3.0 updates were under plan by 35,000 units, \$2 million. Compared to the previous quarter, IFG-Europe Win 3.0 units and revenues increased by 53% and \$9 million, respectively. The remainder of the IFG-Europe growth came from Win 3.0 updates which increased by 13,000 units and \$1 million.

	FY92 YTD	FY92 YTD Plan	Variance
IFG-Europe	\$ 42	\$ 60	\$ (18)
USSMD	41	34	7
Domestic OEM	23	22	1
IFG-ROW	15	14	1
OEM-ROW	9	10	(1)
OEM-Europe	6	9	(3)
Adjustments	7	3	4
Net revenues	<u>\$ 143</u>	<u>\$ 152</u>	<u>\$ (9)</u>

IFG-Europe's aggressive plan for Windows resulted in a 30% unfavorable revenue variance. German and French versions of Win 3.0 had shortfalls in units of 76,000 (\$9 million) and 56,000 (\$5 million), respectively. USSMD partially offset the unfavorable European variance. Revenue adjustments were above plan due to a favorable variance in inter business unit royalties from SPAG and MS-DOS bundles (approximately \$3 million each). These bundles represented 250,000 units of Win 3.0 during Q92-2.

Cost of Revenues

Q92-2

The slightly favorable cost of revenues variance was due to lower than planned update revenues, and higher than plan revenues from inter business unit royalties.

YTD

Product Cost of revenues was slightly above plan as a percent of revenues. USSMD, which has relatively lower margins, represented 29% of revenues versus plan of 23% and Domestic OEM shipped more packaged product than planned.

WINDOWS

Operating Expenses (in millions)

	Q92-2	Q92-2 Plan	Variance
Marketing accrual	\$ 3	\$ --	\$ (3)
Product development	2	4	2
Marketing	6	7	1
PSS	8	9	1
Professional fees	1	--	(1)
Payroll & payroll taxes	9	9	--
Other	8	9	1
	<u>\$ 37</u>	<u>\$ 38</u>	<u>\$ 1</u>

The marketing accrual represents a timing mechanism for expenses which will be incurred later in the year. The \$2 million favorable variance in product development consisted of \$1 million in purchased code and \$1 million in third-party development, \$500,000 which was for development of NT/UNIX compatibility which has slipped until late this fiscal year. The favorable variance in PSS is primarily due to lower than planned hiring in the departments which service Windows. The unfavorable variance in professional fees was due to legal expenses related to the Apple litigation.

	FY92YTD	FY92YTD Plan	Variance
Product development	\$ 3	\$ 8	\$ 5
PSS	12	16	4
Marketing accrual	2	--	(2)
Marketing	12	13	1
Payroll & payroll taxes	16	17	1
Other	17	18	1
	<u>\$ 62</u>	<u>\$ 72</u>	<u>\$ 10</u>

Product development continued to reflect significant underspending due to a conservative budget. The primary components of the variance were \$1 million in planned third-party development for NT/UNIX compatibility which slipped to Q92-4, \$700,000 in unspent development for NT and \$600,000 in third-party development for Advanced Windows' Services. The favorable variance in PSS was due to below plan for costs Windows' servicing departments. Payroll and other headcount variances were generally under plan due to the favorable variance in headcount (see table below). The marketing accrual includes a portion of the incremental marketing which was approved in December.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	554	618	64	30	6%	16%
September 30, 1991	524	588	64	352	6	15
June 30, 1991	172	89	(83)	39	2	6
March 31, 1991	133	89	(44)	1	2	5
December 31, 1990	132	85	(47)	8	2	5

Allocations

There were no significant allocation variances.

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**Burdened Operating Income**

**Q92-2**

The unfavorable variance in burdened operating income was due to weak Win 3.0 sales in the IFG-Europe channel. Cost of revenues and expenses were slightly under plan.

**Quarterly Growth**

Win 3.0 revenue growth in the IFG-Europe channel was offset by significant growth in operating expenses, which increased by \$12 million. The increase consisted primarily of accrued marketing (\$3 million), PSS (\$3 million), payroll (\$1 million) and professional fees (\$1 million).

**YTD**

The \$9 million revenue shortfall was offset by lower than planned operating expenses and allocations, resulting in a \$3 million favorable BOI variance.



## NETWORKS

### Q92-2

LAN Manager 2.1 was released on December 6, 1991, reaffirming Microsoft's commitment to the Networking business. The product received favorable technical reviews.

The Networks Business Unit reorganized in December. Ninety product development and marketing employees were re-deployed, effective January 1, 1992, to support Windows NT.

SQL Server 4.2 and a family of related products for client-server applications development were announced on January 15, 1992. The change in version numbering brought MS to a scheme consistent with Sybase and represents a commitment by Microsoft and Sybase to deliver the same features in all versions of SQL Server.

### YTD

The delayed release of LAN Manager 2.1 and concerns regarding OS/2 impaired demand for the product during the first several months of the fiscal year.

Strong Domestic OEM demand for LAN Manager Server and LAN Manager Client offset weakness in the European retail channel.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 17	100.0%	\$ 19	100.0%	\$ 17	100.0%	\$ (2)	\$ -
Cost of revenues	3	19.2	4	19.6	3	18.4	1	-
Operating expense	15	88.6	17	88.6	11	67.3	2	(4)
Allocations	16	89.4	15	83.7	15	84.8	(1)	(1)
Burdened operating income	\$ (17)	(97.2)%	\$ (17)	(91.9)%	\$ (12)	(70.5)%	\$ -	\$ (5)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 34	100.0%	\$ 35	100.0%	\$ (1)
Cost of revenues	6	18.8	7	18.8	1
Operating expense	26	78.1	31	90.4	5
Allocations	30	87.1	31	89.0	1
Burdened operating income	\$ (28)	(84.0)%	\$ (34)	(98.2)%	\$ 6

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
LAN Manager Server	30	\$ 4	\$ 126	34	\$ 2	\$ 64	(4)	\$ 2	\$ 62
LAN Manager Unlimited	1	2	3,288	1	3	3,486	-	(1)	(198)
LAN Manager 1-5 User	3	2	681	7	4	576	(4)	(2)	105
OS/2	100	2	18	57	1	21	43	1	(3)
SQL Server Unlimited	-	1	3,105	1	2	2,040	(1)	(1)	1,065
LAN Manager 10 Pack	2	1	677	2	1	623	-	-	54
LAN Manager 3COM Unltd	1	1	728	-	-	532	1	1	196
LAN Manager Client	4	1	148	1	-	277	3	1	(129)
		\$ 14			\$ 13			\$ 1	
Percentage of net revenues		82%			68%				

The LAN Manager Server revenue and \$/unit variance resulted from a shift in the sales mix to IBM which reported OEM sales of 17,618 units at \$155/unit versus plan of 1,500 units at \$200/unit. Unit sales of LAN Manager Server to customers other than IBM were 20,000 below plan, but were sold at an average \$58/unit higher

Product Group / Business Unit Reporting

MS7029331  
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151

MS-PCA 1189898  
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**NETWORKS**

than plan. Lower than planned IFG shipments resulted in unfavorable revenue variances for LAN Manager Unlimited, LAN Manager 1-5 User, and SQL Server Unlimited products. A price increase during Q92-1 for SQL Server Unlimited resulted in a favorable \$/unit variance. LAN Manager Unlimited \$/unit was below plan due to a shift in sales mix from IFG channels to the lower revenue USSMD channel. Favorable OS/2 unit and revenue variances resulted from higher than planned reporting by IBM, but favorable pricing on these units drove the \$/unit down. LAN Manager Client \$/unit variance resulted from a plan that underestimated the unit sales to OEM customers.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
LAN Manager Server	30	\$ 4	\$ 126	21	\$ 3	\$ 141	9	\$ 1	\$ (15)
LAN Manager Unlimited	1	2	3,288	--	1	3,108	1	1	180
LAN Manager 1-5 User	3	2	681	2	1	597	1	1	84
OS/2	100	2	18	83	3	32	17	(1)	(14)
SQL Server Unlimited	--	1	3,105	1	1	2,358	(1)	--	747
LAN Manager 10 Pack	2	1	677	1	1	607	1	--	70
LAN Manager 3COM Unltd	1	1	728	2	1	604	(1)	--	124
LAN Manager Client	4	1	148	67	3	39	(63)	(2)	109
		<u>\$ 14</u>			<u>\$ 14</u>			<u>\$ --</u>	
Percentage of net revenues		<u>82%</u>			<u>82%</u>				

Significant domestic OEM reporting by IBM resulted in a 43% increase in unit sales for LAN Manager Server. OS/2 revenues were down 31%, despite a 22% increase in units reported, reflecting the favorable pricing granted IBM. SQL Server and LAN Manager 3COM Unlimited revenues reflected no change, as lower unit sales were offset by higher revenue per unit. The unfavorable unit and revenue changes for LAN Manager Client resulted from a missing royalty report from DEC.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
LAN Manager Server	50	\$ 7	\$ 132	71	\$ 5	\$ 65	(21)	\$ 2	\$ 67
LAN Manager Unlimited	1	4	3,221	1	5	3,461	--	(1)	(240)
OS/2	183	4	24	112	4	32	71	--	(8)
LAN Manager 1-5 User	5	3	642	12	7	570	(7)	(4)	72
SQL Server Unlimited	1	3	2,689	2	3	2,031	(1)	--	658
LAN Manager 10 Pack	3	2	648	4	2	616	(1)	--	32
LAN Manager 3COM Unltd	3	2	659	1	--	532	2	2	127
LAN Manager Client	71	3	46	2	--	275	69	3	(229)
		<u>\$ 28</u>			<u>\$ 26</u>			<u>\$ 2</u>	
Percentage of net revenues		<u>82%</u>			<u>74%</u>				

LAN Manager Server's revenue variance resulted from higher than anticipated reporting by IBM during Q92-2. The LAN Manager Unlimited negative revenue variance resulted from a shift in the sales mix from retail to Domestic OEM revenue. The increase in units and lower \$/unit for OS/2 resulted primarily from higher units reported by IBM at favorable pricing. Above plan OEM reporting by DEC resulted in the favorable unit and revenue variances for LAN Manager Client. DEC's low per unit price was primarily responsible for the LAN Manager Client \$/unit variance.

**NETWORKS**

**Channel Revenues (in millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Q92-1</u>	<u>Variance</u>	<u>Change</u>
Domestic OEM	5	3	6	2	(1)
USSMD	4	4	3	--	1
IFG-Europe	4	8	3	(4)	1
IFG-ROW	2	2	2	--	--
OEM-ROW	1	1	2	--	(1)
OEM-Europe	1	1	2	--	(1)
Adjustments	--	--	(1)	--	1
Net revenues	<u>\$ 17</u>	<u>\$ 19</u>	<u>\$ 17</u>	<u>\$ (2)</u>	<u>\$ --</u>

LAN Manager Server exceeded plan in the Domestic OEM channel by 92%, accounting for most of the favorable variance. Lower than anticipated shipments of LAN Manager 1-5 User, LAN Manager Unlimited and SQL Server Unlimited contributed to the negative variance in IFG-Europe.

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Domestic OEM	11	6	5
USSMD	8	8	--
IFG-Europe	7	12	(5)
IFG-ROW	4	4	--
OEM-ROW	3	2	1
OEM-Europe	3	2	1
Adjustments	(2)	1	(3)
Net revenues	<u>\$ 34</u>	<u>\$ 35</u>	<u>\$ (1)</u>

Above plan reporting of LAN Manager Server by IBM and LAN Manager Client by DEC contributed to the Domestic OEM favorable variance. Weakness in the IFG-Europe channel was attributable to lower than anticipated shipments of LAN Manager Unlimited, LAN Manager 1-5 User, and SQL Server Unlimited.

**Cost of Revenues**

**Q92-2**

Cost of revenues, as a percentage of net revenues, was slightly lower than plan. The variance was primarily due to a shift in mix to the OEM channel and lower than planned royalties.

**YTD**

As a percentage of net revenues, cost of revenues mirrored plan (18.8%). The shift in sales mix to OEM, combined with lower royalties, offset higher than planned cost of revenue for SQL and OS/2.

**Operating Expenses (in millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Variance</u>
Marketing accrual	\$ 3	\$ --	\$ (3)
Marketing	3	5	2
Product development	1	2	1
Payroll & payroll taxes	2	3	1
Other	6	7	1
	<u>\$ 15</u>	<u>\$ 17</u>	<u>\$ 2</u>

Product Group / Business Unit Reporting

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153

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**NETWORKS**

Operating expenses were below plan due to a delay in marketing expenditures. A marketing accrual was made to offset the impact when the marketing variance turns around. Payroll for the quarter was below plan due to a hiring freeze that was instituted in anticipation of transferring personnel out of the Networks Business Unit and into the Windows NT group upon release of LAN Manager 2.1. As a result, average headcount for the Networks Business Unit was 27 employees under plan for Q92-2.

	FY92 YTD		
	FY92 YTD	Plan	Variance
Marketing accrual	\$ 4	\$ --	\$ (4)
Marketing	5	9	4
Product development	2	4	2
Payroll & payroll taxes	5	6	1
Other	10	12	2
	<u>\$ 26</u>	<u>\$ 31</u>	<u>\$ 5</u>

Product development expenses trailed plan due to lower than anticipated spending for development related to Mac connectivity and third-party development of SQL Server. Delays in the release of LAN Manager 2.1 and the hiring freeze combined to keep marketing and payroll expenses below plan. An unplanned marketing accrual was recorded to offset the impact when the marketing variance turns around.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	191	218	27	(3)	2%	6%
September 30, 1991	194	212	18	2	2	6
June 30, 1991	192	252	60	(47)	3	7
March 31, 1991	239	252	13	4	4	9
December 31, 1990	235	231	(4)	2	4	10

**Allocations**

**Q92-2**

Allocations were \$535,000 below plan. The largest variances occurred in IFG-Europe and IFG-ROW.

**YTD**

All allocations were below plan by \$1 million. International R&D, IFG-Europe and USSMD accounted for the bulk of the savings.

**Burdened Operating Loss**

**Q92-2**

The burdened operating loss was slightly lower than plan due to the favorable operating expense variance. The favorable results were achieved despite an unfavorable net revenue variance which occurred in IFG-Europe.

**Quarterly Growth**

The sequential increase in burdened operating loss was partially due to the timing of marketing expenditures that accompanied the December release of LAN Manager 2.1. Operating expenses increased \$4 million and allocations \$1 million. Net revenues increased by 2% over the prior quarter.

**YTD**

The year-to-date burdened operating loss was \$6 million less than planned. The favorable variance was due to lower than planned operating expenses. Specifically, slippage of third-party development (\$2 million), and lower

**NETWORKS**

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than planned PSS costs (\$2 million), combined with below planned headcount for the \$5 million operating expense variance.

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## LANGUAGES

### Q92-2

Win Quick C completed its first full quarter of sales. Revenues exceed plan by 76%.

In November, Borland released C++ 3.0 (\$495) and Turbo C++ for Windows (\$150). Microsoft's Professional C 7.0 is expected to be released in February, 1992, having slipped from an original ship date of November, 1991.

A new version of MASM was released in December. Sales for that month were 172% of plan.

### YTD

Quick C for Windows shipped in September, 1991. The product was originally scheduled to ship in July, 1991. Win COBOL, shipped on schedule in Q92-1. All MS Languages are now available for Windows.

Net revenues for the Languages business unit were 75% of plan, as all major product families were below plan.

### Results of Operations (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 14	100.0%	\$ 19	100.0%	\$ 12	100.0%	\$ (5)	\$ 2
Cost of revenues	3	23.0	5	24.4	4	36.2	2	1
Operating expense	8	56.9	8	40.5	6	51.0	-	(2)
Allocations	4	28.8	3	21.8	4	31.3	(1)	-
Burdened operating income	\$ (1)	(8.7)%	\$ 3	13.3%	\$ (2)	(18.5)%	\$ (4)	\$ 1

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 26	100.0%	\$ 35	100.0%	\$ (9)
Cost of revenues	8	29.0	9	25.0	1
Operating expense	14	54.2	15	42.5	1
Allocations	7	29.9	8	23.0	1
Burdened operating income	\$ (3)	(13.1)%	\$ 3	9.5%	\$ (6)

### Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Pro C	26	\$ 5	\$ 203	23	\$ 6	\$ 262	3	\$ (1)	\$ (59)
Quick C for Windows	16	2	109	9	1	107	7	1	2
Pro FORTRAN	5	1	287	12	2	152	(7)	(1)	135
Quick C for Windows Upg	11	1	90	4	-	76	7	1	14
MASM	8	1	106	10	1	92	(2)	-	14
		\$ 10			\$ 10			\$ -	
Percentage of net revenues		68%			51%				

The favorable unit variance and unfavorable \$/unit variance for Pro C were due to unplanned sales of 5,000 OEM Runtime libraries at \$1 per unit. These libraries were sold to Micro Focus for inclusion in other language products under an ongoing license agreement. Pro C's revenue variance was modest given the slippage in version 7.0 (originally scheduled to ship in Q91-4). Pro C updates bore the brunt of the slippage with revenues of \$289,000 versus plan of \$2 million. Quick C for Windows full product and upgrade beat plan by a combined 115% and surpassed the Q92-1 (quarter budgeted for product launch) plan by 28%. The unfavorable unit variance and favorable \$/unit variance in Pro FORTRAN were due to an unmet plan to sell 5,000 license units to Micro Focus for \$3 per unit. Weak demand caused the unfavorable revenue variance in Pro FORTRAN. Pro C/Win SDK

**LANGUAGES**

update (\$1 million) and Pro COBOL (\$815,000), though not in the top five, also contributed to Languages' overall unfavorable revenue variance.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Pro C	26	\$ 5	\$ 203	25	\$ 5	\$ 209	1	\$ -	\$ (6)
Quick C for Windows	16	2	109	3	-	108	13	2	1
Pro FORTRAN	5	1	287	6	1	262	(1)	-	25
Quick C for Windows Upg	11	1	90	-	-	-	11	1	-
MASM	8	1	106	9	1	95	(1)	-	11
		<u>\$ 10</u>			<u>\$ 7</u>			<u>\$ 3</u>	
Percentage of netrevenues		<u>68%</u>			<u>59%</u>				

Quick C for Windows and Quick C for Windows upgrade accounted for the entire change in revenue between Q92-1 and Q92-2. The increase in \$/unit for Pro FORTRAN was caused by a shift in sales mix toward the higher SRP international channels. In Q92-2, 60% of Pro FORTRAN retail units were sold internationally versus 42% in Q92-1.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Pro C	52	\$ 11	\$ 206	40	\$ 10	\$ 261	12	\$ 1	\$ (55)
Pro FORTRAN	10	3	274	25	4	150	(15)	(1)	123
Quick C for Windows	19	2	109	20	2	107	(1)	-	2
MASM	18	2	101	18	2	91	-	-	10
Pro COBOL	4	2	440	6	3	485	(2)	(1)	(45)
		<u>\$ 20</u>			<u>\$ 21</u>			<u>\$ (1)</u>	
Percentage of netrevenues		<u>67%</u>			<u>57%</u>				

The \$/unit variance in Pro C was caused by the unplanned sale of 11,500 OEM Runtime libraries at an average price of \$5 per unit. The favorable FORTRAN \$/unit variance was the result of an unmet plan to sell approximately 10,000 OEM units (including the 5,000 mentioned above) at an average price of \$4 per unit. Slippage in Quick C for Windows to the end of Q92-1 resulted in a revenue shortfall. Pro COBOL revenues were below plan due to weak demand, primarily in IFG-Europe.

**Channel Revenues (in millions)**

	Q92-2		Q92-1		Variance	Change
	Q92-2	Q92-2 Plan	Q92-1	Q92-1		
USSMD	\$ 6	\$ 10	\$ 6	\$ 6	\$ (4)	\$ -
IFG-ROW	4	4	4	4	-	-
IFG-Europe	4	6	3	3	(2)	1
Adjustments	-	(1)	(1)	(1)	1	1
Net revenues	<u>\$ 14</u>	<u>\$ 19</u>	<u>\$ 12</u>	<u>\$ 12</u>	<u>\$ (5)</u>	<u>\$ 2</u>

USSMD sales were 38% below plan and accounted for 44% of Languages net revenues. Slippage of Pro C update and Pro C/Win SDK and update accounted for the majority of the revenue variance. IFG-Europe's revenue variance was due to Pro C (\$1 million versus plan of \$2 million) and Pro C update (\$140,000 versus plan of \$1 million).

**LANGUAGES**

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
USSMD	\$ 12	\$ 20	\$ (8)
IFG-ROW	8	7	1
IFG-Europe	7	10	(3)
Adjustments	(1)	(2)	1
Net revenues	<u>\$ 26</u>	<u>\$ 35</u>	<u>\$ (9)</u>

USSMD sales were weak across all products, with the exception of Pro C, which, when combined with Pro C update, had a slightly positive variance. Unfavorable variances in USSMD included Pro C Win/SDK (\$2 million) and update (\$1 million), Source Profiler (\$1 million), Pro FORTRAN (\$885,000) and update (\$613,000). Strong sales in Japan of Pro C update and Pro C/Win SDK caused a favorable variance in IFG-ROW revenues. IFG-Europe was hurt by Pro C and update with unfavorable variances of \$2 million and \$1 million, respectively.

**Cost of Revenues**

**Q92-2**

Cost of revenues were slightly below plan. This variance was partially due to the slippage of lower margin update revenue.

**YTD**

Cost of revenues were 29% of net revenues versus plan of 25%. This variance was partially explained by sales mix. IFG-ROW had 30% of gross revenues versus plan of 18%, while that channel's product costs, as a percentage of gross revenues, are 117% higher than those of the other two channels combined. Additionally, unfavorable variances in non-product cost of revenues adversely impacted gross profit.

**Operating Expenses (in millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Variance</u>
Payroll & payroll tax	\$ 2	\$ 2	\$ --
Product support services	2	2	--
Marketing	2	2	--
Other	2	2	--
	<u>\$ 8</u>	<u>\$ 8</u>	<u>\$ --</u>

There were no significant variances from plan.

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Payroll & payroll tax	\$ 4	\$ 4	\$ --
Product support services	3	3	--
Marketing	3	3	--
Product development	1	1	--
Other	3	4	1
	<u>\$ 14</u>	<u>\$ 15</u>	<u>\$ 1</u>

Operating expenses were under plan by \$599,000. Lower than planned product development expense accounted for \$458,000 of this variance and payroll and payroll tax accounted for the remainder. The payroll variance was in line with the favorable headcount variance, shown below.

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159

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**LANGUAGES**

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Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	158	152	(6)	6	2%	5%
September 30, 1991	152	162	10	5	2	5
June 30, 1991	147	142	(5)	7	2	5
March 31, 1991	140	143	3	4	2	5
December 31, 1990	136	143	7	1	2	6

**Allocations**

There were no significant allocation variances in Q92-2 or 2 year-to-date.

**Burdened Operating Income****Q92-2**

The \$1 million burdened operating loss was the result of a 25% revenue shortfall. The revenue variance was due to slippage of Pro C 7.0, coupled with lower than planned demand for Pro FORTRAN and Pro COBOL. Operating expenses and allocations were at plan.

**Quarterly Growth**

The quarterly reduction in burdened operating loss was due entirely to the restatement of IFG-Europe cost of revenues. Revenue growth of \$2 million was offset by operating expense growth of \$2 million, primarily in product development, PSS and marketing.

**YTD**

Despite favorable variances in operating expenses and cost of revenues, BOI fell significantly short of plan. The variance was due to the slippage of Pro C 7.0, Quick C for Windows and unfavorable revenue variances in several other products.

**SPAG**

**Q92-2**

USSMD's "Buy 8 Get 10" promotion for the Mouse/Win bundle stimulated revenues to 147% of plan. The promotion was launched in October and concluded in early December.

OEM Mouse unit sales were nearly four times those planned and accounted for 37% of all Mice shipped. This is the result of an industry trend in which PC vendors are increasingly shipping systems which include Mice. Fierce price competition in the OEM market has increased margin pressure on this business.

BallPoint unit shipments were only 62% of plan as distributors sold inventories purchased in Q92-1. In January Dell and Toshiba entered BallPoint OEM agreements. Beginning in February all Dell notebooks will be available with a package which includes the BallPoint Mouse, MS-DOS 5 and Windows 3.0. The BallPoint will be fitted with a custom clip which allows the computers to be closed with the BallPoint attached. Toshiba has also selected BallPoint, with the custom clip, for a promotion of its notebooks.

Mouse/Paintbrush bundle sales were below plan as customers shifted to Naked Mice, OEM Mice and the Mouse/Win bundle.

**YTD**

BallPoint revenues were 280% of plan in Q92-1. However, slower Q92-2 sales led to first half revenues of 165% of plan.

The Mouse/Win bundle was well ahead of plan in Q92-1. With the advent of the "Buy 8 Get 10" promotion in Q92-2, the Mouse/Win bundle became the dominant SPAG revenue generator.

Unit sales continued to shift to the lower revenue, lower margin OEM channel. This shift is a concern for longer term Mouse profitability.

Overall, the Serial Mouse continues to gain share relative to the Bus Mouse. The trend toward serial is driven by the increasing number of computers sold with extra serial ports or dedicated Mouse ports. This trend is positive since the Serial Mouse has higher margins than the Bus Mouse.

**Results of Operations (in millions)**

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 71	100.0%	\$ 67	100.0%	\$ 59	100.0%	\$ 4	\$ 12
Cost of revenues	34	47.8	30	44.6	29	48.8	(4)	(5)
Operating expense	6	8.0	6	8.4	4	6.1	-	(2)
Allocations	7	10.9	7	11.9	7	12.9	-	-
Burdened operating income	\$ 24	33.3%	\$ 24	35.1%	\$ 19	32.2%	\$ -	\$ 5

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 130	100.0%	\$ 121	100.0%	\$ 9
Cost of revenues	63	48.3	55	45.5	(8)
Operating expense	9	7.1	11	8.8	2
Allocations	15	11.8	15	13.1	-
Burdened operating income	\$ 43	32.8%	\$ 40	32.6%	\$ 3

Leading Products (units in thousands, revenues in millions)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Serial Mouse/Win	205	\$ 26	\$ 126	135	\$ 18	\$ 130	70	\$ 8	\$ (4)
Serial Mouse (Naked)	225	16	72	268	19	69	(43)	(3)	3
Serial Mouse/Painbrush	100	10	100	141	14	96	(41)	(4)	4
OEM Mouse	406	8	21	108	3	26	298	5	(5)
Ser. Mouse 5-Pack	13	4	319	9	3	312	4	1	7
		<u>\$ 64</u>			<u>\$ 57</u>			<u>\$ 7</u>	
Percentage of net revenues		<u>91%</u>			<u>82%</u>				

Mouse/Win unit sales were well above plan due in large part to the "Buy 8 Get 10" promotion. Despite the success of this promotion, \$/unit missed plan by only 3%. The price held up due to a favorable sales mix in which IFG-Europe and IFG-ROW, with their higher per unit revenue, weighed more heavily than planned. Strong shipments of the Mouse/Win bundle and the OEM Mouse caused the unfavorable variances in the Naked Serial Mouse and the Mouse/Painbrush bundle. In Europe the Mouse/Painbrush shortfall was \$3 million. OEM Mouse sales were the result of the pointing device market shifting away from retail and towards the OEM channel. Fierce price competition in the OEM area from both Logitech and Taiwanese suppliers has forced \$/unit down to 80% of plan. The Serial Mouse 5-Pack beat plan as more customers than expected took advantage of the volume discount.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Serial Mouse/Win	205	\$ 26	\$ 126	130	\$ 17	\$ 132	75	\$ 9	\$ (6)
Serial Mouse (Naked)	225	16	72	161	11	71	64	5	1
Serial Mouse/Painbrush	100	10	100	90	8	93	10	2	7
OEM Mouse	406	8	21	304	6	21	102	2	-
Ser. Mouse 5-Pack	13	4	319	11	3	305	2	1	14
		<u>\$ 64</u>			<u>\$ 45</u>			<u>\$ 19</u>	
Percentage of net revenues		<u>91%</u>			<u>79%</u>				

The Serial Mouse/Win bundle grew on the strength of the "Buy 8 Get 10" promotion. While significantly below plan, the Naked Serial Mouse grew substantially from the prior quarter. Most of this growth occurred in IFG-Europe. The OEM Mouse, reflecting the industry trend outlined above, grew 34% quarter to quarter.

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Serial Mouse/Win	335	\$ 43	\$ 128	246	\$ 32	\$ 130	89	\$ 11	\$ (2)
Serial Mouse (Naked)	387	28	72	473	33	69	(86)	(5)	3
Ser. Mouse/Painbrush	191	18	96	253	24	95	(62)	(6)	1
OEM Mouse	711	15	21	185	5	26	526	10	(5)
BallPoint	102	10	97	63	6	95	39	4	2
		<u>\$ 114</u>			<u>\$ 100</u>			<u>\$ 14</u>	
Percentage of net revenues		<u>87%</u>			<u>82%</u>				

The Serial Mouse/Win bundle beat plan by 34% through unexpectedly strong demand coupled with the "Buy 8 Get 10" promotion. The Naked Serial Mouse and the Serial Mouse/Painbrush bundle were below plan as sales shifted to the Mouse/Win bundle and to the OEM channel. The OEM Mouse became a dominant product in terms of units. BallPoint dropped off the leading products list in Q92-2 after initial channel fill in Q92-1. Shipments were hurt by large inventories left over from the product launch. Sell-through figures suggest that BallPoint sales should approximate plan going forward.

**SPAG**

**Channel Revenues (in millions)**

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Q92-1</u>	<u>Variance</u>	<u>Change</u>
USSMD	\$ 33	\$ 35	\$ 33	\$ (2)	\$ -
IFG-Europe	26	24	16	2	10
IFG-ROW	9	8	7	1	2
Domestic OEM	7	3	6	4	1
Adjustments	(4)	(3)	(3)	(1)	(1)
<b>Netrevenues</b>	<b>\$ 71</b>	<b>\$ 67</b>	<b>\$ 59</b>	<b>\$ 4</b>	<b>\$ 12</b>

The unfavorable variance in the USSMD channel was primarily attributable to the shift in units to the Domestic OEM channel. The favorable variance in IFG-Europe was due primarily to a \$5 million favorable variance in the Mouse/Win bundle. In addition to the Mouse/Win bundle, the Naked Serial Mouse comprised the majority of the increase in units sold in IFG-Europe over Q92-1. The growth in the IFG-ROW channel was due, again, to higher than planned demand for Mouse/Win bundles. Domestic OEM sales reflect an industry trend. As more OEMs bundle windows, they also need to ship the Mouse in order to make the system complete. This trend will result in significant margin pressure for SPAG since gross margins are only 40% in the OEM channel versus 68% in the retail channels.

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
USSMD	\$ 66	\$ 65	\$ 1
IFG-Europe	42	40	2
IFG-ROW	16	15	1
Domestic OEM	13	6	7
Adjustments	(7)	(5)	(2)
<b>Netrevenues</b>	<b>\$ 130</b>	<b>\$ 121</b>	<b>\$ 9</b>

IFG-Europe's favorable variance was caused by a large variance in the Serial Mouse/Win bundle, which was partially offset by unfavorable variances in the Mouse/Paintbrush bundle and the Naked Mice. Domestic OEM more than doubled plan, benefiting from the previously mentioned trend toward the OEM channel.

**Cost of Revenues**

**Q92-2**

The unfavorable cost of revenues variance was caused by higher than planned sales of the lower margin OEM Mouse and the inter business unit royalty associated with the Mouse/Win bundles.

**YTD**

The same factors that impacted Q92-2 cost of revenues caused the year-to-date unfavorable variance.

## Operating Expenses (in millions)

	Q92-2	Q92-2 Plan	Variance
Product development	\$ -	\$ 1	\$ 1
Marketing accrual	1	-	(1)
Marketing	2	2	-
Payroll & payroll tax	1	1	-
Other	2	2	-
	<u>\$ 6</u>	<u>\$ 6</u>	<u>\$ -</u>

Product development expense was under plan by \$436,000 due to lower than planned third-party development spending.

	FY92 YTD	FY92 YTD Plan	Variance
Marketing	\$ 3	\$ 4	\$ 1
Product development	-	1	1
Marketing accrual	1	-	(1)
Payroll & payroll tax	1	1	-
Other	4	5	1
	<u>\$ 9</u>	<u>\$ 11</u>	<u>\$ 2</u>

Delayed spending caused the favorable marketing expense variance of \$1 million and the offsetting unfavorable marketing accrual variance. Product development expense was below plan due to lower than planned third-party development spending. Work was not begun until January 1992 on BallPoint 2 and the Classic Mouse, both of which were planned to begin in September 1991.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	49	49	-	8	1%	1%
September 30, 1991	41	48	7	(2)	1	1
June 30, 1991	43	41	(2)	5	1	2
March 31, 1991	38	35	(3)	-	1	2
December 31, 1990	38	34	(4)	6	1	2

## Allocations

There were no significant allocation variances in Q92-2 or year-to-date.

## Burdened Operating Income

## Q92-2

Higher than planned Mouse/Win bundle and OEM Mouse sales were offset by unfavorable COGS variances. The lower margin revenue, combined with expenses which approximated plan, resulted in burdened operating income which mirrored plan in absolute dollars but was 1.8 points below the 35.1% plan.

## Quarterly Growth

All leading products had revenue growth, while cost of goods sold and marketing expenses increased only slightly. These results led to 26% growth in BOI.

SPAG

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YTD

BOI was only slightly better than plan. Strong sales of the Mouse/Win bundle, especially during Q92-2 promotions, and the BallPoint mouse in Q92-1, were offset by cost of goods sold. The COGS variance was caused by higher than planned shipments of the low margin OEM Mouse and the inter business unit royalty bearing Mouse/Win bundles.

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Product Group / Business Unit Reporting

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165

MS-PCA 1189911  
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## OTHER PRODUCT GROUPS

### Net Revenues

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Q92-1</u>	<u>Variance</u>	<u>Change</u>
Services	\$ 8	\$ 10	\$ 6	\$ (2)	\$ 2
Books	4	5	5	(1)	(1)
Multimedia	2	1	--	1	2
Eliminations	(8)	(3)	(4)	(5)	(4)
	<u>\$ 6</u>	<u>\$ 13</u>	<u>\$ 7</u>	<u>\$ (7)</u>	<u>\$ (1)</u>

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Services	\$ 14	\$ 18	\$ (4)
Books	9	9	--
Multimedia	2	1	1
Eliminations	(13)	(5)	(8)
	<u>\$ 12</u>	<u>\$ 23</u>	<u>\$ (11)</u>

### Op Inc (Loss)

	<u>Q92-2</u>	<u>Q92-2 Plan</u>	<u>Q92-1</u>	<u>Variance</u>	<u>Change</u>
Services	\$ --	\$ (1)	\$ (6)	\$ 1	\$ 6
Books	(1)	--	--	(1)	(1)
Multimedia	(4)	(5)	(4)	1	--
Eliminations	1	1	1	--	--
Rounding	(2)	(3)	(1)	1	(1)
	<u>\$ (6)</u>	<u>\$ (8)</u>	<u>\$ (10)</u>	<u>\$ 2</u>	<u>\$ 4</u>

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Services	\$ (6)	\$ (3)	\$ (3)
Books	(1)	(1)	--
Multimedia	(8)	(10)	2
Eliminations	1	1	--
Rounding	1	--	1
	<u>\$ (13)</u>	<u>\$ (13)</u>	<u>\$ --</u>

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
Multimedia	125	133	8	5	1%	4%
Books	42	43	1	(1)	1	1
	<u>167</u>	<u>176</u>	<u>9</u>	<u>4</u>	2	6

Note: Service headcount is included in the Other Channel section.

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MS7029345  
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167

MS-PCA 1189912  
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**OTHER PRODUCT GROUPS**

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UPB: See comments in the Worldwide OEM section.

Services: Q92-2 Services' revenue was composed of MSU (worldwide), MCS (worldwide), and PSS (international only). Domestic PSS revenue is recorded as a reduction in expense and is fully distributed to the product groups and channels. Negative revenue variances in MSU and MCS were \$1 million and \$2 million worldwide respectively. Quarterly operating income variances were also unfavorable for MSU and MCS -- \$2 million and \$1 million respectively. See additional MCS analysis.

Multimedia: Revenues exceeded plan by 56%, due to strong OEM revenues for DOS Bookshelf, SBC, and Stat Pack. New products were released during the quarter, including Microsoft Bookshelf for Windows, Multimedia Beethoven the Ninth Symphony, and the Multimedia Development Kit for Windows. Product development costs were favorable to plan by 76% due to delay in spending by Multimedia Publishing on products for FY92.

Books: See separate analysis.



## BOOKS

### Q92-2

Revenues fell short of plan due to weaker than expected sell-through of Running MS-DOS 5th Edition and slippage in the publication date for Power Programming with MASM and Windows 3.1 Companion.

Burdened operating income suffered due to a \$635,000 unplanned provision for inventory obsolescence.

Initial revenues (\$48,000) were received from the manufacturer's representation agreement between Systema Verlag GmbH and MS-Germany marking the start of an aggressive entry into the German market.

### YTD

Net revenues surpassed plan by 5% due to unplanned revenues from the sale of English language editions by MS subsidiaries.

Revenues from the flagship title, Running MS-DOS, trailed plan by 41%.

Demand for titles on Windows programming tools and technical documentation remained very strong, pushing Programming Windows 2nd Edition revenue above plan by 153%.

### Results of Operations (in thousands)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Net revenues	\$ 4,411	100.0%	\$ 5,072	100.0%	\$ 5,043	100.0%	\$ (661)	\$ (632)
Cost of revenues	2,685	60.9	2,424	47.8	2,456	48.7	(261)	(229)
Operating expense	2,097	47.5	2,109	41.6	2,046	40.6	12	(51)
Allocations	492	11.2	520	10.2	474	9.4	28	(18)
Burdened operating income	\$ (863)	(19.6)%	\$ 19	0.4%	\$ 67	1.3%	\$ (882)	\$ (930)

	FY92 YTD		FY92 YTD Plan		Variance
Net revenues	\$ 9,455	100.0%	\$ 9,048	100.0%	\$ 407
Cost of revenues	5,140	54.4	4,369	48.3	(771)
Operating expense	4,142	43.8	4,249	47.0	107
Allocations	968	10.2	1,026	11.3	58
Burdened operating income	\$ (795)	(8.4)%	\$ (596)	(6.6)%	\$ (199)

Books

Leading Products (In thousands)

	Q92-2			Q92-2 Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Programming Windows (2nd Ed)	23	\$ 335	\$ 15	7	\$ 105	\$ 15	16	\$ 230	\$ -
Running MS-DOS (5th Ed)	18	244	14	62	767	12	(44)	(523)	2
Visual Basic Workshop	13	224	18	13	260	20	-	(36)	(2)
Running Excel (2nd Ed)	12	173	14	7	91	14	5	82	-
Windows 3 Companion	13	171	13	8	112	14	5	59	(1)
Programmer's PC Sourcebook	15	146	10	1	18	20	14	128	(10)
PC Excel 3 Workbook	8	117	15	8	34	4	-	83	11
Excel 3 Companion	9	114	12	7	91	14	2	23	(2)
Running Windows (2nd Ed)	8	99	12	6	75	12	2	24	-
Parent's Guide To Software	13	95	7	3	22	7	10	73	-
		<u>\$1,718</u>			<u>\$1,575</u>			<u>\$ 143</u>	
Percentage of net revenues		<u>39%</u>			<u>31%</u>				

Leading Products revenue exceeded plan by 9% despite a 68% shortfall in Running MS-DOS 5th Edition. Excluding Running MS-DOS 5th Edition, Leading Products revenues exceeded plan by 82%. Programming Windows revenues were 219% above plan due to a non-recurring \$108,000 sale to Borland and strong demand in both the domestic and international markets for titles on Windows development tools. Running MS-DOS 5th Edition revenues were significantly below plan due to channel filling shipments in Q91-4 and Q92-1. Some displacement of this title by competing publishers' MS-DOS titles has occurred, but large domestic chains continue to report healthy sell-through. Visual Basic Workshop was released during the quarter in response to growing demand for titles on Windows development tools, however, revenues trailed plan by 14%. Programmer's PC Sourcebook surpassed plan due to a one-time bookclub sale in December (\$58,000) at a highly discounted price, and due to strong international revenues (\$51,000). Increased demand for Running MS Excel, stimulated by a cooperative advertising campaign with B. Dalton and direct advertising in PC Computing, pushed revenues 90% above plan.

	Q92-2			Q92-1			Change		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Programming Windows (2nd Ed)	23	\$ 335	\$ 15	16	\$ 252	\$ 16	7	\$ 83	\$ (1)
Running MS-DOS (5th Ed)	18	244	14	47	558	12	(29)	(314)	2
Visual Basic Workshop	13	224	18	-	-	-	13	224	18
Running Excel (2nd Ed)	12	173	14	12	161	13	-	12	1
Windows 3 Companion	13	171	13	9	119	13	4	52	-
Programmer's PC Sourcebook	15	146	10	6	126	20	9	20	(10)
PC Excel 3 Workbook	8	117	15	5	77	16	3	40	(1)
Excel 3 Companion	9	114	12	5	58	11	4	56	1
Running Windows (2nd Ed)	8	99	12	12	139	11	(4)	(40)	1
Parent's Guide To Software	13	95	7	-	-	-	13	95	7
		<u>\$1,718</u>			<u>\$1,490</u>			<u>\$ 228</u>	
Percentage of net revenues		<u>39%</u>			<u>30%</u>				

Leading Products revenue increased 15% over the prior quarter. Excluding Running MS-DOS 5th Edition, Leading Products revenue increased by 58% over Q92-1. The increase in Programming Windows revenues resulted from a one-time \$108,000 sale to Borland and sharply increased international revenues. Running MS-DOS 5th Edition revenues declined 56% from Q92-1 following a significant drop in domestic shipments. Programmer's PC Sourcebook benefited from a \$58,000 bookclub order during Q92-2 that pushed revenues over plan, but reduced the \$/unit.

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## Books

	FY92 YTD			FY92 YTD Plan			Variance		
	Units	Revs	\$/Unit	Units	Revs	\$/Unit	Units	Revs	\$/Unit
Running MS-DOS (5th Ed)	65	\$ 803	\$ 12	109	\$ 1,360	\$ 12	(44)	\$ (557)	\$ -
Programming Windows (2nd Ed)	39	587	15	16	232	15	23	355	-
Running Excel (2nd Ed)	25	333	13	15	203	14	10	130	(1)
Learn CAD Now	16	327	21	30	599	20	(14)	(272)	1
Windows 3 Companion	23	291	13	17	231	14	6	60	(1)
Programmer's PC Sourcebook	21	272	13	5	108	20	16	164	(7)
MS Windows Programmer's Reference	12	252	22	5	90	20	7	162	2
Running Windows (2nd Ed)	20	238	12	15	181	12	5	57	-
Visual Basic Workshop	13	224	18	13	260	20	-	(36)	(2)
MS-DOS Programmer's Reference	23	209	9	7	90	12	16	119	(3)
		<u>\$ 3,536</u>			<u>\$ 3,354</u>			<u>\$ 182</u>	
Percentage of net revenues		<u>37%</u>			<u>37%</u>				

Running MS-DOS 5th Edition revenues were 41% lower than plan. Sell-through is reported to be healthy, but high inventory levels in the channel reduced shipments in Q92-2. The Programming Windows variance resulted from a \$108,000 non-recurring sale to Borland and increasing demand for titles on Windows programming tools. Special advertising promotions and cooperative advertising arrangements stimulated demand for Running MS Excel, and resulted in above plan revenues. Learn CAD Now revenues trailed plan by 45% due to unplanned delays in bringing the title to market.

### Channel Revenues (in thousands)

	Q92-2	Q92-2 Plan	Q92-1	Variance	Change
Press	\$ 4,143	\$ 5,072	\$ 4,908	\$ (929)	\$ (765)
IFG-ROW	84	--	60	84	24
IFG-Europe	83	--	17	83	66
Adjustments	101	--	58	101	43
Net revenues	<u>\$ 4,411</u>	<u>\$ 5,072</u>	<u>\$ 5,043</u>	<u>\$ (661)</u>	<u>\$ (632)</u>

Press channel revenues include principally English language books sold through three primary distribution and fulfillment relationships, including: Publisher Resources Inc. (PRI, a wholly owned subsidiary of Ingram Industries) (domestic), Penguin Books, LTD (Europe, Asia, and Australia), Canada Publishing Corporation (Canada), and German language books sold through Systema Verlag GmbH (Germany). IFG-Europe and IFG-ROW channel revenues include English language titles sold by MS subsidiaries in Europe and ROW, respectively.

### Q92-2

Press channel revenues fell short of plan due to the reduced shipments of Running MS-DOS 5th Edition, late entry of Learn CAD Now, and the slip in publication dates for Power Programming with MASM and Windows 3.1 Companion. Strong shipments of Programming Windows 2nd Edition and Programmer's PC Sourcebook helped to mitigate the overall revenue shortfall.

### Quarterly Growth

IFG-Europe revenues increased significantly from Q92-1 based on large shipments of MS-DOS and Windows programming reference products. Press channel revenues declined due to sharply reduced shipments of MS-DOS 5th Edition, Learn CAD Now, Windows Programmer's Reference and MS-Guide to Managing Memory. Higher Adjustments reflected increased inter business unit royalty revenues.

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171

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Books

	FY92 YTD	FY92 YTD Plan	Variance
Press	\$ 9,051	\$ 9,048	\$ 3
IFG-ROW	144	-	144
IFG-Europe	100	-	100
Adjustments	160	-	160
Net revenues	<u>\$ 9,455</u>	<u>\$ 9,048</u>	<u>\$ 407</u>

Individual titles varied considerably from plan, but overall Press revenues mirrored plan. Unbudgeted revenues from the sale of English language versions of Press titles by MS subsidiaries contributed to the above plan results. Press channel revenues include \$48,000 from Systhema Verlag GmbH, pursuant to a manufacturer's representation agreement between MS-Germany and Systhema. As of December 31, 1991, start-up costs and initial marketing expenses totaling \$672,000 have been capitalized on the balance sheet of MS-Germany.

Product Family Revenues (in thousands)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
Programming	\$ 1,515	34%	\$ 1,400	28%	\$ 1,702	34%	\$ 115	\$ (187)
Systems	1,115	25	1,787	35	1,554	31	(672)	(439)
Applications	1,108	25	1,179	23	1,246	25	(71)	(138)
Other	673	16	706	14	541	10	(33)	132
	<u>\$ 4,411</u>	<u>100%</u>	<u>\$ 5,072</u>	<u>100%</u>	<u>\$ 5,043</u>	<u>100%</u>	<u>\$ (661)</u>	<u>\$ (632)</u>

Q92-2

Strong demand for MS-DOS and Windows Programming titles, release of Visual Basic Workshop, and non-recurring sales boosted Programming revenues past plan. Disappointing sales of Learn CAD Now and the delay in publication of Power Programming with MASM and Guide to Designing the User Interface partially offset these above plan contributions.

Revenues from Systems titles were 38% below plan, primarily due to the rapid decrease in shipments of Running MS-DOS 5th Edition. Strong demand for the best-selling Windows 3 Companion partially offset these unfavorable results. Applications revenues were slightly below plan due to weak sales of Learn CAD Now and slippage of Word for Windows Companion (second edition).

Quarterly Growth

Revenues from Programming titles declined from Q92-1 due to reduced shipments of Windows Programmer's Reference and MS-DOS Programmer's Reference. The dramatic decrease in shipments of MS-DOS 5th Edition resulted in a sharp decline in Systems revenues. Applications revenues suffered as a result of the weakness in sales of Learn CAD Now.

	FY92YTD		FY92YTD Plan		Variance
Programming	\$ 3,217	34%	\$ 2,418	27%	\$ 799
Systems	2,669	28	3,122	35	(453)
Applications	2,354	25	2,266	25	88
Other	1,215	13	1,242	13	(27)
	<u>\$ 9,455</u>	<u>100%</u>	<u>\$ 9,048</u>	<u>100%</u>	<u>\$ 407</u>

Revenues from Programming titles exceeded plan by 33% due to the strength in demand for Programming Windows 2nd Edition and other titles on Windows programming tools. Systems revenues trailed plan by 14%

## Books

pursuant to the decline in shipments of Running MS-DOS 5th Edition. This was partially offset by continued strength in demand for Windows 3 Companion and Running Windows 2nd Edition. Applications titles were 4% ahead of plan due to positive variances from Running MS Excel 2nd Edition (64%), PC Excel 3 Workbook (190%) and Word for Windows Companion (293%), partially offset by the negative variance on Learn CAD Now (45%).

### Significant Customers (In thousands)

	Q92-2		Q92-1		Q91-4		Q91-3		Q91-2	
Publisher Resources, Inc.	\$ 2,609	59%	\$ 3,421	68%	\$ 4,587	75%	\$ 1,872	62%	\$ 2,099	62%
Penguin Books, Ltd.	754	17	867	17	670	11	571	19	743	22
Canada Publishing Corp.	273	6	230	5	394	7	93	3	-	-
Other	775	18	525	10	434	7	490	16	521	16
Total	\$ 4,411	100%	\$ 5,043	100%	\$ 6,085	100%	\$ 3,026	100%	\$ 3,363	100%

PRI revenues declined 24% and 25% from Q92-1 and Q91-4, respectively, due to the build-up of channel inventories, particularly of Running MS-DOS 5th Edition. In addition, Q92-2 revenues were reduced by heavy returns of the out of print titles Running MS-DOS 4th Edition and Quatro Pro Companion. Penguin revenues declined slightly during Q92-2 as a result of the difference in timing between the domestic and European distribution of new titles. Canada Publishing revenues increased slightly during Q92-2 due to the introduction of new titles to this channel.

### Cost of Revenues

#### Q92-2

Cost of revenues exceeded plan due to a \$635,000 unplanned provision for obsolescence. Excluding the provision for obsolescence, cost of revenues, as a percent of net revenues was 1.3% lower than plan. Freight, shipping, and handling costs, as a percentage of net revenues, were above plan due to higher international revenues, which have a higher distribution fee, and due to handling costs incurred to dispose of obsolete inventory. Freight costs exceeded plan by 70% due to charges incurred to gain early entry to international markets, and the cost associated with removing obsolete books from inventory. Royalties were below plan due a shift in the sales mix to international products which carry a lower royalty rate than domestic revenues.

#### YTD

Cost of revenues exceeded plan due to a \$655,000 unplanned provision for obsolescence (\$635,000 in Q92-2 and \$20,000 in Q92-1). Excluding the provision for obsolescence, cost of revenues, as a percent of net revenues was 47.4% compared to plan of 48.3%. Costs in excess of plan for freight and handling were more than offset by a favorable variance in royalties. The variance in royalties was due to higher than planned international sales, which bear a lower royalty rate than domestic sales.

### Operating Expenses (in thousands)

	Q92-2	Q92-2 Plan	Variance
Professional Fees	\$ 58	\$ 218	\$ 160
Marketing	387	265	(122)
Bad Debt	53	18	(35)
Other	1,999	1,608	9
	\$ 2,097	\$ 2,109	\$ 12

Professional Fees were lower than plan due to delays in the start-up of Systhema operations and the capitalization of certain related costs by MS-Germany. Marketing expense surpassed plan by 46% due to aggressive funding of cooperative advertising campaigns with major bookstore chains. Bad Debt exceeded plan due to deterioration in the accounts receivable aging of certain foreign publishers and other small in-house accounts.

**Books**

	<u>FY92 YTD</u>	<u>FY92 YTD Plan</u>	<u>Variance</u>
Professional Fees	\$ 153	\$ 308	\$ 155
Travel & Entertainment	124	192	68
Other	3,865	3,749	(116)
	<u>\$ 4,142</u>	<u>\$ 4,249</u>	<u>\$ 107</u>

Professional Fees were below plan due to delays in the start-up of Syschema operations at MS-Germany. The variance in T&E is the direct result of cost controls. The variance in Other consists principally of unfavorable corporate distributions (\$100,000) to the business unit.

Headcount	Actual	Plan	Variance	Change	As a Percent of Total	
					Operating	Prod Groups
December 31, 1991	64	65	1	(2)	1%	2%
September 30, 1991	66	65	(1)	1	1	2
June 30, 1991	65	67	2	-	1	2
March 31, 1991	65	67	2	2	1	2
December 31, 1990	63	67	4	2	1	2

**Allocations**

For Q92-2 and YTD, allocations were below plan in absolute dollars except for Legal.

**Burdened Operating Loss**

**Q92-2**

The burdened operating loss was higher than plan due to a \$661,000 revenue shortfall and the \$635,000 increase in the provision for obsolescence.

**Quarterly Growth**

The burdened operating loss exceeded that of the prior quarter due to a 13% drop in revenues and the unplanned provision for obsolescence.

**YTD**

The burdened operating loss exceeded plan by \$199,000, primarily due to the unplanned provision for obsolescence. Excluding this expense, the burdened operating loss would have been favorable to plan by 77%.

## INTERNATIONAL R&D

International product development groups localize a variety of Microsoft products into a total of approximately 29 languages. The localization process includes converting the software into the foreign language, as well as the accompanying help functions, computer-based training and documentation. In some instances, the product must also be re-engineered so that it is compatible with varying hardware configurations in these countries.

The primary International R&D group is IPG, based in Redmond and Ireland. IPG localizes products for most of the world, including Western and Eastern Europe, Africa, the Moslem republics, Latin America and Canada. BiDi is responsible for bi-directional (Middle Eastern) products. The Japanese, Korean and Taiwanese product development groups localize products for their respective countries.

### Q92-2

IPG shipped 29 products in the quarter. Among these were Win Publisher 1.0, Entertainment Pack 2.0, Win QC 1.0, PM Excel 3.0, and Mouse 8.0. Italian, Swedish, and Spanish versions of Mac Excel 3.0 were also shipped. French and German versions of Win Word 2.0 are expected to ship in January. IPG Ireland shipped Alphabet+ for Eastern European/Cyrillic languages. This was the first MS product to ship that was entirely IPG developed. There are currently 175 projects in progress in IPG.

### YTD

Products shipped year-to date totaled 55. Major product releases included the release of French and German Win Works simultaneously with the US release, and the release of many versions of the MS-DOS 5 upgrade. Major products released by International R&D in Japan include Win Word J 1.2 and Win Excel 3.1.

### Localization Costs (in millions)

	Q92-2		Q92-2 Plan		Q92-1		Variance	Change
IPG	\$ 14.6	63.5%	\$ 19.1	70.3%	\$ 12.9	67.9%	\$ 4.5	\$ 1.7
Japan	6.0	26.1	6.1	22.7	4.6	24.2	0.1	1.4
BiDi	1.9	8.2	1.1	4.1	1.0	5.3	(0.8)	0.9
Korea	0.3	1.2	0.4	1.4	0.3	1.6	0.1	-
Taiwan	0.2	1.0	0.4	1.5	0.2	1.0	0.2	-
	<u>\$ 23.0</u>	<u>100.0%</u>	<u>\$ 27.1</u>	<u>100.0%</u>	<u>\$ 19.0</u>	<u>100.0%</u>	<u>\$ 4.1</u>	<u>\$ 4.0</u>

	FY92 YTD		FY92 YTD Plan		Variance
IPG	\$ 27.5	65.4%	\$ 35.4	68.9%	\$ 7.9
Japan	10.6	25.2	11.8	23.0	1.2
BiDi	2.9	7.0	2.6	5.1	(0.3)
Korea	0.6	1.3	0.7	1.4	0.1
Taiwan	0.4	1.1	0.8	1.6	0.4
	<u>\$ 42.0</u>	<u>100.0%</u>	<u>\$ 51.3</u>	<u>100.0%</u>	<u>\$ 9.3</u>

Localization expenses are significantly below plan due to lower than planned headcount, which has resulted from recruiting difficulties and slippage in timing of product availability versus budget. The unfavorable variance in the BiDi group is due to legal fees incurred as a result of the Al Alamiyah lawsuit.

### Headcount

Headcount figures are given below for worldwide International R&D.

INTERNATIONAL R&D

	<u>Actual</u>	<u>Plan</u>	<u>Variance</u>	<u>Change</u>	<u>As a Percent of Total</u>	
					<u>Operating</u>	<u>Prod Groups</u>
December 31, 1991	1,002	1,244	242	83	11%	29%
September 30, 1991	919	1,137	218	94	11	28
June 30, 1991	825	863	38	127	11	28
March 31, 1991	698	848	150	94	11	27
December 31, 1990	604	769	165	86	10	25



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*Finance*  
*Tax Matters*

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## TAX MATTERS

### DOMESTIC

#### IRS Examination

The examination of MS Corp and its foreign subsidiaries for FY 88-89 continues. This examination began March, 1991. To date, the IRS has proposed several adjustments. None of the adjustments are material. The agents are expected to finish the domestic tax field work by Q92-3.

As reported previously, the IRS has raised three industry issues: 1) whether stock option compensation constitutes wages eligible for the research and development credit; 2) transfer pricing in Ireland; and 3) whether our operations in Ireland constitute "manufacturing". The IRS is continuing its examination with principal focus in these areas. They have also expanded their scrutiny of our research and development credits. No adjustments have yet been proposed in these areas.

#### New Legislation

During Q92-2 legislation was enacted which extends the research and development credit scheduled to expire on December 31, 1991 for 6 months.

#### Proposed Legislation

Dan Rostenkowski, Chairman of the House Ways & Means Committee (HWMC), introduced a tax bill in mid 1991 which would require purchased software to be amortized over 14 years. Currently, the tax law allows an amortizable life of 5 years or less for these items. Frank Gaudette testified to the HWMC in early October, on behalf of the Software Publishers Association. The CFO, Treasurer and MS Tax continue to work with various trade associations (Software Publishers Association, American Electronics Association) to oppose the extended life for software.

#### Tax Rate

Taxes were provided at 31% for FY 91. Taxes are being provided at 32% for FY 92. The increase is due primarily to the size of the stock option "spread" (see below).

#### "Spread" From Stock Plans

The "spread" from stock option exercises is deductible and reduces both federal and state taxes. The amounts of the spread and approximate tax benefits are (in millions):

	FY92		FY91	
	Spread	Tax Benefit	Spread	Tax Benefit
Q1	\$ 101.4	\$ 34.5	\$ 21.9	\$ 7.4
Q2	126.4	43.0	116.2	39.5
Q3	0.0	0.0	90.3	30.7
Q4	0.0	0.0	73.3	24.9
Total	\$ 227.8	\$ 77.5	\$ 301.7	\$ 102.5

#### B&O Litigation

MS is suing the State of Washington for a refund of B&O taxes. During Q92-2, MS filed interrogatories and requests for production of documents. The State responded in late Q92-2. During Q92-3 we will request additional information from the State and continue preparation to ask for a summary judgment ruling in the case.

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Tax Matters

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## TAX MATTERS

### State Tax Exams

MS was questioned or audited by a number of states during Q92-2 about state tax matters. No material adjustments are anticipated at this time.

State	Tax	Years Under Audit	Status
PA	Sales	88-91	Ongoing
NY	Sales	88-91	Ongoing
FL	Sales	86-91	Begins 1/92
TX	Sales	88-91	Begins 1/92
MO	Sales	89-92	Begins 4/92
OH	Income	87-88	Appeal filed
FL	Income	86-90	Ongoing
GA	Income	88-90	Appeal filed
NY	Income	88-90	Ongoing
NC	Income	87-89	Ongoing
NJ	Income	86-89	Ongoing
MO	Income	89-91	Begins 4/92
IL	Income	89-90	Begins 5/92
NYC	Income	88-91	Begins 6/92
CN	Income	88-90	Begins 8/92
MD	Income	88-91	Begins 9/92
VA	Income	89-91	Begins 8/92
TX	Franchise	TBD	Not scheduled

## INTERNATIONAL

### Tax Audits

Audits of MS International BV and MS Manufacturing BV by Dutch tax inspectors continue in process. No material issues have been raised to date and no material adjustments are anticipated.

### Subsidiary Operations

Tax planning and compliance continued during the quarter. Issues included:

- Australia: Potential withholding tax on retail packaged product;
- Canada: Initial MS WorkGroup Canada tax return filed;
- Germany: Review of tax issues relating to potential acquisition of real estate;
- Hong Kong: Review of tax issues associated with posting of MS Legal personnel to handle piracy issues;
- Ireland: Ruling request filed with Irish Revenue regarding the use of subcontractors;  
Review of tax issues related to new facilities required for IPG group;
- Italy: Status of software for VAT and withholding tax purposes in light of new ruling aimed at the educational market;
- Holland: Potential use of European real estate holding company in light of new facility needs in Germany, France and U.K.;
- Spain: Capital contribution and cash flow issues.

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*Finance*  
***Corporate Risk Management and Audit***

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## **CORPORATE RISK MANAGEMENT AND AUDIT**

### **Insurance**

#### **Self Insurance - Washington State Workers' Compensation**

On December 2, 1991, Microsoft received approval from the State of Washington to self insure (self fund) workers' compensation. Final certification was granted after passing work place safety inspections following establishment of an enhanced safety program. Net savings should exceed \$20,000 per month. EPIC Insurance Services, Inc. was retained to administer claims and pay benefits under the program. To limit financial exposure, excess insurance was obtained limiting Microsoft's per claim obligation to \$200,000 and total annual aggregate benefit obligation to \$500,000.

In addition to the net estimated savings of \$275,000 for the first year, additional benefits of self insurance are improved and more personalized delivery of statutory employee benefits and enhanced visibility and management of work place safety.

### **Corporate Audit**

#### **Audits**

An audit of employee terminations resulted in suggestions for improvements in Human Resources, Recruiting and Payroll.

An audit of industrial insurance premiums resulted in suggestions for improvement of procedures and claims for recovery of \$70,000 in back premium overpayments.

At Frank Gaudette's request, Corporate Audit performed limited procedures on accounts receivable and other accounting problems at Spain. The subsidiary had serious credit problems and is suing its major distributors. An additional provision of \$800 thousand for uncollectible accounts was recorded in December. The controller has resigned and the general manager is being terminated. Brian Reynolds, general manager of Ireland, will serve as temporary general manager. Paul Lovell from International Finance is serving as temporary controller.

#### **Apple**

Support of Microsoft Legal in assembly of financial information for Apple lawsuit interrogatories and consultation on financial aspects of our defense was provided during the period.

#### **Software Piracy**

Meetings were conducted with three Big 6 accounting firms to encourage them to pursue piracy as part of their audit and consulting services. Specific anti-piracy activity is now under way by all three firms, both locally and nationally. Our anti-piracy program is being introduced to the Institute of Internal Auditors at their March 4 meeting.

#### **Manager of Corporate Audit**

A Manager of Corporate Audit was recruited and started January 9.

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*Corporate Risk Management and Audit*

183

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*Administration*  
***Manufacturing***

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## MANUFACTURING

### Throughput

#### Campus North Component Pieces (in thousands)

	Q92-2		Q92-1	
	Total CP	CP/Build Day	Total CP	CP/Build Day
In-house	75,448	1,237	75,182	1,193
Off site	2,094	34	1,858	29
	<u>77,542</u>	<u>1,271</u>	<u>77,040</u>	<u>1,222</u>

The number of component pieces produced daily increased 4% from Q92-1. The increase was due to the buildup of channel inventories for the holiday season and the release of Win Word 2.0. Production efficiency continued to improve through increased control and management of temporary employees.

Microsoft Ireland, which provides the majority of the package products sold by our European subsidiaries, measures production in terms of the gross number of packages built. Dublin produced 1.5 million units, a 10% increase over Q92-1 production of 1.4 million units.

### Backlog

Domestic manufacturing plans production based on Product Marketing's forecast of demand and rate based demand received directly from customers. Buildable backlogs occur when customer demand exceeds forecast or when the plant fails to build to forecasted demand. Non-buildable backlog occurs when orders have been placed for products that have not yet been released to manufacturing.

Domestic backlog of \$13 million, a 76% increase over Q92-1, was comprised entirely of buildable backlog. Significant products were Windows Office (\$5 million), Win Word (\$3 million), Mac Office (\$2 million), and Mac Word (\$2 million). The Windows Office and Win Word backlog was due to several months of underforecasted demand. The Mac Office backlog was due to the release of version 2.0. The backlog for this product has since been cleared. The Mac Word backlog was due to a last minute packaging change.

### MS Ireland

	Dec 31, 1991	Sept 30, 1991
Buildable backlog	17,000	8,000
Non-buildable backlog	<u>51,000</u>	<u>35,000</u>
	<u>68,000</u>	<u>43,000</u>

Irish manufacturing demand is created by firm orders from the European subsidiaries. The backlog definition is consistent with that used domestically, however, since transactions are valued at transfer price, backlog is tracked in units rather than dollars. Ireland's backlog was primarily due to new products for which software had not been released.

### International

The Redmond International Focused Factory, which became operational in Q91-4, continues to reduce response times to customer demands by improving the forecasting process. IFF's work with raw material suppliers has improved supplier responsiveness and the suppliers have begun to deliver smaller, more frequent lots. The smaller, frequent deliveries facilitate a smooth flow of product through the entire manufacturing process.

Ireland is now providing full warehousing and shipping service to MS UK's customers. As a result, MS UK no longer has a warehouse. Ireland has reorganized into four customer-focused factories (UK, Germany, France and Rest of Europe) to become more responsive to customer-specific needs. In a movement towards JIT, all Ireland's product specific raw material requirements are being delivered, built and shipped in the same day.

Manufacturing

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187

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During Q92-2, Puerto Rico duplicated 10 million disks, a 20% increase over Q92-1. This represented 55% of Campus North's total duplication requirement. The integration of Puerto Rico into the domestic manufacturing cycle has improved to the point where the geographical distance has little impact on the total process time.

**Headcount**

	<u>Actual</u>	<u>Plan</u>	<u>Q92-1</u>	<u>Variance</u>	<u>Change</u>
Campus North	430	491	426	61	4
IFF	118	104	105	(14)	15
Puerto Rico	81	90	62	9	19
Ireland	341	334	286	(7)	55
	<u>970</u>	<u>1019</u>	<u>877</u>	<u>49</u>	<u>93</u>

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*Administration  
Facilities*

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## FACILITIES

### Worldwide Facility Distribution

Location	December 31, 1991		June 30, 1991
	Square Feet	% of Total	Square Feet
Corporate Campus	1,300,000	36%	1,000,000
Other Domestic	1,197,000	33%	958,000
International	1,110,000	31%	906,000
Total	<u>3,607,000</u>	<u>100%</u>	<u>2,864,000</u>

At December 31, 1991, Microsoft occupied 3,607,000 square feet of office and manufacturing and distribution (M&D) space worldwide. This total was an increase of 15% and 26% over September 30, 1991 and June 30, 1991, respectively.

### Ownership Trends

Location	December 31, 1991		June 30, 1991	
	Own	Lease	Own	Lease
US	63%	37%	54%	46%
International	15%	85%	11%	89%
Total	<u>48%</u>	<u>52%</u>	<u>41%</u>	<u>59%</u>

The table above depicts the recent trend towards ownership of property in key strategic locations. The portion of total property occupied that is owned has increased from 41% to 48% (measured in square footage) from June to December. This increase was primarily due to the completion of Building 16 on the Corporate Campus. Another factor was the completion of Microsoft Place in Reading (England). This trend towards ownership will continue in the near term as Building 17 and 18 are occupied, and as new office facilities in France and Germany are acquired.

### Property Type Trends

Location	December 31, 1991		June 30, 1991	
	Office	M&D	Office	M&D
US	89%	11%	87%	13%
International	75%	25%	69%	31%
Total	<u>85%</u>	<u>15%</u>	<u>81%</u>	<u>19%</u>

The type of property which Microsoft occupies has shifted increasingly towards office space, and away from M&D space. At June 30, 1991, 81% of the worldwide space occupied by Microsoft was office space; this percentage increased to 85% by December. This shift was caused both by the addition of office space in Building 16, Dallas and Charlotte PSS sites, and Dublin (Ireland) and by the elimination of the warehouse space in Reading (England). This trend of reducing warehouse space should continue in the near term, although additional manufacturing and distribution space will be added in Ireland with the pending expansion of production capacity there.

## FACILITIES

### DOMESTIC FACILITIES

#### Domestic Facility Distribution

Location	December 31, 1991		June 30, 1991
	Square Feet	% of Total	Square Feet
Corporate Campus	1,300,000	52%	1,000,000
Domestic Field	515,000	21%	344,000
Washington State	418,000	17%	350,000
M&D	264,000	11%	264,000
Total	<u>2,497,000</u>	<u>100%</u>	<u>1,958,000</u>

Microsoft occupied over 2,500,000 million square feet of building space in the United States by December 31, 1991. This was this is an increase of 15% (317,624 square feet) over Q92-1. By the end of fiscal 1992, Microsoft will occupy nearly 3,000,000 million square feet nationwide, a 58% increase in square footage over fiscal 1991. This growth was due to the completion and occupancy of Buildings 16, 17 and 18, increases in the SMSD, MCS, and MSU field locations, the expansion of PSS sites in Charlotte, Dallas and Bellevue, and additional leased space in the Bellevue/Redmond area.

#### Corporate Campus Development

Corporate Campus comprises 1,300,000 square feet of office space, an increase of 154,000 square feet (13%) during the quarter. The increase was due to the occupancy of Building 16. By FYE92, Buildings 17 and 18 will have been occupied, and Corporate Campus will have 1,700,000 square feet of office space.

#### LID/Road Work

Five activities are currently underway pertaining to future Corporate Campus organization. First, final assessments for street and utility improvements for LID 88-ST-51 (Bel-Red Road) are underway.

Second, the proposed elimination of the east-west connector between Bel-Red Road and 156th Avenue (F-line) to the southern edge of Corporate Campus is currently under debate by both the City of Bellevue and the City of Redmond.

Third, a revised appraisal for Microsoft's petition to purchase the existing public streets within Corporate Campus has been submitted.

Fourth, a preliminary proposal has been submitted to the Department of Transportation, which is receptive to placing the proposed Northeast 31st Street Overpass at Northeast 40th Street instead. A formal proposal will be submitted to the Department of Transportation in Q92-3.

Fifth, a proposal has been submitted regarding the proposed annexation of the Phase 7 property, at the south end of Corporate Campus, to Redmond.

#### Land and Building Acquisitions

During Q92-2, Buildings 1-4 were purchased from Teachers Insurance Annuity Association for \$47 million. The two land acquisitions expected to close during the coming quarter are the Simpson Timber 9.2 acre parcel for \$6.2 million (\$673 thousand per acre), and the Faust/Marshall 1.0 acre parcel Q92-3 for \$314 thousand. These land purchases will increase domestic ownership to 288 acres, including Canyon Park.

#### Washington State

In addition to Corporate Campus, Microsoft occupies 682,000 square feet in Washington State, of which 280,000 square feet (41%) is owned. Projections indicate that an additional 71,000 square feet of space will be occupied in

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**FACILITIES**

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Washington. The occupancy of new space in Bellevue by PSS and MSU will be the primary reasons for this increase.

**Domestic Field Locations**

Domestic Field (non-Washington State) office space increased 34% during the past quarter to 515,000 square feet, all of which is leased. During the next two quarters, 121,000 square feet of additional Domestic Field square footage will come on line.

Major activity during Q92-2 included expansions of the New York, Philadelphia and Washington, D.C., field offices, the relocation of the SMSD, MCS and MSU in Boston, and the opening of a new MSU site in Los Angeles in conjunction with the relocation of the SMSD and MCS offices. PSS operations in Charlotte and Dallas were started during Q92-2. Future additions of 60,000 and 42,000 square feet to the Charlotte and Dallas sites, respectively, are planned.

## FACILITIES

### INTERNATIONAL FACILITIES

#### International Facility Distribution

Location	December 31, 1991		June 30, 1991, 199
	Square Feet	% of Total	Square Feet
Europe	603,000	54%	457,000
ROW	299,000	27%	291,000
Other	208,000	19%	158,000
	<u>1,110,000</u>	<u>100%</u>	<u>906,000</u>

Note: "Other" includes Ireland, Puerto Rico and development offices in the United Kingdom and Israel.

During the past quarter, space occupied outside the United States increased 8%, from a total of 1,029,000 square feet to 1,110,000 square feet. Growth occurred most rapidly in European office space. Other increases have been in ROW and IPG (Ireland) office space. The table above depicts the current allocation of international space and growth during the past two quarters.

During Q92-2, expanded offices were occupied in Reading, Zurich, Oslo, Canberra, and Dublin. A new development office was established in Eastleigh. Commitments for future space were executed during the quarter for Tokyo, Copenhagen, Amsterdam and Melbourne.

In Q92-3, it is expected that additional commitments will be made for office space in Paris, Munich, Brussels, Hong Kong, Seoul and Vancouver. Before the end of FY93, new offices are planned for Athens, Dubai, and in cities in Malaysia, Chile and Colombia.

Ownership of property in Europe continued to increase. The new offices in England are owned by Microsoft, as will be the proposed office expansion for the subsidiary in France. Microsoft is currently evaluating land acquisition opportunities in Munich for a possible long-term office development there.

#### Europe

In the Northern Region, England occupied their new office building in December, 1991. The transition to the new building is notable for the simultaneous elimination of a warehouse in England due to direct shipments from M&D (Ireland). In the Nordic countries, a new sales office in Oslo was occupied during the quarter and a lease was signed for an expanded office in Copenhagen. The new warehouse facility in Sweden should be occupied during Q92-3.

In the Central Region, Switzerland occupied new offices comprising 20,000 square feet in Zurich during the past quarter. Germany will lease additional office space in Munich during Q92-3 to accommodate growth. Evaluation of land purchase opportunities in Munich continues. A purchase of land could take place during calendar year 1992.

Activity in the Southern Region included the execution of a lease for a new office facility for the Netherlands. The new building of approximately 55,000 square feet will be completed near the end of FY93. France is expected to commit to the development of Phase 2 of their office facility; Phase 2 will add approximately 100,000 square feet to the existing 110,000 square feet in Les Ulis at a cost of approximately \$18 million. Approval for additional office space for Belgium was obtained in Q92-2; the space should be occupied during Q92-3. Spain may require additional space in Barcelona during the coming quarter, and additional space in Madrid before the end of FY92.

#### ROW

In the Far East Region, Japan entered into a pre-lease agreement for 85,000 square feet of office space in Tokyo. The new facility will be occupied during Q93-3, and will allow the subsidiary to consolidate the existing two offices. While rental rates in Tokyo are very high by international standards, lease terms are very favorable to tenants. Korea will double the size of its current office to 22,000 square feet during Q92-3 by expanding into an adjacent floor. This should provide sufficient space for two years of growth in Seoul. A new office has been

## FACILITIES

established in Hong Kong, and because of the rapid growth of that office, a move to a new office will take place before the end of FY92.

Developments in ICON include the renegotiation of the lease for the Canada headquarters in Toronto to accommodate future growth. Poor real estate market conditions in Toronto should, as in other cities around the world, work in Microsoft's favor. The sales office in Vancouver will be moved before the end of FY92, and will be in the same building as the new Work Group Canada offices. Also in ICON, Australia occupied new offices in Canberra during the past quarter, and will move into new space in Melbourne during Q92-3.

In Latin America during Q92-2, Venezuela doubled the size of their office during Q92-3 to 3,500 square feet. As mentioned, new offices are expected to be established in Columbia and Chile prior to the end of FY92.

### **Other**

In Ireland, IPG occupied an additional 57,000 square feet of office space during Q92-2. The leases for this space are short-term, and intended to provide IPG with room for growth until a long-term space solution is achieved. Currently, we are evaluating whether to lease or invest in additional real estate for IPG.

During Q92-3, M&D is expected to commit to an expansion of the manufacturing facility in Dublin, adding 80,000 square feet to the existing 70,000 square feet. The expansion will accommodate the increasing demands on M&D by the European subsidiaries; the current facility is operating in excess of the originally planned capacity.

The development office in Eastleigh, England was successfully opened. Finance and administration support for the office comes from England.

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*Administration*  
***Investor Relations / Stock Activity***

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## INVESTOR RELATIONS / STOCK ACTIVITY

### Q92-2 Earnings Release

On Friday, January 17, 1992, financial results for the second quarter were released.

#### Selected Earnings Estimates

Analyst	Q92-1	Q92-2	Q92-3	Q92-4	FY92
Alex Brown	0.72	0.86	0.91	0.96	3.52
CI Lawrence	0.73	0.87	0.91	1.02	3.58
Cowen & Co.	0.73	0.98	0.93	1.09	3.70
Dean Witter	0.76	0.91	0.94	1.01	3.60
DLJ Securities	0.72	0.87	0.90	0.93	3.50
Goldman Sachs	0.73	0.87	0.90	0.96	3.50
Kidder Peabody	0.74	0.88	0.93	1.05	3.65
Merrill Lynch	0.70	0.87	0.84	0.95	3.44
Montgomery	0.73	0.87	0.90	0.95	3.50
Piper Jaffray	0.73	0.85	0.90	0.98	3.53
Shearson Lehman	0.71	0.88	0.90	1.00	3.55
Smith Barney	0.76	0.90-0.95	0.92	1.03	3.60

Q92-3, Q92-4 and FY92 estimates as of January 20, 1992.

Net income per share was \$0.75 for Q91-1 and \$0.90 for Q92-2.

#### Stock Options/Cashless Exercises

Q92-2 saw a 37% increase in stock option exercise activity (1,340 optionees) over the same period of fiscal 1991. Contributing to the increase was the 24 point increase in the stock price during the quarter. Alex. Brown & Sons facilitated trades for over 92% of the Q92-2 optionees as part of Microsoft's cashless stock option exercise program.

#### Summary of Shares Exercised (adjusted for 3-for-2 stock split)

	Q91-2	Q91-4	Q91-4	Q92-1	Q92-2
Shares exercised	2,646,181	2,291,302	1,488,896	1,818,849	1,745,788
Number of optionees	977	1,606	964	1,640	1,340
Price: High	50.50	74.37	75.83	90.00	111.25
Low	36.37	49.00	65.12	61.75	87.00

#### Shares Outstanding

	Number of Shares	Percent
Officer, directors and 10% shareholders		
William H. Gates	56,700,930	32%
Paul Allen	25,197,500	14
Steve Ballmer	9,987,762	6
	91,886,192	52
Other officers and directors	1,919,773	1
Total officers and directors	93,805,965	53
Other holders (float)	84,112,142	47
Total shares outstanding	177,918,107	100%

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199

Investor Relations / Stock Activity

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**INVESTOR RELATIONS / STOCK ACTIVITY**

**Fifteen Largest Institutional Holdings (in thousands)**

Name	September 30, 1991		June 30, 1991		Change
	Shares Held	Percent Outstanding	Shares Held	Percent Outstanding	
Fidelity Mgmt	3,386	1.90%	2,226	1.28%	1,660
Investors Research	3,058	1.72	2,303	1.31	755
Alliance Capital	2,792	1.57	3,808	2.19	(1,015)
Provident Invnt Counsel	2,138	1.20	1,963	1.13	176
Wells Fargo	1,951	1.10	1,975	1.13	(24)
State Street Reas & Mgmt	1,930	1.08	1,142	0.66	788
Jennison Assoc. Capital	1,873	1.05	1,717	0.99	156
Kemper Financial Ser.	1,872	1.05	1,161	0.67	711
Thomson Advisory	1,853	1.04	1,685	0.96	167
Mellon Bank	1,168	0.66	1,131	0.65	36
Bankers Trust NY Corp.	1,103	0.62	1,207	0.69	(104)
Lynch & Mayer	1,091	0.61	1,278	0.73	(187)
IDS Financial Corp.	1,011	0.57	845	0.48	166
Hellman Jordan Mgmt	990	0.56	1,077	0.62	(87)
Miller Anderson & Sherrerd	989	0.56	49	0.03	940
	<u>27,205</u>	<u>15.29%</u>	<u>23,567</u>	<u>13.52%</u>	<u>4,138</u>

Two hundred sixty three institutional investors held 55.2 million shares (68% of the "Other holders" category) at September 30, 1991.

**Market Capitalization**

The top twenty-five companies in the United States ranked by market capitalization as of Monday, January 20, 1992 (MSFT at \$122.50 per share) were:

Firm	Market Capitalization (in billions)
Exxon	\$72.9
Philip Morris	62.7
Merck & Co.	56.6
General Electric	56.3
Wal-Mart Stores	56.0
International Business Machines	52.9
American Telephone & Telegraph	47.5
Coca Cola Co.	46.1
Bristol-Myers Squibb	40.9
British Telecommun	38.5
Johnson & Johnson	32.1
DuPont	29.7
British Petroleum	28.9
GTE	27.6
Procter & Gamble	27.3
Mobil	25.8
Abbott Labs	24.5
PepsiCo	23.7
Amoco Corp.	23.5
American Home Products	23.4
Chevron Corp.	23.3
Bellaouth Corp.	22.7
Pfizer, Inc.	21.9
Microsoft Corp.	21.7
Eli Lilly & Co.	21.4

**Employee Stock Purchase Plan**

The second period of the 1991 Employee Stock Purchase Plan concluded on December 31, 1991. The purchase price for the period ended December 31, 1991 was \$60.67, based on the market value of \$71.38 on July 1, 1991. The six month rate of return was 83% based on the price on the last trading day of the period (\$111.25 on December 31, 1991).

**INVESTOR RELATIONS / STOCK ACTIVITY**

A total of 4,593 domestic employees participated and 133,138 shares were issued the second week of January.  
 A total of 5,921 employees are enrolled in the next period (a 29% increase from the period ending December 31, 1991). Only 27 employees participating in the plan at December 31, 1991 withdrew from the next period.  
 The opening price for the current ESPP period ending June 30, 1992 was \$114.00.

**Summary of Stock Option Activity as of December 31, 1991**

Shares Available for Grant

Period	Beginning of Period	Additions		Reductions	End of Period
		New Approvals	Forfeited Shares	Net Shares Granted	
FY82	0	18,120,000	0	(5,142,000)	12,978,000
FY83	12,978,000	0	624,300	(5,576,400)	8,025,900
FY84	8,025,900	0	2,347,206	(4,548,690)	5,824,416
FY85	5,824,416	0	1,407,258	(3,940,290)	3,291,384
FY86	3,291,384	8,400,000	1,249,467	(7,407,474)	5,533,377
FY87	5,533,377	12,000,000	1,176,813	(7,218,600)	11,491,590
FY88	11,491,590	0	1,432,356	(11,663,160)	1,260,786
FY89	1,260,786	15,000,000	1,762,769	(15,156,990)	2,866,565
FY90	2,866,565	18,750,000	1,464,813	(12,853,890)	10,227,488
FY91	10,227,488	7,500,000	1,364,086	(9,195,074)	9,896,500
Q92-1	9,896,500	0	229,351	(7,120,702)	3,005,149
Q92-2	3,005,149	20,000,000	112,439	(552,800)	22,564,788
Cumulative	0	99,770,000	13,170,858	(90,376,070)	22,564,788

Outstanding Stock Options

Period	Beginning of Period	Additions Net Shares Granted (1)	Reductions		End of Period
			Shares Exercised	Forfeited Shares	
FY82	0	5,142,000	0	0	5,142,000
FY83	5,142,000	5,576,400	(11,400)	(624,300)	10,082,700
FY84	10,082,700	4,548,690	(430,752)	(2,347,206)	11,853,432
FY85	11,853,432	3,940,290	(1,289,418)	(1,407,258)	13,097,046
FY86	13,097,046	7,407,474	(3,624,096)	(1,249,467)	15,630,957
FY87	15,630,957	7,218,600	(5,048,496)	(1,176,813)	16,624,248
FY88	16,624,248	11,663,160	(2,778,633)	(1,432,356)	24,076,419
FY89	24,076,419	15,156,990	(3,070,647)	(1,762,769)	34,399,993
FY90	34,399,993	12,853,890	(7,845,159)	(1,464,813)	37,943,911
FY91	37,943,911	9,195,074	(7,215,714)	(1,364,086)	38,559,185
Q92-1	38,559,185	7,120,702	(1,818,849)	(229,351)	43,631,687 (2)
Q92-2	43,631,687	552,800	(1,745,788)	(112,439)	42,326,260
Cumulative	0	90,376,070	(34,878,952)	(13,170,858)	42,326,260

Notes: (1) "Net Shares Granted" is equal to gross shares less ISOs converted to NQSOs.  
 (2) Restated from 43,424,098 for timing differences.

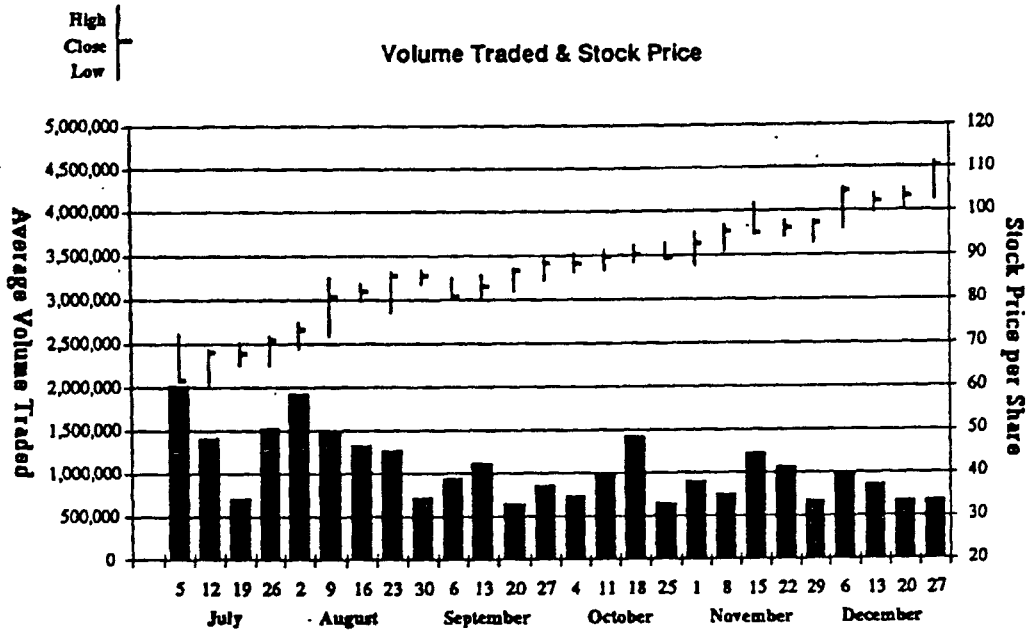
**INVESTOR RELATIONS / STOCK ACTIVITY**

**Summary of Q92-2 Stock Market Activity**

	Microsoft Prices	S & P 500	Nasdaq Industrial Index
Quarter High	112	418.31	669.37
Quarter Low	86 1/4	371.38	572.44
Quarter Close 12/31/91	111 1/4	417.09	668.95
Previous Qtr Close 9/30/91	89	387.88	590.19
% Change	20%	7%	12%

**Short Interest Reported:**

Total Trades	48,785	
Total Volume	57,759,657	2,280,102 shares as of 9/13/91
Total Block Trades	834	2,231,020 shares as of 12/13/91
Total Block Volume	12,989,168	49,082 Decrease



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***Human Resources***

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**HUMAN RESOURCES**

**Management & Employee Development Center**

The Management and Employee Development Center provides Manager Training and Development courses for domestic employees. Demand for these courses is increasing. Compared to Q91-2, we had a 128% increase in participants and a 96% increase in sessions.

**Management and Employee Development  
Courses Conducted during Q92-2**

Course Title	Number of Sessions	Number of Participants
<b>MANAGEMENT COURSES</b>		
Effective Management Skills	6	125
Interpersonal Review Skills	7	103
Effective Interviewing Skills	5	65
Time/Business Organization Workshop	2	36
Selling Your Ideas	3	41
Effective Business Writing	3	42
Conducting Effective Meetings	4	58
Microsoft Management Styles	2	38
Presentation Skills	4	47
Managing Interpersonal Relations	1	21
Team Leadership	1	6
<b>TECHNICAL LEADERSHIP PROGRAM</b>		
Software Quality Dynamics	1	9
Leading Technical Reviews	1	8
Managing Projects	3	52
Workshop - Modular I & II	1	19
Modular III	1	17
Modular IV	1	16
Modular V	3	34
<b>EMPLOYEE COURSES</b>		
Interpersonal Review Skills	8	136
Time/Business Organization Workshops	7	363
Selling Your Ideas	10	132
Effective Business Writing	7	128
Managing Interpersonal Relations	7	141
<b>TOTALS</b>	<u>88</u>	<u>1,637</u>

**Management and Employee Development  
Program Participation during Q92-1**

Department	No. of Participants	Participation Rate
SMSD	1,043	37 %
Applications	609	52
Systems	470	44
International	224	33
F&A	219	13
MS Press	103	54
LCA	11	21
	<u>2,679</u>	35

## **HUMAN RESOURCES**

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### **Software Learning Center**

The Software Learning Center conducts product training for domestic employees. Class requests totaled 1,684 during the quarter, and participants totaled 1,048. Finance and Administration had 38% of the department's employees attend, while SMSD had 21%, International 18%, Applications 9%, Systems had 7%, and Press/MM and LCA had 7% of their employees attend.

### **Employee Relations**

Our employee relations effort assists managers and employees resolve distractions from their work. Topics covered included performance problems, internal conflict, career counseling and personal issues.

During Q92-2, 28% of our activity was performance related, resulting in 18 performance improvement plans, 16 probationations and 38 terminations. The remaining percentages were: 32% for personal issues, 32% for career counseling, 4% for disability issues, and 4% for harassment. Forty-three exit interviews were conducted. The most common concern during exit interviews continued to be lack of management skills.

### **Affirmative Action**

Overall female and minority representation was stable this past quarter. The female population is 40% and the minority is 12%. We continue to need female representation at the senior manager and executive levels, minority representation in middle management, and both female and minority representation in technical and professional positions.

Key community outreach activities held this quarter included sponsorship and participation in the UNCF Seahawk Gala, MS volunteers teaching a "C" programming course at Rainier Beach Teaching Academy and Minority Student Day.

### **Employee Communications**

"Micronews," the weekly employee newsletter, is now averaging 24 pages in length and has a circulation of over 9,000 copies each week. This includes the field edition sent to all domestic field locations.

"Micronews North" is published for the Campus North staff every two weeks and "Micronews PSS" is published monthly for all PSS locations. "International Micronews," consisting of features which are not location specific, is assembled and sent out twice a month to all subsidiaries. "Micronews" also appears both on-line and on the BBSO.

The first round table meeting between Mike Hallman and mid-level managers was held during Q92-2. The purpose of the round table meeting was to create a forum to discuss ways to encourage creativity and effectiveness for Microsoft's employees, and to retain the Microsoft culture in an era of rapid growth.

### **Domestic Compensation**

New salary ranges for 1992 were approved and implemented. Division plans were updated for February review.

### **International Compensation and Benefits**

The William M. Mercer consulting firm was selected as the vendor for the Multinational Insurance Pooling project. A pooling and benefit analysis will be conducted to explore direct and indirect cost savings. The targeted completion date for the project is June, 1992.

### **HR Systems**

As of December 31, 1991, total headcount was 10,041 (7,175 domestic and 2,866 subsidiary), a net increase of 48% from one year ago.

Based on average headcount and the number of terminations for the last 12 months (not counting product localization associates, co-op and intern positions), the annual domestic turnover rate was 6%. The international subsidiary turnover rate was 9%.

**HUMAN RESOURCES**

The largest number of employees are between the ages of 20 and 29, accounting for 44% of the domestic work force. Forty-two percent are between 30 and 39 and 13% are 40 years of age or older. Less than 1% of the work force is younger than 20. The average age of a domestic employee is 31 years. The average length of service is 2.3 years for domestic employees and 1.7 years for subsidiary employees.

**Headcount by Location as of December 31, 1991**

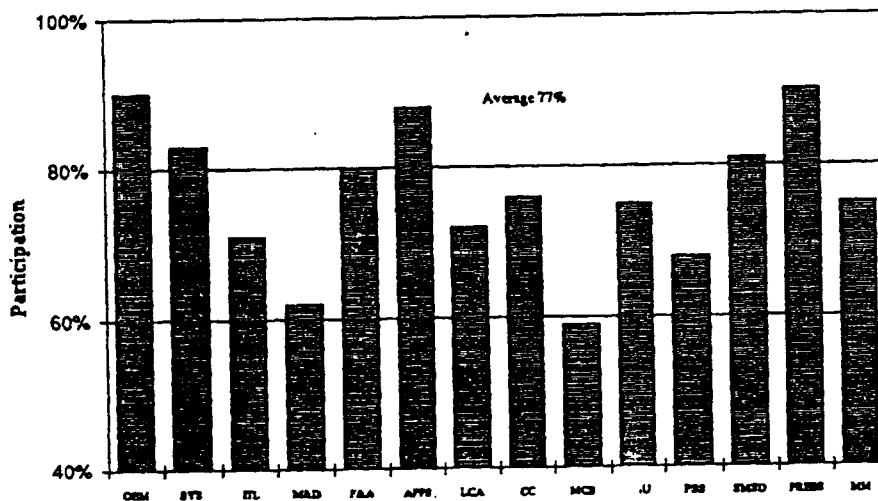
Location	Number of Employees
Corporate Campus	4,265
Subsidiaries	2,866
Field Sales & Development	1,163
PSS	1,071
Campus North	548
MSU	128
	<u>10,041</u>

Preparation of the February review cycle began in October with information briefings conducted in November for approximately 1,400 managers, supervisors and leads. Review related activity will continue at a high level until the February 1-15 pay cycle.

**Employee Benefits**

Savings Plus 401(k) participation closed this quarter at 77%, same as the previous quarter. Participation in this plan remains higher than the industry average of 70-72%. Manufacturing participation increased again for the third consecutive quarter and was up 1% to 62%.

**401(k) Savings Plus Plan Participation**



As shown below, the Microsoft Stock Fund is the largest holding in the 401(k) Savings Plus Plan.

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**HUMAN RESOURCES**

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**401(k) Savings Plus Plan Allocation**

	<u>December 31, 1991</u>
Savings Plus Investment Option	
Microsoft Stock Fund	\$ 38,000,401
Fidelity U.S. Equity Index Fund	11,970,013
Fidelity Retirement Money Market Fund	11,747,319
Fidelity Intermediate Bond Fund	7,908,232
Fidelity Magellan Fund	2,928,062
Fidelity Growth Company Fund	1,694,017
Fidelity Overseas Fund	673,384
	<u>\$ 74,921,428</u>



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*Administration*  
***Information Technology***

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