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Microsoft

OEM Division Market Intelligence Report

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December 2, 1991

Digital Research:

How they sell to OEMs.

This reports findings of interviews with directors, group managers and account managers from the OEM division. The information gathered is only complete enough to outline general conclusions and to identify possible implications for Microsoft. Please direct any comments, suggestions or questions to me. Your feedback is valued and appreciated.

Summary

DRI sells by tuning a sales pitch based on combinations of technology/features, compatibility, flexibility and price. They are not highly scientific about it but try a number of combinations until finding the best combination for an account. They are tenacious and go to extremes in order to close OEM licenses by rendering "commitment" meaningless, playing with payment terms and offering low prices.

DR-DOS 6.0 positioning emphasizes advanced technology and more features (data compression) than "the old version" (meaning MS-DOS 5.0). DR-DOS 6.0 is offered in ROM version for portables and embedded systems. Version 5.0 is also offered in disk media as a low-end OS that OEMs can ship into highly price-sensitive markets that are unconcerned with compatibility. Both versions carry OEM prices at a 50%-70% discount from the MS equivalent. DR-DOS 5.0 is sold at a 10%-20% discount from version 6.0 royalties except in 6.0 ROM that has been licensed at a 90% discount. It is fair to say that price is the major part of any pitch DRI makes for either product.

DRI is signing OEMs that ship products into developing markets, areas with thin MS coverage and into markets where MS quality/compatibility is not demanded (both by ignorance and lack of quality concern). They have also had some success selling DR-DOS on its technical merits (version 6.0 with disk compression and version 6.0 ROM with power management). They have good coverage of OEMs in South East Asia and South America. Other areas of penetration are PC motherboard and PC peripheral OEM business that MS avoids to prevent resultant channel conflict. Finally DRI has its own leads to follow and has licensed some OEMs that MS doesn't know and some that we don't pursue since they have problems paying the bills.

Relatively new to the ORI pitch and falling out of their acquisition by Novell is "DR-DOS: the DOS customized for your [Network] network". There is more to this merger than marketing a client OS, which led me to consider discussion Novell/Bodand merger rumors and the possible impact on MS. Suffice to say, the rumor will help sell papers and such a merger would be encouraged by IBM to divide the DOS OS market as they fight to make OS/2 or Pink or whatever a winner.

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Plaintiff's Exhibit

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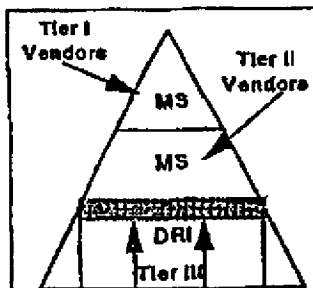
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Implications for Microsoft

- DRI's strength in the embedded systems segment could be used by DRI to push their OS onto desktops. This strength gets them in the door to accounts otherwise belonging to MS.
- DOS customized for networking adds to DRI's "More Advanced, More Features" pitch. Novell's distribution strengths give credibility to DRI's custom client OS.
- Novell/DRI's VAR and direct marketing strengths could displace MS in these channels at a time when they are becoming more important to reaching the market. A Novell/Borland merger would accentuate such a problem.
- DRI is finding fertile ground where MS has little presence both geographically and within market strata. These companies and markets grow into MS targets (i.e. fit the revenue/headcount goals) and when they do it becomes very difficult to displace DRI.
- Compatibility is either an issue for an OEM or not. If not, then the price feature comparison makes DRI the choice. The two key features that seem to be generating demand for DR-DOS in this scenario are data compression in version 6.0 and ROM power features in version 5.0. The press has not been overly critical of DR-DOS compatibility. Some users may feel similarly.
- DRI strengths in third tier PC vendors, and especially on lower-end PCs is mostly a pricing issue. MS should study the possibility of 8086/8088 pricing at low levels. DRI has licensed DR-ROM DOS 6.0 at \$1.50-\$1 royalty rates.

DRI's Customers

In general, DRI is fenced into seeking opportunities in Third Tier accounts and geographies where thinly covered by Microsoft. Some accounts signed by DRI are financially unhealthy. With few



exceptions MS controls Tier I and II markets, though DRI is putting pressure on the low-end Tier II vendors (Vobis, Cardinal). With DR-ROM DOS's early release to market they have made much headway. The potential exists for them to push their way up from the likes of embedded systems and into full PCs for companies that span both form factors.

Tier III is composed of a potpourri of vendor types: small PC producers, embedded system houses, PC motherboard shops, PC peripheral producers (hard drives), vertical market/system integrator producers, and more. DRI has licensed many motherboard manufacturers that bundle DR-DOS packaged product with the board and ship as one shrink-wrap unit to screw-driver assemblers overseas. This results in a large amount of down-channel unbundling, gray market reselling and channel conflict which MS has chosen to avoid.



The DRI Sales Pitch

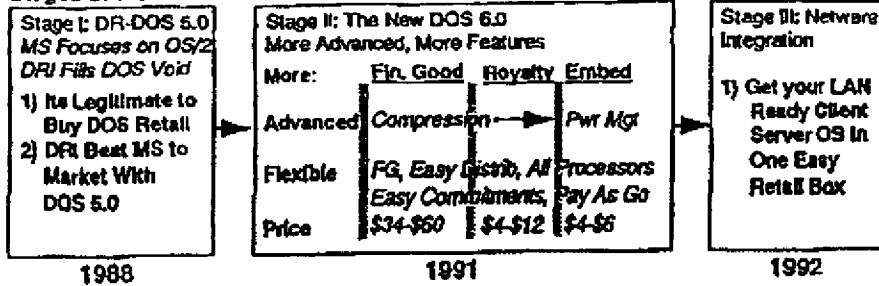
DRI's sales pitch can be roughly staged in terms of version releases as shown below. Stage III is really an extension to the DR-DOS 6.0 "more" pitch where they offer more advanced technology, more flexible terms, and more value. With the

addition of "DR-DOS customized for your (Novell) network" and a captive VAR audience with open ears the start of demand pull for the product may be possible.

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Stages of the DRI Sales Pitch:



Pricing

DRI prices range widely, though average around 50% of Microsoft's giving them one of their strongest sales pitches. It is used effectively for 5.0 in combination with the "if you just need a vanilla OS with basic compatibility" pitch. It also works well with 6.0 and the "get more features at a lower price" pitch.

DR-DOS Pricing Summary

	Avg.	Hi	Low
Package	\$39.00	\$60	\$34
Royalty	\$8.31	\$15	\$5
ROM	\$8.20	\$12	\$1

Pricing details summarized in this table are attached to the back of this report. DRI does not differentiate prices in terms of per-processor, per-system, or per-copy the way we do. Further, no distinction is apparent for different processors. The price is the same whether shipped with an 8086 or 80486-33 multiprocessor system. Basically, whatever definition/application of the terminology that is needed to close a deal is used. Even volume guidelines are thrown to the wind since it is possible to get the same prices at 100K or 250K commitments. What does seem consistent is that DR-DOS pricing is typically 50%-60% of the MS guideline royalty for disk media versions. ROM versions can be as low as 10% our royalty. DR-DOS version 5.0 is usually licensed at a 10%-20% discount from version 6.0 royalties. Localized version pricing is unclear from the one example we have where DRI charged the OEM a one-time \$5,000 flat fee (I think this is per-language but we haven't confirmed).

Commitments

Depending on the customer and pricing, DRI has defined commitment to mean everything from "all due on signing" (royalty \$/unit times unit commitment that is) to "customer expects to ship N units". The lower the pricing, the more bits to the "commitment". Quotes for extremely low prices usually carry commitment requirements such as "all due on signing" or "quarterly min commit payments", though there are a large number of pay as you go customer licenses.

Another play on commitments that DRI uses is to quote the price at N unit commitment, and if the commitment is not met, add \$2 (or some amount) to the royalty on future shipments and a back-bill payment for all past units shipped.

Credibility/Professionalism

There is evidence that DRI is at a disadvantage insofar as credibility counts to an account. Some of our accounts have expressed distaste over DRI's high-pressure "close the sale" approach and with some of their account managers. Alternatively, DRI has worked hard at Borlandizing their public image, trying to become perceived as the smaller, smarter, more responsive choice vis-a-vis Microsoft, just as Borland has developed this perception versus Lotus.

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DR-DOS OEM Licensees

There is no evidence to support price differentiation on the basis of per-processor/system/copy licenses. Most of the DR-DOS 6.0 packaged product is like our "Easy Distribution" packaged MS-DOS 5.0 which includes a Concise Guide and diskette set shrink wrapped together. Royalties below for packaged product include a COGS component built into the total shown in the "Royalty" column. CompuAdd Express pays an additional \$3.00 for the package and EMI buys the package separately also (though we do not know the \$ figure) so others may also. Royalty figures represent a best estimate by account managers. This table helps develop an understanding for DRI pricing, though is an incomplete list of their OEM licenses.

Product License	Ver	Product/ Commit	Shipping DOS	Est. Royalty	Comment
AMAX	6.0	Package	MS	\$39	(quote) Per-copy package deal w/ no commit priced at \$39
AMAX	6.0	Rty/pkg	MS	\$0	AMAX numbers are from a quote, unknown if they licensed DR-DOS
AMAX	6.0	Rty/pkg	MS	\$10	(quote) For 10K & 25K, commitment call for payment due on signing
AMS	6.0	Rty	DRI	?	Delivers DR-DOS 6.0 on HDD and 286 systems (GEM too).
Flash	6.0	Rty/disk	?	\$5	System is integrated copier/fax. DR-DOS 5.0
CompuAdd Exp.	6.0	Rty/pkg	DRI	\$3	Additional \$3 for Pkg, \$11 total. DR-DOS 5.0
Cardinal		Rty/pkg	DRI	\$8	Large DR-DOS vendor, MS producer going into volume chan.
EMI	6.0	Rty/pkg	MS/DRI	\$8	250K Commitment, laptop computers only, desktops ship MS-DOS
PfinaPann	6.0	?	DRI	<\$10	Mexican OEM
Sun Moon Star	6.0	Rty/pkg	MS	\$5	They do not ship DR-DOS, but ship MS-DOS instead.
Unknown (SD)	6.0	Rty/pkg	DRI	\$8	Taiwan motherbd producer displacing MS Canada business
Unknown (STD)	6.0	Rty/pkg	DRI	\$8	Taiwan motherbd producer displacing MS Canada business
Diamond Power	6.0	Rty/pkg	MS	\$10	Pkg is like "Easy Distribution"
Hasepang	6.0	Rty/pkg	DRI	\$15	Company ships 286 PC systems & 20K mother boards/yr.
Philips	6.0	Rty/pkg	MS	\$6	(from HeadStart acquisition, \$500K prepaid's, \$6 royalty)
Supra Corp	6.0	Rty/pkg	MS	\$6	\$1 discount (\$5 rty) if they do not ship the OEM shell.
Ampro	6.0	Rty/ROM	DRI	\$8	Distributor of DR-ROM DOS.
Commodore	6.0	Rty/ROM	DRI	\$1	Royalty can go to \$1.50 if 250K min commit is missed.
Handheld Tech	6.0	Rty/ROM	DRI	\$15	Produce data terminals (w/ie, Hertz type)
Republic Tech	6.0	Rty/ROM	DRI	\$12	
Teleart	6.0	Rty/ROM	DRI	\$4	Min commit @ \$4, pay \$6 backfill if shipments are lower
Sinclair	6.0	?	not ship	?	Removed proprietary 280-nips RISC chip that emulates Intel i86.
Commax Technologies	6.0	?	DRI	?	Laptop manufacturer
Redd Information Systems	6.0	?	DRI	?	
Burnell Systems	6.0	?	?	?	Soviet/US joint venture
Premier Innovations	6.0	?	DRI	?	
Multiscrit Corp	?	?	DRI	?	develop advanced technology for DR-DOS
OnStar	?	?	MS	?	No information on DR license, converted to MS-DOS 6.0
GCH	?	?	DRI	?	No information on DR license, converted to MS-DOS 6.0
Infini	?	?	DRI	?	No information on DR license, converted to MS-DOS 6.0
Voble	6.0	?	MS/DRI	\$7-\$8	Shipping MS DOS, pushing DR-DOS to customers

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