



Annual Shareholders' Meeting  
November 12, 1996  
8:00 - 9 00 am  
Meydenbauer Center

**BOB HERBOLD:** Good morning. Welcome to our annual shareholders' meeting. I'm Bob Herbold, Executive Vice President and Chief Operating Officer. I would like to begin this morning by introducing several people. First of all, Mike Brown, our Vice President of Finance and Chief Financial Officer. Bill Neukom, Senior Vice President of Law and Corporate Affairs. And Bill Gates, our Chairman and Chief Executive Officer.

Now there are several people in the audience that we should recognize. First of all, Mark Peek who's representing Deloitte and Touche, our independent public auditors. Like to introduce Larry Bailey representing Preston Gates and Ellis, our primary law firm. Now I'd like to introduce the members of the board. First of all, Bob O'Brien, who is our chairman of the audit and the compensation committee. David Marquardt has just arrived. Dick Hackborn. Jon Shirley, chairman of our Finance Committee. Mr. Gary Reed. And the newest member of our board, Jill Barad. As far as I know, Paul Allen has not arrived, but we do expect him.

I'd like to indicate that what we'll have is a formal meeting. And when that is over, we will open it up for questions and answers. So you'll have plenty of opportunity to get that question that you're just dying to ask out on the table.

Plaintiff's Exhibit  
**5819**  
Comes V. Microsoft

MS-CC-MDL 00000642549  
HIGHLY CONFIDENTIAL

We'd like to begin by asking Bill Neukom to report on the notice of the meeting as well as the proxies that were received. Bill.

**BILL NEUKOM:** Thank you Bob. The notice of the meeting and the proxy statement were mailed by Chase Mellon Shareholder Services, the company's transfer agent, on September 27 of this year to all shareholders of record as of September 9. As a result, this meeting is being held pursuant to proper notice. Proxies representing approximately 85 percent of the approximately 6,000,000 shares of the company's outstanding stock have been received and a quorum is present today. If anyone in the audience who is a shareholder has not executed and returned a proxy, you may vote at this meeting by completing a ballot proxy card. Those are available at the reception table outside this meeting room. Thanks.

**BOB HERBOLD:** I'd like to mention that the minutes of the annual Shareholders' Meeting of October 27, 1995 are available on the table outside the meeting room if you're interested.

Let me begin with a brief description of Fiscal Year 1996. It was a fantastic year. It was the 21st year of consecutive record revenue and profit. Our revenues grew to \$8.7 billion, which is an increase of 46 percent. The revenue growth compounded over the past five years was plus 36 percent per year. Net income increased to \$2.2 billion from \$1.45 billion a year ago, and that's an increase of 51 percent. All channels and product divisions had strong results and that was an outstanding year, and we won't be able to do that every year.

Product groups-let me review what was going on within the individual product organizations. Platform revenues grew 74 percent to \$4.1 billion. And that was fueled by the Windows 95 introduction where over 40 million copies were sold. Applications and content grew 27 percent to \$4.6 billion. Office revenues-Office is our suite, our desktop application suite-was up 50 percent in Fiscal Year 1996, which is a terrific result.

If you look at individual channels, OEM grew 52 percent-OEM is our vehicle for placing our operating systems and some applications on the PCs-was up 52 percent to \$2.5 billion. That reflects a strong PC shipment, but it also reflects Windows 95 adoption. U.S. and Canada as a unit, in terms of finished goods, grew 43 percent to \$2.7 billion. Europe grew 36 percent to \$2.0 billion. And other international areas grew 59 percent to \$1.5 billion. Naturally, that was led by Japan that had an absolutely terrific year.

Let me talk a bit about licensing. It continued to increase in popularity in Fiscal Year '96. It grew to 48 percent of our finished goods revenues, and that's in contrast to 42 percent a year ago. Licensing represents the highest percent of finished goods in Europe where it's up to 56 percent. In North America, it's 47 percent, and 33 percent in the Far East.

Let me spend a moment on cost of goods sold. It's an area where we've been able to achieve really meaningful decreases, primarily due to key trends in the industry, due to efficiencies also in packaging, plus the fact that we're shipping more licensed product, and the shift from 3.5-inch disks over to CD-ROMs enables us to reduce our cost of goods sold from 14.8 percent down to 13.7 percent. Now we would have been lower during the fiscal year except for Windows 95 which had a lot of retail activity, and retail shipments have a higher

cost of goods sold. You see that in the fourth quarter where our cost of goods sold was down to 10.7 percent. That reflects the natural slowdown in retail on Windows 95 compared to the very rapid growth in the beginning of the fiscal year. You recall it was launched on August 24, truly a memorable date for all of us.

Our after-tax profit margin was 25.3 percent, slightly higher than the 24.5 percent of a year ago. As far as headcount, we grew from 17,801 people in June of 1995 to 20,561 in June of 1996 for an increase of 16 percent. While this is a big increase, revenue per head increased to a new all-time high of \$421,000 per employee, and that's in contrast to \$334,000 per employee a year ago. If you look at the Puget Sound area, or Greater Redmond, as we call it, if you include our Canyon Park headcount of 457 people, the total headcount in Puget Sound was 11,057 people, or 54 percent of our total headcount.

As far as the balance sheet, total cash equaled \$6.9 billion at the end of the fiscal year, and that's an increase of \$2.2 billion. We don't have any long-term debt at this juncture. We're positioned well to make future investments that we know we'll have to make.

Let me talk a bit about stock buyback, which is a very active issue at Microsoft. Our program has as its purpose to provide shares for our stock options. We repurchased 13.5 million shares in Fiscal Year '96 for \$1.4 billion. So that's an average cost of \$102 per share during the year. Life to date, we've purchased 64.3 million shares of our own stock at an average cost of \$59. So the cost to date of that buyback program has been \$3.8 billion. The value of those shares that we purchased currently is \$9.3 billion. That's based on a market price of \$144 a share. The buyback program is obviously enhanced by our selling of put warrants, which you can read about in our financial statements.

Now let me talk about the first quarter of Fiscal Year '97. We're off to a good start. Our revenues were \$2.3 billion, which was an increase of 14 percent versus year ago. But you'll recall a year ago was the quarter that contained the launch of Windows 95. So that's a very tough base period for us, so we're quite proud of 14 percent increase, given what was going on at that time a year ago.

Absent Content group, the revenue was \$1.11 billion; that's up 13 percent versus year ago. For the first time, we sold more 32-bit Windows apps than 16. That's very meaningful in that it truly does signal that the 32-bit operating system and the apps that are associated with it are definitely the trend for the future. The installed base of Office and Office apps now exceeds 50 million. MSNBC, both interactive and cable, was launched in July. Microsoft Network, which now has over 1.6 million subscribers, was relaunched to become a Web-based product in September of this year.

The Platform group revenue was \$1.2 billion. That's up 15 percent versus year ago. Version 4.0 of Windows NT Workstation was released, and revenues were 4X versus year ago. Truly a hot product. NT Server and our server apps increased 250 percent versus year ago. So that entire BackOffice suite is really rolling at this point.

Let me talk about financial information availability to you folks. One thing we wanted to really emphasize is that while we continue to send out the paper report of the annual report and the proxy, all of that information is available to you online via Microsoft.com, and we would encourage you to experiment with that if

you haven't been using it regularly. It's a lot of fun; it enables you to ask some what-if questions about our financial future as well as get a lot more information about our company than what you can get by reading the annual report or attending this meeting. Not that we don't want you to attend this meeting, but...

Let's look forward to the remainder of the fiscal year for a moment. It's one of the most competitive environments that we've ever faced, and Bill will talk about that in a moment. We have faced very tough retail competition in the desktop apps area, but we're very bullish about Office 97. It's a very significant release for our Office suite and has great capabilities. So we're bullish about that area for the remaining nine months, but it is a very competitive business. R&D should grow much faster than revenues as we invest in the future. We're poised to have a good holiday season in the interactive media area with some great new products, branching from Encarta Deluxe, which is a great new version of our encyclopedia that has a lot of connections to the Internet, all the way over to Monster Truck, an exciting new game that I'm sure you would have fun experimenting with.

I want to take a moment to emphasize how important it is that we take the long term view in this business. Now the stock price was up this year versus a year ago. We like to see that, but we have to remind ourselves that there will be periods when that won't be the case. We're truly investing in this company for the long haul and we want you to think that way as well. We appreciate your long term confidence and we will work hard to deserve it.

Now I want to emphasize a couple of very important risks that we all need to keep in mind. We have serious competition in virtually every part of this business at this juncture, probably the most serious competition we've ever faced, if you look across the board. We're dependent on the continual growth of PC shipments. The role of the server threatens the role of the operating system on the desktop; it's an important issue for us at Microsoft. The role of the thin client and the design of applications could really compete for a lot of our applications business. We'll have continuing pricing pressure. It exists in virtually every part of our business. We've been talking about saturation of desktop applications for years, and now we're really beginning to experience it. Piracy continues to be a big issue around the world. Some parts of the world are more problematic than others, but in general it's a huge issue for us. And naturally, there's always litigation in this business. It's a business where, from the standpoint of patents and the like, you can often get surprises. So consequently, you really do need to understand just how risky this business is.

That concludes the summary of the business. At this juncture, I'd like to introduce Bill Gates for his perspective on the business and on the future. Thank you.

**BILL GATES:** Well the last fiscal year, we made an incredible amount of progress, not only financially, but also in terms of some of our technical strategies. In particular, we made the transition from a 16-bit operating system environment to the 32-bit environment based on the strong momentum of both Windows 95 and Windows NT. The launch, just over a year ago, not only had high visibility; it had very, very high customer satisfaction. And the kind of backing we got from software developers and hardware developers for things like the plug and play, autoplay, and other improvements we made there, were really quite strong.

Windows NT Server is really the foundation of our overall enterprise strategy. We have a series of products that run on Windows NT which are the BackOffice

products. And since they only run on NT, the popularity of NT Server is critical. And over the last year, the sales of that product have really surprised us with the momentum they've built up. The sales are more than triple our nearest competitor, which is NetWare 4.1, and they're more than double all the different UNIX servers combined.

Now on top of NT, last March we brought out Exchange. And that's our industrial-strength messaging platform. We've done a lot to make it easy to administer and make it work in very large companies. And we're off to a fast start there. The key competitor is Lotus Notes, which has been in the marketplace for about five years. So we're very pleased with the reception we've had, including some very major design wins. Our advantage over other approaches is the way we integrate in with the NT operating system, the common security and directory approach that we're taking there.

We've been putting a lot into our content efforts, including the joint venture with NBC. Those were launched very rapidly in July. And for a new cable service and a new online service, they're doing very, very well. It's quite some time before those ventures will be profitable, and it will require not only good work, but also growth in the overall market in both cases. But we're feeling very good about the milestones we've achieved there.

The Internet is certainly the thing that has absorbed most of our attention since the launch of Windows 95. And Internet Explorer 3.0 got off to a very fast start. It won virtually all the reviews. And it's been gaining share. But its share to date is probably on the order of 15 to 20 percent versus Netscape, which still has a dominant position in that market. It's very important to us that people see how we're embracing Internet standards across the entire product line, how we're extending those standards in rich new ways. And although I feel very, very good about how we've done that in the last year, we still have quite a bit of work to do. We have a set of competitors that are working in concert with each other there that pose a major challenge to us, perhaps the largest challenge that we've faced for a long, long time.

So as we look forward, you'll see two big themes for us in the next year: this Internet focus, continuing the momentum, and a focus on making it easy to manage PCs. A lot of work on simplicity that get at some of the concerns people have about cost of ownership.

A major product initiative for us, probably the most important, is Office 97. This is a major update of our Office productivity tools, both the individual products and Office itself, that will come out early in the calendar year. And it's an incredible set of advances. The Internet capabilities, user friendliness, the integration-this is a big step forward, and we expect that to do quite well. Internet Explorer, we'll bring out the 4.0 version that brings the desktop and the browser together and actually brings some editing capability into the browser. With NT, we put out in our Developers' Conference last week some directory technology that will be part of NT 5.0, which we hope to get into customers' hands before the end of calendar '97. That's a major project initiative.

We have a low-end version of Windows that runs in small, hand-held devices called Windows CE, and actually this month, the first hardware partners will ship their products based on that software. And over the course of 1997, a number of additional partners will be entering that space.

Products like SQL Server-another case where we have an incredibly dominant competitor, Oracle, in that database business. We're investing quite heavily to compete with them, particularly with the 7.0 release that will come out in the summer time frame during calendar '97.

On the content side, there's a lot going on. The Microsoft Network relaunch is part of that. It's another challenging business, in that you have to have a lot of customers in order to make that a profitable business and certainly there's some tense competition with other online services like AOL and with more straightforward Internet service providers who don't have the content costs or benefit that we have as part of our combined offering.

I mentioned the thrust in terms of simplicity. And this is an effort that, like the Internet, touches all of our product line. We announced with our PC partners a form of the PC family that has the lowest initial purchase price and yet a simple way that you can avoid modifying the hardware configuration during the life of the device. So it's more like a terminal than a typical PC, and we've been very pleased with the reaction to that. Obviously, people like Sun and Oracle are not involved in that. They're coming up with their own solution to address some of those customer needs.

On the pure software front, the most important thing we're doing here is called Zero Administration Windows. And this is where we keep all the information about what applications you're using and what changes you've made on the server. And so as you're working with your PC, you're not at risk of losing the information, and yet the administrator can make sure you have the latest applications, and make sure that you can even move from PC to PC without any effort. There's a lot of architectural work going into that, but we expect to deliver that as part of the NT 5 server work, and in addition, provides client software for many of the versions of Windows that are out there today.

Looking out a little further beyond the one-year horizon, I think the Internet is certainly good news in terms of the importance of software. People are asking for software like Merchant Server that helps them do transactions on the network. They're asking for software that helps them track different customer types coming in. And we're responding aggressively to those new opportunities. I think the Internet will drive PC sales. Now at the same time, there will be non-PC devices, low-end devices, connecting up to the network as well. And it's up to us to prove that the PC offers extra benefits that allow it to retain the lion's share of the market there. Our success is very dependent on improvements in the PC.

The hardware evolution is going to be very rapid. Performance of the microprocessor will be going up as it has in the past. Graphics improvements, storage improvement, screen technology improvements, even bandwidth connections into the Internet will be going up quite rapidly. Bandwidth is the most difficult of those because it requires new infrastructure, and you have regulatory issues and huge investments required. But we're working with phone companies and cable companies worldwide to foster these high speed connections through technologies like ISDN, ADSL, and PC cable modems.

In the area of software innovation, one of the big things we've always provided is deep integration. For example, making it so when you buy a Windows computer, you have everything you need to take full advantage of the Internet. We're going to take this integration concept further and further and share between all the different ways you browse information. We're going to do things like

automatic...turning the computer on so you don't have boot time. Lots of work in multimedia.

And a new challenge for us is what we call scaleability. Today people understand Windows NT Server is a very powerful product, and they're embracing it very broadly. But still people who have the most demanding applications somehow feel that mainframes or UNIX-based systems can tackle higher-end, more demanding applications than we can with Windows NT. That's largely not true, but we have to fill in the remaining missing pieces there and get a very strong message out to the marketplace that Windows NT scales better than any other system. And there's a lot of deep technical work that goes into this: hierarchical storage management, clusters, symmetric multiprocessors scaling up to 16 processors. We feel quite confident during calendar '97 that we will get a very strong scaleability message out, including doing some showcases of how far we can go on that.

As part of a recent organization refinement, I've now got Nathan Myhrvold very focused on advanced technology work. And I would say that the future of the company really lies on taking this advanced work and coupling it with our very popular Windows and Office products. And so we'll be increasing our investments there, and he'll be driving our work, in particular, into things like teaching computers to understand human speech-speech recognition, speech synthesis. Even video recognition. And making the computer more automatically adaptable-learning from what you use so that you can work with it in a better way.

I'm very pleased that we can take a long-term approach in investing in this R&D, and I think between the advanced R&D and the way that we listen to customers about refining these products, we have a bright future. However, I'm always conservative in terms of how I look at things from a financial point of view. It is a very competitive environment. When you have the position we are in, there are lots and lots of companies coming to compete with us. And I do think we have something to prove in terms of a number of the issues that I went through.

So the focus of the company is the same as always and our belief in the potential of creating PCs as very empowering tools is also stronger than ever. Thank you.

**BOB HERBOLD:** I'd like to ask Bill Neukom if the count has been completed. Bill?

**BILL NEUKOM:** The polls are now closed at this point

**BOB HERBOLD:** I'd like to cover Proposal Number One, which was the election of the directors. We have eight nominees. They all appeared in the proxy. This requires a plurality of shares represented at the meeting in order to pass. And I'd like to ask for a motion for this proposal. And a second. Thank you. Bill, what is the result of the voting?

**BILL NEUKOM:** We have received proxies and ballots from shareholders holding more than a majority of the shares represented at this meeting, and voting for the eight nominees.

**BOB HERBOLD:** In which case I'd like to announce that the eight directors that were nominated have been elected to serve until the next annual Shareholders' Meeting. And let's give them a round of applause.

I'd like to cover Proposal Number Two which dealt with the approval of an amendment to the 1991 stock option plan to reserve an additional 100,000,000 shares of common stock for future stock options. This requires a majority of the shares represented at the meeting in order to pass, and I'd like to call for a nomination-or a motion. A second? Bill, do you have the results of this balloting?

**BILL NEUKOM:** Yes, we do. We have received affirmative proxies and ballots from shareholders representing more than a majority of the shares presented at this meeting in favor of this resolution.

**BOB HERBOLD:** In that case, the additional shares are approved and reserved.

The third proposal in the proxy dealt with approval of the adoption of the 1997 Employee Stock Purchase Plan. It includes the reservation of 10,000,000 shares of common stock for future employee purchases. This also requires a majority of the shares represented here at the meeting in order to pass. I'd like to ask for a motion for this proposal. A second? Good. Thank you. Bill, do you have the results?

**BILL NEUKOM:** Yes, we do. And again, we have received affirmative proxies and ballots representing more than a majority of the shares presented at this meeting in favor of this Proposal Number Three.

**BOB HERBOLD:** Good. In which case that is passed and approved. And that completes the business portion of our meeting. I'd now like to call for a motion to adjourn so that we can move on to the Q&A part. Is there such a motion? And a second?

**DIFFERENT SPEAKER:** I second it.

**BOB HERBOLD:** Great. In this case, we need a voice vote. All in favor say "Ay."

**MULTIPLE SPEAKERS:** Ay.

**BOB HERBOLD:** And those opposed...In which case this meeting is officially adjourned and we will now move to the question and answer portion.

Last updated March 21, 1997

© 1997 Microsoft Corporation. All rights reserved. [Legal Notices](#).

MS-CC-MDL 000000642556  
HIGHLY CONFIDENTIAL