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Microsoft

Mr. Terry Lautenbach
Senior Vice President and General
Manager, U.S.
IBM Corporation
2000 Purchase Street
Purchase, New York 10577

Dear Terry:

It has been some time since we had dinner. We talked then about getting together again quickly to make progress on our proposal to work together even more closely on PC systems software. Since that time, IBM has focused most extensively on its potential involvement with our Windows add-on to DOS. Resolution of that question has stopped much progress on other parts of the proposal. Let me go back to basic principles and outline our view of what we are trying to achieve together and its value.

1. We are trying to establish a platform on which ISVs can build the generation of innovative applications that will drive PC penetration of office desks another quantum leap.
2. We want to migrate our current customer base on DOS to that new platform.
3. We must maintain high market share and run profitable software businesses.

The Microsoft/IBM relationship is critical to all three goals. Our competition is UNIX and only UNIX. Over time the benefit of our new features will pull people from DOS. Macintosh will always be a niche player. UNIX is a tough competitor that neither of us control and is run by groups without software profit objectives. Those groups even look like they will finally get together. Together we can maintain our strong position on the desktop if we:

1. Make quicker decisions factoring in PC user needs.
2. Promote OS/2 as an "Open" system. "Open" means hardware independent.
3. Promote OS/2 effectively to software developers, end users, and other hardware manufacturers.
4. Make our development teams lean and efficient so they focus on those features that produce real benefit.
5. Avoid the temptation to mold OS/2 to help our applications software businesses. They must compete on their own or OS/2 will suffer.
6. Allow IBM to optimize its hardware to best exploit OS/2.

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1990 is a critical year for OS/2. We are starting to see shipping Presentation Manager applications but as importantly we will ship OS/2 2.0 optimized for the 386 this year. With this release there is no doubt that any customers with a 386 system and 4 meg of RAM are better off with OS/2 than DOS. I feel strongly that this is the first OS/2 system that will make sense for a lot of customers. Between us I think we can sell a million in the year after 2.0 ships. That exceeds your forecast. From there we should be able to double our business every year for three or four years.

We both have invested a lot of money in OS/2 and will continue to do so although Jim and I want to cut staff. The best way for us and our customers to benefit from that investment is to focus on this 386 with 4 meg RAM platform. Some people worry that means abandoning our investment in 286 software. We should sell those other customers DOS and pull them into our graphical fold (SAA CUA) with Windows.

Jim is putting together a counter proposal for me on these issues. I am open minded. OS/2 success is my company's number one priority and our relationship is vital to that success.

There are two other things we need to do to drive OS/2 success. First, we need to make OS/2 networking more of a mutual marketing, as well as technical, priority. We are gearing up more emphasis in our sales force on this and your own sales efforts in this area seem somewhat diffuse. Perhaps, as Jim and I have discussed, we should even repackage our current offerings to make networking a more fundamental piece of OS/2.

Second, I believe we need to get a project strategy to take our new "portable" OS/2 code base to RIOS. To fight UNIX it is essential that the IBM sales force not have a major platform where they must sell UNIX instead of OS/2.

I look forward to Jim's comeback proposal to me. I suggest we have a chance to work it over some before you and I meet again. Let me propose a late November meeting. Time is passing and UNIX is moving forward quickly. We will call your office to schedule a meeting soon.

Sincerely,



Bill Gates
Chairman

WHG/jlg

cc: Jim Cannavino

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