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353

Lesley Halverson (LCA)

From: Steve Ballmer
Sent: Sunday, December 01, 1996 9:26 PM
To: Bill Gates; Amar Nehru
Cc: Brad Silverberg; Brad Chase; Paul Martiz
Subject: RE: Netscape Revenues (Long mail)

I asked amar to send it broadly I may have gone overboard we should have been more precise that home page means ads of all kinds sorry The isp revenue we did not dig into it will have to lower one of our other estimates if sizable we will brainstorm how to get a grab

-----Original Message-----
From: Bill Gates
Sent: Sunday, December 01, 1996 9:24 PM
To: Amar Nehru
Cc: Brad Silverberg; Brad Chase; Steve Ballmer; Paul Martiz
Subject: RE: Netscape Revenues (Long mail)

What kind of data do we have about how much software companies pay Netscape?

In particular I am curious about their deals with Corel, Lotus and Intuit. All of these ship a lot of units of Netscape. In our discussions we must have some kind of sense of the revenue which Netscape gets from this.

I was surprised at the ISP revenue being so high. The services revenue is NOT primarily from the home page as is stated in this report. Netscape does better selling things like the SEARCH button. Someone should be more concrete about what they get (non-barter) from the home page. I think its quite low.

I don't think this analysis needed to be sent to so many people.

-----Original Message-----
From: Amar Nehru
Sent: Wednesday, November 27, 1996 11:54 AM
To: Executive Staff
Cc: Linda Glenicki; Katie Bright; John Leftwich; Pieter Knook; Mich Mathews; Rosa Garcia; Susan Norberg; Richard Liotta; Strategic Business Decisions; Business Development & Investments (BDI); Joseph Lacson; Greg Maffei's Direct Reports; Debbie Hill; David Heimer (LCA); Bill Henningsgaard; Patricia Hollenbeck; Dave Wright (OEM); Bengt Akerind; Amar Nehru; Scot Land; Carla Lewis
Subject: Netscape Revenues (Long mail)

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Over the last two months, we have tried to develop a basic understanding of Netscape's business. Our intent is to better understand Netscape's strategy and future directions. We are trying to prepare similar reports on Lotus Notes and other businesses.

- Given:
Netscape reports revenues as follows:
- Total product category revenues: ads and services; servers and browsers;
 - Total revenues by channels: direct (LORGs and online); ISP/OEM/VARs and retail.

What we don't know, for example, is how much browser revenue is generated by direct, OEM, ISP, VARs and retail, respectively. Therefore, we have focused on trying to understand this level.

Process:
(a) We started with publicly available information for calendar Q2-96 (in bold in the exhibits); (b) we have coordinated with OEM, PNS, ECU, OCU and the field to develop our best estimates of the revenue generated by each product category in each of the channels for the second quarter; (c) we have polled some of the analysts to learn their view of the likely Q3-96 revenue splits; and (d) we have tried to predict the split of product and channel revenue for Q4-96 based upon the Q2 and Q3 information, trends impacting the industry and analysts' perspectives.

Though we are 70% confident about our numbers, we believe this is a decent platform to understand their business. The following three exhibits and accompanying discussion summarize our assessment.

(EXHIBIT 1)
<< OLE Object: Microsoft Excel Worksheet >>

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Exhibit 1: we have coordinated with various MS groups to expand on the public information about Netscape. The numbers in the box are what we believe to be the company's revenues by product and channel. The following provides a breakout of estimates for the quarter ended June 30, 1996:

Browsers: Browser revenue for the quarter amounted to \$45 million (a 32% increase over the last quarter) representing 60% of total Netscape revenue. Of the \$45 million, ISP's commanded the largest share at 40% of browser revenue, with direct sales to LORGs via site licenses coming in second at 28% share.

Direct: Direct revenue was estimated at \$12.7 million. From a reporting standpoint, Netscape buckets LORG and Online sales as Direct revenues.

- LORGs (\$9.9 million): For the quarter, Netscape shipped 650,000 units in North America and 100,000 units in ROW with an average price of \$12.31 and \$19.95, respectively.
- Online sales (\$2.7 million) are generated from Netscape's two online programs: 1.) The General Store; and 2.) Quick Purchase. The online sales estimate was per Todd Finch, CEO Netscape Canada. Unit volume was not known, however, using a \$49 per unit assumption (represents price per unit via The General Store during the quarter ended June 30, 1996), volume of paid copies was estimated at 55,000 units.

OEM: Netscape considers an OEM as anyone who bundles or loads Navigator onto an OEM's product. This includes hardware and software companies (i.e. Oracle, Informix, etc). We believe that browser distribution via software companies classified in the OEM category is negligible. In addition, Netscape doesn't have a small system builders program, thus estimates were based on Multinational Corporations (MNC's) and named accounts.

- For the quarter, Netscape MNC OEM's shipped 293,000 units in the North America and 536,000 in ROW, with an average unit price of \$2.38 and \$3.20, respectively. Examples include Fujitsu, which shipped 291,000 units at an average price of \$4.50 and DEC, which shipped 145,000 units at an average price of \$5.50 per unit.
- Worldwide, OEM named accounts shipped 210,000 units at an average price of \$7.87 per unit. Greater than 90% of named account revenue was generated outside of North America.

ISP: ISP's represent any entity that provides Internet access and satisfies Netscape's ISP program criteria. ISP's include major and minor telephone companies and Internet Access Providers. Large ISP data was derived through detailed account drill down and/or inferred from what we know about IE, whereas Small ISP data was derived via extrapolation from sample data and anecdotal evidence.

- For the quarter, Netscape's large ISP's distributed 915,000 units in North America and 651,000 units in ROW at an average price per unit of \$6.90 and \$7.34 respectively. Examples of these accounts are (1) Netcom: distributed 250,000 units at an average price of \$2.40 per unit; and France Telecom: distributed 12,500 units at an average price of \$8.00 per unit.
- Small ISP revenue was higher than anticipated (represents 39.2% of total ISP browser revenue) due to the higher price per unit charged (\$16.24) compared to large ISP's (\$7.08).

VAR: For the quarter, the VAR channel was considered the smallest at 7.3% of total browser revenue. This has changed in subsequent quarters (see below) as the company has focused on developing the channel to get leverage in distribution. Revenue was reconstructed from Ingram Micro data along with anecdotal market share figures. Netscape shipped approximately 65,000 units in North America at an average price per unit of \$34.94.

Retail: The retail channel was the second smallest channel due to seasonality, coupled with the anticipated release of Navigator 3.0 which shipped in August. Revenue was reconstructed from Ingram Micro data along with anecdotal market share figures. Netscape shipped approximately 124,000 units in North America at average price per unit of \$34.41.

The estimated units, average price and revenues for the browser and server side of the business are provided in the excel sheet embedded at the bottom of the mail.

Servers: For the quarter, Netscape generated \$16.5 million in server revenue representing a 21% increase from the prior quarter and 420% growth over the same quarter in the previous year. Estimates are that over 62% of server revenue was derived from the direct channel. As noted below, this has shifted somewhat due to Netscape's focus on developing an indirect, leveraged channel. We estimate that Netscape shipped 15,000 servers in the North America LORG channel at an average price per server of \$770.

Commerce Applications: Netscape generated approximately \$800k from a handful of corporate accounts. 100% of this revenue is considered direct as the channel has not yet geared up to support and sell Netscape's Commerce products.

Advertising/Services: Netscape reported \$12.8 million in revenue from consulting on Commerce Applications and Enterprise Servers, and designing and developing web sites for third parties. In addition, a good portion of the \$12.8 million stems from selling advertising space on Netscape's home page

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(represents only cash revenue. Does not include bartered advertising space). It is estimated that 100% of these revenues were generated from the direct channel.

(EXHIBIT 2)

<< OLE Object: Microsoft Excel Worksheet >>

Exhibit 2: we have talked to Goldman and H&Q to get their view on Netscape's Q3-96 revenue for the September 30 ended quarter. The company reported \$100 million of revenue versus the consensus forecast of approximately \$84 million. All numbers in bold are reported. The significant points are: analysts estimate that direct browser revenue has decreased substantially in keeping with the company's goal to sell more product via the channel. At the same time, total browser revenue has grown significantly versus the prior quarter (\$45mm to \$59mm; +31%) largely due to the release of Navigator 3.0. Also, the analysts suggest that the mix within OEM/ISP/VAR category has skewed more to OEMs in Q3. Finally, the server business is growing robustly on a dollar basis (+45%). This is reinforcement of an increased focus on the Intranet segment.

(EXHIBIT 3)

<< OLE Object: Microsoft Excel Worksheet >>

Exhibit 3: we have used our understanding and the analysts estimates of Q3-96 revenue splits to project Q4 revenues by product and channel. Analyst estimates for Q4 revenues range from \$115mm to \$120mm. Marshall Senk at Robertson Stephens believes that Q4 revenues will be \$119mm. We estimate \$109mm as above. Our major thoughts are listed below.

Browsers (-15% approximately vs Q3):

We estimate Netscape's browser revenue to decline from \$59 million in the Q3 period. The decrease will be caused by:

- adopting a CAL model, which will increase the effective average price of the browser/client. If unit run rate remains unchanged, this could increase revenue. However, the more likely impact of the price increase could be reduced browser growth and a further shift in focus to the server side. But we estimate client pricing to be either free or marginal upto the end of calendar year 96.
- MS's Unix browser will decelerate Netscape browser revenue growth for direct sales to LOGs and the ISP/OEM/VAR category.
- IEAK will impact direct and VAR browser revenue.
- No new Navigator release in this quarter (the Q3 Netscape browser revenues were inflated due to Nav 3.0 release).
- However, this decrease will be partly offset by seasonality in the retail and direct channels due to the Christmas sell-in.

Servers (+50% vs Q3):

- Cross-platform and the Unix proposition will allow Netscape to grow the server business. With CAL, where the money will be made on concurrent attachments, there is further incentive for the company to push in the server market.
- Some of the current thinking on NT's Unix strategy might be useful at a later stage to address Netscape's server revenue momentum.

Commercial apps (no change vs Q3):

- We do not believe that this will be a material portion of Netscape's business in Q4.

Ads/Services (+30% vs Q3):

- This is a difficult revenue stream to impact. The company gets a lot of leverage from the Homepage. All of this revenue, we believe, is generated via direct and in the US. Perhaps an interesting thought is to open up Microsoft.com and try to replicate the leverage Netscape gets from its site.

Please let us know if questions. The excel attachment below has all the detailed work and assumptions from PNS, OEM and the channel orgs. Thanks to Cam, Bengt Akerlind, Joseph Lacson, Dave Wright (OEM), Bill Henningsgaard, Patricia Hollenbeck, Susan Noberg, Scott Land and many others in the channel and field for their help and to Richard for pulling it together.

amar

<< File: Netscape Revenue Taxonomy Nov. 1996 >>

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