

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

/X/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 1995

/ / TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 0-14278

MICROSOFT CORPORATION  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

WASHINGTON  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

91-1144442  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

ONE MICROSOFT WAY, REDMOND, WASHINGTON  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)

98052-6399  
(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (206) 882-8080

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: COMMON STOCK

Indicate by check mark whether the registrant (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of  
1934 during the preceding 12 months (or for such shorter period that the  
registrant was required to file such reports), and (2) has been subject to such  
filing requirements for the past 90 days. Yes /X/ No / /

Indicate by check mark if disclosure of delinquent filers pursuant to Item  
405 of Regulation S-K is not contained herein, and will not be contained, to the  
best of registrant's knowledge, in definitive proxy or information statements  
incorporated by reference in Part III of this Form 10-K or any amendment to this  
Form 10-K. / /

The aggregate market value of the common stock held by non-affiliates of  
the registrant as of September 8, 1995 was \$34,330,611,220.

The number of shares outstanding of the registrant's common stock as of  
September 8, 1995 was 589,952,132.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement dated September 25, 1995 to be  
delivered to shareholders in connection with the Annual Meeting of Shareholders  
to be held October 27, 1995 are incorporated by reference into Part III.

## MICROSOFT CORPORATION

FORM 10-K

FOR THE FISCAL YEAR ENDED JUNE 30, 1995

## INDEX

	PAGE
	----
PART I	
Item 1. Business.....	1
Item 2. Properties.....	10
Item 3. Legal Proceedings.....	11
Item 4. Submission of Matters to a Vote of Security Holders.....	11
Item E.0. Executive Officers of the Registrant.....	11
PART II	
Item 5. Market for Registrant's Common Stock and Related Stockholder Matters.....	13
Item 6. Selected Financial Data.....	14
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	14
Item 8. Financial Statements and Supplementary Data.....	18
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures.....	18
PART III	
Item 10. Directors and Executive Officers of the Registrant.....	30
Item 11. Executive Compensation.....	30
Item 12. Security Ownership of Certain Beneficial Owners and Management.....	30
Item 13. Certain Relationships and Related Transactions.....	30
PART IV	
Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.....	31
Signatures.....	33

## PART I

## ITEM 1. BUSINESS

## GENERAL

Microsoft Corporation (the "Company" or "Microsoft") was founded as a partnership in 1975 and incorporated in 1981. Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including operating systems for personal computers (PCs), workstations, and servers; business and consumer programs for productivity, reference, education, and entertainment; and development tools. Microsoft also markets personal computer books and input devices and is engaged in the research and development of online and advanced technology software products. Microsoft(R) products are available for most PCs, including Intel-type microprocessor-based computers and Apple computers.

Microsoft's business strategy emphasizes the development of a broad line of microcomputer software products for business and personal use, marketed through multiple channels of distribution. The Company is divided into four main groups: the Platforms Product Group; the Applications and Content Product Group; the Sales and Support Group; and the Operations Group.

The Platforms Product Group is comprised of four divisions, each responsible for a particular area of platforms software development and marketing. The Personal Systems Division designs and develops operating systems and technologies (such as multimedia, user interface, and online browsers) for general and home PC users. The Business Systems Division is responsible for computing solutions for corporate and enterprise use, including client-server operating systems, networking products, and server and workgroup applications. The Developer Division creates database products, as well as programming language products and software development tools. The Consumer Systems Division is developing software products and technologies for use on the emerging public networks, including future interactive television networks, and for creating advanced multimedia applications, such as 3D titles.

The Applications and Content Product Group has two divisions that create and market productivity programs for PCs and multimedia content titles. The group also includes online systems and research. The Desktop Applications Division creates productivity applications. The Consumer Division develops products designed for the home, school, and small business market, including multimedia consumer products and PC input devices. The MSN Division is responsible for an online and Internet service. Microsoft Research is a research lab dedicated to creating new technology in support of the Company's vision for the evolution of personal computing.

The Sales and Support Group is responsible for building long-term business relationships with customers. This group is organized to serve three customer types: OEMs (original equipment manufacturers), end users, and organizations. The Sales and Support Group manages the channels that serve those customers. These include the OEM channel and the following geographic channels: U.S. and Canada, Europe, and Other International. The group also provides support for the Company's products through Product Support Services, Consulting Services, and Solutions Providers.

The Operations Group is responsible for managing business operations and overall business planning. This includes the process of manufacturing and delivering finished goods, licenses, subscriptions, and fulfillment orders; the publishing efforts of Microsoft Press; and other corporate functions.

## PRODUCTS

## PERSONAL SYSTEMS

The Personal Systems Division develops desktop operating systems software, which performs operations such as allocating computer memory, scheduling the execution of applications software, and managing the flow of information and communication among the various components of the PC. The division's primary desktop operating systems for PCs are: Microsoft Windows(R) 95, Microsoft MS-DOS(R), Microsoft Windows 3.1, and Microsoft Windows for Workgroups. (Windows 3.1 and Windows for Workgroups 3.11 are hereafter referred to collectively as "Windows 3.x.")

Windows 95: Microsoft's new personal operating system, designed to be the successor to MS-DOS and Windows 3.x, was released commercially on August 24, 1995. Windows 95 is a fully integrated, multitasking 32-bit operating system, compatible with mainstream PCs and most Windows 3.x and MS-DOS software applications. Windows 95 was also designed for the next generation of applications, games, PCs, and peripherals.

MS-DOS: Microsoft MS-DOS is a single-user, single-tasking operating system designed for PCs that utilize Intel microprocessor chips. Since the introduction of MS-DOS in 1981, the Company has enhanced MS-DOS as new technologies have developed and new user needs have arisen. MS-DOS has been preinstalled by OEMs on most PCs.

Windows 3.1: Microsoft Windows 3.1 is a graphical operating system for MS-DOS-based PCs. Microsoft Windows 3.1 supports high-performance Windows-based applications, and offers ease of use and aesthetic appeal, scalable TrueType(R) fonts, built-in multimedia functionality, and straightforward integration into corporate computing environments.

Windows for Workgroups 3.11: Windows for Workgroups 3.11 integrates network and workgroup functionality directly into the Windows operating system. With Windows for Workgroups, users can share files, data, and printers, with ease of access and security.

#### BUSINESS SYSTEMS

The Business Systems Division is focused on delivering a broad range of business computing solutions for organizations. The division develops and markets an integrated product line of software for creating business solutions, including foundation operating systems for servers and workstations, as well as applications for business servers. Server applications development is divided into the areas of databases, connectivity, systems management, and workgroup applications. Server software products are marketed separately or as a part of an integrated family of products, the Microsoft BackOffice(TM). The BackOffice family includes the following key products.

Windows NT Workstation and Server: Microsoft Windows NT(TM) Workstation is a powerful desktop operating system designed for demanding business needs. It is a 32-bit, multithreaded operating system for mission critical computing which provides the same feature and applications programming interface (API) set across four hardware platforms: Intel, Alpha AXP, MIPS, and Power PC. The operating system provides integrated mail and networking with remote access, pre-emptive multitasking, and support for background communication sessions. The Windows NT Server is designed to be the network foundation for a new generation of business applications. It provides extensive network management features, administration tools, security, and fault tolerance. It is a platform for business critical applications and database, connectivity, system management, and mail servers.

SQL Server: Microsoft SQL Server is a high-performance relational database management system designed specifically for distributed computing. SQL Server supports the Structured Query Language, which is a commonly used language through which application programs communicate with relational databases. The Company provides SQL Server for Windows NT systems. This product is developed in the Developer Division and marketed as part of BackOffice by the Business Systems Division.

SNA Server: Microsoft SNA Server is a robust, highly fault-tolerant, and easy-to-maintain gateway product that connects PC local area networks (LANs) with IBM host systems using SNA protocols.

Systems Management Server: Microsoft Systems Management Server is a software tool that helps information technology departments centrally manage distributed-computing environments. With Systems Management Server, system administrators can distribute and install software to PCs throughout an enterprise, meter software licenses, conduct remote diagnostics, and perform a detailed inventory of hardware and software resources.

Mail Server: Microsoft Mail Server for PC networks is a system for distributing messages and information. It provides administrative utilities for managing message files, addresses, and mail system

capabilities. Microsoft Mail Server supports users of popular desktop platforms, including Windows 95, Windows 3.x, MS-DOS, Macintosh, and OS/2.

Mail: Microsoft Mail for PC networks includes client-access software for Windows 95, Windows 3.x, MS-DOS, Macintosh, and OS/2 platforms. In addition, this workgroup application offers large corporate users support for multiple network environments. A companion product, Microsoft Mail for AppleTalk networks, is used by companies with Macintosh servers. Microsoft Mail Remote for Windows offers software for remote clients used by travelers or those working at home to stay in touch with the office mail system.

Schedule+: Microsoft Schedule+ is a calendar and scheduling program that helps individuals and groups manage their time and resources. The program can search other workgroup members' schedules to determine meeting availability times, provide invitees the means to accept, decline, or tentatively accept invitations to meetings, and automatically notify attendees if a meeting is canceled or rescheduled.

#### DEVELOPER PRODUCTS

The Developer Division provides software development tools, database products, and technical information to Windows developers worldwide. These products and services help independent software developers, corporate developers, solutions developers, and hobbyists create a wide variety of applications, primarily for Windows 95, Windows 3.x, and Windows NT.

Database Products: Database products control the maintenance and utilization of structured data organized into a set of records or files. The Company offers database products which span the needs of a wide variety of users, from individuals to large corporations. These products include Microsoft Access, Microsoft FoxPro(R), Microsoft SQL Server, and a variety of database connectivity technologies. Microsoft Access is a relational database management application, also offered in conjunction with Microsoft Office, which provides access to structured business data. Microsoft FoxPro is a desktop database development tool which is compatible with the industry standard xBase development language. FoxPro supports xBase applications on MS-DOS, Windows 3.x, Windows 95, Windows NT, Macintosh, and UNIX. The Open Database Connectivity (ODBC) product provides access and connectivity to read and write to various databases from other computer industry vendors from within Microsoft Windows applications.

Software Development Tools and Computer Languages: Software development tools and computer languages allow software developers to write programs in a particular computer language and translate programs into a binary machine-readable set of commands that activate and instruct the hardware. The Company develops and markets a number of software development environments, language compilers, and software testing tools. Microsoft Visual C++(TM) is the Company's development system for 16- and 32-bit application development on Windows 3.x, Windows 95, and Windows NT. The Microsoft Visual Basic(TM) programming system for Windows 95, Windows 3.x, and Windows NT operating systems provides easy access to a wide variety of data sources by integrating the Microsoft Access database engine and the ability to leverage investments in commercial applications through OLE 2.0. Additionally, the Company offers professional, highly-integrated development environments in the FORTRAN language for MS-DOS, Windows 3.x, and Windows NT.

Developer Information Products: The Company provides third party software developers with a wide range of technical and support information that assists them in developing software products intended to run on Windows 3.x, Windows 95, and Windows NT. Developers subscribe to the Microsoft Developer Network (MSDN) information service and receive periodic updates via CD-ROMs, magazines, and several on-line information services.

#### CONSUMER SYSTEMS

The Consumer Systems Division is developing advanced system software. Core technologies under development include broadband networking and multimedia operating system architecture, advanced video and graphics, and new authoring system technologies for interactive television. The group is also responsible

for the development and marketing activities of the Company's SoftImage products, which include authoring and editing systems for film and video.

#### DESKTOP APPLICATIONS SOFTWARE

The Desktop Applications Division develops applications software, which provides the PC with instructions for the performance of end user tasks. The Company's desktop applications software is designed for use by a broad class of end users, regardless of business, industry, or market segment. Primary examples of desktop applications software are word processing, spreadsheet, and presentation graphics programs. The Company's desktop applications programs are developed principally for Windows 95, Windows 3.x, and Macintosh operating systems.

**Microsoft Office:** Microsoft Office(R) is a suite of software programs featuring seamless integration of the most commonly used desktop applications. Microsoft Office is based upon a document-centric concept, with common commands and extensive use of object linking and embedding (OLE) cross-application capabilities. Microsoft Office is available in two editions, Standard and Professional. The Standard Edition includes Microsoft Word, Microsoft Excel, and the Microsoft PowerPoint(R) presentation graphics program. The Microsoft Office for Windows 95 version also includes Schedule+, while earlier versions of the Standard Edition included a client-access license for Microsoft Mail. The Standard Edition is available for Windows 95, Windows 3.x, and Macintosh operating systems. The Microsoft Office Professional Edition for Windows adds the Microsoft Access(R) database.

**Microsoft Word:** The Company's principal word processing program is Microsoft Word. Versions of Microsoft Word for Windows 95 and for Windows 3.x provide all the features that users of word processing products expect in the Windows graphical environment, plus the ability to handle graphics, tables, spreadsheet data, charts, and images imported from other Windows-based software programs. The Company also has Windows NT and Macintosh versions of Microsoft Word.

**Microsoft Excel:** The Company's spreadsheet program is Microsoft Excel, which is available for Windows 95, Windows 3.x, Windows NT, and Macintosh operating systems. It is an integrated spreadsheet with pivot table, database, and business graphics capabilities. Microsoft Excel allows full linking and embedding of objects that permits users to view and edit graphics or charts from other Windows-based programs from the worksheet in which the object is stored. Microsoft Excel graphics capabilities can be linked to its spreadsheets to allow simultaneous changes to charts as changes are made to the spreadsheets.

**Microsoft PowerPoint:** Microsoft PowerPoint is a presentation graphics program for producing slides, overheads, transparencies, and prints. The Company markets versions of PowerPoint for Windows 95, Windows 3.x, and the Macintosh.

**Microsoft Project:** Microsoft Project is a critical path project scheduling and resource allocation program that runs on Windows 95, Windows 3.x, and Macintosh operating systems. The product can perform as a budgeting, monitoring, and cost estimating tool for large business projects and as a critical path and schedule planning tool.

#### ONLINE SERVICES

The MSN Division manages MSN, The Microsoft Network, a new, interactive online service. MSN provides easy and inexpensive access for users to a wide range of graphically-rich online content, a compelling business model and platform for independent content providers (ICPs), and rich and powerful development tools.

**The Microsoft Network:** Client-access software for MSN is included as a feature of Windows 95, which was released commercially on August 24, 1995. The online service provides access to the Internet, electronic mail, bulletin boards, and myriad additional services offered by Microsoft and by independent content providers. The Microsoft Internet Explorer, an Internet browser, takes advantage of various technical advances in Windows 95 and includes real-time audio capabilities. Content and service providers aligned with MSN

have flexibility in creating products and pricing their services, such as subscriptions, online transactions, and ticket events. Services may be supported by advertising and commerce.

MSN is owned by The Microsoft Network, LLC (formerly the Microsoft Online Services Partnership). Microsoft owns 80% of the entity and a wholly owned subsidiary of Tele-Communications, Inc. (TCI) owns the remaining 20%.

#### CONSUMER PRODUCTS

The Microsoft Consumer Division develops and markets useful, enjoyable, and fundamental software and services for small businesses, schools, and homes. The division is developing and managing a synergistic product line focusing on the following categories of consumer usage: Information, Productivity, Kids, Personal Finance, Entertainment, and PC Input Devices. Many of the titles are available on CD-ROM.

**Information:** Reference titles include Microsoft Encarta(TM) and Microsoft Bookshelf(R), which are both available for Windows 3.x and Macintosh operating systems. The Encarta multimedia encyclopedia database blends text in articles with a wealth of innovative, interactive information presented through animations, videos, maps, charts, sounds, and pictures. Bookshelf is a multimedia reference library that integrates seven well-respected and authoritative works on one compact disc, including a dictionary, world atlas, world almanac, thesaurus, concise encyclopedia, and two books of quotations.

**Personal interest** titles include Microsoft Cinemania(TM), an interactive guide to the movies with entries for 19,000 films, Microsoft Dinosaurs, and many musical titles.

**Geography and travel** products include Automap Road Atlas, a comprehensive route-planning program with detailed maps and road information for routes in North America.

**Productivity:** The Company's leading consumer productivity products are Microsoft Works and Microsoft Publisher. The Company markets versions of Microsoft Works that run on Windows 95, Windows 3.x, MS-DOS, and Macintosh operating systems. Microsoft Works is an integrated software program that contains basic word processing, spreadsheet, and database capabilities that allows the easy exchange of information from one tool to another. Microsoft Publisher is an easy-to-use, entry-level desktop publishing tool for Windows 95 and Windows 3.x operating systems. Publisher features an interactive tool that automates the design process of 12 custom publications, including newsletters, calendars, greeting cards, and invitations.

**Kids:** Titles for children include Microsoft Creative Writer and Microsoft Fine Artist. Creative Writer is a full-featured creative writing and publishing program; Fine Artist is a comprehensive art program. Both products take advantage of the computer's ability to integrate text, high-quality graphics, sound, and animation to produce an enriching creative experience for children. The Company also has a series of products based on the popular children's books and television series, The Magic School Bus.

**Personal Finance:** Microsoft Money is a financial organization product that allows users to computerize their household finances. Microsoft Money is available for systems running Windows 95 and became available August 24, 1995. It is visually appealing, easy to use, and focuses on the financial tasks that people do most often. Microsoft Money provides enhanced online home-banking services with 17 different banks in the U.S. Users who are customers of participating banks will be able to pay bills online, access up-to-date statements and balances, transfer funds, and send email messages and inquiries to their banks.

**Entertainment:** The Company also has a line of entertainment products. Microsoft Flight Simulator, which was developed by Bruce Artwick Organization Ltd., is a popular airplane-flying game available for MS-DOS and Macintosh operating systems. Microsoft Golf, licensed from Access Software, Inc., is a realistic simulation of the sport of golf for Windows 95 and Windows 3.x operating systems.

**PC Input Devices:** The Company's major input device is the Microsoft Mouse, a hand-held pointing device that facilitates use of a PC. It can be used with MS-DOS, Windows 95, and Windows 3.x operating systems and works with many applications products from Microsoft and other companies. The Microsoft BallPoint(R) Mouse is designed especially for use with laptop and notebook computers. The BallPoint Mouse is shipped with a universal clamp that fits on the keyboards of most laptop computers and a positioner that allows

the user to adjust the angle of the mouse to the keyboard. The Company also designed and markets the Microsoft Natural Keyboard(TM), an ergonomically-designed keyboard.

#### MICROSOFT PRESS

Microsoft Press publishes books about software products from Microsoft and other software developers and about current developments in the industry. Books published by Microsoft Press typically are written and copyrighted by independent authors who submit their manuscripts to the Company for publication and who receive royalties based on net revenues generated by the book.

Microsoft Press contracts with an independent commercial printer for the manufacturing of its books. Publisher's Resources, Inc. acts as the Company's main fulfillment house in the United States, maintaining the majority of the inventory of Microsoft Press books. Books are marketed by independent sales representatives and by Microsoft Press sales personnel. Internationally, Microsoft Press has numerous international agreements with publishers for the worldwide distribution of its books. Microsoft Press has granted a publisher in England the right to distribute English language versions of its books in all countries except the United States, Canada, Central and South America, and certain Asian countries. In most cases, Microsoft Press provides each publisher with a book's manuscript, and the publisher arranges for its translation and the printing, marketing, and distribution of the translated version.

#### PRODUCT DEVELOPMENT

The PC software industry is characterized by extremely rapid technological change, which requires a continuous and high level of expenditures for enhancing existing products and developing new products. The Company is committed to continued high expenditures for research and product development.

Most of the Company's software products are developed internally. The Company also purchases technology, licenses intellectual property rights, and oversees third party development for certain products. Product documentation is also created internally. Internal development enables Microsoft to maintain closer technical control over the products and gives the Company the freedom to designate which modifications and enhancements are most important and when they should be implemented. The Company has created a substantial body of proprietary development tools and has evolved a development methodology for creating and enhancing its products. These tools and methodology are also designed to simplify a product's portability among different operating systems or computers.

The Company believes that a crucial factor in the success of a new product is getting it to market quickly to respond to new user needs or advances in hardware design, without compromising product quality. The Company strives to become as informed as possible at the earliest possible time about changing usage patterns and hardware advances that may affect software design.

During fiscal years 1993, 1994, and 1995, the Company spent \$470 million, \$610 million, and \$860 million, respectively, on product research and development activities. Those amounts represented 12.5%, 13.1%, and 14.5%, respectively, of net revenues in each of those years.

#### LOCALIZATION

In order to best serve the needs of users in foreign countries, Microsoft "localizes" many of its products to reflect local languages and conventions. In France, for example, all user messages and documentation are in French and all monetary references are in French francs, and in the United Kingdom, monetary references are in British pounds and user messages and documentation reflect certain British conventions. Various Microsoft products have been localized into more than 30 languages.

#### MANUFACTURING

The Company has manufacturing facilities located in the United States, Puerto Rico, and Ireland. The Company's manufacturing operations involve disk replication, assembly of purchased parts, and final packaging. Quality control tests are performed on purchased parts, finished disks, and other products. The



chief materials and components used in Microsoft products include disks or CD-ROMs, books, and multicolor printed materials. The Company is often able to acquire component parts and materials on a volume discount basis. The Company has multiple sources for raw materials, supplies, and components.

The Company contracts a substantial portion of its manufacturing activity to third parties. Outside manufacturers produce various software products, documentation, and hardware such as mouse pointing devices and keyboards. There are other custom manufacturers in the event that outsourced manufacturing becomes unavailable from current sources.

#### MARKETING AND DISTRIBUTION

Microsoft aligns its sales and marketing people with three customer types: end users, organizations, and OEMs. The Company's sales and marketing staff seeks to build long-term relationships with these customers of Microsoft products. Microsoft has four major channels of distribution which deliver product to end users: finished goods in the U.S. and Canada, Europe, and Other International; and OEM.

The end user customer unit has responsibility for activities that target end users who make individual buying decisions for the PCs they use at work or home. All sales and marketing activities aimed at end user customers are performed by this unit, including developing and administering distributor and reseller relationships; reseller sales terms and conditions; channel marketing and promotions; end user marketing programs; support policies; and seminars, events, and sales training for resellers. The key products licensed and sold are the Company's personal operating systems and consumer and desktop applications.

The organization customer unit has responsibility for activities that target groups of users in organizations of all sizes. The unit works with Solutions Providers, the Microsoft Consulting Services division, and directly with organizations to create enterprise-wide solutions to business computing problems. The unit's sales and marketing activities include providing technical training of Solutions Providers and channel resellers; developing support policies; and supporting and providing seminars, events, and sales training for resellers and Solutions Providers. Key products are the Company's business systems, developer software, and software sold via volume licensing programs. In the U.S., the organization customer unit is further segregated into an enterprise customer unit, which services only large organization customers, and a more specialized unit which services small and medium customers.

The OEM customer unit includes the sales force which works with original equipment manufacturers that include Microsoft software on their PCs.

#### FINISHED GOODS CHANNELS

**Distributors and Resellers:** The Company markets its products in the finished goods channels primarily through independent non-exclusive distributors and resellers. Distributors include Computer 2000, Ingram Micro, and Merisel. Resellers include Egghead Software, Softbank, Software Spectrum, and Stream International (formerly Corporate Software). Microsoft has a network of field sales representatives and field support personnel who solicit orders from distributors and resellers and provide product training and sales support.

**Large Accounts:** The Company has a program designed to make it easier for large organizations to acquire and maintain Microsoft products. The program, Microsoft Select, offers flexible software acquisition, licensing, and maintenance options specially designed to meet the needs of large multinational organizations. Targeted audiences include technology specialists and influential end users in large enterprises. Marketing efforts and fulfillment are generally coordinated with the Microsoft network of large account resellers.

**Solutions Providers:** Microsoft's Solutions Providers program is a comprehensive support relationship with independent organizations that provide network and system integration, custom development, training, and technical support for business computing solutions. The program supports value-added resellers (VARs), system integrators, consultants, and developers, as well as technical support and training organizations. Under this business partnership strategy, the Company provides sales and product information, development services, early access to Microsoft products, and customer support tools including priority telephone support, education,

and business development support. To ensure high-quality technical services for the Company's products, Microsoft Solutions Providers are required to have Microsoft-certified professionals on staff.

**Consulting Services:** The Company's Consulting Services Division assists customers in using the Company's computer operating systems, applications, and communications products. The group works with Solutions Providers and helps create enterprise-wide computing solutions for large corporate accounts.

**Direct Marketing:** Microsoft promotes some of its products through direct marketing techniques directed toward existing and potential users of the Company's products. Promotional materials are typically delivered through the mail, utilizing lists of targeted individuals. Fulfillment of product to the end user is accomplished by either direct shipment or through resellers.

**International Sales Sites:** The Company has established marketing, support, and/or distribution subsidiaries in Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Colombia, Costa Rica, the Czech Republic, Denmark, Ecuador, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Ireland, Israel, Italy, Japan, Malaysia, Mexico, Morocco, the Netherlands, New Zealand, Norway, the People's Republic of China, Peru, the Philippines, Poland, Portugal, Puerto Rico, Russia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Arab Emirates, the United Kingdom, and Venezuela.

The Company's international operations, both OEM and finished goods, are subject to certain risks common to foreign operations in general, such as governmental regulations, import restrictions, and foreign exchange rate fluctuations. Microsoft hedges a portion of its foreign exchange risk.

#### OEM CHANNEL

The Company's operating systems are licensed primarily to OEMs under agreements that grant the OEMs the right to distribute copies of Microsoft's products with their computers. The Company also markets certain language and applications programs to OEMs under similar arrangements. In addition, the Company markets the Microsoft Mouse, BallPoint Mouse, and Natural Keyboard to OEMs for distribution to buyers of their computers. In almost all cases, the products are distributed under Microsoft trademarks. The Company has OEM agreements covering one or more of its products with virtually all of the major microcomputer OEMs, including AST Research, Acer, Digital Equipment Corporation, Dell, Compaq, Gateway 2000, Hewlett-Packard, IBM, NEC, Olivetti, Packard Bell, and Toshiba.

#### ADVERTISING

The Company works closely with large advertising and direct marketing firms. Advertising, direct marketing, worldwide packaging, and marketing materials are targeted to various end-user segments. The Company utilizes broad consumer media (television, radio, and business publications) and trade publications. Microsoft has programs under which qualifying resellers and OEMs are reimbursed for certain advertising expenditures. Microsoft also invests heavily in direct marketing and customer satisfaction areas. In 1996, the Company plans to spend more than \$150 million on a broad campaign emphasizing the Microsoft brand identity.

#### CUSTOMERS

As described above, Microsoft has three customer types: end users, organizations, and OEMs. Most end users of Microsoft products are individuals in businesses, government agencies, educational institutions, and at home. These end users obtain Microsoft products primarily through distributors, resellers, and OEMs, which include certain Microsoft products with their hardware. Notes to Financial Statements describe customers that represent more than 10% of the Company's revenues. The Company's practice is to ship its products promptly upon receipt of purchase orders from its customers and, consequently, backlog is not significant.

## PRODUCT SUPPORT SERVICES

The Company's Product Support Services group, with locations in the U.S. and in various Microsoft subsidiaries, provides product support coverage options to meet the needs of users of Microsoft products. The Company hires individuals with proven product expertise and provides them with productivity tools, continuous product education and training, and consistent processes to deliver quality support for Microsoft products. Certain telephone support is also supplied by qualified third-party support organizations. Coverage options range from standard no-charge toll telephone support to fee-based offerings providing unlimited 800 number telephone and electronic technical support across all Microsoft products 24 hours per day, 7 days per week.

Users have access to Microsoft KnowledgeBase, a library of thousands of technical articles that is updated regularly with useful information regarding Microsoft products. Microsoft provides access to KnowledgeBase via MSN, America Online, CompuServe(R), GEnie(TM), Prodigy, and the Internet. Additionally, the Company offers two information subscription services: Microsoft TechNet and Microsoft Developer Network.

As a supplement or alternative to direct support, the Company enhances the third party support channel by providing Microsoft Solutions Providers with education, training, tools, and support. Microsoft Solutions Providers include Authorized Training Centers, which offer advanced product education and certification on Microsoft products; and Authorized Support Centers, which provide a wide spectrum of multinational support, multivendor support, and integration services.

## COMPETITION

The microcomputer software business is intensely competitive and subject to extremely rapid technological change. Microsoft faces formidable competition in all areas of its business activity, including competition from many companies whose revenues and resources are much larger than Microsoft's.

**Operating systems.** Microsoft's operating systems products face substantial competition from a number of sources. Major competitors such as IBM, Apple Computer, Digital Equipment Corporation, and others, which are vertically integrated in both software development and hardware manufacture, have developed operating systems that they preinstall on computers of their own manufacture. Many of these operating system software products are also licensed to third party OEMs for preinstallation on their machines. Microsoft's operating systems products compete with UNIX-based operating systems from a wide range of companies including IBM, AT&T, Hewlett Packard, Sun Microsystems, Novell, The Santa Cruz Operation, and others. Variants of UNIX run on a wide variety of computer platforms and are gaining increasing acceptance as desktop operating systems. As microcomputer technology increasingly moves toward connectivity and communications, Microsoft's operating systems products will face increased competition from network server operating systems, such as Novell NetWare, and "middleware" products such as Lotus Notes from IBM. Microsoft's operating systems products also face constant competition from software pirates who unlawfully copy and distribute Microsoft's copyrighted software products.

**Business systems.** The Company is a fairly recent entrant into enterprise-wide computing solutions. As such, competitors enjoy larger market shares and installed bases. Software developers that provide competing server applications include Oracle, Sybase, and Informix. There are also several software vendors who offer connectivity servers. Additionally, Lotus Development (now owned by IBM) has a large installed base of Lotus Notes and cc:Mail, which compete with the Company's workgroup products.

**Desktop applications.** The Company's competitors include many software application vendors, such as Lotus, Oracle, Claris, and Novell. Some of the competitors in this arena do not offer products in every major desktop application category (e.g., spreadsheet, word processors, databases, etc.) and as a result may be able to more effectively focus their efforts on enhancing particular product offerings.

**Online services.** An enormous range of companies, including media conglomerates, telephone companies, cable companies, retailers, hardware manufacturers, and software developers, are competing to make online services widely available to computer users. Microsoft's new online services network, MSN, faces

formidable competition from both established online networks, such as CompuServe (owned by H&R Block), Prodigy (owned by IBM and Sears), America Online, and others, and impending entrants, such as a number of new online networks that will be offered by AT&T. MSN and other online networks also face competition from online services that are offered to users directly via the Internet, including, in particular, the World Wide Web portion of the Internet. Additionally, Netscape, Adobe, Sun Microsystems, and many other companies offer software for Internet servers and for user navigation of the Internet.

**Developer.** The Company's developer products compete against offerings from Sybase, Borland, and many other companies.

**Consumer.** Microsoft's Consumer division faces many smaller but focused competitors, particularly in the areas of entertainment and education. Examples include Intuit, Broderbund, Electronic Arts, Softkey, The Learning Company, Davidson Associates, Voyager, Comptons, Edmark, Sierra On-Line, and Dorling Kindersley. Still other competitors own branded content, such as Walt Disney and Lucas Arts. Additionally, as platforms become more powerful, PC-based games will compete head-to-head with games created for proprietary systems such as Nintendo and Sega. The Consumer Division's input devices face substantial competition from computer manufactures, since computers are typically sold with a keyboard and mouse, and other manufacturers of these devices.

The Company believes that the principal competitive factors in marketing PC software are the product's reputation, features and functions, ease of use, reliability, price relative to performance, timeliness of delivery, and availability and quality of support services. There is no assurance that the Company's competitive position will not be adversely affected by one or more of these factors in the future, particularly in view of the fast pace of technological change in the software industry.

#### EMPLOYEES

As of June 30, 1995, the Company employed 17,801 people, 12,193 domestically and 5,608 internationally. Of the total, 5,397 were in product research and development, 9,166 in sales, marketing, and support, 1,639 in manufacturing and distribution, and 1,599 in finance and administration. Microsoft's success is highly dependent on its ability to attract and retain qualified employees. Competition for employees is intense in the software industry. To date, the Company believes it has been successful in its efforts to recruit qualified employees, but there is no assurance that it will continue to be as successful in the future. None of the Company's employees are subject to collective bargaining agreements. The Company believes that relations with its employees are excellent.

#### ITEM 2. PROPERTIES

The Company's corporate offices consist of approximately 2.2 million square feet of office building space located in Redmond, Washington. There are two sites that total approximately 300 acres of land. The Company is constructing a 225,000 square foot office building, which is expected to be completed in the spring of 1996. Additionally, construction is continuing on another series of office buildings with approximately 685,000 square feet of space. Occupancy on this site will be phased starting in the fall of 1995 and completed by spring of 1996. The Company owns all of its corporate campus.

The Company's domestic manufacturing and distribution operation consists of a 265,000 square foot facility situated on 23 acres in nearby Snohomish County, Washington, and a 45,000 square foot disk duplication facility in Humacao, Puerto Rico. The Puerto Rican facility, which began operation in April 1990, is leased under a 10-year lease, with an option to renew for an additional 10 years. The Company's European manufacturing operation consists of a 155,000 square foot facility situated on 12 acres in Dublin, Ireland. The Ireland site also includes a 25,000 square foot office building for international localization. An additional 80,000 of square feet of office space for localization is being constructed in Ireland.

The Company owns a 65,000 square foot office building on seven acres of land plus another 33 acres near London, England. In Les Ulis, France, the Company owns a 110,000 square foot office building on four acres of land.

In addition, the Company leases office space in numerous locations in the United States and many other countries.

### ITEM 3. LEGAL PROCEEDINGS

See Notes to Financial Statements -- Contingencies.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 1995.

### ITEM E.O. EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of Microsoft as of September 8, 1995 were as follows:

NAME	AGE	POSITION WITH THE COMPANY
----	---	-----
William H. Gates	39	Chairman of the Board; Chief Executive Officer
Steven A. Ballmer	39	Executive Vice President, Worldwide Sales and Support
Robert J. Herbold	53	Executive Vice President; Chief Operating Officer
Frank M. (Pete) Higgins	37	Group Vice President, Applications and Content Group
Paul A. Maritz	40	Group Vice President, Platforms Group
Nathan P. Myhrvold	36	Group Vice President, Applications and Content Group
James E. Allchin	43	Senior Vice President, Business Systems Division
Roger J. Heinen, Jr.	44	Senior Vice President, Developer Division
Joachim Kempin	53	Senior Vice President, Worldwide OEM Sales
Craig J. Mundie	46	Senior Vice President, Consumer Systems Division
William H. Neukom	53	Senior Vice President, Law and Corporate Affairs; Secretary
Jeffrey S. Raikes	37	Senior Vice President, North America
Brad A. Silverberg	41	Senior Vice President, Personal Systems Division
Patricia Q. Stonesifer	39	Senior Vice President, Consumer Division
Bernard P. Vergnes	50	Senior Vice President, Microsoft; President, Microsoft Europe
Michael W. Brown	49	Vice President, Finance; Chief Financial Officer

Mr. Gates co-founded Microsoft in 1975 and has been its Chief Executive Officer and Chairman of the Board since the original partnership was incorporated in 1981.

Mr. Ballmer was named Executive Vice President, Worldwide Sales and Support in February 1992. He had been Senior Vice President, Systems Software since 1989. From 1984 until 1989, Mr. Ballmer served as Vice President, Systems Software. He joined Microsoft in 1980.

Mr. Herbold joined Microsoft as Executive Vice President and Chief Operating Officer in November 1994. Herbold had been with The Procter & Gamble Company since 1968, with experience in information services, advertising and market research. Most recently, he was P&G's Senior Vice President, Information Services and Advertising.

Mr. Higgins was named Group Vice President, Applications and Content Group in May 1995. He was named Senior Vice President, Desktop Applications Division in March 1993. He had been Vice President, Desktop Applications Division since 1992 and previously, Vice President, Analysis Business Unit since 1991. Mr. Higgins joined Microsoft in 1983.

Mr. Maritz was named Group Vice President, Platforms Group in May 1995. He was named Senior Vice President, Product and Technology Strategy in November 1994 and had been Senior Vice President, Systems

Division since February 1992. He had been Vice President, Advanced Operating Systems since 1989. Mr. Maritz joined Microsoft in 1986.

Mr. Myhrvold was named Group Vice President, Applications and Content Group in May 1995. He was named Senior Vice President, Advanced Technology in July 1993. He had been Vice President, Advanced Technology and Business Development since 1989. Mr. Myhrvold joined Microsoft in 1986.

Mr. Allchin was named Senior Vice President, Business Systems Division in November 1994. He had been Vice President, Business Systems Division, since July 1991. Prior to joining Microsoft in 1991, Mr. Allchin spent seven years at Banyan Systems, Inc., where he held numerous positions, most recently Senior Vice President and Chief Technology Officer.

Mr. Heinen joined Microsoft as Senior Vice President, Developer Division in January 1993. He had been Senior Vice President and General Manager of the Macintosh Software Division at Apple Computer, Inc. from 1990 to 1993. Prior to 1990, Heinen was a corporate consulting engineer for software at Digital Equipment Corporation.

Mr. Kempin was named Senior Vice President, Worldwide OEM Sales in August 1993. He had been Vice President, OEM Sales since 1987. Mr. Kempin had served as General Manager of Microsoft's German subsidiary since its inception in 1983.

Mr. Mundie was named Senior Vice President, Consumer Systems Division in May 1995. He had been Vice President, Advanced Consumer Technology since July 1993. He joined Microsoft as General Manager, Advanced Consumer Technology Group in December 1992. Previously, Mr. Mundie had been CEO of Alliant Computer Systems Corporation, which declared bankruptcy on May 25, 1992 and was liquidated.

Mr. Neukom was named Senior Vice President, Law and Corporate Affairs in February 1994. He joined Microsoft in 1985 as Vice President. Mr. Neukom formerly was a member of the Seattle law firm of Shidler McBroom Gates & Lucas (now Preston Gates & Ellis), Microsoft's primary outside law firm.

Mr. Raikes was named Senior Vice President, Microsoft North America in January 1992. He had been Vice President, Office Systems since 1990. Mr. Raikes came to Microsoft in 1981.

Mr. Silverberg was named Senior Vice President, Personal Systems Division in November 1994. He joined Microsoft in August 1990 as Vice President, Personal Operating Systems Division. From 1987 until joining Microsoft, Mr. Silverberg served as Vice President, Engineering for Borland International, Inc.

Ms. Stonesifer was named Senior Vice President, Consumer Division in November 1994, after having been Vice President, Consumer Division since June 1993. She had been Vice President, Support since 1992 and General Manager of Product Support Services since 1991. Previously, she was General Manager of Microsoft Canada and before that, General Manager for Microsoft Press. Prior to joining Microsoft in 1988, Ms. Stonesifer was with Que Corporation, a publisher of books for computer users.

Mr. Vergnes is a Senior Vice President of Microsoft and was named President, Microsoft Europe in April 1992. He had been Vice President, Europe since 1989. Mr. Vergnes served as General Manager of Microsoft's French subsidiary since its inception in 1983.

Mr. Brown was named Chief Financial Officer in August 1994 and Vice President, Finance in April 1993. He had been Treasurer since February 1990, after joining Microsoft in January 1990. Previously, Mr. Brown was a partner in the accounting firm Deloitte & Touche, Microsoft's independent auditors.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's common stock is traded on The Nasdaq Stock Market under the symbol MSFT. On September 8, 1995, there were 35,643 holders of record of the Company's common stock. The Company has not paid cash dividends on its common stock.

QUARTERLY FINANCIAL AND STOCK PRICE INFORMATION  
(IN MILLIONS, EXCEPT PER SHARE DATA)

	QUARTER ENDED				YEAR
	SEPTEMBER 30	DECEMBER 31	MARCH 31	JUNE 30	
1993					
Net revenues.....	\$ 818	\$ 938	\$ 958	\$1,039	\$3,753
Operating income.....	289	326	338	373	1,326
Net income.....	209	236	243	265	953
Earnings per share.....	0.35	0.39	0.40	0.43	1.57
Common stock price per share:					
High.....	41	47 1/2	47 1/8	49	49
Low.....	32 3/4	37 7/8	38 3/8	39 7/8	32 3/4
1994					
Net revenues.....	\$ 983	\$1,129	\$ 1,244	\$1,293	\$4,649
Operating income.....	343	415	480	488	1,726
Net income.....	239	289	256	362	1,146
Earnings per share.....	0.39	0.48	0.42	0.59	1.88
Common stock price per share:					
High.....	44 1/4	43 1/4	44 5/8	54 5/8	54 5/8
Low.....	35 1/8	38	39	41	35 1/8
1995					
Net revenues.....	\$ 1,247	\$1,482	\$ 1,587	\$1,621	\$5,937
Operating income.....	437	520	549	532	2,038
Net income.....	316	373	396	368	1,453
Earnings per share.....	0.51	0.60	0.63	0.58	2.32
Common stock price per share:					
High.....	59 1/4	65 1/8	74 1/8	92 3/8	92 3/8
Low.....	46 7/8	53 7/8	58 1/4	68 3/4	46 7/8

## ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS  
(IN MILLIONS, EXCEPT EARNINGS PER SHARE)

	YEAR ENDED JUNE 30				
	1991	1992	1993	1994	1995
Net revenues.....	\$1,843	\$2,759	\$3,753	\$4,649	\$5,937
Net income.....	463	708	953	1,146	1,453
Earnings per share.....	0.82	1.20	1.57	1.88	2.32
Return on net revenues.....	25.1%	25.7%	25.4%	24.7%	24.5%
Cash and short-term investments.....	\$ 686	\$1,345	\$2,290	\$3,614	\$4,750
Total assets.....	1,644	2,640	3,805	5,363	7,210
Stockholders' equity.....	1,351	2,193	3,242	4,450	5,333

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## RESULTS OF OPERATIONS FOR 1993, 1994, AND 1995

Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including operating system platforms for personal computers (PCs), workstations, and servers; business and consumer applications for productivity, reference, education, and entertainment; and development tools. Microsoft also sells personal computer books and input devices, and is engaged in the research and development of online and advanced technology software products.

## NET REVENUES

Microsoft's net revenues grew 24% in the fiscal year ended June 30, 1994 and 28% in fiscal year 1995. Software license volume (as opposed to price) increases have been the principal factor in Microsoft revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and corporate license programs, such as Microsoft Select, is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, e.g., Microsoft Office, are less than the sum of the prices for the individual programs included in these products when such programs are licensed separately.

Product groups. Microsoft has a platforms product group and an applications and content product group.

Platforms product group revenues were \$1.52 billion, \$1.83 billion, and \$2.36 billion in 1993, 1994, and 1995.

Principal personal systems products have been the MS-DOS and Microsoft Windows operating systems. MS-DOS is preinstalled on PCs by most OEMs, and revenues from such licenses increased steadily in both 1994 and 1995. Revenues from retail upgrade versions of MS-DOS decreased in both 1994 and 1995 after a strong increase in 1993 when the MS-DOS 6 Upgrade was released. There were no major upgrades of MS-DOS in 1994 or 1995. The Microsoft Windows operating system was an increasingly strong contributor to revenues as the number of new PCs preinstalled with windows increased rapidly during the three-year period. Windows units licensed to new users were 15 million, 30 million, and 40 million in 1993, 1994, and 1995.

Business systems products offer an enterprise-wide distributed client/server environment based on the Microsoft Windows NT operating system and the server applications in the Microsoft BackOffice family of products. Revenues from these products increased strongly in 1994 and 1995.



Revenues from developer products increased steadily in all three years, as more independent software vendors, corporate developers, and solutions developers licensed tools to develop software for Windows and Windows NT.

Applications and content product group revenues were \$2.24 billion, \$2.82 billion, and \$3.58 billion in 1993, 1994, and 1995.

Increases in desktop applications revenues were led by strong sales of Microsoft Office. The Microsoft Office Standard product includes the Microsoft Excel spreadsheet, the Microsoft Word word processor, the Microsoft PowerPoint presentation graphics program, and a Microsoft Mail client-access license, while the Microsoft Office Professional version also includes the Microsoft Access database management system. Sales of stand-alone versions of Microsoft Excel and Microsoft Word decreased in 1994 and 1995 as the sales mix continued to shift to integrated product suites.

Microsoft Home, a broad range of consumer products, also showed continued growth. The Microsoft Home brand includes CD-ROM multimedia reference titles and software products for home and small office productivity, children's creativity, and entertainment. Microsoft also markets the Microsoft Mouse and Microsoft Natural Keyboard. Mouse sales were flat during the three-year period, while the initial introduction of the keyboard increased revenues in 1995.

Sales channels. Microsoft distributes its products primarily through OEM licenses, corporate licenses, and retail packaged products. OEM channel revenues are license fees from original equipment manufacturers. Microsoft has three major geographic sales and marketing organizations: U.S. and Canada, Europe, and elsewhere in the world (Other International). Sales of corporate licenses and packaged products in these channels are primarily to distributors and resellers.

OEM channel revenues were \$731 million in 1993, \$1.18 billion in 1994, and \$1.65 billion in 1995. The primary source of OEM revenues is the licensing of operating systems, particularly MS-DOS and Microsoft Windows. As such, OEM channel revenues are highly dependent on PC shipment volume.

U.S. and Canada channel revenues were \$1.37 billion, \$1.58 billion, and \$1.88 billion in 1993, 1994, and 1995.

Revenues in Europe were \$1.26 billion, \$1.36 billion, and \$1.49 billion in 1993, 1994, and 1995. Growth rates have been lower in Europe than in other geographic areas due to general economic slowness, higher existing market shares, and a more dramatic shift to corporate licensing programs.

Other International channel revenues were \$392 million in 1993, \$532 million in 1994, and \$924 million in 1995. Growth rates continue to be strong due to customer acceptance of newly localized products, particularly in Japan, and early entrance into emerging markets.

Microsoft's operating results are affected by foreign exchange rates. Approximately 44%, 40%, and 37% of Microsoft's revenues were collected in foreign currencies during 1993, 1994, and 1995. Since much of Microsoft's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates on net income is less than on revenues.

#### OPERATING EXPENSES

Cost of revenues. As a percentage of revenues, cost of revenues was 16.9% in 1993, 16.4% in 1994, and 14.8% in 1995. The percentage decreased due to a greater proportion of licenses to OEMs and corporations, lower disk prices from vendors, and a higher proportion of CD-ROM versions. These factors were offset somewhat by increased sales of lower-margin products such as integrated suites and upgrades.

Research and development. Microsoft made substantial investments in R&D in 1994, and the rate of growth accelerated in 1995. Expense increases resulted primarily from development staff headcount growth and higher levels of third-party development costs in many areas, including development efforts for Windows 95 and The Microsoft Network. R&D costs also increased for business systems, consumer systems, desktop applications, and consumer products.

Sales and marketing. The increase in the absolute dollar amount of sales and marketing expense in 1995 was due primarily to increased product-specific marketing programs, a Microsoft brand advertising campaign, and continued expansion of Product Support Services. In 1994, sales and marketing expenses increased at a slower rate than revenues due to a concerted performance orientation at all sales sites.

General and administrative. Increases in general and administrative expenses in 1994 and 1995 were primarily attributable to higher legal costs and growth in the computer systems and the number of people necessary to support overall increases in the scope of Microsoft's operations.

#### NONOPERATING ITEMS

Interest income, which was \$83 million, \$104 million, and \$193 million in 1993, 1994, and 1995, increased primarily as a result of a larger investment portfolio generated by cash from operations.

In the fourth quarter of 1995, Microsoft paid a \$46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger.

In the third quarter of 1994, Microsoft recorded a \$120 million charge to reflect the estimated impact of a jury verdict in the Stac Electronics patent litigation and related expenses. In June 1994, Microsoft reached an agreement with Stac to settle the litigation and adjusted its estimate accordingly, resulting in a credit of \$30 million in the fourth quarter and a net pretax charge of \$90 million for 1994.

#### PROVISION FOR INCOME TAXES

The effective tax rate increased from 32.0% in 1993 to 33.5% in 1994 and 33.0% in 1995 primarily because of an increase in the U.S. statutory income tax rate.

#### NET INCOME

Net income as a percent of revenues decreased in 1995 due to increased relative research and development, sales and marketing, and general and administrative expenses, offset by the lower relative cost of revenues and the higher relative net nonoperating income. The net income percentage decreased in 1994, primarily due to the patent litigation charge and increased research and development expenses, offset by the lower relative level of sales and marketing expenses.

#### FINANCIAL CONDITION

Microsoft's cash and short-term investments totaled \$4.75 billion at June 30, 1995. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are investment grade and liquid. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. Microsoft's portfolio is invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs. Microsoft has no material long-term debt. Microsoft has \$70 million of standby multicurrency lines of credit that support foreign currency hedging and international cash management.

Stockholders' equity at June 30, 1995 exceeded \$5.3 billion.

Cash generated from operations has been sufficient historically to fund Microsoft's investment in research and development activities and facilities expansion. As Microsoft grows, investments will continue in research and development in existing and advanced areas of technology. Microsoft's cash will also be used to acquire technology and to fund ventures and other strategic opportunities. Additions to property, plant, and equipment are expected to continue, including facilities and computer systems for research and development, sales and marketing, product support, and administrative staff. For example, on June 30, 1995, commitments related to the construction of new buildings approximated \$150 million.

The exercise of stock options by employees provides additional cash. These proceeds have been used in Microsoft's open market stock repurchase program through which Microsoft provides shares for stock option and stock purchase plans. This program will continue in 1996.

During 1995, to enhance its stock repurchase program, Microsoft sold equity put warrants to independent third parties. These put warrants entitle the holders to sell shares of Microsoft common stock to Microsoft on certain dates at specified prices.

Also during 1995, a subsidiary of Tele-Communications, Inc. (TCI) purchased a 20% minority interest in the newly formed Microsoft Online Services Partnership. TCI contributed \$125 million of TCI common stock, and Microsoft contributed the business assets of its online service, The Microsoft Network, which was in development.

Management believes existing cash and short-term investments together with funds generated from operations will be sufficient to meet operating requirements in 1996. Microsoft's cash and short-term investments are also managed to be available for strategic investment opportunities or other potential large-scale cash needs that may arise in pursuit of Microsoft's long-term strategies.

Microsoft shareholders have also authorized the issuance of up to 100 million shares of preferred stock, which may be used for any proper corporate purpose.

Microsoft has not paid cash dividends on its common stock.

#### OUTLOOK AND UNCERTAINTIES

Microsoft does not provide forecasts of potential future financial performance. While management of Microsoft is optimistic about Microsoft's long-term prospects, the following issues and uncertainties, among others, should be considered in evaluating its growth outlook.

Rapid technological change. The personal computer software industry is characterized by rapid technological change and uncertainty as to the impact of emerging areas such as the Internet and online services, the information highway, networked collaboration products, and electronic commerce.

Long-term investment cycle. Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. Microsoft's plans for 1996 include significant investments in software research and development and related product opportunities from which significant revenues are not anticipated for a number of years. Management expects total spending for research and development in 1996 to increase over spending in 1995.

Customer acceptance. While Microsoft performs extensive usability and beta testing of new products, user acceptance and corporate penetration rates ultimately dictate the success of development and marketing efforts of products such as Windows 95, Microsoft Office for Windows 95, or the Microsoft BackOffice family of products.

Product ship schedules. Delays in the release of new products can cause operational inefficiencies that impact manufacturing and distribution logistics, independent software vendor (ISV) and OEM relationships, and telephone support staffing.

Prices. Future prices Microsoft is able to obtain for its products may decrease from historical levels depending on competitive market or cost factors. Prices of software in Europe are generally higher than in the U.S. to cover localization costs and higher costs of distribution. Such price uplifts could erode in the future.

Integrated suites. The price of integrated suites such as Microsoft Office, is less than the sum of the prices for the individual programs included in this product when such programs are licensed separately. Revenues from Microsoft Office may continue to increase as a percentage of total revenues.

Saturation. Product upgrades, enabling users to upgrade from earlier versions of Microsoft's products or from competitors' products, have lower prices and margins than new products. As the desktop applications market becomes saturated, the sales mix shifts from standard products to upgrade products. This trend is expected to continue.

Channel mix. Average revenue per license is lower from OEM licenses than from retail versions, reflecting the relatively lower direct costs of operations in the OEM channel. An increasingly higher percentage of revenues was achieved through the OEM channel during 1994 and 1995.

Corporate licenses. Average revenue per unit from corporate license programs is lower than average revenue per unit from retail versions shipped through the finished goods channels. Unit sales under corporate licensing programs may continue to increase.

Cost of revenues. Although cost of revenues as a percentage of net revenues decreased in 1994 and 1995, it varies with channel mix and product mix within channels. Changes in channel and product mix, including the potential retail upgrade cycle of Windows 95, may increase cost of revenues as a percentage of net revenues in 1996.

Sales and marketing and support investments. Microsoft's plans for 1996 include continued investments in its sales and marketing and support groups. Microsoft brand advertising is also expected to increase.

Foreign exchange. A large percentage of Microsoft's sales and costs of manufacturing and marketing are transacted in local currencies. As a result, Microsoft's international results of operations are subject to foreign exchange rate fluctuations.

Intellectual property rights. Microsoft diligently defends its intellectual property rights, but unlicensed copying of software represents a loss of revenues to Microsoft. While this adversely affects U.S. revenues, revenue loss is even more significant outside of the U.S., particularly in certain countries where laws are less protective of intellectual property rights. Throughout the world, Microsoft actively educates consumers on the benefits of licensing genuine products and educates lawmakers on the advantages of a business climate where intellectual property rights are protected. There can be no assurance that continued efforts will affect revenues positively.

Future growth rates. If a substantial number of users upgrade to Windows 95, revenue growth rates in the initial shipping quarters of 1996 could be at relatively high levels. Revenue growth rates in the comparable quarters of 1997 may not approach such levels. As discussed above, operating expenses are expected to increase in 1996. Because of the fixed nature of a significant portion of such expenses, coupled with the possibility of slower revenue growth, operating margins in 1997 may decrease from those in 1996.

Litigation. Litigation regarding intellectual property rights, patents, and copyrights is increasing in the PC software industry. In addition, there are government regulation and investigation risks along with other general corporate legal risks.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

##### INDEX TO FINANCIAL STATEMENTS

Income Statements for the three years ended June 30, 1995.....	19
Cash Flows Statements for the three years ended June 30, 1995.....	20
Balance Sheets as of June 30, 1995 and 1994.....	21
Stockholders' Equity Statements for the three years ended June 30, 1995.....	22
Notes to Financial Statements.....	23
Independent Auditors' Report.....	29
Schedule II -- Valuation and Qualifying Accounts for the three years ended June 30, 1995.....	32

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

INCOME STATEMENTS  
(IN MILLIONS, EXCEPT EARNINGS PER SHARE)

	YEAR ENDED JUNE 30		
	1993	1994	1995
Net revenues.....	\$3,753	\$4,649	\$5,937
Operating expenses:			
Cost of revenues.....	633	763	877
Research and development.....	470	610	860
Sales and marketing.....	1,205	1,384	1,895
General and administrative.....	119	166	267
Total operating expenses.....	2,427	2,923	3,899
Operating income.....	1,326	1,726	2,038
Interest income -- net.....	82	102	191
Noncontinuing items.....	--	(90)	(46)
Other expenses.....	(7)	(16)	(16)
Income before income taxes.....	1,401	1,722	2,167
Provision for income taxes.....	448	576	714
Net income.....	\$ 953	\$1,146	\$1,453
Earnings per share.....	\$ 1.57	\$ 1.88	\$ 2.32
Weighted average shares outstanding.....	606	610	627

See accompanying notes.

CASH FLOWS STATEMENTS  
(IN MILLIONS)

	YEAR ENDED JUNE 30		
	1993	1994	1995
<b>CASH FLOWS FROM OPERATIONS</b>			
Net income.....	\$ 953	\$ 1,146	\$ 1,453
Depreciation and amortization.....	151	237	269
Current liabilities.....	177	360	419
Accounts receivable.....	(121)	(146)	(91)
Inventories.....	(51)	23	15
Other current assets.....	(35)	(27)	(75)
	-----	-----	-----
Net cash from operations.....	1,074	1,593	1,990
	-----	-----	-----
<b>CASH FLOWS FROM FINANCING</b>			
Common stock issued.....	229	280	332
Common stock repurchased.....	(250)	(348)	(649)
Stock option income tax benefits.....	207	151	179
	-----	-----	-----
Net cash from financing.....	186	83	(138)
	-----	-----	-----
<b>CASH FLOWS USED FOR INVESTMENTS</b>			
Additions to property, plant, and equipment.....	(236)	(278)	(495)
Other assets.....	(17)	(64)	(230)
Short-term investments.....	(723)	(860)	(651)
	-----	-----	-----
Net cash used for investments.....	(976)	(1,202)	(1,376)
	-----	-----	-----
Net change in cash and equivalents.....	284	474	476
Effect of exchange rates on cash.....	(62)	(10)	9
Cash and equivalents, beginning of year.....	791	1,013	1,477
	-----	-----	-----
Cash and equivalents, end of year.....	1,013	1,477	1,962
Short-term investments.....	1,277	2,137	2,788
	-----	-----	-----
Cash and short-term investments.....	\$2,290	\$ 3,614	\$ 4,750
	=====	=====	=====

See accompanying notes.

BALANCE SHEETS  
(IN MILLIONS)

	JUNE 30	
	1994	1995
<b>ASSETS</b>		
Current assets:		
Cash and short-term investments.....	\$3,614	\$4,750
Accounts receivable -- net of allowances of \$92 and \$139.....	475	581
Inventories.....	102	88
Other.....	121	201
	-----	-----
Total current assets.....	4,312	5,620
Property, plant, and equipment -- net.....	930	1,192
Other assets.....	121	398
	-----	-----
Total assets.....	\$5,363	\$7,210
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable.....	\$ 324	\$ 563
Accrued compensation.....	96	130
Income taxes payable.....	305	410
Other.....	188	244
	-----	-----
Total current liabilities.....	913	1,347
	-----	-----
Minority interest.....	--	125
	-----	-----
Put warrants.....	--	405
	-----	-----
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital -- shares authorized 2,000; issued and outstanding 581 and 588.....	1,500	2,005
Retained earnings.....	2,950	3,328
	-----	-----
Total stockholders' equity.....	4,450	5,333
	-----	-----
Total liabilities and stockholders' equity.....	\$5,363	\$7,210
	=====	=====

See accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS  
(IN MILLIONS)

	YEAR ENDED JUNE 30		
	1993	1994	1995
<b>COMMON STOCK AND PAID-IN CAPITAL</b>			
Balance, beginning of year.....	\$ 657	\$1,086	\$1,500
Common stock issued.....	229	280	332
Common stock repurchased.....	(7)	(17)	(30)
Proceeds from sale of put warrants.....	--	--	49
Reclassification of put warrant obligation.....	--	--	(25)
Stock option income tax benefits.....	207	151	179
	-----	-----	-----
Balance, end of year.....	1,086	1,500	2,005
	-----	-----	-----
<b>RETAINED EARNINGS</b>			
Balance, beginning of year.....	1,536	2,156	2,950
Common stock repurchased.....	(243)	(331)	(668)
Reclassification of put warrant obligation.....	--	--	(380)
Net income.....	953	1,146	1,453
Translation adjustment.....	(90)	(21)	(27)
	-----	-----	-----
Balance, end of year.....	2,156	2,950	3,328
	-----	-----	-----
Total stockholders' equity.....	\$3,242	\$4,450	\$5,333
	=====	=====	=====

See accompanying notes.



NOTES TO FINANCIAL STATEMENTS  
(IN MILLIONS)

SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation. The financial statements include the accounts of Microsoft and its subsidiaries. Significant intercompany transactions and balances have been eliminated.

Foreign currencies. Assets and liabilities recorded in foreign currencies on the books of foreign subsidiaries are translated at the exchange rate on the balance sheet date. Translation adjustments resulting from this process are charged or credited to equity. Revenues, costs, and expenses are translated at average rates of exchange prevailing during the year. Gains and losses on foreign currency transactions are included in other expenses.

Revenue recognition. Revenue from sales to distributors and resellers is recognized when related products are shipped. Revenue from corporate license programs generally is recognized when the product is installed by the user. Finished goods revenue attributable to significant support (telephone support and specified and unspecified enhancements) is recognized when such obligations are fulfilled. Costs related to insignificant obligations, which includes telephone support for certain products, are accrued.

Revenue from products licensed to original equipment manufacturers is recognized when the licensed products are shipped by the OEM.

Revenue from software maintenance, service, and support contracts is recognized ratably over the contract period.

Provisions are recorded for returns and bad debts.

Research and development. Research and development costs are expensed as incurred. The current accounting rule, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, does not materially affect the Company.

Telephone support. Telephone support costs are included in sales and marketing.

Income taxes. Income tax expense includes U.S. and international income taxes, plus an accrual for U.S. taxes on undistributed earnings of international subsidiaries. Certain items of income and expense are not reported in tax returns and financial statements in the same year. The tax effect of this difference is reported as deferred income taxes. Tax credits are accounted for as a reduction of tax expense in the year in which the credits reduce taxes payable.

Earnings per share. Earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options, computed using the treasury stock method.

Financial instruments. The Company considers all liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents. Short-term investments generally mature between three months and three years from the purchase date. All cash and short-term investments are classified as available for sale. Cost approximates market value for all classifications of cash and short-term investments; realized and unrealized gains and losses are not material.

Statement of Financial Accounting Standard Accounting for Certain Investments in Debt and Equity Securities was adopted in 1995 and did not have a material impact on the financial statements.

Inventories. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property, plant, and equipment. Property, plant, and equipment is stated at cost and depreciated using the straight-line method. Estimated lives are as follows: buildings, 30 years; leasehold improvements, the lease term; computer equipment and other, principally three years.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

Diversification of risk. The Company's investment portfolio is diversified and consists of short-term investment grade securities. At June 30, 1994 and 1995, approximately 40% of accounts receivable represented amounts due from ten channel purchasers. Two of these each accounted for approximately 10%, 13%, and 12% of revenues in 1993, 1994, and 1995.

Finished goods sales to international customers in Europe, Japan, Australia, and Canada are primarily billed in local currencies. Payment cycles are relatively short, generally less than 90 days. European manufacturing costs and international selling, distribution, and support costs are generally disbursed in local currencies. Local currency cash balances in excess of short-term operating needs are generally converted into U.S. dollar cash and short-term investments upon receipt. Therefore, foreign exchange rate fluctuations generally do not create a risk of material transaction gains or losses. As a result, Microsoft's hedging activities for transaction exposures have been minimal. No material hedge contracts were outstanding at June 30, 1995.

Translated results of operations of the Company's foreign subsidiaries are affected by foreign exchange rates. During 1995 and for 1996, the Company hedged a percentage of planned translated international finished goods revenues by purchasing options on the applicable currencies. Premiums paid for the options, which were not material, are being amortized over the lives of the options. Any gains will be recognized when and if realized.

Reclassifications. Certain reclassifications have been made for consistent presentation.

CASH AND SHORT-TERM INVESTMENTS

	JUNE 30	
	1994	1995
Cash and equivalents:		
Cash.....	\$ 263	\$ 135
Commercial paper.....	619	1,035
Money market preferreds.....	180	255
Certificates of deposit.....	218	492
Bank loan participations.....	197	45
	-----	-----
Cash and equivalents.....	1,477	1,962
	-----	-----
Short-term investments:		
Municipal securities.....	1,245	1,291
Corporate notes and bonds.....	423	866
U.S. Treasury securities.....	417	444
Commercial paper.....	52	187
	-----	-----
Short-term investments.....	2,137	2,788
	-----	-----
Cash and short-term investments.....	\$3,614	\$4,750
	=====	=====

PROPERTY, PLANT, AND EQUIPMENT

	JUNE 30	
	1994	1995
Land.....	\$ 162	\$ 206
Buildings.....	440	607
Computer equipment.....	532	707
Other.....	311	387
	-----	-----
Property, plant, and equipment -- at cost.....	1,445	1,907
Accumulated depreciation.....	(515)	(715)
	-----	-----
Property, plant, and equipment -- net.....	\$ 930	\$1,192
	=====	=====

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

## INCOME TAXES

The provision for income taxes was composed of:

	1993	1994	1995
	-----	-----	-----
Current taxes:			
U.S. and state.....	\$352	\$470	\$518
International.....	123	94	151
	-----	-----	-----
Current taxes.....	475	564	669
Deferred taxes.....	(27)	12	45
	-----	-----	-----
Provision for income taxes.....	\$448	\$576	\$714
	=====	=====	=====

Differences between the U.S. statutory and effective tax rates were:

	1993	1994	1995
	-----	-----	-----
U.S. statutory rate.....	34.0%	35.0%	35.0%
Tax exempt income.....	(0.6)	(0.9)	(1.1)
Foreign sales corporation.....	(1.0)	(1.0)	(0.7)
Tax credits.....	(0.9)	(2.1)	(1.6)
State taxes and other -- net.....	0.5	2.5	1.4
	-----	-----	-----
Effective tax rate.....	32.0%	33.5%	33.0%
	=====	=====	=====

Deferred income tax balances were:

	JUNE 30	
	1994	1995
	-----	-----
Deferred income tax assets:		
Revenue items.....	\$ 61	\$ 68
Expense items.....	143	221
	-----	-----
Deferred income tax assets.....	204	289
	-----	-----
Deferred income tax liabilities:		
International earnings.....	(147)	(276)
Other.....	(4)	(5)
	-----	-----
Deferred income tax liabilities.....	(151)	(281)
	-----	-----
Net deferred income tax asset.....	\$ 53	\$ 8
	=====	=====

U.S. and international components of income before income taxes were:

	1993	1994	1995
	-----	-----	-----
U.S.....	\$ 960	\$1,281	\$1,549
International.....	441	441	618
	-----	-----	-----
Income before income taxes.....	\$1,401	\$1,722	\$2,167
	=====	=====	=====

The Internal Revenue Service is examining the Company's U.S. income tax returns for 1990 and 1991. The Company believes any adjustments from the examination will not be material to the financial statements. Income taxes paid were \$187 million, \$247 million, and \$430 million in 1993, 1994, and 1995.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

## COMMON STOCK

Shares of common stock outstanding were as follows:

	1993	1994	1995
	----	----	----
Balance, beginning of year.....	544	565	581
Issued.....	27	25	19
Repurchased.....	(6)	(9)	(12)
	---	---	---
Balance, end of year.....	565	581	588
	===	===	===

The Company repurchases its common stock in the open market to provide shares for issuance to employees under stock option and stock purchase plans. The Company's Board of Directors authorized continuation of this program in 1996.

## PUT WARRANTS

In connection with the Company's stock repurchase program, put warrants were sold to independent third parties during 1995. The put warrants entitle the holders to sell shares of Microsoft common stock to the Company at specified prices. On June 30, 1995, 8.0 million warrants were outstanding with a strike price of \$69.75 per share. The warrants expire at various dates between February 1996 and November 1996, are exercisable only at maturity, and are settleable in cash at Microsoft's option. The maximum potential repurchase obligation of \$405 million has been reclassified from stockholders' equity to put warrants as of June 30, 1995. There was no impact on earnings per share in 1995.

## EMPLOYEE STOCK AND SAVINGS PLANS

Employee stock purchase plan. The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. During 1993, 1994, and 1995, employees purchased 1.0 million, 1.1 million, and 1.0 million shares at average prices of \$33.29, \$34.16, and \$46.76 per share. At June 30, 1995, 2.1 million shares were reserved for future issuance.

Savings plan. The Company has a savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. Under the plan, participating U.S. employees may defer up to 15% of their pretax salary, but not more than statutory limits. The Company contributes fifty cents for each dollar contributed by a participant, with a maximum contribution of 3% of a participant's earnings. The Company's matching contributions to the savings plan were \$7 million, \$9 million, and \$12 million in 1993, 1994, and 1995.

Stock option plans. The Company has stock option plans for directors, officers, and all employees, which provide for nonqualified and incentive stock options. The Board of Directors determines the option price (not to be less than fair market value for incentive options) at the date of grant. Options granted prior to 1995 generally vest over four and one-half years and expire ten years from the date of grant. Options granted during and after 1995 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest over seven and one-half years and expire after ten years. At June 30, 1995, options for 58.5 million shares were vested and 92.8 million shares were available for future grants under the plans.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

Stock options outstanding were as follows:

	NUMBER	PRICE PER SHARE	
		RANGE	WEIGHTED AVERAGE
Balance, June 30, 1992.....	120.3	\$ 0.31-39.79	\$12.44
Granted.....	24.4	30.88-44.25	34.30
Exercised.....	(26.2)	0.31-36.92	7.95
Canceled.....	(4.4)	4.97-44.13	14.23
-----			
Balance, June 30, 1993.....	114.1	0.31-44.25	18.06
Granted.....	26.2	35.50-50.13	37.47
Exercised.....	(20.9)	1.51-44.25	11.42
Canceled.....	(5.5)	5.01-44.13	28.67
-----			
Balance, June 30, 1994.....	113.9	0.31-50.13	23.29
Granted.....	21.7	47.75-83.13	50.50
Exercised.....	(17.6)	0.31-47.75	15.81
Canceled.....	(4.2)	5.11-75.00	35.40
-----			
Balance, June 30, 1995.....	113.8	1.54-83.13	29.12
=====			

#### LEASES

The Company has operating leases for most U.S. and international sales and support offices and certain equipment. Rental expense for operating leases was \$54 million, \$68 million, and \$86 million in 1993, 1994, and 1995. Future minimum rental commitments under noncancelable leases, in millions of dollars, are: 1996, \$78; 1997, \$65; 1998, \$56; 1999, \$44; 2000, \$28; and thereafter, \$13.

#### THE MICROSOFT NETWORK

During 1995, a wholly owned subsidiary of Tele-Communications, Inc. (TCI) purchased a 20% minority interest in the newly formed Microsoft Online Services Partnership. TCI contributed \$125 million of TCI common stock and Microsoft contributed the business assets of its online service, The Microsoft Network, which was in development. Microsoft owns 80% of the entity, whose operations have not been material to the financial results of Microsoft. The entity was subsequently reorganized into The Microsoft Network, LLC.

#### NONCONTINUING ITEMS

In the fourth quarter of 1995, the Company paid a \$46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger.

In the third quarter of 1994, the Company recorded a \$120 million charge to reflect the estimated impact of a jury verdict in the Stac Electronics patent litigation and related expenses. In June 1994, the Company reached an agreement with Stac to settle the litigation and adjusted its estimate accordingly, resulting in a credit of \$30 million in the fourth quarter and a net pretax charge of \$90 million for 1994.

#### CONTINGENCIES

On July 15, 1994, Microsoft and the U.S. Department of Justice (DOJ) entered into a consent decree resolving the DOJ's non-public investigation of Microsoft. In the consent decree, which involves no admission of wrongdoing on Microsoft's part, Microsoft agreed to make certain changes in its OEM licensing practices. Microsoft also agreed to employ a uniform duration in its nondisclosure agreement for precommercial versions

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

of certain operating system products, and clarified the rights and responsibilities of those signing such nondisclosure agreements. The consent decree was approved by the U.S. District Court for the District of Columbia on August 21, 1995.

The Antitrust Division of the DOJ has stated that it is conducting an investigation concerning Microsoft's inclusion of client-access software for The Microsoft Network in Windows 95. Although there is no assurance that this matter will be resolved favorably and that Microsoft's future financial statements will not be adversely affected, Microsoft currently believes that resolution of this matter will not have a material adverse effect on its financial condition or results of operations.

INFORMATION BY GEOGRAPHIC AREA

	1993	1994	1995
	-----	-----	-----
Net revenues			
U.S. operations.....	\$2,655	\$3,472	\$4,495
European operations.....	1,289	1,401	1,575
Other international operations.....	395	375	558
Eliminations.....	(586)	(599)	(691)
	-----	-----	-----
Total net revenues.....	\$3,753	\$4,649	\$5,937
	=====	=====	=====
Operating income			
U.S. operations.....	\$ 961	\$1,394	\$1,709
European operations.....	360	346	412
Other international operations.....	18	31	91
Eliminations.....	(13)	(45)	(174)
	-----	-----	-----
Total operating income.....	\$1,326	\$1,726	\$2,038
	=====	=====	=====
Identifiable assets			
U.S. operations.....	\$2,944	\$4,397	\$5,862
European operations.....	1,133	1,366	1,806
Other international operations.....	310	423	689
Eliminations.....	(582)	(823)	(1,147)
	-----	-----	-----
Total identifiable assets.....	\$3,805	\$5,363	\$7,210
	=====	=====	=====

Intercompany sales between geographic areas are accounted for at prices representative of unaffiliated party transactions. "U.S. operations" include shipments to customers in the U.S., licensing to OEMs, and exports of finished goods directly to international customers, primarily in Canada, South America, and Asia. Exports and international OEM transactions are primarily in U.S. dollars and totaled \$426 million, \$787 million, and \$1,263 million in 1993, 1994, and 1995. "Other international operations" primarily include subsidiaries in Australia, Japan, Korea, and Taiwan. International revenues, which include European operations, other international operations, exports, and OEM distribution, were 55.3%, 54.0%, and 55.3% of total revenues in 1993, 1994, and 1995.

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Microsoft Corporation:

We have audited the accompanying balance sheets of Microsoft Corporation and subsidiaries as of June 30, 1994 and 1995, the related statements of income, cash flows, and stockholders' equity for each of the three years ended June 30, 1995. Our audits also included the financial statement schedule listed in the Index at Item 8. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Microsoft Corporation and subsidiaries as of June 30, 1994 and 1995, and the results of their operations and their cash flows for each of the three years ended June 30, 1995 in conformity with generally accepted accounting principles. Also, in our opinion the financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington  
July 17, 1995  
(August 21, 1995 as to  
Contingencies Note)

## PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to Directors may be found under the caption "Election of Directors and Management Information" on pages 1 and 2 of the Company's Proxy Statement dated September 25, 1995, for the Annual Meeting of Shareholders to be held October 27, 1995 (the "Proxy Statement"). Such information is incorporated herein by reference. Information with respect to Executive Officers may be found on pages 11 and 12 hereof, under the caption "Executive Officers of the Registrant."

## ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "Information Regarding Executive Officer Compensation" on pages 4 through 8 and "Information Regarding the Board and its Committees" on page 2 is incorporated herein by reference.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information set forth under the caption "Information Regarding Beneficial Ownership of Principal Shareholders, Directors, and Management" on page 3 of the Proxy Statement is incorporated herein by reference.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth under the caption "Certain Transactions" on page 8 of the Proxy Statement is incorporated herein by reference.



## PART IV

## ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

## (a) Financial Statements and Schedules

The financial statements of Microsoft as set forth under Item 8 are filed as part of this report.

Supplemental Schedule II -- Valuation and Qualifying Accounts is filed on page 32 of this report.

Financial statement schedules other than those listed above have been omitted since they are either not required, not applicable, or the information is otherwise included.

The independent auditors' report with respect to the above-listed financial statements and schedule appears on page 29 of this report.

## (b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of fiscal 1995.

## (c) Exhibit Listing

EXHIBIT NUMBER -----	DESCRIPTION -----
3.1	Restated Articles of Incorporation(1)
3.2	Bylaws(1)
10.1	Microsoft Corporation 1991 Stock Option Plan(1)
10.2	Microsoft Corporation 1981 Stock Option Plan(2)
10.3	Microsoft Corporation Stock Option Plan for Non-Employee Directors(1)
10.4	Microsoft Corporation Stock Option Plan for Consultants and Advisor(1)
10.5	Microsoft Corporation 1991 Employee Stock Purchase Plan
10.6	Microsoft Corporation Savings Plus Plan(1)
10.7	Trust Agreement dated June 1, 1993 between Microsoft Corporation and First Interstate Bank of Washington(3)
10.8	Form of Indemnification Agreement(3)
11.	Computation of Earnings Per Share
21.	Subsidiaries
23.	Independent Auditors' Consent
27.	Financial Data Schedule
99.1	Financial Statements for the Microsoft Corporation 1991 Employee Stock Purchase Plan for the Three Years Ended June 30, 1995
99.2	Financial Statements for the Microsoft Corporation Savings Plus Plan for the Two Years Ended December 31, 1994 and the Nine Months Ended December 31, 1992

(1) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1994.

(2) Incorporated by reference to Registration Statement 33-37623 on Form S-8.

(3) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1993.

## SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS

ALLOWANCE FOR DOUBTFUL ACCOUNTS  
(IN MILLIONS)

	YEAR ENDED JUNE 30		
	1993	1994	1995
	-----	-----	-----
Balance, beginning of year.....	\$ 57	\$ 76	\$ 92
Additions charged to expense.....	47	27	51
Deductions.....	(28)	(11)	(4)
	-----	-----	-----
Balance, end of year.....	\$ 76	\$ 92	\$139
	====	====	====

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Redmond, State of Washington, on September 13, 1995.

## MICROSOFT CORPORATION

By /s/ MICHAEL W. BROWN

-----  
 Michael W. Brown,  
 Vice President, Finance;  
 Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on September 13, 1995.

SIGNATURE -----	TITLE -----
/s/ WILLIAM H. GATES ----- William H. Gates	Chairman of the Board of Directors and Chief Executive Officer
/s/ PAUL G. ALLEN ----- Paul G. Allen	Director
/s/ RICHARD A. HACKBORN ----- Richard A. Hackborn	Director
/s/ DAVID F. MARQUARDT ----- David F. Marquardt	Director
/s/ ROBERT D. O'BRIEN ----- Robert D. O'Brien	Director
----- Wm. G. Reed, Jr.	Director
/s/ JON A. SHIRLEY ----- Jon A. Shirley	Director
/s/ MICHAEL W. BROWN ----- Michael W. Brown	Vice President, Finance; Chief Financial Officer (Principal Financial and Accounting Officer)

## EXHIBIT 10.5

MICROSOFT CORPORATION  
1991 EMPLOYEE STOCK PURCHASE PLAN

As approved by the Board of Directors  
on August 11, 1990 and the  
Shareholders on October 26, 1990,  
and amended by the Board of Directors  
on April 23, 1994 and May 13, 1995

MICROSOFT CORPORATION  
1991 EMPLOYEE STOCK PURCHASE PLAN

Microsoft Corporation (the "Company") does hereby establish its 1991 Employee Stock Purchase Plan as follows:

1. Purpose of the Plan. The purpose of this Plan is to provide eligible employees who wish to become shareholders in the Company a convenient method of doing so. It is believed that employee participation in the ownership of the business will be to the mutual benefit of both the employees and the Company. It is the intention of the Company to have the Plan qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1986. The provisions of the Plan shall, accordingly, be construed so as to extend and limit participation in a manner consistent with the requirements of that Section of the Code.

2. Definitions.

2.1 "Base pay" means regular straight time earnings, plus review cycle bonuses and overtime payments, payments for incentive compensation, and other special payments except to the extent that any such item is specifically excluded by the Board of Directors of the Company (the "Board").

2.2 "Account" shall mean the funds accumulated with respect to an individual employee as a result of deductions from his paycheck for the purpose of purchasing stock under this Plan. The funds allocated to an employee's account shall remain the property of the respective employee at all times but may be commingled with the general funds of the Company.

3. Employees Eligible to Participate. Any regular employee of the Company or any of its subsidiaries who is in the employ of the Company on one or more offering dates is eligible to participate in the Plan, except (a) employees whose customary employment is less than 20 hours per week, and (b) employees whose customary employment is for not more than five months in any calendar year.

4. Offerings. There will be twelve separate consecutive six-month offerings pursuant to the Plan. The first offering shall commence on January 1, 1991. Thereafter, offerings shall commence on each subsequent July 1 and January 1, and the final offering under this Plan shall commence on July 1, 1996 and terminate on December 31, 1996. In order to become eligible to purchase shares, an employee must sign an Enrollment Agreement, and any other necessary papers on or before the commencement date (January 1 or July 1) of the particular offering in which he wishes to participate. Participation in one offering under the Plan shall neither limit, nor require, participation in any other offering.

5. Price. The purchase price per share shall be the lesser of (1) 85% of the fair market value of the stock on the offering date; or (2) 85% of the fair market value of the stock on the last business day of the offering. Fair market value shall mean the closing bid price as reported on the National Association of Securities Dealers Automated Quotation System or, if the stock is traded on a stock exchange, the closing price for the stock on the principal such exchange.

6. Offering Date. The "offering date" as used in this Plan shall be the commencement date of the offering, if such date is a regular business day, or the first regular business day following such commencement date. A different date may be set by resolution of the Board.

7. Number of Shares to be Offered. The maximum number of shares that will be offered under the Plan is 6,750,000. The shares to be sold to participants under the Plan will be common stock of the Company. If the total number of shares for which options are to be granted on any date in accordance with Section 10 exceeds the number of shares then available under the Plan (after deduction

of all shares for which options have been exercised or are then outstanding), the Company shall make a pro rata allocation of the shares remaining available in as nearly a uniform manner as shall be practicable and as it shall determine to be equitable. In such event, the payroll deductions to be made pursuant to the authorizations therefor shall be reduced accordingly and the Company shall give written notice of such reduction to each employee affected thereby.

8. Participation.

8.1 An eligible employee may become a participant by completing an Enrollment Agreement provided by the Company and filing it with Shareholder Services prior to the Commencement of the offering to which it relates.

8.2 Payroll deductions for a participant shall commence on the offering date, and shall end on the termination date of such offering unless earlier terminated by the employee as provided in Paragraph 14.

9. Payroll Deductions.

9.1 At the time a participant files his authorization for a payroll deduction, he shall elect to have deductions made from his pay on each payday during the time he is a participant in an offering at the rate of 2%, 4%, 6%, 8%, or 10% of his base pay.

9.2 All payroll deductions made for a participant shall be credited to his account under the Plan. A participant may not make any separate cash payment into such account nor may payment for shares be made other than by payroll deduction.

9.3 A participant may discontinue his participation in the Plan as provided in Section 14, but no other change can be made during an offering and, specifically, a participant may not alter the rate of his payroll deductions for that offering.

10. Granting of Option. On the offering date, this Plan shall be deemed to have granted to the participant an option for as many full shares as he will be able to purchase with the payroll deductions credited to his account during his participation in that offering. Notwithstanding the foregoing, no participant may purchase more than 2,250 shares of stock during any single offering.

11. Exercise of Option. Each employee who continues to be a participant in an offering on the last business day of that offering shall be deemed to have exercised his option on such date and shall be deemed to have purchased from the Company such number of full shares of common stock reserved for the purpose of the Plan as his accumulated payroll deductions on such date will pay for at the option price.

12. Employee's Rights as a Shareholder. No participating employee shall have any right as a shareholder with respect to any shares until the shares have been purchased in accordance with Section 11 above and the stock has been issued by the Company.

13. Evidence of Stock Ownership.

13.1 Promptly following the end of each offering, the number of shares of common stock purchased by each participant shall be deposited into an account established in the participant's name at a stock brokerage or other financial services firm designated by the Company (the "ESPP Broker").

13.2 The participant may direct, by written notice to the Company at the time of his enrollment in the Plan, that his ESPP Broker account be established in the names of the participant and one other person designated by the participant, as joint tenants with right of survivorship, tenants in common, or community property, to the extent and in the manner permitted by applicable law.

13.3 A participant shall be free to undertake a disposition (as that term is defined in Section 424(c) of the Code) of the shares in his account at any time, whether by sale, exchange, gift, or other transfer of legal title, but in the absence of such a disposition of the shares, the shares must remain in the participant's account at the ESPP Broker until the holding period set forth in Section 423(a) of the Code has been satisfied. With respect to shares for which the Section 423(a) holding period has been satisfied, the participant may move those shares to another brokerage account of participant's choosing or request that a stock certificate be issued and delivered to him.

13.4 A participant who is not subject to payment of U.S. income taxes may move his shares to another brokerage account of his choosing or request that a stock certificate be issued and delivered to him at any time, without regard to the satisfaction of the Section 423(a) holding period.

14. Withdrawal.

14.1 An employee may withdraw from an offering, in whole but not in part, at any time prior to the last business day of such offering by delivering a Withdrawal Notice to the Company, in which event the Company will refund the entire balance of his deductions as soon as practicable thereafter.

14.2 To re-enter the Plan, an employee who has previously withdrawn must file a new Enrollment Agreement in accordance with Section 8.1. The employee's re-entry into the Plan will not become effective before the beginning of the next offering following his withdrawal, and if the withdrawing employee is an officer of the Company within the meaning of Section 16 of the Securities Exchange Act of 1934 he may not re-enter the Plan before the beginning of the second offering following his withdrawal.

15. Carryover of Account. At the termination of each offering the Company shall automatically re-enroll the employee in the next offering, and the balance in the employee's account shall be used for option exercises in the new offering, unless the employee has advised the Company otherwise. Upon termination of the Plan, the balance of each employee's account shall be refunded to him.

16. Interest. No interest will be paid or allowed on any money in the accounts of participating employees.

17. Rights Not Transferable. No employee shall be permitted to sell, assign, transfer, pledge, or otherwise dispose of or encumber either the payroll deductions credited to his account or any rights with regard to the exercise of an option or to receive shares under the Plan other than by will or the laws of descent and distribution, and such right and interest shall not be liable for, or subject to, the debts, contracts, or liabilities of the employee. If any such action is taken by the employee, or any claim is asserted by any other party in respect of such right and interest whether by garnishment, levy, attachment or otherwise, such action or claim will be treated as an election to withdraw funds in accordance with Section 14.

18. Termination of Employment. Upon termination of employment for any reason whatsoever, including but not limited to death or retirement, the balance in the account of a participating employee shall be paid to the employee or his estate.

19. Amendment or Discontinuance of the Plan. The Board shall have the right to amend, modify, or terminate the Plan at any time without notice, provided that no employee's existing rights under any offering already made under Section 4 hereof may be adversely affected thereby, and provided further that no such amendment of the Plan shall, except as provided in Section 20, increase above 6,750,000 the total number of shares to be offered unless shareholder approval is obtained therefor.

20. Changes in Capitalization. In the event of reorganization, recapitalization, stock split, stock dividend, combination of shares, merger, consolidation, offerings of rights, or any other change in the structure of the common shares of the Company, the Board may make such adjustment, if any, as it may deem appropriate in the number, kind, and the price of shares available for purchase under the Plan, and in the number of shares which an employee is entitled to purchase.

21. Share Ownership. Notwithstanding anything herein to the contrary, no employee shall be permitted to subscribe for any shares under the Plan if such employee, immediately after such subscription, owns shares (including all shares which may be purchased under outstanding subscriptions under the Plan) possessing 5% or more of the total combined voting power or value of all classes of shares of the Company or of its parent or subsidiary corporations. For the foregoing purposes the rules of Section 425(d) of the Internal Revenue Code of 1986 shall apply in determining share ownership. In addition, no employee shall be allowed to subscribe for any shares under the Plan which permits his rights to purchase shares under all "employee stock purchase plans" of the Company and its subsidiary corporations to accrue at a rate which exceeds \$25,000 of the fair market value of such shares (determined at the time such right to subscribe is granted) for each calendar year in which such right to subscribe is outstanding at any time.

22. Administration. The Plan shall be administered by the Board. The Board shall be vested with full authority to make, administer, and interpret such rules and regulations as it deems necessary to administer the Plan, and any determination, decision, or action of the Board in connection with the construction, interpretation, administration, or application of the Plan shall be final, conclusive, and binding upon all participants and any and all persons claiming under or through any participant.

The Board may delegate any or all of its authority hereunder to such committee as it may designate.

23. Notices. All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received by Shareholder Services of the Company or when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

24. Termination of the Plan. This Plan shall terminate at the earliest of the following:

24.1 December 31, 1996;

24.2 The date of the filing of a Statement of Intent to Dissolve by the Company or the effective date of a merger or consolidation wherein the Company is not to be the surviving corporation, which merger or consolidation is not between or among corporations related to the Company. Prior to the occurrence of either of such events, on such date as the Company may determine, the Company may permit a participating employee to exercise the option to purchase shares for as many full shares as the balance of his account will allow at the price set forth in accordance with Section 5. If the employee elects to purchase shares, the remaining balance of his account will be refunded to him after such purchase.

24.3 The date the Board acts to terminate the Plan in accordance with Section 19 above.

24.3 The date when all shares reserved under the Plan have been purchased.

25. Limitations on Sale of Stock Purchased Under the Plan. The Plan is intended to provide common stock for investment and not for resale. The Company does not, however, intend to restrict or influence any employee in the conduct of his own affairs. An employee, therefore, may sell stock purchased under the Plan at any time he chooses, subject to compliance with any applicable Federal or state securities laws. THE EMPLOYEE ASSUMES THE RISK OF ANY MARKET FLUCTUATIONS IN THE PRICE OF THE STOCK.



26. Governmental Regulation. The Company's obligation to sell and deliver shares of the Company's common stock under this Plan is subject to the approval of any governmental authority required in connection with the authorization, issuance, or sale of such shares.

[The number of shares set forth in Sections 7, 10, and 19 have been changed to reflect the effect of three-for-two stock splits in 1991 and 1992, and a two-for-one stock split in 1994.]

## EXHIBIT 11.

COMPUTATION OF EARNINGS PER SHARE  
(In millions, except earnings per share)

	Year Ended June 30		
	1993	1994	1995
Weighted average common shares outstanding	556	571	582
Common equivalent shares from stock options	50	39	45
Average common and equivalent shares outstanding (1)	606	610	627
Net income	\$ 953	\$1,146	\$1,453
Earnings per share (1)	\$1.57	\$ 1.88	\$ 2.32

(1) Fully diluted earnings per share have not been presented because the effects are not material.

## SUBSIDIARIES

Antura S.A.R.L.  
 ASCII Network Technology, Inc. (Japan JV)  
 CorporacionMicrosoft Del Ecuador S.A.  
 Corporation MS 90 de Venezuela SA  
 Dram Realty, Inc.  
 Dreamworks Interactive L.L.C. (U.S. JV)  
 Forethought Inc.  
 Fox Software GmbH (Germany)  
 Fox Software, Inc.  
 Fox Software (U.K.) Limited  
 Fox Software S.A.R.L. (France)  
 GraceMac Corporation  
 HomePlate, Inc.  
 ImageWare Research and Development, Inc. (Canada)  
 Microsoft A.O. (Russia)  
 Microsoft AG (Switzerland)  
 Microsoft Aktiebolag (Sweden)  
 Microsoft B.V. (The Netherlands)  
 Microsoft Bilgisayar Yazilim Hizmetleri Limited  
 Sirketi (Turkey)  
 Microsoft Canada Inc.  
 Microsoft Caribbean, Inc. (Puerto Rico)  
 Microsoft CH (Korea)  
 Microsoft Chile S.A.  
 Microsoft Colombia Inc.  
 Microsoft Company, Limited (Japan)  
 Microsoft Coris, S.P.A. (Italy JV)  
 Microsoft Corporation-Beijing Representative Office  
 (The Peoples Republic of China)  
 Microsoft Corporation (Dubai Branch)  
 Microsoft Corporation Limitada (Colombia)  
 Microsoft Corporation (India) Private Limited  
 Microsoft d.o.o., Ljubljana (Slovenia)  
 Microsoft Danmark ApS (Denmark)  
 Microsoft de Argentina S.A.  
 Microsoft De Centroamerica S.A. (Costa Rica)  
 Microsoft Distribution Limited (Ireland)  
 Microsoft Europe S.A.R.L. (European Headquarters)  
 Microsoft France S.A.R.L.  
 Microsoft FSC Corp.  
 Microsoft Gesellschaft m.b.H. (Austria)  
 Microsoft G.m.b.H. (Germany)  
 Microsoft Hellas S.A. (Greece)  
 Microsoft Hong Kong Limited  
 Microsoft Iberica S.R.L. (Spain)  
 Microsoft Informatica Limitada (Brazil)  
 Microsoft Institute PTY Limited  
 Microsoft International BV (The Netherlands)  
 Microsoft Israel Ltd.  
 Microsoft Kft (Hungary)  
 Microsoft Limited (U.K.)  
 Microsoft (Thailand) Limited  
 Microsoft (S.A.) (Proprietary) Limited (South Africa)  
 Microsoft Manufacturing B.V. (Ireland manufacturing)  
 Microsoft Maroc S.A.R.L. (Morocco)  
 Microsoft Mexico, S.A. de C.V.  
 Microsoft New Zealand Limited  
 Microsoft Norge AS (Norway)  
 Microsoft N.V. (Belgium)  
 Microsoft Oy (Finland)  
 Microsoft Perc, S.A.  
 Microsoft Phillipines, Inc.  
 Microsoft Properties France S.A.R.L.  
 Microsoft Properties UK Limited  
 Microsoft Pty Limited (Australia)  
 Microsoft Puerto Rico, Inc. (Manufacturing)  
 Microsoft Rendermorphics Limited (U.K.)  
 Microsoft (Malaysia) Sdn. Bhd.  
 Microsoft Singapore Pte Ltd  
 Microsoft Slovakia s.r.o.  
 MSFT-Software Para Microcomputadores, LDA (Portugal)  
 Microsoft S.p.A. (Italy)  
 Microsoft sp. z.o.o. (Poland)  
 Microsoft s.r.o. (Czech Republic)  
 Microsoft Taiwan Corporation  
 Microsoft Venezuela, S.A.  
 Microsoft Workgroup Canada, Inc.  
 MSHC Inc. (Holding Company)  
 NRI India, Inc.  
 On Australia Pty. Limited (Australia JV)  
 SoftCapital, Inc.  
 SOFTIMAGE France S.A.R.L.  
 SOFTIMAGE, Inc. (Canada)  
 SOFTIMAGE, Italy S.R.L.  
 SOFTIMAGE U.K. Limited  
 Technology Resources Management Corporation  
 The Monotype Corporation

## INDEPENDENT AUDITORS' CONSENT

Microsoft Corporation:

We consent to the incorporation by reference in Registration Statement Numbers 33-06335, 33-18381, 33-25575, 33-33695, and 33-37623 (Microsoft Corporation 1981 Stock Option Plan), 33-44302 and 33-51583 (Microsoft Corporation 1991 Stock Option Plan), 33-37622 (Microsoft Corporation 1991 Employee Stock Purchase Plan), 33-10732 (Microsoft Corporation Savings Plus Plan), 33-36498 (Microsoft Corporation Stock Option Plan for Non-Employee Directors) and 33-45617 (Microsoft Corporation Stock Option Plan for Consultants and Advisors) of Microsoft Corporation on Forms S-8 and 33-29823, 33-34794, 33-36347, 33-46958, 33-49496, 33-56039, 33-57277, 33-57899, 33-58867, 33-62725, and 33-64870 of Microsoft Corporation on Forms S-3 of our report dated July 17, 1995 (August 21, 1995 as to Contingencies Note) appearing in and incorporated by reference in this Annual Report on Form 10-K of Microsoft Corporation for the year ended June 30, 1995.

/S/ DELOITTE & TOUCHE LLP

Seattle, Washington  
September 25, 1995

YEAR

	JUN-30-1995	
	JUN-30-1995	4,750
		0
		720
		139
		88
	5,620	1,907
		715
		7,210
	1,347	
		0
		2,005
	0	
		0
		3,328
	7,210	
		5,937
	5,937	877
		3,848
		16
		51
		2
		2,167
		714
	1,453	
		0
		0
		0
		1,453
		2.32
		2.32

MICROSOFT CORPORATION  
1991 EMPLOYEE STOCK PURCHASE PLAN  
FINANCIAL STATEMENTS FOR THE  
THREE YEARS ENDED JUNE 30, 1995,  
1994, AND 1993, AND  
INDEPENDENT AUDITORS' REPORT

## INDEPENDENT AUDITORS' REPORT

Plan Administrator  
Microsoft Corporation  
1991 Employee Stock Purchase Plan  
Redmond, Washington

We have audited the accompanying statements of assets available for benefits of the Microsoft Corporation 1991 Employee Stock Purchase Plan (the Plan) as of June 30, 1995 and 1994, and the related statements of changes in assets available for benefits for the years ended June 30, 1995, 1994, and 1993. These financial statements are the responsibility of the Plan Administrator. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Plan Administrator, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the assets available for benefits of the Plan as of June 30, 1995 and 1994, and the changes in assets available for benefits for the years ended June 30, 1995, 1994, and 1993, in conformity with generally accepted accounting principles.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington  
August 11, 1995

MICROSOFT CORPORATION  
1991 EMPLOYEE STOCK PURCHASE PLANSTATEMENTS OF ASSETS AVAILABLE FOR BENEFITS  
JUNE 30, 1995 AND 1994

	1995 -----	1994 -----
ASSETS:		
Cash	\$295,579	\$492,243
ASSETS AVAILABLE FOR BENEFITS	\$295,579 =====	\$492,243 =====

See note to financial statements.

2



MICROSOFT CORPORATION  
1991 EMPLOYEE STOCK PURCHASE PLAN

STATEMENTS OF CHANGES IN ASSETS AVAILABLE FOR BENEFITS  
YEARS ENDED JUNE 30, 1995, 1994, AND 1993

	1995 -----	1994 -----	1993 -----
ASSETS AVAILABLE FOR BENEFITS, beginning of period	\$ 492,243	\$ 961,962	\$ 366,638
ADDITIONS:			
Employee contributions	48,835,432	48,614,990	34,114,121
DEDUCTIONS:			
Cost of shares purchased	49,032,095	39,084,709	33,518,797
CHANGES IN ASSETS AVAILABLE FOR BENEFITS	(196,664)	(469,719)	595,324
ASSETS AVAILABLE FOR BENEFITS, end of period	<u>\$ 295,579</u>	<u>\$ 492,243</u>	<u>\$ 961,962</u>

See note to financial statements.

3

MICROSOFT CORPORATION  
1991 EMPLOYEE STOCK PURCHASE PLAN

NOTE TO FINANCIAL STATEMENTS  
YEARS ENDED JUNE 30, 1995, 1994, AND 1993

NOTE 1: THE PLAN

The following description of the Microsoft Corporation 1991 Employee Stock Purchase Plan (the Plan) provides only general information. Participants should refer to the Plan agreement for a complete description of the Plan's provisions.

**GENERAL:** The Plan Administrator believes the Plan meets the qualification standards of Section 423 of the Internal Revenue Code of 1986. The Plan is not subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The Plan covers substantially all employees of Microsoft Corporation (the Company) whose customary employment is greater than 20 hours per week, and more than five months in any calendar year.

**CONTRIBUTIONS:** Participants may make contributions to the Plan through payroll deductions (not exceeding 10% of their compensation) for the purpose of purchasing the Company's common stock. The Plan commenced on January 1, 1991, and participants are given the opportunity to purchase shares on each June 30 and December 31 until such time as the Plan is terminated (see Termination of the Plan). The maximum number of shares that will be offered under the Plan is 6,750,000.

**OPTIONS GRANTED AND WITHDRAWALS:** Participants are granted the option to purchase shares of Microsoft Corporation common stock from the Company at 85% of the lesser of the fair market value on the first or last day of each six-month period ending June 30 or December 31. If the participant does not exercise the option, the Company refunds the participant for amounts withheld. The Plan purchased 1,049,695, 1,147,508, and 1,006,988, shares during the years ended June 30, 1995, 1994, and 1993, respectively. A total of 4,686,060 shares have been purchased under the Plan since inception with 2,063,940 shares reserved for future issue.

**ASSETS AVAILABLE FOR BENEFITS:** Assets available for benefits represent cash in participant accounts that was less than the amount necessary to purchase a full share and cash contributed to the Plan greater than the cost of the maximum number of shares allowed to be purchased in a six-month period (see Limitations). Participants may carry over such amounts to the next period.

**LIMITATIONS:** No employee shall be permitted to subscribe for any shares under the Plan if such employee owns shares representing 5% or more of the total combined voting power or value of all classes of shares of the Company. Additionally, no participant may purchase more than 2,250 shares of stock during a six-month period, or purchase shares through the Plan with an aggregate fair market value in excess of \$25,000 in any one calendar year.

**TERMINATION OF THE PLAN:** The Plan shall terminate at the earliest of the following:

- o December 31, 1996

- o The date of the filing of a statement of intent to dissolve by the Company or the effective date of a merger or consolidation (except with a related company) where the Company is not to be the surviving corporation
- o The date the Board acts to terminate the Plan
- o The date when all shares reserved under the Plan have been purchased

In the event of a dissolution, merger, or acquisition, the Company may permit a participating employee to exercise options to the extent that employee payroll deductions have accumulated. In the event of termination, Plan assets will be distributed to the participants.

PLAN ADMINISTRATION: All expenses for administration of the Plan are paid by the Company, and are not reflected in the accompanying statements.

MICROSOFT CORPORATION  
SAVINGS PLUS PLAN

FINANCIAL STATEMENTS FOR THE  
TWO YEARS ENDED DECEMBER 31, 1994, AND  
NINE MONTHS ENDED DECEMBER 31, 1992, AND  
INDEPENDENT AUDITORS' REPORT

## INDEPENDENT AUDITORS' REPORT

Plan Administrator  
Microsoft Corporation Savings Plus Plan  
Redmond, Washington

We have audited the accompanying statements of assets available for benefits of the Microsoft Corporation Savings Plus Plan (the Plan) as of December 31, 1994 and 1993, and the related statements of changes in assets available for benefits for the two years ended December 31, 1994, and the nine months ended December 31, 1992. These financial statements are the responsibility of the Plan administrator. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by the Plan administrator, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the assets available for benefits of the Plan as of December 31, 1994 and 1993, and the related statements of changes in assets available for benefits for the two years ended December 31, 1994, and the nine months ended December 31, 1992, in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of assets held for investment as of December 31, 1994, and reportable transactions for the year then ended are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington  
July 10, 1995

## MICROSOFT CORPORATION SAVINGS PLUS PLAN

STATEMENTS OF ASSETS AVAILABLE FOR BENEFITS  
DECEMBER 31, 1994 AND 1993

	1994	1993
	-----	-----
ASSETS:		
Investments held by trustee at fair value:		
Microsoft Corporation Stock Fund	\$ 96,047,305	\$ 57,717,671
Fidelity Magellan Fund	30,791,846	19,930,432
Fidelity U.S. Equity Index Fund	23,368,129	20,685,406
Fidelity Retirement Money Market Fund	19,881,402	16,776,143
Fidelity Growth Company Fund	17,814,128	11,638,038
Fidelity Intermediate Bond Fund	15,775,411	14,653,568
Fidelity Overseas Fund	11,290,171	5,292,574
Participant loans receivable	1,867,625	1,122,588
	-----	-----
ASSETS AVAILABLE FOR BENEFITS	\$216,836,017	\$147,816,420
	=====	=====

See notes to financial statements.

## MICROSOFT CORPORATION SAVINGS PLUS PLAN

STATEMENTS OF CHANGES IN ASSETS  
AVAILABLE FOR BENEFITS  
TWO YEARS ENDED DECEMBER 31, 1994, AND  
NINE MONTHS ENDED DECEMBER 31, 1992

	1994	1993	1992
	-----	-----	-----
ADDITIONS:			
Investment income:			
Interest and dividends	\$ 4,440,600	\$ 4,978,058	\$ 2,530,108
Net appreciation in fair value of investments	25,559,250	328,116	4,705,139
	-----	-----	-----
Total net investment income	29,999,850	5,306,174	7,235,247
Contributions:			
Employer	10,616,736	8,539,976	5,003,882
Employee	35,374,522	26,901,086	16,310,632
	-----	-----	-----
Total contributions	45,991,258	35,441,062	21,314,514
	-----	-----	-----
Total additions	75,991,108	40,747,236	28,549,761
DEDUCTIONS:			
Benefits paid to participants	6,971,511	2,734,102	1,320,423
	-----	-----	-----
CHANGES IN ASSETS AVAILABLE FOR BENEFITS	69,019,597	38,013,134	27,229,338
ASSETS AVAILABLE FOR BENEFITS:			
Beginning of year	147,816,420	109,803,286	82,573,948
	-----	-----	-----
End of year	\$216,836,017	\$147,816,420	\$109,803,286
	=====	=====	=====

See notes to financial statements.

## MICROSOFT CORPORATION SAVINGS PLUS PLAN

## NOTES TO FINANCIAL STATEMENTS

TWO YEARS ENDED DECEMBER 31, 1994, AND

NINE MONTHS ENDED DECEMBER 31, 1992

NOTE 1: DESCRIPTION OF THE PLAN AND  
SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**PLAN DESCRIPTION:** The Microsoft Corporation Savings Plus Plan (the Plan) is a defined contribution plan. All employees of Microsoft Corporation (the Company) who have reached 18 years of age may enroll during the month following completion of six months of service or during any subsequent quarterly enrollment period. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Plan is administered by the Vice President of Human Resources and Administration of Microsoft Corporation.

**CONTRIBUTIONS:** Participants may contribute from 1% to 15% of their compensation, tax deferred, through payroll deductions up to a maximum of \$9,240 under current law. The amount of a participant's tax-deferred contributions may be subject to limitations. Participant contributions may be suspended at any time. Contributions may be reinstated on the first day of the quarter that is at least six months after contributions were suspended.

The Company makes a matching contribution equal to 50% of a participant's contributions up to 6% of the participant's individual compensation. Company contributions are funded on a semimonthly basis.

**VESTING:** Employee contributions are fully vested immediately. Employer contributions vest fully upon completion of two years of service by a participant, or when a participant reaches age 65, dies, or becomes disabled.

**DISTRIBUTIONS:** Participants may make a withdrawal from the vested portion of their account if the Plan administrator determines a withdrawal is necessary to avoid a financial hardship or if the participant is at least 59-1/2 years of age.

**FORFEITURES:** Any nonvested interest of a terminated employee shall not be forfeited to the Plan until a one-year period of severance service has passed. At this time, the forfeited amount is distributed to the Plan. If a terminated employee is reemployed before five consecutive one-year periods of severance have passed, the forfeited amount will be reallocated to the individual's account.

**ADMINISTRATIVE EXPENSES:** Expenses for administration of the Plan are paid by the Company.

**PLAN AMENDMENT AND TERMINATION:** The Company has the right to modify, amend, suspend or terminate the Plan at any time and for any reason. If the Plan is terminated, account balances will be fully vested and will be distributed in the form and manner determined by the Plan administrator.

**VALUATION OF INVESTMENTS AND PARTICIPANT LOANS:** Investments are recorded at fair value. Security transactions are accounted for as of the trade date. Fair market value is based on quoted prices. Loans to participants are recorded at contract value, which approximates fair value. Dividend income is recorded on the ex-dividend date and interest income is recorded as earned.



## NOTE 2: INVESTMENTS

Fidelity Investments (Fidelity) is trustee of the Plan. All Plan investments are held by Fidelity. Investment funds available to participants are summarized as follows:

**MICROSOFT CORPORATION STOCK FUND:** The Microsoft Corporation Stock Fund consists entirely of the Company's common stock.

**FIDELITY U.S. EQUITY INDEX FUND:** The Fidelity U.S. Equity Index Fund consists mainly of common stocks of the companies that make up Standard & Poor's 500 Index. The fund seeks investment results that correspond to the total return performance of United States publicly traded common stocks.

**FIDELITY RETIREMENT MONEY MARKET FUND:** The Fidelity Retirement Money Market Fund strives to maintain a stable \$1 share price while its yield will fluctuate with changes in market conditions. The fund seeks as high a level of current income as is consistent with the preservation of capital and liquidity.

**FIDELITY INTERMEDIATE BOND FUND:** The Fidelity Intermediate Bond Fund consists of investment-grade fixed income obligations. The fund seeks a high level of current income.

**FIDELITY MAGELLAN FUND:** The Fidelity Magellan Fund consists of common stocks, and securities convertible to common stock, issued by companies operating in the United States or abroad. The fund seeks long-term capital appreciation.

**FIDELITY GROWTH COMPANY FUND:** The Fidelity Growth Company Fund consists mainly of investments in companies with above average growth characteristics as demonstrated in earnings or gross sales. The fund seeks long-term capital appreciation.

**FIDELITY OVERSEAS FUND:** The Fidelity Overseas Fund consists of investments in securities of issuers whose principal activities are outside the United States. The fund seeks long-term capital appreciation.

The following details activity for each of the participant-directed investment accounts at fair value.

	Microsoft Corporation Stock Fund	Fidelity Magellan Fund	Fidelity U.S. Equity Index Fund	Fidelity Retirement Money Market Fund
	-----	-----	-----	-----
Balance, December 31, 1993	\$57,717,671	\$19,930,432	\$20,685,406	\$16,776,143
Net investment income (loss)	30,227,408	(534,447)	235,253	753,604
Employer contributions	2,965,531	2,303,844	1,207,840	1,055,766
Employee contributions	9,650,674	7,649,724	3,981,633	3,294,995
Benefits paid to participants	(2,610,753)	(712,176)	(940,002)	(1,177,295)
Transfers	(1,903,226)	2,154,469	(1,802,001)	(821,811)
	-----	-----	-----	-----
Balance, December 31, 1994	\$96,047,305	\$30,791,846	\$23,368,129	\$19,881,402
	=====	=====	=====	=====

	Fidelity Growth Company Fund	Fidelity Intermediate Fund	Fidelity Overseas Fund	Participant Loan Fund	Total assets available for benefits
	-----	-----	-----	-----	-----
Balance, December 31, 1993	\$11,638,038	\$14,653,568	\$5,292,574	\$1,122,588	\$147,816,420
Net investment income (loss)	(300,914)	(286,380)	(94,674)		29,999,850
Employer contributions	1,304,567	964,777	814,411		10,616,736
Employee contributions	4,729,657	3,052,750	3,015,089		35,374,522
Benefits paid to participants	(606,881)	(646,537)	(277,867)		(6,971,511)
Transfers	1,049,661	(1,962,767)	2,540,638	745,037	
	-----	-----	-----	-----	-----
Balance, December 31, 1994	\$17,814,128	\$15,775,411	\$11,290,171	\$1,867,625	\$216,836,017
	=====	=====	=====	=====	=====

## NOTE 3: PARTICIPANT LOANS

Effective January 1, 1993, Plan participants are permitted to borrow up to 50% of the total vested account balance. Participants are limited to one residential loan and one nonresidential loan outstanding. The interest rate for residential loans is based on the yield for the Federal Home Loan Mortgage Corporation 30-year mortgage commitment for a standard conventional fixed rate mortgage, plus 1%. The interest rate for nonresidential loans will be the prime rate on corporate loans plus 1%. The range of interest rates was 7% - 9.5% for nonresidential loans and 8.78% - 10.26% for residential loans for the year ended December 31, 1994. Loan repayment is made through after-tax semimonthly payroll deductions over a period of up to 15 years for residential loans and five years for nonresidential loans. If a participant's employment terminates for any reason and the loan balance is not paid in full by the participant in the month of termination, the loan balance will be cancelled and become taxable income to the participant.

## NOTE 4: TAX STATUS

The Internal Revenue Service has determined and informed the Plan by a letter dated June 18, 1990, that the Plan is tax-exempt under the appropriate sections of the Internal Revenue Code (the Code). The Plan has been amended subsequent to the date of the determination letter. The Plan administrator, however, believes that the Plan is in compliance with the applicable requirements of the Code. As such, they believe the Plan is tax-exempt as of the financial statement date. Accordingly, no provision for income taxes has been recorded.

## MICROSOFT CORPORATION SAVINGS PLUS PLAN

ITEM 27(a) - SUPPLEMENTAL SCHEDULE OF ASSETS HELD FOR INVESTMENT  
DECEMBER 31, 1994

	Shares or units	Cost	Fair value
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DESCRIPTION OF ASSETS:			
Microsoft Corporation Stock Fund	1,571,326	\$ 45,542,299	\$ 96,047,305
Fidelity U.S. Equity Index Fund	1,381,912	21,918,218	23,368,129
Fidelity Retirement Money Market Fund	19,881,402	19,881,402	19,881,402
Fidelity Intermediate Bond Fund	1,604,823	16,602,396	15,775,411
Fidelity Magellan Fund	460,955	31,616,996	30,791,846
Fidelity Growth Company Fund	653,490	18,421,938	17,814,128
Fidelity Overseas Fund	413,559	11,132,566	11,290,171
Participant loans receivable		1,867,625	1,867,625
		-----	-----
		\$166,983,440	\$216,836,017
		=====	=====

## MICROSOFT CORPORATION SAVINGS PLUS PLAN

ITEM 27(d) - SUPPLEMENTAL SCHEDULE OF REPORTABLE TRANSACTIONS  
YEAR ENDED DECEMBER 31, 1994

	Purchases	Sales			
	Purchase price	Selling price	Cost of asset	Fair value of asset on transaction date	Net gain (loss)
SERIES OF TRANSACTIONS:					
Microsoft Corporation Stock Fund	\$16,657,341	\$8,526,670	\$5,020,086	\$8,526,670	\$3,506,584
Fidelity Magellan Fund	15,318,082	2,938,371	3,001,448	2,938,371	(63,077)
Fidelity Intermediate Bond Fund	5,573,490	3,089,675	3,153,371	3,089,675	(63,696)
Fidelity Overseas Fund	7,510,209	1,227,829	1,164,110	1,227,829	63,719
Fidelity Retirement Money Market Fund	7,921,260	4,816,001	4,816,001	4,816,001	
Fidelity U.S. Equity Index Fund	6,457,870	3,306,876	3,050,705	3,306,876	256,171
Fidelity Growth Company Fund	9,157,878	1,990,665	2,004,396	1,990,665	(13,731)