
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended December 31, 2003

or

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: (425) 882-8080

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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's common stock as of January 31, 2004 was 10,794,392,603.

MICROSOFT CORPORATION
FORM 10-Q
For the Quarter Ended December 31, 2003
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Part I. Financial Information**Item 1. Financial Statements****MICROSOFT CORPORATION**
INCOME STATEMENTS
(In millions, except earnings per share)(Unaudited)

	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	2002(1)	2003	2002(1)	2003
Revenue	\$ 8,541	\$ 10,153	\$ 16,287	\$ 18,368
Operating expenses:				
Cost of revenue	2,137	2,344	3,481	3,824
Research and development	1,515	2,971	3,222	4,582
Sales and marketing	2,159	2,467	3,574	3,972
General and administrative	497	896	749	1,367
Total operating expenses	6,308	8,678	11,026	13,745
Operating income	2,233	1,475	5,261	4,623
Losses on equity investees and other	(12)	(5)	(34)	(15)
Investment income	375	842	416	1,605
Income before income taxes	2,596	2,312	5,643	6,213
Provision for income taxes	731	763	1,737	2,050
Net income	\$ 1,865	\$ 1,549	\$ 3,906	\$ 4,163
Earnings per share:				
Basic	\$ 0.17	\$ 0.14	\$ 0.36	\$ 0.39
Diluted	\$ 0.17	\$ 0.14	\$ 0.36	\$ 0.38
Weighted average shares outstanding:				
Basic	10,703	10,810	10,711	10,800
Diluted	10,846	10,899	10,916	10,908

(1) The three and six months ended December 31, 2002 results have been restated to reflect a two-for-one stock split in February 2003 and for retroactive adoption of the fair value recognition provisions of SFAS 123, *Accounting for Stock Based Compensation*, as discussed in Note 3.

See accompanying notes.

MICROSOFT CORPORATION
BALANCE SHEETS
(In millions)(Unaudited)

	June 30 2003(1)	Dec. 31 2003
Assets		
Current assets:		
Cash and equivalents	\$ 6,438	\$ 6,149
Short-term investments	42,610	46,628
Total cash and short-term investments	49,048	52,777
Accounts receivable, net of allowance for doubtful accounts of \$242 and \$187	5,196	5,608
Inventories	640	621
Deferred income taxes	2,506	2,068
Other	1,583	1,326
Total current assets	58,973	62,400
Property and equipment, net	2,223	2,178
Equity and other investments	13,692	14,901
Goodwill	3,128	3,110
Intangible assets, net	384	345
Deferred income taxes	2,161	1,259
Other long-term assets	1,171	1,744
Total assets	\$81,732	\$85,937
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 1,573	\$ 1,360
Accrued compensation	1,416	1,143
Income taxes	2,044	3,500
Short-term unearned revenue	7,225	6,229
Other	1,716	1,695
Total current liabilities	13,974	13,927
Long-term unearned revenue	1,790	1,623
Other long-term liabilities	1,056	1,044
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital—shares authorized 24,000; outstanding 10,771 and 10,789	49,234	52,676
Retained earnings, including accumulated other comprehensive income of \$1,840 and \$2,195	15,678	16,667
Total stockholders' equity	64,912	69,343
Total liabilities and stockholders' equity	\$81,732	\$85,937

(1) The June 30, 2003 balance sheet has been restated for retroactive adoption of the fair value recognition provisions of SFAS 123, *Accounting for Stock Based Compensation*, as discussed in Note 3.

See accompanying notes.

MICROSOFT CORPORATION
CASH FLOWS STATEMENTS
(In millions)(Unaudited)

	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	2002(1)	2003	2002(1)	2003
Operations				
Net income	\$ 1,865	\$ 1,549	\$ 3,906	\$ 4,163
Depreciation, amortization, and other noncash items	275	300	548	628
Stock based compensation	1,058	3,232	2,106	4,247
Net recognized (gains)/losses on investments	140	(321)	615	(600)
Stock option income tax benefits	296	148	661	637
Deferred income taxes	(592)	(985)	(1,531)	(979)
Unearned revenue	2,500	2,774	6,593	4,988
Recognition of unearned revenue	(2,795)	(3,166)	(5,538)	(6,149)
Accounts receivable	(349)	(1,004)	402	(328)
Other current assets	404	607	367	293
Other long-term assets	(50)	55	(22)	41
Other current liabilities	(375)	1,256	422	980
Other long-term liabilities	390	129	410	77
Net cash from operations	2,767	4,574	8,939	7,998
Financing				
Common stock issued	365	189	904	884
Common stock repurchased	(936)	(730)	(4,433)	(1,775)
Common stock dividend	—	(1,729)	—	(1,729)
Net cash used for financing	(571)	(2,270)	(3,529)	(2,620)
Investing				
Additions to property and equipment	(276)	(172)	(436)	(339)
Acquisition of companies, net of cash acquired	(9)	—	(879)	(4)
Purchases of investments	(19,406)	(22,377)	(46,091)	(46,975)
Maturities of investments	3,302	825	6,532	3,475
Sales of investments	14,370	19,775	37,958	38,146
Net cash used for investing	(2,019)	(1,949)	(2,916)	(5,697)
Net change in cash and equivalents	177	355	2,494	(319)
Effect of exchange rates on cash and equivalents	37	26	42	30
Cash and equivalents, beginning of period	5,338	5,768	3,016	6,438
Cash and equivalents, end of period	\$ 5,552	\$ 6,149	\$ 5,552	\$ 6,149

(1) The three and six months ended December 31, 2002 cash flows statements have been restated for retroactive adoption of SFAS 123, *Accounting for Stock Based Compensation*, as discussed in Note 3.

See accompanying notes.

MICROSOFT CORPORATION
STOCKHOLDERS' EQUITY STATEMENTS
(In millions)(Unaudited)

	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	2002(1)	2003	2002(1)	2003
Common stock and paid-in capital				
Balance, beginning of period	\$ 44,235	\$ 51,298	\$ 41,845	\$ 49,234
Common stock issued	385	174	1,705	869
Common stock repurchased	(114)	(90)	(457)	(225)
Stock based compensation expense, net of income taxes	1,354	1,294	2,767	2,798
	<u>45,860</u>	<u>52,676</u>	<u>45,860</u>	<u>52,676</u>
Retained earnings				
Balance, beginning of period	12,282	15,382	12,997	15,678
Net income	1,865	1,549	3,906	4,163
Other comprehensive income:				
Net gains/(losses) on derivative instruments	(22)	(4)	46	13
Net unrealized investments gains/(losses)	24	403	(140)	267
Translation adjustments and other	36	77	31	75
	<u>1,903</u>	<u>2,025</u>	<u>3,843</u>	<u>4,518</u>
Comprehensive income	1,903	2,025	3,843	4,518
Common stock dividend	—	—	—	(1,729)
Common stock repurchased	(886)	(740)	(3,541)	(1,800)
	<u>13,299</u>	<u>16,667</u>	<u>13,299</u>	<u>16,667</u>
Balance, end of period	13,299	16,667	13,299	16,667
	<u>59,159</u>	<u>69,343</u>	<u>59,159</u>	<u>69,343</u>
Total stockholders' equity	\$ 59,159	\$ 69,343	\$ 59,159	\$ 69,343

- (1) The three and six months ended December 31, 2002 stockholders' equity statements have been restated for retroactive adoption of SFAS 123, *Accounting for Stock Based Compensation*, as discussed in Note 3.

See accompanying notes.

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Accounting Policies

Basis of Presentation

In the opinion of management, the accompanying balance sheets and related interim statements of income, cash flows, and stockholders' equity include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include estimates of loss contingencies and product life cycles, and assumptions such as the elements comprising a software arrangement, including the distinction between upgrades/enhancements and new products; when technological feasibility is achieved for the Company's products; the potential outcome of future tax consequences of events that have been recognized in the Company's financial statements or tax returns; and determining when investment impairments are other-than-temporary. Actual results and outcomes may differ from management's estimates and assumptions.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis and financial statements and notes thereto included in the Microsoft Corporation 2003 Form 10-K.

Certain reclassifications have been made to prior period amounts to conform with current period presentation.

Note 2 – Stock Split

In February 2003, outstanding shares of our common stock were split two-for-one. All prior share and per share amounts have been restated to reflect the stock split.

Note 3 – Accounting Changes

Effective July 1, 2003, we adopted the fair value recognition provisions of SFAS 123, *Accounting for Stock-Based Compensation*, using the retroactive restatement method described in SFAS 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*. Under the fair value recognition provisions of SFAS 123, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. The June 30, 2003 balance sheet has been restated for the retroactive adoption of the fair value recognition provisions of SFAS 123 which resulted in a \$13.89 billion increase in common stock and paid-in capital, a \$10.00 billion decrease in retained earnings, and a \$3.89 billion increase in deferred income taxes.

Stock-based employee compensation expense was \$1.06 billion (\$709 million after-tax or \$0.07 per diluted share) and \$2.11 billion (\$1.41 billion after-tax or \$0.13 per diluted share) for the three and six months ended December 31, 2002, respectively, and \$3.23 billion (\$2.17 billion after-tax or \$0.20 per diluted share) and \$4.25 billion (\$2.85 billion after-tax or \$0.26 per diluted share) for the three and six months ended December 31, 2003, respectively. The amounts for the three and six months ended December 31, 2003 include \$2.21 billion (\$1.48 billion after-tax or \$0.14 per diluted share) due to the completion of the employee stock option transfer program, which is described in the following footnote.

Note 4 – Stock-Based Compensation

In fiscal year 2004, we implemented changes in employee compensation designed to help us continue to attract and retain the best employees, and to better align employee interests with those of our shareholders.

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Employees are now granted stock awards instead of stock options. The stock award program offers employees the opportunity to earn shares of our stock over time, rather than options that give employees the right to purchase stock at a set price. We also completed an employee stock option transfer program in the second quarter of fiscal 2004 whereby employees could elect to transfer all of their vested and unvested stock options with a strike price of \$33 or higher (“eligible options”) to JPMorgan Chase Bank (JPMorgan). The unvested eligible options that were transferred to JPMorgan became vested upon the transfer. The price paid by JPMorgan for the transferred options was determined by reference to the arithmetic average of the closing prices of Microsoft common stock during the period from November 14, 2003 to December 8, 2003, which was \$25.5720.

A total of 18,503 (51%) of the 36,539 eligible Microsoft employees elected to participate in the stock option transfer program and 344.6 million (55%) of the 621.4 million eligible options were tendered. Under the terms of the program, JPMorgan paid Microsoft \$382 million for the transferred options. Microsoft made an initial payment of \$219 million to participating employees for the transferred options, with a remaining portion to be paid in one or more payments that are subject to participating employees’ continued employment over the next two or three years. The options that were transferred to JPMorgan resulted in stock-based compensation expense of \$2.21 billion (\$1.48 billion after-tax or \$0.14 per diluted share). This expense consists of the unrecognized compensation costs of the options that were transferred, less the amounts payable applicable to those previously unvested options for which payment is contingent upon continued employment of participating employees. The contingent payments applicable to unvested eligible options that are subject to continued employment of participating employees will be recognized as compensation expense over the vesting period of the contingent payments.

The stock option transfer program also resulted in a decrease to our long term deferred tax assets due to the excess of recorded compensation expense for these options over the related tax deduction reported on our tax return. For the six months ended December 31, 2003, deferred tax assets were reduced by approximately \$2.01 billion with an offsetting reduction in paid-in capital, reflecting the reduction of previously recorded deductions reported on our tax return in excess of stock based compensation expense. Following is a description of our stock plans.

We have stock plans for directors and for officers and employees. The plans provide for awards of stock options and stock awards. At December 31, 2003, an aggregate of 808 million shares were available for future grant under our stock plans. In addition, awards that expire or are cancelled without delivery of shares generally become available for issuance under the plans. The options transferred to JPMorgan have been removed from our plans; any options transferred to JPMorgan that expire without being exercised will not become available for grant under any of our plans.

Stock Awards

Stock Awards are grants that entitle the holder to shares of common stock as the award vests. A total of 29 million stock awards with a weighted-average fair value of \$26.10 per share were granted during the first six months of fiscal 2004, generally vesting over a five year period.

Shared Performance Stock Awards

Shared Performance Stock Awards are a form of stock award in which the number of shares ultimately received depends on Microsoft’s performance against specified performance targets. Shared Performance Stock Awards for 30 million shares at target with a weighted-average fair value of \$26.09 per share were made during the first six months of fiscal 2004 for the fiscal 2004-2006 performance period. At the end of the performance

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

period, the number of shares of stock and stock awards issued will be determined by adjusting upward or downward from the target in a range between 33% and 150% (0% to 150% for certain executive officers). The final performance percentage on which the payout will be based, considering company performance metrics established for the performance period, will be determined by the board of directors or a committee of the board in its sole discretion. Shares of stock are issued at the end of the performance period and as the stock awards vest over the following two years.

Stock Options

Nonqualified stock options have been granted to our directors under the director stock plan. Nonqualified and incentive stock options have been granted to our officers and employees under the employee stock plan. Options granted before 1995 generally vest over four and one-half years and expire ten years from the date of grant. Options granted between 1995 and 2001 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest either over four and one-half years or over seven and one-half years and expire ten years from the date of grant. Options granted after 2001 vest over four and one-half years and expire ten years from the date of grant. At December 31, 2003, stock options for 580 million shares were vested.

Stock options outstanding under our stock-based compensation plans were as follows:

(In millions, except per share amounts)

	Shares	Price per Share	
		Range	Weighted Average
Balance, June 30, 2003	1,549	0.40 – 59.56	29.30
Granted	2	25.46 – 29.96	26.75
Exercised	(91)	0.51 – 29.38	9.01
Stock option transfer program	(345)	33.03 – 59.56	38.70
Canceled	(36)	2.31 – 58.28	33.27
Balance, December 31, 2003	1,079	0.40 – 59.56	27.82

For various price ranges, weighted average characteristics of outstanding stock options under our stock-based compensation plans at December 31, 2003 were as follows:

(In millions, except per share amounts)

Range of Exercise Prices	Outstanding Options			Exercisable Options	
	Shares	Remaining Life (Years)	Weighted Average Price	Shares	Weighted Average Price
\$ 0.40 – \$15.00	57	2.0	\$ 6.97	51	\$ 6.92
15.01 – 25.00	333	6.1	21.54	131	17.66
25.01 – 33.00	405	6.1	28.23	209	28.08
33.01 – 41.00	171	4.7	34.22	108	34.28
41.01 – 59.56	113	4.9	44.80	81	44.63

The information presented differs from the information presented in Microsoft's 2003 10-K primarily due to the impact of the stock option transfer program as well as to correctly calculate the weighted average remaining life of outstanding options.

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Note 5 – Inventories

The components of inventories were as follows:

<u>(In millions)</u>	<u>June 30 2003</u>	<u>Dec. 31 2003</u>
Finished goods	\$ 393	\$ 380
Raw materials and work in process	247	241
Inventories	\$ 640	\$ 621

Note 6 – Earnings Per Share

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options, stock awards and shared performance stock awards using the “treasury stock” method.

The components of basic and diluted earnings per share were as follows:

Earnings Per Share

<u>(In millions, except earnings per share)</u>	<u>Three Months Ended Dec. 31</u>		<u>Six Months Ended Dec. 31</u>	
	<u>2002</u>	<u>2003</u>	<u>2002</u>	<u>2003</u>
Net income available for common shareholders (A)	\$ 1,865	\$ 1,549	\$ 3,906	\$ 4,163
Weighted average outstanding shares of common stock (B)	10,703	10,810	10,711	10,800
Dilutive effect of employee stock based compensation	143	89	205	108
Common stock and common stock equivalents (C)	10,846	10,899	10,916	10,908
Earnings per share:				
Basic (A/B)	\$ 0.17	\$ 0.14	\$ 0.36	\$ 0.39
Diluted (A/C)	\$ 0.17	\$ 0.14	\$ 0.36	\$ 0.38

For the three months ended December 31, 2002 and 2003, 1,056 million and 818 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the effect was antidilutive. For the six months ended December 31, 2002 and 2003, 1,096 million and 836 million shares attributable to outstanding stock options were excluded from the calculation of diluted earnings per share because the effect was antidilutive. For the six months ended December 31, 2003, 20 million shared performance stock awards, out of 30 million granted, have been excluded from the calculation of diluted earnings per share because the number of shares ultimately received will be determined by the board of directors or a committee of the board in its sole discretion, considering company performance against metrics established for the performance period, as discussed in Note 4.

Note 7 – Unearned Revenue

Unearned revenue from volume licensing programs represents customer billings, paid either upfront or annually at the beginning of each billing coverage period, which are accounted for as subscriptions with revenue recognized ratably over the billing coverage period. For certain licensing arrangements, revenue attributable to undelivered elements, including free post-delivery telephone support and the right to receive unspecified upgrades/enhancements of Microsoft Internet Explorer on a when-and-if-available basis, is based on the sales price of those elements when sold separately and is recognized ratably on a straight-line basis over the related product’s life cycle. The percentage of revenue recorded as unearned due to undelivered elements ranges from

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

approximately 15% to 25% of the sales price for Windows XP Home, approximately 5% to 15% of the sales price for Windows XP Professional, and approximately 1% to 15% of the sales price for desktop applications, depending on the terms and conditions of the license and prices of the elements. Product life cycles are currently estimated at three and a half years for Windows operating systems and two years for desktop applications. Unearned revenue also includes payments for online advertising for which the advertisement has yet to be displayed and payments for post-delivery support services to be performed in the future.

The components of unearned revenue were as follows:

<u>(In millions)</u>	<u>June 30 2003</u>	<u>Dec. 31 2003</u>
Volume licensing programs	\$5,472	\$4,579
Undelivered elements	2,847	2,624
Other	696	649
Unearned revenue	\$9,015	\$7,852

Unearned revenue by segment was as follows:

<u>(In millions)</u>	<u>June 30 2003</u>	<u>Dec. 31 2003</u>
Client	\$3,165	\$2,954
Server and Tools	2,185	1,945
Information Worker	3,305	2,635
Other segments	360	318
Unearned revenue	\$9,015	\$7,852

Of the \$7.85 billion of unearned revenue at December 31, 2003, \$2.56 billion is expected to be recognized in the third quarter of fiscal 2004, \$1.94 billion in the fourth quarter of fiscal 2004, \$1.08 billion in the first quarter of fiscal 2005, \$647 million in the second quarter of fiscal 2005, and \$1.62 billion thereafter.

The revenue earned from the Upgrade Advantage programs for the three months ended in fiscal years 2003 and 2004 was as follows (in millions):

<u>September 30, 2002</u>	<u>December 31, 2002</u>	<u>March 31, 2003</u>	<u>June 30, 2003</u>	<u>September 30, 2003</u>	<u>December 31, 2003</u>
\$464	\$480	\$450	\$421	\$379	\$296

Note 8 – Stockholders' Equity

As discussed in Note 4 – Stock-Based Compensation, 344.6 million options were transferred to JPMorgan under the stock option transfer program. The options transferred to JPMorgan were amended and restated upon transfer to contain terms and conditions typical of equity option transactions entered into between sophisticated financial counterparties at arm's-length using standard terms and definitions for equity derivatives. The options have strike prices ranging from \$33.03 to \$59.56 per share and expire between February 2004 and December 2006.

We repurchase our common shares primarily to manage the dilutive effects of our stock-based compensation plans and other issuances of common shares. During the December quarter, we repurchased 30.5 million shares of common stock for \$830 million, compared to 38.8 million shares for \$999 million in the

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

comparable quarter of the prior year. For the first six months of fiscal 2004, we repurchased 73.8 million shares of common stock for \$2.0 billion, compared to 159.4 million shares of common stock for \$4.0 billion in the comparable period of the prior year. In any period, cash used in financing activities related to common stock repurchased may differ from the comparable change in Stockholders' Equity, reflecting timing differences between the recognition of share repurchase transactions and their settlement for cash.

Note 9 – Investment Income

The components of investment income are as follows:

(In millions)	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	2002	2003	2002	2003
Dividends and interest	\$ 515	\$ 521	\$ 1,031	\$ 1,005
Net gains (losses) on investments	(104)	310	(232)	555
Net gains (losses) on derivatives	(36)	11	(383)	45
Investment income	\$ 375	\$ 842	\$ 416	\$ 1,605

Net gains (losses) on investments includes other-than-temporary impairments of \$43 million in the second quarter of fiscal 2004 compared to \$421 million in the second quarter of the prior year, and \$61 million for the six month period ended December 31 compared to \$855 million in the six month period ended December 31, 2002.

Note 10 – Contingencies

We are a defendant in *U.S. v. Microsoft* and *New York v. Microsoft*, companion lawsuits filed by the Antitrust Division of the U.S. Department of Justice (DOJ) and a group of eighteen state Attorneys General alleging violations of the Sherman Act and various state antitrust laws. After the trial, the District Court entered Findings of Fact and Conclusions of Law stating that we had violated Sections 1 and 2 of the Sherman Act and various state antitrust laws. A Judgment was entered on June 7, 2000 ordering, among other things, our breakup into two companies. On June 28, 2001, the U.S. Court of Appeals for the District of Columbia Circuit affirmed in part, reversed in part, and vacated the Judgment in its entirety and remanded the case to the District Court for a new trial on one Section 1 claim and for entry of a new judgment consistent with its ruling. In its ruling, the Court of Appeals substantially narrowed the bases of liability found by the District Court, but affirmed some of the District Court's conclusions that we had violated Section 2. We entered into a settlement with the United States on November 2, 2001. Nine states (New York, Ohio, Illinois, Kentucky, Louisiana, Maryland, Michigan, North Carolina and Wisconsin) agreed to settle on substantially the same terms on November 6, 2001. On November 1, 2002, the Court approved the settlement as being in the public interest, conditioned upon the parties' agreement to a modification to one provision related to the Court's ongoing jurisdiction. Two trade groups unsuccessfully sought to intervene to challenge the approval of the settlement and have appealed. Nine states and the District of Columbia continued to litigate the remedies phase of *New York v. Microsoft*. On November 1, 2002, the Court entered a Final Judgment in this part of the litigation that largely mirrored the settlement between us, the DOJ and the settling states, with some modifications and a different regime for enforcing compliance. The Court declined to impose other and broader remedies sought by the non-settling states. Two states, Massachusetts and West Virginia, appealed from this decision. West Virginia dismissed its appeal as part of a settlement with us of several other cases. Oral argument on both appeals was heard by the U.S. Court of Appeals for the D.C. Circuit on November 4, 2003.

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

The European Commission has instituted proceedings in which it alleges that we have failed to disclose information that our competitors claim they need to interoperate fully with Windows 2000 clients and servers and that we have engaged in discriminatory licensing of such technology and improper bundling of multimedia playback technology in the Windows operating system. The remedies sought, though not fully defined, include mandatory disclosure of our Windows operating system technology, either the removal of Windows Media technology from Windows or a “must carry” obligation requiring OEMs to install competitive media players with Windows, and imposition of fines in an amount that could be as large as 10% of our worldwide annual revenue. We deny the European Commission’s allegations and intend to contest the proceedings vigorously. An oral hearing was held on November 12-14, 2003. In other ongoing investigations, various foreign governments and several state Attorneys General have requested information from us concerning competition, privacy, and security issues.

A large number of antitrust and unfair competition class action lawsuits have been filed against us in various state and federal courts. The federal cases have been consolidated in the U.S. District Court for Maryland with the exception of one case which is currently pending in the U.S. District Court for the Eastern District of Arkansas. These cases allege that we have competed unfairly and unlawfully monopolized alleged markets for operating systems and certain software applications, and they seek to recover on behalf of variously defined classes of direct and indirect purchasers overcharges we allegedly charged for these products. To date, courts have dismissed all claims for damages against us by indirect purchasers under federal law and in 16 states. Eight of those state court decisions have been affirmed on appeal. Claims on behalf of foreign purchasers have also been dismissed. Appeals of several of these rulings are still pending. No trials have been held concerning any liability issues. Courts in eleven states have ruled that these cases may proceed as class actions, while courts in two states have denied class certification status, and another court has ruled that no class action is available for antitrust claims in that state. The Maryland District Court has certified a class of direct purchasers of our operating system software that acquired the software from the shop.Microsoft.com web site or pursuant to a direct marketing campaign and otherwise denied certification of the proposed classes. Members of the certified class licensed fewer than 550,000 copies of at-issue operating system software from Microsoft. In September 2003, we reached an agreement with plaintiffs’ counsel to settle this action. The settlement has been preliminarily approved by the court but still requires final approval. In 2003, we reached an agreement with counsel for the California plaintiffs to settle all claims in 27 consolidated cases in that state. Under the proposed settlement, class members will be able to obtain vouchers on a claims made basis that entitle the class members to be reimbursed up to the face value of their vouchers for purchases of a wide variety of platform-neutral computer hardware and software. The total amount of vouchers issued will depend on the number of class members who claim and are issued vouchers. Two-thirds of the amount of vouchers unissued or unredeemed by class members will be made available to certain schools in California in the form of vouchers that also may be redeemed for cash against purchases of a wide variety of platform-neutral computer hardware, software and related services. The court in California preliminarily approved this proposed settlement, but it still requires final approval by the court. In 2003, we also reached similar agreements to settle all claims in Montana, Florida, West Virginia, North Carolina, the District of Columbia, North Dakota, Kansas, Tennessee and South Dakota. The proposed settlements in these states are structured similarly to the California settlement, except that, among other differences, one-half of the amounts of vouchers unissued to class members will be made available to certain schools in the relevant states. The maximum amount of vouchers to be issued in these settlements, including the California settlement, is \$1.55 billion. The actual costs of these settlements will be less than that maximum amount, depending on the number of class members and schools who are issued and redeem vouchers. The settlements in Florida and Montana have received final approval by the relevant court. The proposed settlements in West Virginia, the District of Columbia, North Carolina, Tennessee, South Dakota and Kansas have received preliminary approval by the courts in those states, but still require final approval. We intend to continue

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
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vigorously defending the remaining lawsuits, with trial scheduled to begin in Minnesota on March 1, 2004. We estimate the total cost to resolve all of these cases will range between \$935 million and \$1.1 billion with the actual cost dependent upon many unknown factors such as the quantity and mix of products for which claims will be made, the number of eligible class members who ultimately use the vouchers, the nature of hardware and software that is acquired using the vouchers, and the cost of administering the claims process. In accordance with SFAS 5, *Accounting for Contingencies*, and FIN 14, *Reasonable Estimation of the Amount of a Loss*, we have recorded a contingent liability of \$919 million, net of administrative expenses paid.

On March 8, 2002, Sun Microsystems, Inc. filed suit against us alleging violations of federal and state antitrust and unfair competition laws as well as claims under the Federal Copyright Act. Sun seeks injunctive relief and unspecified treble damages along with its fees and costs. We deny these allegations and will vigorously defend this action. The case has been transferred for pretrial purposes to the U.S. District Court in Baltimore, Maryland and is being coordinated with the antitrust and unfair competition class actions described above. On January 21, 2003, the Court granted Sun's motion for a preliminary injunction and entered an injunction requiring us to distribute certain Sun Java software with Microsoft Windows XP and certain other products. The injunction also prohibits us from distributing our version of Java software in a variety of ways. The U.S. Court of Appeals for the Fourth Circuit granted our request for a stay of the preliminary injunction order. On June 26, 2003, a three judge panel of the Fourth Circuit issued a unanimous opinion vacating the preliminary injunction requiring us to distribute Sun Java software and upheld the preliminary injunction prohibiting us from distributing our version of Java software in certain ways.

On December 18, 2003, RealNetworks, Inc. filed suit against us alleging violations of federal and state antitrust and unfair competition laws, related to streaming media features of Windows and related technologies. RealNetworks seeks damages and injunctive relief, including a permanent injunction requiring Microsoft to offer a version of Windows products with no streaming media features. We deny the allegations and will vigorously defend the action. RealNetworks filed the case in federal court in San Jose, California but is seeking transfer for pretrial purposes to the U.S. District Court in Baltimore. We have filed a motion to transfer the case from San Jose to Seattle for trial.

We are the defendant in more than 30 patent infringement cases. In the case of *Eolas Technologies, Inc. and University of California v. Microsoft*, filed in the U.S. District Court for the Northern District of Illinois on February 2, 1999, the plaintiffs accused the browser functionality of Windows of infringement. On August 11, 2003, the jury awarded the plaintiffs approximately \$520 million in damages for infringement from the date the plaintiffs' patent issued through September 2001. The plaintiffs are seeking an equitable accounting for damages from September 2001 to the present. On January 14, 2004, the trial court entered final judgment of \$565 million, including post-trial interest of \$45 million, and entered an injunction against distribution of any new products, but stayed execution of the judgment and the injunction pending our appeal which we intend to pursue in due course. On October 30, 2003, the U.S. Patent Office issued a letter stating that it has initiated a Director-ordered re-examination of the Eolas patent. We believe the total cost to resolve this case will not be material to our financial position or results of operations. The actual costs are dependent upon many unknown factors such as success on appeal and the events of a retrial of the case should the case be remanded to trial following appeal. The trial of *InterTrust v. Microsoft*, filed in the U.S. District Court for Northern California on April 26, 2001, is anticipated in 2005. The plaintiff in this case has accused a large number of products, including Windows and Office, of infringement. In *InterTrust*, injunctive relief also may be awarded that could adversely impact distribution of Windows or Office. In *TVI v. Microsoft*, filed in U.S. District Court for the Northern District of California, plaintiff accuses the Autoplay feature of Windows of infringement. This case is scheduled for trial in July of 2004. Adverse outcomes in some or all of the pending cases may result in significant monetary damages or injunctive relief against us.

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

We are also subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business.

While management currently believes that resolving all of these matters, individually or in aggregate, will not have a material adverse impact on our financial position or our results of operations, the litigation and other claims noted above are subject to inherent uncertainties and management's view of these matters may change in the future. Were an unfavorable final outcome to occur, there exists the possibility of a material adverse impact on our financial position and the results of operations for the period in which the effect becomes reasonably estimable.

Note 11 – Guarantees

We have unconditionally guaranteed the repayment of certain Japanese Yen denominated bank loans and related interest and fees of Jupiter Telecommunication, Ltd., a Japanese cable company (Jupiter). These guarantees arose on February 1, 2003 in conjunction with the expiration of prior financing arrangements, including previous guarantees by us. The financing arrangements were entered into by Jupiter as part of financing its operations. As part of Jupiter's new financing agreement, we agreed to guarantee repayment by Jupiter of the loans of approximately \$55 million. The estimated fair value and the carrying value of the guarantees was \$10.5 million and did not result in a charge to operations. The guarantees are in effect until the earlier of repayment of the loans, including accrued interest and fees, or February 1, 2009. The maximum amount of the guarantees is limited to the sum of the total due and unpaid principal amounts, accrued and unpaid interest, and any other related expenses. Additionally, the maximum amount of the guarantees, denominated in Japanese yen, will vary based on fluctuations in foreign exchange rates. If we were required to make payments under the guarantees, we may recover all or a portion of those payments upon liquidation of Jupiter's assets. The proceeds from such liquidation cannot be accurately estimated due to the multitude of factors that would affect the valuation and realization of the proceeds in the event of liquidation.

In connection with various operating leases, we issued residual value guarantees, which provide that if we do not purchase the leased property from the lessor at the end of the lease term, then we are liable to the lessor for an amount equal to the shortage (if any) between the proceeds from the sale of the property and an agreed value. As of December 31, 2003, the maximum amount of the residual value guarantees was approximately \$271 million. We believe that proceeds from the sale of properties under operating leases would exceed the payment obligation and therefore no liability to us currently exists.

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products. We evaluate estimated losses for such indemnifications under SFAS 5 as interpreted by FASB Interpretation 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). We consider such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. To date, we have not encountered material costs as a result of such obligations and have not accrued any liabilities related to such indemnifications in our financial statements.

Our product warranty accrual reflects management's best estimate of probable liability under our product warranties (primarily relating to the Xbox console). We determine the warranty accrual based on known product failures (if any), historical experience, and other currently available evidence. Product warranty and changes to the accruals were not significant for any of the periods presented.

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Note 12 – Segment Information*(In millions)*

Three Months Ended Dec. 31	2002	2003
Revenue		
Client	\$ 2,421	\$ 3,016
Server and Tools	1,672	1,949
Information Worker	2,382	2,856
Microsoft Business Solutions	151	177
MSN	578	596
Mobile and Embedded Devices	37	58
Home and Entertainment	1,283	1,201
Reconciling Amounts	17	300
Consolidated	<u>\$ 8,541</u>	<u>\$ 10,153</u>

Operating Income/(Loss)		
Client	\$ 1,948	\$ 2,438
Server and Tools	465	544
Information Worker	1,924	2,130
Microsoft Business Solutions	(66)	(42)
MSN	(153)	112
Mobile and Embedded Devices	(38)	(34)
Home and Entertainment	(341)	(241)
Reconciling Amounts	(1,506)	(3,432)
Consolidated	<u>\$ 2,233</u>	<u>\$ 1,475</u>

(In millions)

Six Months Ended Dec. 31	2002	2003
Revenue		
Client	\$ 5,302	\$ 5,674
Server and Tools	3,258	3,727
Information Worker	4,729	5,270
Microsoft Business Solutions	272	314
MSN	1,114	1,200
Mobile and Embedded Devices	65	109
Home and Entertainment	1,788	1,833
Reconciling Amounts	(241)	241
Consolidated	<u>\$ 16,287</u>	<u>\$ 18,368</u>

Operating Income/(Loss)		
Client	\$ 4,426	\$ 4,640
Server and Tools	1,011	1,052
Information Worker	3,814	3,950
Microsoft Business Solutions	(105)	(95)
MSN	(246)	209
Mobile and Embedded Devices	(68)	(48)
Home and Entertainment	(512)	(417)
Reconciling Amounts	(3,059)	(4,668)
Consolidated	<u>\$ 5,261</u>	<u>\$ 4,623</u>

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
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Segment information is presented in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*. This standard is based on a management approach, which requires segmentation based upon our internal organization and reporting of revenue and operating income based upon internal accounting methods. Our financial reporting systems present various data for management to run the business, including internal profit and loss statements (P&Ls) prepared on a basis not consistent with U.S. GAAP. Assets are not allocated to segments for internal reporting presentations. A portion of amortization and depreciation is included with various other costs in an overhead allocation to each segment and it is impracticable for the Company to separately identify the amount of amortization and depreciation by segment that is included in the measure of segment profit or loss.

Our segments are designed to promote better alignment of strategies and objectives between development, sales, marketing, and services organizations; provide for more timely and rational allocation of development, sales, and marketing resources within businesses; and focus long-term planning efforts on key objectives and initiatives. Our seven segments are: Client; Server and Tools; Information Worker; Microsoft Business Solutions; MSN; Mobile and Embedded Devices; and Home and Entertainment.

The segments are used to allocate resources internally and provide a framework to determine management responsibility. Due to our integrated business structure, operating costs included in one segment may benefit other segments, and therefore the segments are not designed to measure operating income or loss directly related to the products included in each segment. Inter-segment sales cost commissions are estimated by management and used to compensate or charge each segment for such shared costs, and to incent shared efforts. Management will continually evaluate the alignment of development, sales organizations, and inter-segment commissions for segment reporting purposes, which may result in changes to segment allocations in future periods.

The Company retroactively adopted the fair value recognition provisions of SFAS 123 on July 1, 2003. For internal management reporting, the equity compensation expense for stock awards, shared performance-based stock awards, and the employee stock purchase plan have been allocated to the segments, using a non-GAAP accelerated amortization method in the case of stock awards and shared performance-based stock awards. For example, the compensation expense for stock award grants will be expensed in the fiscal year of grant and the compensation expense for performance-based stock award grants will be expensed over three years. Costs related to options granted in prior years, including the costs associated with the stock option transfer program discussed in Note 4, were not allocated to segments by management and therefore are not included in segment operating income and are included as reconciling items. Additionally, as the broad use of stock awards and performance-based awards began in the current year, there is no comparable expense included in the corresponding period of the prior year. The following table outlines the equity compensation expense included in segment operating income for the three and the six months period ended December 31, 2003.

(In millions)

<u>Three Months Ended Dec. 31</u>	<u>2002</u>	<u>2003</u>
Client		\$ 36
Server and Tools		94
Information Worker		44
Microsoft Business Solutions		9
MSN		21
Mobile and Embedded Devices		8
Home and Entertainment		18
Reconciling Amounts	1,058	3,002
Consolidated	<u>\$ 1,058</u>	<u>\$ 3,232</u>

MICROSOFT CORPORATION
NOTES TO FINANCIAL STATEMENTS—(Continued)
(Unaudited)

(In millions)

<u>Six Months Ended Dec. 31</u>	<u>2002</u>	<u>2003</u>
Client		\$ 70
Server and Tools		181
Information Worker		85
Microsoft Business Solutions		18
MSN		40
Mobile and Embedded Devices		16
Home and Entertainment		36
Reconciling Amounts	2,106	3,800
Consolidated	<u>\$ 2,106</u>	<u>\$ 4,246</u>

Client includes revenue and operating expenses associated with Windows XP Professional and Home, Windows 2000 Professional, and other standard Windows operating systems. Server and Tools consists of revenue and operating expenses associated with server software licenses and client access licenses (CALs) for Windows Server, SQL Server, Exchange Server, and other servers. It also includes developer tools, training, certification, Microsoft Press, Premier product support services, and Microsoft consulting services. Information Worker includes Microsoft Office, Microsoft Project, Microsoft Visio, SharePoint Portal Server CALs, other information worker products including LiveMeeting and OneNote, an allocation for CALs, and professional product support services. Microsoft Business Solutions includes Microsoft Great Plains, Microsoft Navision, Microsoft Axapta, Microsoft Solomon, Microsoft CRM, bCentral and other business applications and services. MSN includes MSN subscriptions and the MSN network of Internet products and services. Mobile and Embedded Devices includes Windows Mobile™ software, Windows Embedded device operating systems, MapPoint, and Windows Automotive. Home and Entertainment includes the Xbox video game system, PC games, consumer software and hardware, and TV platform.

Corporate and reconciling amounts include adjustments to state revenue and operating income in accordance with U.S. GAAP and corporate level expenses not specifically attributed to a segment. For revenue, reconciling items include certain undelivered elements of unearned revenue and allowances for certain sales returns and rebates. Corporate and reconciling items for operating income/(loss) for the second quarter include general and administrative expenses (\$497 million in the second quarter of fiscal year 2003 and \$896 million in 2004), broad-based research and development expenses (\$59 million in the second quarter of fiscal year 2003 and \$85 million in 2004), and certain corporate level sales and marketing costs (\$159 million in the second quarter of fiscal year 2003 and \$208 million in 2004), \$2.21 billion in stock based compensation related to the employee stock option transfer program, and other reconciling items, including additional stock based compensation expense (\$791 million in the second quarter of fiscal year 2003 and \$35 million in 2004). Corporate and reconciling items for operating income/(loss) for the first six months include general and administrative expenses (\$749 million in the first six months of fiscal 2003 and \$1.37 billion in 2004), broad-based research and development expenses (\$109 million in the first six months of fiscal 2003 and \$163 million in 2004), and certain corporate level sales and marketing costs (\$285 million in the first six months of fiscal 2003 and \$408 million in 2004), \$2.21 billion in stock based compensation related to the employee stock option transfer program, and other reconciling items, including additional stock based compensation expense (\$1.91 billion in the first six months of fiscal 2003 and \$509 million in 2004). The internal segment operating income or loss also includes non-GAAP accelerated methods of depreciation and amortization, and accelerated amortization of stock awards and performance-based stock awards. Additionally, losses on equity investees and minority interest are classified in operating income for internal reporting presentations.

INDEPENDENT ACCOUNTANTS' REPORT

To the Board of Directors and Stockholders of Microsoft Corporation
Redmond, Washington

We have reviewed the accompanying consolidated balance sheet of Microsoft Corporation and subsidiaries (the Company) as of December 31, 2003, and the related consolidated statements of income, stockholders' equity, and cash flows for the three-month and six-month periods ended December 31, 2003 and 2002. These interim financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Microsoft Corporation and subsidiaries as of June 30, 2003, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended prior to restatement for the adoption of SFAS No. 123, *Accounting for Stock-Based Compensation* (not presented herein); and in our report dated July 17, 2003 (September 3, 2003 as to certain information in Note 20), we expressed an unqualified opinion on those consolidated financial statements. We also audited the adjustments described in Note 3 that were applied to restate the June 30, 2003 consolidated balance sheet of Microsoft Corporation and subsidiaries (not presented herein). In our opinion, such adjustments are appropriate and have been properly applied and the information set forth in the accompanying consolidated balance sheet as of June 30, 2003 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
January 30, 2004

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis (MD&A) contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of factors discussed in "Issues and Uncertainties" and elsewhere in this report. We undertake no duty to update any forward-looking statement to conform the statement to actual results or changes in our expectations.

Management Summary

Revenue for the second quarter of fiscal year 2004 was \$10.15 billion, an increase of 19% over the second quarter of fiscal year 2003. The revenue growth was driven primarily by licensing of the recently launched Office 2003, increased licensing of Windows operating systems through OEMs and Server and Tools products, and 19% growth in MSN revenue.

During the second quarter, the continued strong PC shipment growth influenced our overall revenue growth. We estimate that total PC shipments grew 12% from the second quarter of the prior year reflecting strength in the consumer segment and notebook sales. We also observed an improvement in overall IT spending. We estimate that total server hardware shipments grew 13%, with Windows Server shipments growing faster than the overall sector at 19% in the second quarter of fiscal 2004. The net impact of foreign exchange rates on revenue was positive in the second quarter compared to a year ago, primarily due to a stronger Euro and Japanese yen versus the U.S. dollar. Had the rates from the prior year's second quarter been in effect in the second quarter of fiscal 2004, translated international revenue earned in local currencies would have been approximately \$312 million lower. Certain manufacturing, selling, distribution, and support costs are disbursed in local currencies, and a portion of international revenue is hedged, thus offsetting a portion of the translation exposure.

Revenue for the first six months of fiscal year 2004 was \$18.37 billion, an increase of 13% over the first six months of fiscal year 2003. The revenue growth was driven by 13% growth in estimated PC shipments, reflecting strength primarily in the consumer segment and notebook sales. We estimate that total server hardware shipments grew 12%, with Windows Server shipments growing faster than the overall sector at 16% in the first six months of fiscal 2004. The revenue growth was also driven by revenue recognized from multi-year licensing that occurred prior to the Company's transition to its new licensing program (Licensing 6.0) in the first quarter of fiscal 2003. Prior to the July 31, 2002 transition date to Licensing 6.0, the Company experienced a significant growth in multi-year licensing arrangements as customers enrolled in the Company's maintenance programs, primarily Upgrade Advantage programs and Enterprise Agreements.

Unearned revenue as of December 31, 2003 decreased \$1.16 billion from June 30, 2003. The decrease reflected a \$223 million decrease in unearned revenue related to undelivered elements as deferral rates were lowered and product life cycles lengthened for the underlying products licensed in the first half of fiscal 2004 compared to fiscal 2003, resulting in a higher proportion of revenue earned. The decline also reflects a net decrease of \$893 million in unearned revenue from volume licensing programs as \$675 million of revenue was earned from previously deferred revenue from Upgrade Advantage programs.

The net impact of foreign exchange rates on revenue was positive in the first six months of fiscal 2004, primarily due to a stronger Euro and Japanese yen versus the U.S. dollar. Had the rates from the prior year's first six months been in effect in the first six months of fiscal 2004, translated international revenue earned in local currencies would have been approximately \$477 million lower. Certain manufacturing, selling, distribution, and support costs are disbursed in local currencies, and a portion of international revenue is hedged, thus offsetting a portion of the translation exposure.

For the full fiscal 2004, PC shipments are expected to grow at double digit rates. In the second half of the fiscal year, we expect PC market growth to be driven by both consumer and business demand for PCs. We believe the overall server hardware sector and IT spending outlook is improving. Our enterprise server products

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revenue results should be positively influenced by the continued shift to lower cost X86 server architecture. As a result, we expect overall server hardware shipment growth for fiscal 2004 to reach double digit growth with Windows Server operating systems licenses growing faster than the overall sector. We believe foreign exchange rates will stabilize during the second half of our fiscal year and we will continue to benefit from the U.S. dollar's position relative to the Euro and Japanese yen in the second half of the fiscal year.

Consolidated operating income of \$1.48 billion declined 34% for the second quarter of fiscal year 2004 due primarily to \$2.21 billion in stock based compensation expenses related to our employee stock option transfer program completed in the second quarter of fiscal 2004. Increased marketing, legal costs, and employee-related costs associated with additional headcount also contributed to the increase in operating expenses.

Consolidated operating income of \$4.62 billion declined 12% for the first six months of fiscal year 2004 due primarily to \$2.21 billion in stock based compensation expenses related to our employee stock option transfer program completed in the second quarter of fiscal 2004. Increased legal costs and employee-related costs associated with additional headcount also contributed to the increase in operating expenses.

We adopted the fair value recognition provisions of SFAS 123, *Accounting for Stock-Based Compensation*, on July 1, 2003 and restated prior periods to reflect compensation cost under the recognition provisions of SFAS 123 for all awards granted to employees after July 1, 1995. Headcount-related costs in operating expenses include stock-based compensation. Total stock-based compensation costs included in operating expenses for the second quarter of fiscal 2004 were \$3.23 billion, compared to \$1.06 billion in the prior year's comparable quarter and \$4.25 billion for the first six months of fiscal 2004, compared to \$2.11 billion for the first six months of fiscal 2003.

SEGMENT PRODUCT REVENUE/OPERATING INCOME (LOSS)

Our seven segments are:

- Client
- Server and Tools
- Information Worker
- Microsoft Business Solutions
- MSN
- Mobile and Embedded Devices
- Home and Entertainment

The revenue and operating income/(loss) amounts in this MD&A are presented in accordance with U.S. GAAP. Segment Information appearing in Note 12 of the Notes to Financial Statements are presented in accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*.

The following table presents our segment revenue and operating income, determined in accordance with U.S. GAAP:

(In millions) Three Months Ended Dec. 31	Revenue		Operating Income/(Loss)	
	2002	2003	2002	2003
Client	\$ 2,534	\$ 3,059	\$ 1,952	\$ 2,072
Server and Tools	1,763	2,134	234	(204)
Information Worker	2,285	2,895	1,663	1,674
Microsoft Business Solutions	135	190	(87)	(69)
MSN	459	546	(197)	(79)
Mobile and Embedded Devices	38	63	(75)	(112)
Home and Entertainment	1,327	1,266	(412)	(394)
Corporate and Other	—	—	(845)	(1,413)
Consolidated	\$ 8,541	\$ 10,153	\$ 2,233	\$ 1,475

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(In millions) Six Months Ended Dec. 31	Revenue		Operating Income/(Loss)	
	2002	2003	2002	2003
Client	\$ 5,341	\$ 5,868	\$ 4,235	\$ 4,336
Server and Tools	3,388	4,000	526	166
Information Worker	4,553	5,182	3,322	3,265
Microsoft Business Solutions	241	318	(181)	(148)
MSN	886	1,037	(344)	(21)
Mobile and Embedded Devices	66	116	(140)	(144)
Home and Entertainment	1,812	1,847	(656)	(667)
Corporate and Other	0	0	(1,501)	(2,164)
Consolidated	\$ 16,287	\$ 18,368	\$ 5,261	\$ 4,623

Client

Client revenue was \$3.06 billion in the second quarter, growing 21% from the second quarter of the prior year. Client includes revenue from Windows XP Professional and Home, Windows 2000 Professional, and other standard Windows operating systems. Windows OEM license units grew 27%, driving a 26% growth in OEM revenue compared to the prior year. The mix of Windows units shipped with the Professional version remained steady at 55% of total Windows licenses compared to the prior year. In the first quarter of fiscal 2003, we completed our transition to new licensing terms under which OEMs are billed for products when Certificates of Authenticity (COAs) are acquired rather than upon PC shipment, which resulted in reported licenses in the second quarter of the prior year to be unusually low as some OEMs accumulated inventory at the end of the first quarter of fiscal 2003. Revenue from commercial and retail licensing grew 4% compared to the prior year's second quarter. Client operating income for the second quarter of fiscal year 2004 grew 6% compared to the second quarter of the prior year as a result of 21% growth in revenue partially offset by 70% growth in operating expenses, primarily from \$307 million of stock based compensation expense related to the employee stock option transfer program, other headcount-related costs, and a \$60 million settlement charge in the second quarter of fiscal 2004.

Client revenue was \$5.87 billion in the first six months of fiscal 2004, representing 10% growth from the first six months of the prior year. The six month revenue growth reflected Windows OEM license units growth of 13%, driving a 14% growth in OEM revenue compared to the prior year. The mix of Windows units shipped with the Professional version decreased to 58% from 59% of total Windows licenses in the first six months of the prior year as OEM shipments of consumer PCs grew at a faster rate than business PCs in the first six months of fiscal 2004. Revenue from commercial and retail licensing declined 5% compared to the prior year's first six months. Client operating income for the first six months of fiscal year 2004 grew 2% compared to the first six months of the prior year due to 10% growth in revenue partially offset by 39% growth in operating expenses, primarily related to the stock based compensation expense from the employee stock option transfer program, headcount-related costs, and a settlement charge in the second quarter of fiscal 2004.

We anticipate that total PC shipments will grow at double digit rates for the rest of fiscal 2004, continuing to influence our growth in Client revenue. We do not expect a significant incremental shift toward our higher priced Windows Professional version.

Server and Tools

Server and Tools revenue grew 21% to \$2.13 billion in the second quarter. Server and Tools consists of server software licenses and client access licenses (CALs) for Windows Server, SQL Server, Exchange Server, and other servers. It also includes developer tools, training, certification, Microsoft Press, Premier product support services, and Microsoft consulting services. Server revenue, including CALs, grew \$290 million or 22% driven primarily by an estimated 19% increase in Windows-based server shipments driving 17% growth in new Windows Server license sales as well as growth in SQL Server and Exchange Server revenue. Consulting and Premier product support services increased \$70 million or 29% compared to the prior year's second quarter.

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Revenue from developer tools, training, certification, Microsoft Press and other services grew \$11 million or 5%. Server and Tools reported an operating loss of \$204 million in the second quarter of 2004, compared to operating income of \$234 million in the second quarter of the prior year. While revenue increased 21%, Server and Tools reported an operating loss because of stock based compensation costs of \$651 million related to the employee stock option transfer program, and a 10% increase in operating expenses including headcount related costs.

Server and Tools revenue grew 18% to \$4.00 billion in the first six months of fiscal 2004. Server revenue, including CALs, grew \$504 million or 20% driven primarily by an estimated 16% increase in Windows-based server shipments driving growth in new Windows Server license sales as well as growth in SQL Server and Exchange Server revenue. Consulting and Premier product support services increased \$107 million or 23% compared to the prior year's first six months. Revenue from developer tools, training, certification, Microsoft Press and other services was consistent with the prior year's first six months. Server and Tools operating income for the first six months of fiscal 2004 decreased to \$166 million compared to \$526 million in the prior year primarily due to the stock based compensation costs from the employee stock option transfer program in the second quarter of fiscal 2004 and an 11% increase in operating expenses including headcount related costs.

Information Worker

Revenue from Information Worker was \$2.90 billion in the second quarter of fiscal 2004, increasing 27% from the prior year's second quarter. Information Worker includes revenue from Microsoft Office, Microsoft Project, Microsoft Visio, SharePoint Portal Server CALs, other information worker products including Microsoft LiveMeeting and OneNote, and professional product support services. Revenue for the quarter included \$137 million of revenue deferred from the first quarter of fiscal 2004 for purchases of Office XP made in the first quarter that included rights to upgrade to Office 2003 when Office 2003 was released in the second quarter. Revenue from retail packaged product sales grew 36% from the second quarter of fiscal 2003 in part due to the release of the new Office 2003 during the second quarter. OEM licensing revenue from Office products and pre-installed versions of Office in Japan grew 22% from the second quarter of fiscal 2003. Contributing to the increase in revenue was a lower deferral rate for undelivered elements in the quarter ended December 31, 2003 as compared to the prior year's comparable quarter, which resulted in a higher proportion of revenue earned. Information Worker operating income for the second quarter of fiscal year 2004 increased 1% due to the 27% growth in revenue from the prior year, which were mostly offset by an increase in operating expenses, primarily related to \$351 million in stock-based compensation expense from the employee stock option transfer program, headcount related costs, and increased costs associated with Office 2003 launch.

Revenue from Information Worker was \$5.18 billion in the first six months of fiscal 2003, increasing 14% from the prior year's first six months. Revenue growth was driven by recognition of unearned revenue from a large increase in multi-year licenses signed prior to the transition to the Company's Licensing 6.0 programs and 26% growth in retail packaged product sales in part due to the release of the new Office 2003. OEM and pre-installed versions of Office in Japan grew 30% in the first six months of fiscal 2004. Information Worker operating income for the first six months of fiscal year 2004 declined 2% due to an increase in operating expenses, primarily related to the stock based compensation expense from the employee stock option transfer program and higher sales and marketing expenses, partially offset by the 14% growth in revenue from the prior year.

Microsoft Business Solutions

Microsoft Business Solutions revenue for the second quarter was \$190 million, a 41% increase compared to \$135 million in the prior year's second quarter. Microsoft Business Solutions includes Microsoft Great Plains, Microsoft Navision, Microsoft Axapta, Microsoft Solomon, Microsoft CRM, bCentral and other business applications and services. The revenue increase of \$55 million was primarily attributable to continued growth in licensing of Navision products and Business Contact Manager as well as the timing of licensing agreements. Microsoft Business Solutions operating loss for the second quarter of fiscal year 2004 declined 21% led by the 41% increase in revenue, partially offset by a 17% increase in operating expenses primarily related to stock based compensation expense from the employee stock option transfer program.

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Microsoft Business Solutions revenue for the first six months of fiscal 2004 was \$318 million compared to \$241 million in the prior year's first six months. The additional sales attributable to the acquisition of Navision at the beginning of the fiscal year resulted in the majority of the revenue increase from the prior year. Microsoft Business Solutions operating loss for the first six months of fiscal 2004 declined 18% led by the 32% increase in revenue, partially offset by a 10% increase in operating expenses primarily related to stock based compensation expense from the employee stock option transfer program.

MSN

MSN revenue totaled \$546 million in the second quarter growing 19% from the second quarter of the prior year. MSN includes MSN subscriptions and the MSN network of Internet products and services. MSN Network services revenue grew \$93 million or 47% as a result of growth in paid search and growth in the overall Internet advertising market. MSN subscription revenue declined \$6 million or 2% as the number of subscribers continued to decline as our narrowband subscriber base continues to migrate to competitively priced broadband or other ISPs. Subscription revenue may decline for the remainder of the fiscal year as the overall MSN subscriber base is expected to continue to decline. MSN incurred an operating loss of \$79 million for the second quarter of fiscal 2004, compared to an operating loss of \$197 million in the prior year's second quarter. The operating loss in the second quarter included \$144 million related to stock based compensation costs related to the employee stock option transfer program.

MSN revenue totaled \$1.04 billion in the first six months of fiscal 2004 compared to \$886 million in the prior year's first six months. MSN Subscription revenue declined 4% or \$23 million, reflecting a decrease in the overall subscriber base. MSN Network services grew 49% or \$174 million as a result of Internet advertising revenue. MSN reported an operating loss of \$21 million compared to a loss of \$344 million in the first six months of the prior year. The improvement in operating results was driven primarily from lower operating expenses and a \$48 million one-time refund of prior year taxes, partially offset by the costs related to the employee stock option transfer program which was recorded in the second quarter of fiscal 2004.

Mobile and Embedded Devices

Mobile and Embedded Devices second quarter revenue totaled \$63 million, compared to \$38 million in the prior year's second quarter. Mobile and Embedded Devices includes Windows Mobile software, Windows Embedded device operating systems, MapPoint, and Windows Automotive. The increase in revenue was driven by growth in all businesses. The revenue growth realized by MapPoint is expected to ease in future quarters, as the year-over-year growth reflects the addition of revenue from the acquisition of Vicinity Corporation toward the end of the second quarter of the prior fiscal year. Mobile and Embedded Devices operating loss was 49% higher in the second quarter of fiscal 2004 compared to the prior year's second quarter, primarily due to \$58 million related to stock based compensation expense from the employee stock option transfer program, partially offset by 66% growth in revenue.

Fiscal 2004 revenue for the first six months totaled \$116 million, compared to \$66 million in the prior year's first six months. The increase in revenue was driven by growth in all businesses. Mobile and Embedded Devices operating loss was 3% higher in the first six months of fiscal 2004 compared to the prior year's first six months, primarily driven by stock based compensation expense from the employee stock option transfer program, partially offset by the 76% growth in revenue.

Home and Entertainment

Home and Entertainment revenue was \$1.27 billion in the second quarter of fiscal 2004, declining 5% from \$1.33 billion in the prior year's second quarter. Home and Entertainment includes the Xbox video game system, PC games, consumer software and hardware, and TV platform. Xbox revenue increased \$15 million or 2% from the prior year's second quarter, with \$175 million related to higher volumes of Xbox software, offset by a \$37 million decline due to lower Xbox console volumes and a \$123 million decrease related to price reductions of

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Xbox consoles and software. Xbox console volumes declined 6%. This decline primarily reflects a change in the timing of the introduction of our Xbox holiday offering, which in fiscal 2004 occurred in the first quarter and in fiscal 2003 occurred in the second quarter. Xbox's life to date U.S. games attach rate according to NPD data was 6.4 games per console with over 400 games available. Revenue from consumer hardware and software and PC games declined \$78 million or 18% compared to the second quarter of fiscal 2003 due to stronger sales of our PC games software titles in the prior year and a decline in revenue from PC gaming devices.

Home and Entertainment operating loss for the second quarter of fiscal year 2004 improved 4% from the second quarter of fiscal year 2003 driven by increasing margins from a shift in the product mix toward higher margin Xbox software for the Xbox console, lower product development costs and lower marketing costs, partially offset by stock based compensation associated with the employee stock option transfer program.

Home and Entertainment revenue was \$1.85 billion in the first six months of fiscal 2004, increasing 2% from \$1.81 billion in the prior year's first six months. Xbox revenue increased \$68 million or 6% from the prior year's first six months, with \$177 million related to higher volumes of Xbox software and \$46 million increase due to higher Xbox console volumes and a \$155 million decrease related to price reductions of Xbox consoles and software. Xbox console volumes increased 5%. Revenue from consumer hardware and software and PC games declined \$35 million or 5% compared to the prior year's first six months due to a decline in revenue from PC gaming devices.

Home and Entertainment operating loss for the first six months of fiscal year 2004 increased 2% from the first six months of fiscal year 2003 driven by 2% growth in operating expenses, including stock based compensation costs associated with the employee stock option transfer program.

Cost of revenue

Cost of revenue includes manufacturing and distribution costs for products and programs sold, operation costs related to product support service centers and product distribution centers, costs incurred to support and maintain Internet-based products and services, and costs associated with the delivery of consulting services. Cost of revenue was \$2.34 billion, or 23.1% of revenue, in the second quarter, compared to \$2.14 billion, or 25.0% of revenue, in the second quarter of the prior year. The increase in absolute dollars resulted primarily from \$215 million in stock based compensation expense associated with the employee stock option transfer program. The increase in absolute dollars in cost of revenue was partially offset by a 12% decrease in Home & Entertainment costs, due to a decrease in Xbox console units sold and lower costs of producing the Xbox console and higher margined Xbox games sold. Cost of revenue was \$3.82 billion, or 20.8% of revenue, in the first six months of fiscal 2004, compared to \$3.48 billion, or 21.4% of revenue, in the first six months of the prior year. The cost of sales growth was primarily driven by stock based compensation expense from the employee stock option transfer program and an increase in product support and consulting services, partially offset by a decline in Xbox consoles product costs.

Research and development

Research and development expenses include payroll, employee benefits, equity compensation and other headcount-related costs associated with product development. Research and development expenses also include third-party development and programming costs, localization costs incurred to translate software for international markets, and the amortization of purchased software code and services content. Research and development expenses in the second quarter of fiscal 2004 were \$2.97 billion, 29.3% of revenue, compared to \$1.52 billion, 17.7% of revenue, in the second quarter of the prior year. The increase was primarily due to \$1.31 billion in stock based compensation expense from the employee stock option transfer program and \$167 million or 14% increase in headcount-related costs. Research and development expenses for the first six months of fiscal 2004 were \$4.58 billion, 24.9% of revenue, an increase of 42% over the first six months of the prior year. The six month increase was primarily due to the stock based compensation expense from the employee stock option transfer program and \$105 million or 4% increase in other headcount-related costs.

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Sales and marketing

Sales and marketing expenses include payroll, employee benefits, equity compensation and other headcount-related costs associated with sales and marketing personnel and advertising, promotions, tradeshow, seminars, and other programs. Sales and marketing expenses were \$2.47 billion in the second quarter, or 24.3% of revenue, compared to \$2.16 billion in the second quarter of the prior year, or 25.3% of revenue. Sales and marketing costs increased in absolute dollars due to stock based compensation expense associated with the employee stock option transfer program. Sales and marketing expenses were \$3.97 billion for the first six months of fiscal 2004, or 21.6% of revenue, compared to \$3.57 billion in the first six months of fiscal 2003, or 21.9% of revenue. The absolute dollar increase was due to the stock based compensation expense related to the employee stock option transfer program and \$53 million or 3% increase in other headcount related costs.

General and administrative

General and administrative costs include payroll, employee benefits, equity compensation and other headcount-related costs associated with the finance, legal, facilities, certain human resources and other administrative headcount, and legal and other administrative fees. General and administrative costs were \$896 million in the second quarter compared to \$497 million in the comparable quarter of the prior year. General and administrative costs increased in the second quarter primarily from \$280 million in stock based compensation expense and \$19 million in fees and expenses associated with the employee stock option transfer program as well as higher legal costs including settlement costs and headcount-related expenses. For the first six months of fiscal 2004, general and administrative costs were \$1.37 billion compared to \$749 million in the first six months of the prior year. General and administrative costs in the second quarter of fiscal 2003 included a charge of approximately \$210 million related to the settlement of class action lawsuits. The second quarter of fiscal 2004 included the expenses associated with the employee stock option transfer program and certain settlement costs.

NON-OPERATING ITEMS, INVESTMENT INCOME, AND INCOME TAXES

Losses on equity investees and other incorporates Microsoft's share of income or loss from equity method investments and income or loss attributable to minority interests. Losses on equity investees and other declined to \$5 million in the second quarter of fiscal 2004, compared to \$12 million in the comparable quarter of fiscal 2003. Losses on equity investees and other declined to \$15 million in the first six months of fiscal 2004, compared to \$34 million in the comparable period of fiscal 2003. These decreases were a result of reduced losses and increased income generated by the equity investees for the period ended December 31, 2003, as well as a reduction in the number of equity investees through sale of investments in fiscal year 2003.

The components of investment income are as follows:

(In millions)	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	2002	2003	2002	2003
Dividends and interest	\$ 515	\$ 521	\$ 1,031	\$ 1,005
Net gains (losses) on investments	(104)	310	(232)	555
Net gains (losses) on derivatives	(36)	11	(383)	45
Investment income	\$ 375	\$ 842	\$ 416	\$ 1,605

Dividends and interest income was relatively consistent for both the comparable quarterly and six month periods even though the overall portfolio earning such income increased mainly due to the non-recurring dividends earned in the prior comparable periods related to the AT&T 5% convertible preferred debt holding. Net gains (losses) on investments includes other-than-temporary impairments of \$43 million in the second quarter of fiscal 2004 compared to \$421 million in the second quarter of the prior year, and \$61 million for the six month period ended December 31, 2003 compared to \$855 million in the prior year comparable period and were down mainly due to improved market conditions. Realized gains from investments increased to \$353 million compared

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to \$317 million in the second quarter of the prior year, and were \$616 million compared to \$623 million in the six month period of the prior year. Net losses on derivative instruments of \$383 million for the six month period ended December 31, 2002 were driven mainly by the impact of decreasing interest rates on interest rate sensitive instruments noted during the first quarter of fiscal 2003.

Income Taxes

The effective tax rate for both the second quarter and first six months of fiscal 2004 is approximately 33%. The effective tax rate for fiscal 2003 was 32%, reflecting a benefit in the second quarter of \$126 million from the reversal of previously accrued taxes.

STOCK-BASED COMPENSATION

Effective July 1, 2003, we adopted the fair value recognition provisions of SFAS 123, *Accounting for Stock-Based Compensation*, using the retroactive restatement method described in SFAS 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*. Under the fair value recognition provisions of SFAS 123, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Stock-based employee compensation expense was \$1.06 billion (\$709 million after-tax or \$0.07 per diluted share) and \$2.11 billion (\$1.41 billion after-tax or \$0.13 per diluted share) for the three and six months ended December 31, 2002, respectively, and \$3.23 billion (\$2.17 billion after-tax or \$0.20 per diluted share) and \$4.25 billion (\$2.85 billion after-tax or \$0.26 per diluted share) for the three and six months ended December 31, 2003, respectively. The amounts for the three and six months ended December 31, 2003 include \$2.21 billion (\$1.48 billion after-tax or \$0.14 per diluted share) due to the stock option transfer program, which is described below. The June 30, 2003 balance sheet has been restated for the retroactive adoption of the fair value recognition provisions of SFAS 123 which resulted in a \$13.89 billion increase in common stock and paid-in capital, a \$10.00 billion decrease in retained earnings, and a \$3.89 billion increase in deferred income taxes.

In fiscal year 2004, we implemented changes in employee compensation designed to help us continue to attract and retain the best employees, and to better align employee interests with those of our shareholders. Employees are now granted stock awards instead of stock options. The stock award program offers employees the opportunity to earn shares of our stock over time, rather than options that give employees the right to purchase stock at a set price. We also completed an employee stock option transfer program in the second quarter of fiscal 2004 whereby employees could elect to transfer all of their vested and unvested stock options with a strike price of \$33 or higher (“eligible options”) to JPMorgan. The unvested eligible options that were transferred to JPMorgan became vested upon the transfer. The price paid by JPMorgan for the transferred options was determined by reference to the arithmetic average of the closing prices of Microsoft common stock during the period from November 14, 2003 to December 8, 2003, which was \$25.5720.

A total of 18,503 (51%) of the 36,539 eligible Microsoft employees elected to participate in the stock option transfer program and 344.6 million (55%) of the 621.4 million eligible options were tendered. Under the terms of the program, JPMorgan paid Microsoft \$382 million for the transferred options. Microsoft made an initial payment of \$219 million to participating employees for the transferred options, with a remaining portion to be paid in one or more payments that are subject to participating employees’ continued employment over the next two or three years. The options that were transferred to JPMorgan resulted in stock-based compensation expense of \$2.21 billion (\$1.48 billion after-tax or \$0.14 per diluted share). This expense consists of the unrecognized compensation costs of the options that were transferred, less the amounts payable applicable to those previously unvested options for which payment is contingent upon continued employment of participating employees. The contingent payments applicable to unvested eligible options that are subject to continued employment of participating employees will be recognized as compensation expense over the vesting period of the contingent payments.

The stock option transfer program also resulted in a decrease to our long term deferred tax assets due to the excess of recorded compensation expense for these options over the related tax deduction reported on our tax

return. For the six months ended December 31, 2003, deferred tax assets were reduced by approximately \$2.01 billion with an offsetting reduction in paid-in capital, reflecting the reduction of previously recorded deductions reported on our tax return in excess of stock based compensation expense.

FINANCIAL CONDITION

Cash and short-term investments totaled \$52.78 billion as of December 31, 2003 compared to \$49.05 billion as of June 30, 2003. The portfolio consists primarily of fixed-income securities, diversified among industries and individual issuers. Our investments are generally liquid and investment grade securities. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions, in order to diversify financial risk.

Unearned revenue as of December 31, 2003 decreased \$395 million from September 30, 2003 reflecting a sequential decrease in unearned revenue associated with Upgrade Advantage contracts billed in prior periods and lower average deferral rates on Windows and Office partially offset by sequential growth in new and recurring multi-year licensing agreements.

Cash and short-term investments totaled \$52.78 billion as of December 31, 2003. Cash flow from operations was \$8.0 billion in the first six months of fiscal 2004, a decrease of \$941 million from the first six months of the prior year. The decrease reflects an approximately \$2.22 billion decline in cash flow from unearned revenue resulting from a decline in multi-year contract billings, build up in accounts receivable, and gains on our portfolio investments. Cash used for financing was \$2.62 billion in the first six months of fiscal 2004, a decrease of \$909 million from the first six months of the prior year, reflecting a decrease of approximately \$2.66 billion in stock repurchases, partially offset by a cash dividend of \$1.73 billion. During the first six months of fiscal 2004, we repurchased 73.8 million shares of common stock, compared to 159.4 million shares of common stock in the comparable period of the prior year. Cash used for investing was \$5.70 billion in the first six months of fiscal 2004, an increase of approximately \$2.78 billion from the first six months of the prior year.

We have no material long-term debt. Stockholders' equity at December 31, 2003 was \$69.34 billion. We will continue to invest in sales, marketing, product support infrastructure, and existing and advanced areas of technology. Additions to property and equipment will continue, including new facilities and computer systems for R&D, sales and marketing, support, and administrative staff. Commitments for constructing new buildings were \$153 million on December 31, 2003. We have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources.

We believe existing cash and short-term investments together with funds generated from operations should be sufficient to meet operating requirements. Our philosophy regarding the maintenance of a balance sheet with a large component of cash and short-term investments, as well as equity and other investments, reflects our views on potential future capital requirements relating to research and development, creation and expansion of sales distribution channels, investments and acquisitions, share dilution management, legal risks, and challenges to our business model. We continuously assess our investment management approach in view of our current and potential future needs.

Off-balance sheet arrangements

We have unconditionally guaranteed the repayment of certain Japanese Yen denominated bank loans and related interest and fees of Jupiter Telecommunication, Ltd., a Japanese cable company (Jupiter). These guarantees arose on February 1, 2003 in conjunction with the expiration of prior financing arrangements, including previous guarantees by us. The financing arrangements were entered into by Jupiter as part of financing its operations. As part of Jupiter's new financing agreement, we agreed to guarantee repayment by Jupiter of the loans of approximately \$55 million. The estimated fair value and the carrying value of the guarantees was \$10.5 million and did not result in a charge to operations. The guarantees are in effect until the earlier of repayment of

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the loans, including accrued interest and fees, or February 1, 2009. The maximum amount of the guarantees is limited to the sum of the total due and unpaid principal amounts, accrued and unpaid interest, and any other related expenses. Additionally, the maximum amount of the guarantees, denominated in Japanese yen, will vary based on fluctuations in foreign exchange rates. If we were required to make payments under the guarantees, we may recover all or a portion of those payments upon liquidation of Jupiter's assets. The proceeds from such liquidation cannot be accurately estimated due to the multitude of factors that would affect the valuation and realization of the proceeds in the event of liquidation.

In connection with various operating leases, we issued residual value guarantees, which provide that if we do not purchase the leased property from the lessor at the end of the lease term, then we are liable to the lessor for an amount equal to the shortage (if any) between the proceeds from the sale of the property and an agreed value. As of December 31, 2003, the maximum amount of the residual value guarantees was approximately \$271 million. We believe that proceeds from the sale of properties under operating leases would exceed the payment obligation and therefore no liability to us currently exists.

We provide indemnifications of varying scope and size to certain customers against claims of intellectual property infringement made by third parties arising from the use of our products. We evaluate estimated losses for such indemnifications under SFAS 5, *Accounting for Contingencies*, as interpreted by FASB Interpretation 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). We consider such factors as the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. To date, we have not encountered material costs as a result of such obligations and have not accrued any liabilities related to such indemnifications in our financial statements.

RECENTLY ISSUED ACCOUNTING STANDARDS

In December 2003, the FASB issued Interpretation 46R (FIN 46R), a revision to Interpretation 46 (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46R clarifies some of the provisions of FIN 46 and exempts certain entities from its requirements. FIN 46R is effective at the end of the first interim period ending after March 15, 2004. Entities that have adopted FIN 46 prior to this effective date can continue to apply the provisions of FIN 46 until the effective date of FIN 46R. Microsoft adopted FIN 46 on July 1, 2003 and it did not have a material impact on our financial statements. The early adoption of FIN46R did not have a material impact on our financial statements.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

Our financial statements and accompanying notes are prepared in accordance with U.S. GAAP. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for us include revenue recognition, accounting for stock-based compensation, impairment of investment securities, impairment of goodwill, accounting for research and development costs, accounting for legal contingencies, and accounting for income taxes.

We account for the licensing of software in accordance with American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*. The application of SOP 97-2 requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence (VSOE) of fair value exists for those elements. End users receive certain elements of our products over a period of time. These elements include free post-delivery telephone support and the right to receive unspecified upgrades/enhancements of Microsoft Internet Explorer on a when-and-if-available basis, the fair value of which is recognized over the product's estimated life cycle. Changes to the elements in a software arrangement, the ability to identify VSOE for those elements, the fair value of the respective elements, and changes to a product's estimated life cycle could materially impact the amount of

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earned and unearned revenue. Judgment is also required to assess whether future releases of certain software represent new products or upgrades and enhancements to existing products.

We account for stock-based compensation in accordance with the fair value recognition provisions of SFAS 123. The application of SFAS 123 requires judgment, including the expected life and stock price volatility for stock options and expected dividends and forfeitures for all stock-based awards. Changes in the expected or actual outcome of forfeitures due to service- and/or performance-related conditions could materially impact the amount of stock-based compensation expense recognized.

SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, and Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) 59, *Accounting for Noncurrent Marketable Equity Securities*, provide guidance on determining when an investment is other-than-temporarily impaired. This determination requires significant judgment. In making this judgment, we evaluate, among other factors, the duration and extent to which the fair value of an investment is less than its cost; the financial health of and near-term business outlook for the investee, including factors such as industry and sector performance, changes in technology, and operational and financing cash flow; and our intent and ability to hold the investment.

SFAS 142, *Goodwill and Other Intangible Assets*, requires that goodwill be tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis (July 1st for Microsoft) and between annual tests in certain circumstances. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value and/or goodwill impairment for each reporting unit.

We account for research and development costs in accordance with several accounting pronouncements, including SFAS 2, *Accounting for Research and Development Costs*, and SFAS 86, *Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*. SFAS 86 specifies that costs incurred internally in creating a computer software product should be charged to expense when incurred as research and development until technological feasibility has been established for the product. Once technological feasibility is established, all software costs should be capitalized until the product is available for general release to customers. Judgment is required in determining when technological feasibility of a product is established. We have determined that technological feasibility for our products is reached shortly before the products are released to manufacturing. Costs incurred after technological feasibility is established are not material, and accordingly, we expense all research and development costs when incurred.

We are subject to various legal proceedings and claims, the outcomes of which are subject to significant uncertainty. SFAS 5, *Accounting for Contingencies*, requires that an estimated loss from a loss contingency should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our financial position or our results of operations.

SFAS 109, *Accounting for Income Taxes*, establishes financial accounting and reporting standards for the effect of income taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Judgment is required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns. Fluctuations in the actual outcome of these future tax consequences could materially impact our financial position or our results of operations.

ISSUES AND UNCERTAINTIES

This Quarterly Report on Form 10-Q contains statements that are forward-looking. These statements are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could differ materially because of issues and uncertainties such as those listed below and elsewhere in this report, which, among others, should be considered in evaluating our financial outlook.

Challenges to our Business Model

Since our inception, our business model has been based upon customers agreeing to pay a fee to license software developed and distributed by us. Under this commercial software model, software developers bear the costs of converting original ideas into software products through investments in research and development, offsetting these costs with the revenue received from the distribution of their products. We believe the commercial software model has had substantial benefits for users of software, allowing them to rely on our expertise and the expertise of other software developers that have powerful incentives to develop innovative software that is useful, reliable, and compatible with other software and hardware. In recent years, there has been a growing challenge to the commercial software model, often referred to as the Open Source model. Under the Open Source model, software is produced by loosely associated groups of unpaid programmers, and the resulting software and the intellectual property contained therein is licensed to end users at substantially no cost. The most notable example of Open Source software is the Linux operating system. While we believe that our products provide customers with significant advantages in security and productivity, and generally have a lower total cost of ownership than Open Source software, the popularization of the Open Source model continues to pose a significant challenge to our business model, including recent efforts by proponents of the Open Source model to convince governments worldwide to mandate the use of Open Source software in their purchase and deployment of software products. To the extent the Open Source model gains increasing market acceptance, sales of our products may decline, we may have to reduce the prices we charge for our products, and revenue and operating margins may consequently decline.

Intellectual Property Rights

We defend our intellectual property rights, but unlicensed copying and use of software and intellectual property rights represents a loss of revenue to us. While this adversely affects U.S. revenue, the impact on revenue from outside the United States is more significant, particularly in countries where laws are less protective of intellectual property rights. Throughout the world, we actively educate consumers about the benefits of licensing genuine products and educate lawmakers about the advantages of a business climate where intellectual property rights are protected. However, continued educational and enforcement efforts may not affect revenue positively and further deterioration in compliance with existing legal protections or reductions in the legal protection for intellectual property rights of software developers could adversely affect revenue.

From time to time we receive notices from others claiming we infringe their intellectual property rights. The number of these claims may grow. Responding to these claims may require us to enter into royalty and licensing agreements on unfavorable terms, require us to stop selling or to redesign affected products, or to pay damages or to satisfy indemnification commitments with our customers.

We have made and expect to continue making significant expenditures to acquire the use of technology and intellectual property rights, including via cross-licenses of broad patent portfolios.

New Products and Services

We have made significant investments in research, development and marketing for new products, services and technologies, including Longhorn, Microsoft .NET, Xbox, business applications, MSN, mobile and wireless technologies. Significant revenue from new product and service investments may not be achieved for a number of years, if at all. Moreover, some of these products and services may not be profitable, and even if they are profitable, operating margins for these businesses may not be as high as the margins we have historically experienced.

Litigation

As discussed in Note 10 – Contingencies of the Notes to Financial Statements, we are subject to a variety of claims and lawsuits. Adverse outcomes in some or all of the pending cases may result in significant monetary damages or injunctive relief against us. We are also subject to a variety of other claims and suits that arise from time to time in the ordinary course of our business. While management currently believes that resolving all of these matters, individually or in the aggregate, will not have a material adverse impact on our financial position or results of operations, the litigation and other claims noted above are subject to inherent uncertainties and management's view of these matters may change in the future. If an unfavorable final outcome occurs, there exists the possibility of a material adverse impact on our financial position and the results of operations for the period in which the effect becomes reasonably estimable.

Security

Maintaining the security of computers and computer networks is an issue of critical importance for Microsoft and our customers. There are individuals and groups who develop and deploy viruses, worms and other malicious software programs that attack our products. While this is an industry-wide phenomenon that affects computers across all platforms, Microsoft's customers have been victims of such attacks and will likely continue to be so. We are devoting significant resources to addressing these critical issues. We are focusing our efforts on engineering more secure products, optimizing security and reliability options and settings when we deliver products, and providing guidance to help our customers make the best use of our products and services to protect against computer viruses and other attacks on their computing environment. In addition, we are working to improve the deployment of software patches to address security vulnerabilities discovered after our products are released. We are also investing in mitigation technologies that secure customers from attacks even when such software patches are not deployed. We are also advising customers on how to help protect themselves from security threats through the use of our online automated security tools, our published security guidance and the deployment of security software such as firewalls, antivirus and other security software. These steps could adversely affect our operating margins. Despite these efforts, actual or perceived security vulnerabilities in our products could lead some customers to seek to return products, to reduce or delay future purchases or to purchase competitive products. Customers may also increase their expenditures on protecting their computer systems from attack, which could delay adoption of new technologies. Any of these actions by customers could adversely affect our revenue.

Declines in Demand for Software

If overall market demand for PCs, servers and other computing devices declines significantly, or consumer or corporate spending for such products declines, our revenue will be adversely affected. Additionally, our revenue would be unfavorably impacted if customers reduce their purchases of new software products or upgrades to existing products because new product offerings are not perceived as adding significant new functionality or other value to prospective purchasers. A significant number of customers purchased license agreements providing upgrade rights to specific licensed products prior to the transition to Licensing 6.0 in July 2002. These agreements will expire in fiscal year 2004 and 2005 and the rate at which such customers renew these contracts could adversely affect future revenue. We are making significant investments in the next release of the Windows operating system, codenamed Longhorn. If this system is not perceived as offering significant new functionality or value to prospective purchasers, our revenue and operating margins could be adversely affected.

Product Development Schedule

The development of software products is a complex and time-consuming process. New products and enhancements to existing products can require long development and testing periods. Significant delays in new product releases or significant problems in creating new products, particularly any delays in the Longhorn operating system, could adversely affect our revenue.

General Economic and Geo-Political Risks

Softness in corporate information technology spending or other changes in general economic conditions that affect demand for computer hardware or software could adversely affect our revenue. Terrorist activity and armed conflict pose the additional risk of general economic disruption and could require changes in our international operations and security arrangements, thus increasing our operating costs. These conditions lend additional uncertainty to the timing and budget for technology investment decisions by our customers.

Competition

We continue to experience intensive competition across all markets for our products and services. These competitive pressures may result in decreased sales volumes, price reductions, and/or increased operating costs, such as for marketing and sales incentives, resulting in lower revenue, gross margins and operating income.

Taxation of Extraterritorial Income

In August 2001, a World Trade Organization (“WTO”) dispute panel determined that the tax provisions of the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (“ETI”) constitute an export subsidy prohibited by the WTO Agreement on Subsidies and Countervailing Measures. The U.S. government appealed the panel’s decision and lost its appeal. On October 1, 2003 the Senate Finance Committee approved the Jumpstart our Business Strength (JOBS) Act that would repeal ETI, provide a three year phase-out of current ETI benefits, and would replace ETI with a phased in production activity exclusion that would not be fully effective until 2012. On October 28, 2003, the House Ways & Means Committee approved the American Jobs Creation Act of 2003 that would likewise repeal ETI, provide a three year phase-out of future ETI benefits, and would replace ETI with a phased-in tax rate reduction that would not be fully effective until 2007. Both bills carry over to the 2004 session of this Congress. While neither bill will fully replace our current ETI tax benefits, both bills must still pass their respective chambers and be reconciled in conference, so we remain unable to assess the ultimate form and financial impact of this legislation, if enacted. If the ETI provisions are repealed and financially comparable replacement tax legislation is not enacted, the loss of the ETI tax benefit to us could be significant.

Other Potential Tax Liabilities

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. We are regularly under audit by tax authorities. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different than that which is reflected in historical income tax provisions and accruals. Should additional taxes be assessed as a result of an audit or litigation, a material effect on our income tax provision and net income in the period or periods for which that determination is made could result.

Finite Insurance Programs

In addition to conventional third party insurance arrangements, we have entered into captive insurance arrangements for the purpose of protecting against possible catastrophic and other risks not covered by traditional insurance markets. As of December 31, 2003, potential coverage available under captive insurance arrangements was \$2.0 billion, subject to deductibles, exclusions, and other restrictions. While we believe these arrangements are an effective way to insure against such risks, the potential liabilities associated with certain of the issues and uncertainties discussed herein or other events could exceed the coverage provided by such arrangements.

Business Disruptions in the Event of a Catastrophic Event

We are a highly automated business and a disruption or failure of our systems in the event of a major earthquake, cyber-attack, terrorist attack or other catastrophic event could cause delays in completing sales and

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providing services. Our corporate headquarters, a significant portion of our research and development activities and certain other critical business operations are located in the Seattle, Washington area, and we have other business operations in the Silicon Valley area of California, both of which are near major earthquake faults. A catastrophic event that results in the destruction or disruption of any of our critical business or information technology systems could severely affect our ability to conduct normal business operations and as a result our future operating results could be adversely affected.

Other

Other issues and uncertainties may include: warranty and other claims for hardware products such as Xbox; the effects of the Consent Decree in *U.S. v. Microsoft* and Final Judgment in *State of New York v. Microsoft* on the Windows operating system and server business, including those associated with protocol and other disclosures required by the Decree and Final Judgment and the ability of PC manufacturers to hide end user access to certain new Windows features; the continued availability of third party distribution channels for MSN service and other online services; factors associated with our international operations, and financial market volatility or other changes affecting the value of our investments, such as the Comcast Corporation securities held by us, that may result in a reduction in carrying value and recognition of losses including impairment charges.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to foreign currency, interest rate, and fixed income and equity price risks. A portion of these risks is hedged, but fluctuations could impact our results of operations and financial position. We hedge a portion of anticipated revenue and accounts receivable exposure to foreign currency fluctuations, primarily with option contracts. We monitor our foreign currency exposures daily to maximize the overall effectiveness of our foreign currency hedge positions. Principal currencies hedged include the Euro, Japanese yen, British pound, and Canadian dollar. Fixed income securities are subject to interest rate risk. The portfolio is diversified and structured to minimize credit risk. Securities held in our equity and other investments portfolio are subject to price risk, and are generally not hedged. However, we use options to hedge our price risk on certain highly volatile equity securities that are held primarily for strategic purposes.

We use a value-at-risk (VAR) model to estimate and quantify our market risks. VAR is the expected loss, for a given confidence level, in fair value of our portfolio due to adverse market movements over a defined time horizon. The VAR model is not intended to represent actual losses in fair value, but is used as a risk estimation and management tool. The model used for currencies and equities is geometric Brownian motion, which allows incorporation of optionality with regard to these risk exposures. For interest rate risk, the mean reverting geometric Brownian motion is used to reflect the principle that fixed-income securities prices revert to maturity value over time.

Value-at-risk is calculated by, first, simulating 10,000 market price paths over 20 days for equities, interest rates and foreign exchange rates, taking into account historical correlations among the different rates and prices. Each resulting unique set of equities prices, interest rates, and foreign exchange rates is applied to substantially all individual holdings to re-price each holding. The 250th worst performance (out of 10,000) represents the value-at-risk over 20 days at the 97.5th percentile confidence level. Several risk factors are not captured in the model, including liquidity risk, operational risk, credit risk, and legal risk.

Certain securities in our equity portfolio are held for strategic purposes. We hedge the value of a portion of these securities through the use of derivative contracts such as put-call collars. In these arrangements, we hedge a security's market risk below the purchased put strike and forgo most or all of the benefits of the security's appreciation above the sold call strike, in exchange for premium received for the sold call. We also hold equity securities for general investment return purposes. We have incurred material impairment charges related to these securities in prior periods. The VAR amounts disclosed below are used as a risk management tool and reflect an estimate of potential reductions in fair value of our portfolio. Losses in fair value over a 20-day holding period

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can exceed the reported VAR by significant amounts and can also accumulate over a longer time horizon than the 20-day holding period used in the VAR analysis. VAR amounts are not necessarily reflective of potential accounting losses, including determinations of other-than-temporary losses in fair value in accordance with U.S. GAAP.

The VAR numbers are shown separately for interest rate, currency, and equity risks. These VAR numbers include the underlying portfolio positions and related hedges. We use historical data to estimate VAR. Given reliance on historical data, VAR is most effective in estimating risk exposures in markets in which there are no fundamental changes or shifts in market conditions. An inherent limitation in VAR is that the distribution of past changes in market risk factors may not produce accurate predictions of future market risk.

The following table sets forth the VAR calculations for substantially all of the Company's positions:

(In millions) Risk Categories	June 30, 2003	Dec. 31, 2003	Three Months Ended Dec. 31, 2003		
			Average	High	Low
Interest Rates	\$ 448	\$ 767	\$ 757	\$ 817	\$ 642
Currency Rates	141	216	213	267	152
Equity Prices	869	994	996	1,081	913

The total VAR for the combined risk categories is \$987 million at June 30, 2003 and \$1.33 billion at December 31, 2003. The total VAR is 32% less at June 30, 2003 and 33% less at December 31, 2003 than the sum of the separate risk categories for each of those years in the above table, due to the diversification benefit of the combination of risks. The change in VAR is due primarily to asset allocation shifts, increased foreign exchange volatility, and portfolio growth.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14(c) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the quarter ended December 31, 2003 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Part II. Other Information**Item 1. Legal Proceedings**

See notes to financial statements.

In the previously reported case of *Imagexpo v. Microsoft*, in the U.S. District Court for the Eastern District of Virginia, the plaintiff accused the whiteboarding feature of the NetMeeting functionality in Windows of infringement. On November 14, 2003, the jury found Microsoft liable for willful infringement and awarded \$62.3 million in damages. On December 30, 2003 we entered an agreement with the plaintiff pursuant to which we paid \$60 million in exchange for dismissal of the case and a paid-up license to patents of ImageExpo and related companies.

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Shareholders was held on November 11, 2003.

The following proposals were adopted by the margins indicated:

- To elect a Board of Directors to hold office until the next annual meeting of shareholders and until their successors are elected and qualified.

	Number of Shares	
	For	Withheld
William H. Gates III	9,091,941,264	262,764,184
Steven A. Ballmer	9,091,832,976	262,872,472
James I. Cash, Jr.	8,763,216,892	591,488,556
Raymond V. Gilmartin	8,823,242,145	531,463,303
Ann McLaughlin Korologos	8,815,461,873	539,243,575
David F. Marquardt	9,091,568,427	263,137,021
Charles H. Noski	9,089,298,739	265,406,709
Helmut Panke	9,090,402,253	264,303,195
Wm. G. Reed, Jr.	9,030,465,947	324,239,501
Jon A. Shirley	7,013,929,267	2,340,776,181

- To adopt amendments to the 2001 Stock Plan.

For	5,961,061,877
Against	1,289,253,004
Abstain	88,502,310
Broker non-vote	2,015,888,257

- To adopt amendments to the 1999 Stock Option Plan for Non-Employee Directors.

For	5,705,203,349
Against	1,533,602,969
Abstain	100,010,867
Broker non-vote	2,015,888,263

The following proposal was not adopted by the margin indicated:

- Shareholder proposal requesting that the Company refrain from making direct charitable contributions.

For	130,783,517
Against	6,591,845,929
Abstain	616,189,337
Broker non-vote	2,015,886,665

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Item 6. Exhibits and Reports on Form 8-K

(A) EXHIBITS

4	Call Option Transaction Confirmation dated December 11, 2003 between Microsoft Corporation and JPMorgan Chase Bank
10.1	Microsoft Corporation 2001 Stock Plan (as amended and restated September 11, 2003)
10.2	Microsoft Corporation 1999 Stock Plan for Non-Employee Directors (as amended and restated September 11, 2003)
15	Letter re unaudited interim financial information
31.1	Certifications of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certifications of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(B) REPORTS ON FORM 8-K

We filed a report on Form 8-K on October 24, 2003 reporting that on October 23, 2003 we issued a press release announcing our financial results for the fiscal quarter ended September 30, 2003 and filed portions of the press release as an exhibit to that report. We furnished to the SEC reports on Form 8-K on October 23, 2003 and November 13, 2003. The October 23, 2003 Form 8-K was for the purpose of furnishing the press release announcing our financial results for the fiscal quarter ended September 30, 2003. The November 13, 2003 Form 8-K was for the purpose of furnishing our consolidated balance sheets as of June 30, 2003 and September 30, 2003, and the related consolidated statements of income, cash flows, and stockholders' equity for the three months ended September 30, 2002 and 2003 formatted in XBRL (Extensible Business Reporting Language) 2.0 format.

Items 2, 3, and 5 are not applicable and have been omitted.

Call Option Confirmation: Physically-settled only, American-style.

JPMorgan Chase Bank
277 Park Avenue
New York, NY 10172
(212) 622-5270

December 11, 2003

Microsoft Corporation
One Microsoft Way
Redmond, Washington 98052-6399

Attention: Mr. Brent Callinicos, Corporate Vice President and Treasurer

Tel: (425) 706-6738

Fax: (425) 936-7329

Re: Call Option Transaction Confirmation

Outlined below are the principal terms and conditions for the Transaction (the “**Transaction**”) that you (the “**Issuer**”) are entering into with JPMorgan Chase Bank (“**JPMorgan**”). This Confirmation shall supplement, form a part of and be subject to the 1992 ISDA Master Agreement (Multicurrency-Cross Border) dated as of January 22, 1997 between the Issuer and JPMorgan, as amended and supplemented from time to time (the “**Agreement**”), between us together with any related schedules and security or collateral agreements, if any.

The purpose of this letter agreement (this “**Confirmation**”) is to confirm the terms and conditions of the above referenced Transaction entered into between JPMorgan and you on the Trade Date specified below. This Confirmation shall supersede all or any prior written or oral agreements in relation to the Transaction. This Confirmation is subject to, and incorporates, the 2000 ISDA Definitions (including the Annex thereto, the “**2000 Definitions**”) and the 2002 ISDA Equity Derivatives Definitions (the “**Equity Definitions**” and, together with the 2000 Definitions, the “**Definitions**”), each as published by the International Swaps and Derivatives Association, Inc. (“**ISDA**”). This Confirmation constitutes a “Confirmation” as referred to in the Agreement. All provisions contained in the Agreement govern this Confirmation except as expressly modified below. In the event of any inconsistency between the Equity Definitions and the 2000 Definitions, the Equity Definitions shall govern. In the event of any inconsistency between the Definitions or the Agreement, as the case may be, and this Confirmation, this Confirmation shall govern. The terms and conditions of this Confirmation supersede any and all prior written or oral agreements in relation to the Transaction. As set forth in the Program Agreement, this Confirmation amends and restates the terms of certain options previously issued by the Issuer and not previously subject to the Agreement. The Issuer acknowledges and agrees that upon execution, this Confirmation, without any further action or the execution of any further documents or agreements, and notwithstanding any defect or lack of effectiveness of any assignment or transfer of title to any Participating Options (as such term is defined in the Program Agreement (as such term is defined below)) from the Participating Holders (as such term is defined in the Program Agreement), shall be a valid, binding and enforceable obligation of the Issuer to JPMorgan on the terms set forth herein.

The parties are executing this Confirmation pursuant to the terms of the Program Agreement (the “**Program Agreement**”) dated as of October 9, 2003 between the Issuer and JPMorgan.

1. ECONOMIC TERMS:

General Terms:

Trade Date:	December 8, 2003
Option Style:	American
Option Type:	Call
Seller:	The Issuer
Buyer:	JPMorgan
Shares:	The common stock, par value USD0.00000625 per share, of the Issuer, or security entitlements in respect thereof.
Tranche:	The Transaction will be divided into individual Tranches with the Number of Options, Strike Prices and Expiration Dates set forth on Schedule A attached hereto. For purposes of this Confirmation, the Agreement and the Definitions, each Tranche will be considered a separate Transaction under the Agreement, and all Tranches shall be referred to herein collectively as the Transaction.
Number of Options:	For each Tranche, the Number of Options for such Tranche as set forth on Schedule A attached hereto.
Strike Price:	For each Tranche, the Strike Price for such Tranche as set forth on Schedule A attached hereto.
Exchange:	The Nasdaq National Market of the Nasdaq Stock Market, Inc.
Related Exchanges:	The Chicago Board Options Exchange and the Archipelago Exchange.

Procedures for Exercise:

Expiration Time:	The Scheduled Closing Time
Expiration Date:	For each Tranche, the Expiration Date for such Tranche as set forth on Schedule A attached hereto.
Multiple Exercise:	Applicable
Minimum Number of Options:	100,000
Maximum Number of Options:	For each Tranche, the Number of Options for such tranche.
Automatic Exercise:	Applicable
Reference Price:	The Official NASDAQ Closing Price (NOCP).

Settlement Terms:

Physical Settlement:	Applicable
Settlement Currency:	USD

Dividends: As provided in Section 5(a) herein.

Adjustments:

Method of Adjustment: Calculation Agent Adjustment; *provided* that Section 5(a) shall apply in lieu of Calculation Agent Adjustment for all dividends other than dividends (“**Share Dividends**”) of the types described in clauses (i), (ii)(A), (ii)(B) and (ii)(C) of the definition of Potential Adjustment Event contained in Section 11.2(e) of the Equity Definitions.

Extraordinary Events:

Consequences of Merger Events:

Share-for-Share: Modified Calculation Agent Adjustment
 Share-for-Other: Cancellation and Payment (Calculation Agent Determination)
 Share-for-Combined: Component Adjustment

Tender Offer: Applicable

Consequences of Tender Offers:

Share-for-Share: Modified Calculation Agent Adjustment
 Share-for-Other: Cancellation and Payment (Calculation Agent Determination)
 Share-for-Combined: Component Adjustment

Composition of Combined Consideration: Not Applicable

Nationalization, Insolvency or Delisting: Cancellation and Payment (Calculation Agent Determination)

Additional Disruption Events:

Change in Law: Applicable; *provided* that in the event of a Change in Law that requires any Shares that the Issuer delivers to JPMorgan in connection with the Transaction (“**Settlement Shares**”) to be registered under the Securities Act of 1933, as amended, the parties hereto agree to negotiate with each other in good faith to amend, restructure or supplement this Confirmation so that it is no longer illegal for JPMorgan to hold, acquire and dispose of the Settlement Shares and JPMorgan does not incur a materially increased cost in performing its obligations hereunder or in connection herewith.

Failure to Deliver: Applicable

Insolvency Filing: Applicable

Hedging Disruption: Not Applicable

Increased Cost of Hedging: Not Applicable

Loss of Stock Borrow: Not Applicable

Increased Cost of Stock
Borrow: Not Applicable

Determining Party: Calculation Agent

Non-Reliance: Applicable

Agreements and Acknowledgments

Regarding Hedging Activities: Applicable

Additional Acknowledgments: Applicable

2. Calculation Agent: JPMorgan Securities Inc.; *provided* that the Calculation Agent shall make all calculations in consultation with the Issuer; and *provided further* that the Calculation Agent shall, not later than the third Business Day following receipt of a written request by the Issuer, provide the Issuer with a written explanation of the basis for any calculation or determination made hereunder.

3. Account Details: JPMorgan Chase Bank, New York
ABA: 021 000 021
Favor: JPMorgan Chase Bank, London
A/C: 0010962009
CHASUS33

Account for payments to JPMorgan: DTC 060

Account for delivery of Shares to JPMorgan:

Account for payments to the Issuer:

4. Address for notices or communications to Issuer:

Microsoft Corporation
One Microsoft Way
Redmond, Washington 98052-6399
Attention: Treasurer
Telephone No.: 425-706-6738
Facsimile No.: 425-936-7329

Address for notices or communications to JPMorgan:

JPMorgan Chase Bank
277 Park Avenue, 11th Floor
New York, New York, 10172
Attention: EDG Corporate Marketing (Steve Roti)
Telephone No. 212-622-5270
Telecopy No. 212-622-0105

5. Other Provisions:

- (a) **Dividends.** For each Tranche, if (i) at any time after the Trade Date during any calendar quarter, an ex-dividend date for a dividend with respect to the Shares other than a Share Dividend occurs (regardless of when such dividend is paid), and the amount or value of such dividend (as determined by the Calculation Agent) is not equal to the Regular Dividend Amount for such dividend on a per share basis, or (ii) as of the last day of the fourth calendar quarter of any year, no ex-dividend date for a dividend with respect to the Shares other than a Share Dividend shall have occurred during such fourth quarter, then in either case the Strike Price for such Tranche shall be adjusted as of such ex-dividend date or such last day, as the case may be (the “**Adjustment Date**”), by an amount determined by the Calculation Agent so that the Pre-Dividend Valuation of such Tranche equals the Post-Dividend Valuation of such Tranche. Any adjustment pursuant to this paragraph 5(a) shall be rounded to four decimal places.

“**Regular Dividend Amount**” means, for the first dividend that is not a Share Dividend and for which the ex-dividend date occurs during the fourth calendar quarter of any year, USD0.16, or, for any other dividend, USD0.00.

“**Pre-Dividend Valuation**” of any Tranche means the fair value, as determined by the Calculation Agent using the Black-Scholes pricing methodology, of such Tranche based on the “Pre-Dividend Inputs” set forth below.

“**Post-Dividend Valuation**” of any Tranche means the fair value, as determined by the Calculation Agent using the Black-Scholes pricing methodology, of such Tranche based on the “Post-Dividend Inputs” set forth below.

“**Trading Day**” means a Scheduled Trading Day that is not a Disrupted Day.

Pre-Dividend Inputs

Stock Price:	The Official NASDAQ Closing Price (NOCP) of the Shares on the Exchange on the Trading Day prior to the relevant Adjustment Date (the “ Stock Price ”).
Strike Price:	The Strike Price for such Tranche as of such Adjustment Date.
Dividend Yield:	USD0.16 <i>divided by</i> the Stock Price (the “ Dividend Yield ”).
Volatility:	The implied bid volatility displayed on Bloomberg Screen MSFT UQ equity OMON, utilizing US Dollar swap rates and actual dividends, for a listed option with the same strike price and maturity as such Tranche, or, if no such option appears on such Screen, an implied bid volatility determined by the Calculation Agent by linear interpolation between the implied bid volatilities so displayed for the two listed call options that do so appear with strike prices most proximate to the Strike Price for such Tranche (or, if the Strike Price for such Tranche is greater than the strike price for the listed call option with the highest strike price that so appears and that, in the reasonable determination of the Calculation Agent, has significant liquidity, the implied bid volatility so displayed for such option) and between the two listed call options that do so appear with maturities most proximate to the Expiration Date for such Tranche (or, if the Expiration Date for such Tranche is later than the maturity for the listed call option with the latest maturity that so appears, the implied bid volatility displayed for such option) (the “ Volatility ”).

Interest Rate: For any Tranche, the amount (the “**Interest Rate**”) determined by the following equation:

$$\text{Discount Factor} = 1/[e^{(\text{Interest Rate} * N)}]$$

where:

N = The number of days during the period beginning on and including such Adjustment Date to but excluding the Expiration Date for such Tranche, *divided by 365*

Discount Factor = The value that a counterparty would pay on such Adjustment Date for the right to receive USD1.00 on the Expiration Date for such Tranche, expressed as a percentage, as determined by the Calculation Agent by reference to the US Dollar, British Bankers’ Association LIBOR rates, as displayed by BBAM Office BBA LIBOR Fixings, and the US Dollar swap curve on such Adjustment Date as displayed on Bloomberg Screen I52.

Maturity: The Expiration Date for such Tranche (the “**Maturity**”)

Post-Dividend Inputs

Stock Price: The Stock Price minus the Dividend Differential.

Strike Price: The Strike Price for such Tranche as of such Adjustment Date, as adjusted pursuant to this Paragraph 5(a).

Dividend Yield: The Dividend Yield.

Volatility: The Volatility.

Interest Rate: The Interest Rate.

Maturity: The Maturity.

“**Dividend Differential**” means, for any dividend for which an adjustment is being made pursuant to this paragraph 5(a), the difference equal to the amount or value of such dividend (as determined by the Calculation Agent) *minus* the Regular Dividend Amount for such dividend.

- (b) Representations Regarding Shares. (i) The Issuer shall reserve and keep available for issuance to JPMorgan upon settlement or any termination of the Transaction a number of Shares at least equal to the aggregate sum for all Tranches of the product of the Number of Options and the Option Entitlement.

- (ii) The Issuer agrees that any Settlement Shares shall not bear any restrictive legend and that such Settlement Shares shall be deposited in, and the delivery thereof shall be effected through the facilities of, The Depository Trust Company.
- (c) Transfer and Assignment. The Issuer may not transfer any of its rights or obligations under the Transaction. JPMorgan may not transfer any of its rights or obligations under the Transaction except to an affiliate (as such term is defined in Rule 144(a)(1) under the Securities Act of 1933, as amended) by prior notice to the Issuer.
- (d) JPMorgan London Branch. JPMorgan is entering into the Transaction through its London branch. Notwithstanding the foregoing, JPMorgan represents to the Issuer that the obligations of JPMorgan are the same as if it had entered into the Transaction through its head or home office in New York.
- (e) CEA Representation. The Issuer is an “eligible contract participant” (as such term is defined in Section 1(a)(12) of the Commodity Exchange Act, as amended).
- (f) JPMorgan Designation. Notwithstanding any other provision herein to the contrary requiring or allowing JPMorgan to purchase, sell, receive or deliver any shares or other securities to or from the Issuer, JPMorgan may designate any of its affiliates to purchase, sell, receive or deliver such shares or other securities and otherwise to perform JPMorgan’s obligations in respect of the Transaction and any such designee may assume such obligations. JPMorgan shall be discharged of its obligations to the Issuer to the extent of any such performance.
- (g) Securities Contract. The parties hereto intend that (a) JPMorgan be a “financial institution” within the meaning of Section 101(22) of Title 11 of the United States Code (the “**Bankruptcy Code**”), (b) this Confirmation (as such is referred to in, and supplements, forms part of, and is subject to, the Agreement) be a “securities contract,” as such term is defined in Section 741(7) of the Bankruptcy Code, (c) each and every transfer of funds, securities and other property under this Confirmation (as such is referred to in, and supplements, forms part of, and is subject to, the Agreement) be a “settlement payment” or a “margin payment,” as such terms are used in Sections 362(b)(6) and 546(e) of the Bankruptcy Code, (d) the rights given to JPMorgan hereunder upon an Event of Default, Termination Event or Early Termination Date constitute the rights to cause the liquidation of a securities contract and to set off mutual debts and claims in connection with a securities contract, as such terms are used in Sections 555 and 362(b)(6) of the Bankruptcy Code and (e) any or all obligations that either party has with respect to this Confirmation or the Agreement constitute property held by or due from such party to margin, guaranty or settle obligations of the other party with respect to the transactions under the Agreement (including the Transaction) or any other agreement between such parties.
- (h) Waiver of Jury Trial. Each party waives, to the fullest extent permitted by applicable law, any right it may have to a trial by jury in respect of any suit, action or proceeding relating to the Transaction, this Confirmation, or the Agreement. Each party (i) certifies that no representative, agent or attorney of the other party has represented, expressly or otherwise, that such other party would not, in the event of such a suit, action or proceeding, seek to enforce the foregoing waiver and (ii) acknowledges that it and the other party have been induced to enter into the Transaction by, among other things, the mutual waivers and certifications herein.

- (i) Limit on Beneficial Ownership. Notwithstanding any other provisions hereof, JPMorgan shall not be entitled to receive Shares hereunder (whether in connection with exercise of the Transaction or otherwise) to the extent (but only to the extent) that such receipt would result in J.P. Morgan Chase & Co. directly or indirectly beneficially owning (as such term is defined for purposes of Section 13(d) of the Exchange Act) at any time in excess of 9.9% of the outstanding Shares. Any purported delivery hereunder shall be void and have no effect to the extent (but only to the extent) that such delivery would result in J.P. Morgan Chase & Co. directly or indirectly so beneficially owning in excess of 9.9% of the outstanding Shares. If any delivery owed to JPMorgan hereunder is not made, in whole or in part, as a result of this provision, the Issuer's obligation to make such delivery shall not be extinguished and the Issuer shall make such delivery as promptly as practicable after, but in no event later than one Currency Business Day after, JPMorgan gives notice to the Issuer that such delivery would not result in J.P. Morgan Chase & Co. directly or indirectly so beneficially owning in excess of 9.9% of the outstanding Shares.
- (j) No Repurchase. The Issuer agrees that it shall not repurchase any Shares if, immediately following such repurchase, the Number of Options for all Tranches comprising the Transaction would be equal to or greater than 8% of the number of then outstanding Shares.
- (k) Alternative Calculations and Payment on Early Termination and on Certain Extraordinary Events. If, in respect of any Transactions relating to Shares of the Issuer ("**Issuer Share Transactions**"), the Issuer shall owe JPMorgan any amount pursuant to (i) Sections 12.7 or 12.9 of the Equity Definitions (except in the event of an Insolvency, Nationalization, Tender Offer or Merger Event, in each case, in which the consideration or proceeds to be paid to holders of Shares as a result of such event consists solely of cash) or (ii) pursuant to Section 6(d)(ii) of the Agreement (except in the event of an Event of Default in which the Issuer is the Defaulting Party or a Termination Event in which the Issuer is the Affected Party, other than an Event of Default of the type described in Section 5(a)(iii), (v), (vi) or (vii) of the Agreement or a Termination Event of the type described in Section 5(b)(i), (ii), (iii), (iv), or (v) of the Agreement that, in the case of either such an Event of Default or such a Termination Event, resulted from an event or events outside the Issuer's control) (a "**Payment Obligation**"), the Issuer may, in its sole discretion, satisfy any such Payment Obligation by the Share Termination Alternative (as defined below) by giving irrevocable telephonic notice to JPMorgan, confirmed in writing within one Currency Business Day, between the hours of 9:00 a.m. and 4:00 p.m. New York local time on the Announcement Date or Early Termination Date, as applicable ("**Notice of Share Termination**"). Upon timely giving of Notice of Share Termination, the following provisions shall apply:

Share Termination Alternative:

Applicable and means that the Issuer shall deliver to JPMorgan the Share Termination Delivery Property on the date (the "**Share Termination Payment Date**") on which the Payment Obligation would otherwise be due, in satisfaction of the Payment Obligation, in the manner reasonably requested by JPMorgan, free of payment.

Share Termination Delivery Property:

A number of Share Termination Delivery Units, as calculated by the Calculation Agent, equal to the Payment Obligation divided by the Share Termination Unit Price. The Calculation Agent shall adjust the Share Termination Delivery Property by replacing any fractional portion of a security therein with an amount of cash equal to the value of such fractional security based on the values used to calculate the Share Termination Unit Price.

Share Termination Unit Price:	The value to JPMorgan of property contained in one Share Termination Delivery Unit on the date such Share Termination Delivery Units are to be delivered as Share Termination Delivery Property, as determined by the Calculation Agent.
Share Termination Delivery Unit:	In the case of a Extraordinary Event (other than an Insolvency, Nationalization, Tender Offer or Merger Event), Termination Event or Event of Default, one Share or, in the case of an Insolvency, Nationalization, Merger Event or a Tender Offer, a unit consisting of the number or amount of each type of property received by a holder of one Share (without regard to any requirement to pay cash or other consideration in lieu of fractional amounts of any securities) in such Nationalization, Insolvency, Tender Offer or Merger Event, as the case may be. If a Share Termination Delivery Unit consists of property other than cash or New Shares, the Calculation Agent will replace such property with cash, New Shares or a combination thereof as components of a Share Termination Delivery Unit in such amounts, as determined by the Calculation Agent, as shall have a value equal to the value of the property so replaced. If such Insolvency, Nationalization, Merger Event or Tender Offer involves a choice of consideration to be received by holders, such holder shall be deemed to have elected to receive the maximum possible amount of cash.
Failure to Deliver:	Applicable
Other applicable provisions:	If Share Termination Alternative is Applicable, the provisions of Sections 9.8, 9.9, 9.10, 9.11 and 9.12 of the Equity Definitions will be applicable, except that all references in such provisions to “Physically-Settled” shall be read as references to “settled by Share Termination Alternative” and all references to “Shares” shall be read as references to “Share Termination Delivery Units”.

- (l) Status of Claims in Bankruptcy. JPMorgan acknowledges and agrees that this Confirmation is not intended to convey to JPMorgan rights with respect to the Transaction that are senior to the claims of common stockholders in any U.S. bankruptcy proceedings of the Issuer; *provided* that nothing herein shall limit or shall be deemed to limit JPMorgan's right to pursue remedies in the event of a breach by the Issuer of its obligations and agreements with respect to the Transaction; and *provided further* that nothing herein shall limit or shall be deemed to limit JPMorgan's rights in respect of any transactions other than the Transaction.
- (m) No Collateral. Notwithstanding any provision of the Agreement, or any other agreement between the parties, to the contrary, the obligations of the Issuer under the Transaction are not secured by any collateral. Without limiting the generality of the foregoing, if the Agreement, or any other agreement between the parties, includes an ISDA Credit Support Annex, or other agreement pursuant to which the Issuer collateralizes obligations to JPMorgan, then the obligations of the Issuer hereunder will not be considered to be obligations under such Credit Support Annex, or other agreement pursuant to which Counterparty collateralizes obligations to JPMorgan, and the Transaction shall be disregarded for purposes of calculating any Exposure, Market Value or similar term thereunder.
- (n) No Netting or Set-off. Any provision in the Agreement with respect to (i) the netting of obligations of the Issuer or (ii) the satisfaction of the Issuer's payment obligations to the extent of JPMorgan's payment obligations to the Issuer in the same currency and in the same Transaction (including, without limitation Section 2(c) thereof), in each case as applied solely to this Transaction, shall not apply to the Issuer and, for the avoidance of doubt, the Issuer shall fully satisfy such payment obligations notwithstanding any payment obligation to the Issuer by JPMorgan in the same currency and in the same Transaction. In calculating any amounts under Section 6(e) of the Agreement, notwithstanding anything to the contrary in the Agreement, clause (i) of the foregoing sentence shall apply as follows: (1) separate amounts shall be calculated as set forth in such Section 6(e) with respect to (a) Issuer Share Transactions and (b) all other Transactions, and (2) such separate amounts shall be payable pursuant to Section 6(d)(ii) of the Agreement.
- (o) Early Termination. For purpose of Section 6(e) of the Agreement, "Second Method" and "Loss" will apply to the Transaction.
- (p) Notices. Part 4, Section (2) of the Schedule shall not apply to the Transaction.
- (q) Netting of Payments. Part 4, Section (3) of the Schedule shall not apply to the Transaction.
- (r) Set-Off. Part 5, Section (4) of the Schedule shall not apply to the Transaction.
- (s) Calculation Agent. Part 5, Section (5) of the Schedule shall not apply to the Transaction.
- (t) FX Transactions and Currency Options. Part 6 of the Schedule shall not apply to the Transaction.

Please confirm that the foregoing correctly sets forth the terms of our agreement by executing the copy of this Confirmation enclosed for that purpose and returning it to us or by sending to us a letter or telex substantially similar to this letter, which letter or telex sets forth the material terms of the Transaction to which this Confirmation relates and indicates your agreement to those terms.

Yours sincerely,

JPMORGAN CHASE BANK

By: /s/ Stephen L. Roti

Name: Stephen L. Roti
Title: Vice President

Confirmed as of the date first above written:

MICROSOFT CORPORATION

By: /s/ Brent Callinicos

Name: Brent Callinicos

Title: Corporate VP, Treasurer

MICROSOFT CORPORATION
2001 STOCK PLAN
(as amended and restated September 11, 2003)

1. Purpose of the Plan. The purposes of this Stock Plan are to attract and retain the best available individuals for positions of substantial responsibility, to provide additional incentive to such individuals, and to promote the success of the Company's business by aligning the financial interests of Employees and Consultants providing personal services to the Company or to any Parent or Subsidiary of the Company with long-term shareholder value.

Awards granted hereunder may be Incentive Stock Options, Nonqualified Stock Options, Stock Awards, or SARs, at the discretion of the Board and as reflected in the terms of the Award Agreement.

2. Definitions. As used herein, the following definitions shall apply:

(a) "Award" shall mean any award or benefits granted under the Plan, including Options, Stock Awards, and SARs.

(b) "Award Agreement" shall mean a written or electronic agreement between the Company and the Awardee setting forth the terms of the Award.

(c) "Awardee" shall mean the holder of an outstanding Award.

(d) "Board" shall mean (i) the Board of Directors of the Company or (ii) both the Board and the Committee, if a Committee has been appointed in accordance with Section 4(a) of the Plan.

(e) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(f) "Committee" shall mean the Compensation Committee appointed by the Board of Directors in accordance with Section 4(a) of the Plan, if one is appointed; provided, however, if the Board of Directors appoints more than one Committee pursuant to Section 4(a), then "Committee" shall refer to the appropriate Committee, as indicated by the context of the reference.

(g) "Common Shares" shall mean the common shares of Microsoft Corporation.

(h) "Company" shall mean Microsoft Corporation, a Washington corporation and any successor thereto.

(i) "Consultant" shall mean any person, except an Employee, engaged by the Company or any Parent or Subsidiary of the Company, to render personal services to such entity, including as an advisor.

(j) “Continuous Status as a Participant” shall mean (1) for Employees, the absence of any interruption or termination of service as an Employee, and (2) for Consultants, the absence of any interruption, expiration, or termination of such person’s consulting or advisory relationship with the Company or the occurrence of any termination event as set forth in such person’s Award Agreement. Continuous Status as a Participant shall not be considered interrupted (i) for an Employee in the case of sick leave, maternity leave, infant care leave, medical emergency leave, military leave, or any other leave of absence authorized in writing by a Vice President of the Company prior to its commencement, and (ii) for a Consultant, in the case of any temporary interruption in such person’s availability to provide services to the Company which has been authorized in writing by a Vice President of the Company prior to its commencement.

(k) “Conversion Options” shall mean the Options described in Section 6(c) of the Plan.

(l) “Employee” shall mean any person, including an officer, who is a common law employee of, receives remuneration for personal services to, is reflected on the official human resources database as an employee of, and is on the payroll of the Company or any Parent or Subsidiary of the Company. A person is on the payroll if he or she is paid from the payroll department of the Company, or any Parent or Subsidiary of the Company. Persons providing services to the Company, or to any Parent or Subsidiary of the Company, pursuant to an agreement with a staff leasing organization, temporary workers engaged through or employed by temporary or leasing agencies, and workers who hold themselves out to the Company, Parent, or Subsidiary to which they are providing services as being independent contractors, or as being employed by or engaged through another company while providing the services are not Employees for purposes of this Plan, whether or not such persons are, or may be reclassified by the courts, the Internal Revenue Service, the U. S. Department of Labor, or other person or entity as, common law employees of the Company, Parent, or Subsidiary, either solely or jointly with another person or entity.

(m) “Effective Date” shall mean January 1, 2001.

(n) “Exchange Act” shall mean the Securities Exchange Act of 1934, as amended.

(o) “FLSA” shall mean the Fair Labor Standards Act of 1938, as amended.

(p) “Incentive Stock Option” shall mean any Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

(q) “Maximum Annual Participant Award” shall have the meaning set forth in Section 5(b).

(r) “Nonqualified Stock Option” shall mean an Option not intended to qualify as an Incentive Stock Option.

(s) “Option” shall mean a stock option granted pursuant to Section 6 of the Plan.

(t) "Parent" shall mean a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

(u) "Participant" shall mean an Employee or Consultant.

(v) "Plan" shall mean this 2001 Stock Plan, including any amendments thereto.

(w) "Share" shall mean one Common Share, as adjusted in accordance with Section 14 of the Plan.

(x) "SAR" shall mean a stock appreciation right awarded pursuant to Section 8 of the Plan.

(y) "Stock Award" shall mean a grant of Shares or of a right to receive Shares or their cash equivalent (or both) pursuant to Section 7 of the Plan.

(z) "Subsidiary," shall mean (i) in the case of an Incentive Stock Option a "subsidiary corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code, and (ii) in the case of a Nonqualified Stock Option, a Stock Award or an SAR, in addition to a subsidiary corporation as defined in (i), a limited liability company, partnership or other entity in which the Company controls 50 percent or more of the voting power or equity interests.

3. Shares Subject to the Plan. Subject to the provisions of Sections 14 and 16 of the Plan, the maximum aggregate number of Shares (increased, proportionately, in the event of any stock split or stock dividend with respect to the Shares) which may be awarded and delivered under the Plan shall not exceed the sum of (a) any Shares available for future awards, as of the Effective Date, under the Microsoft Corporation 1991 Stock Option Plan, as amended ("1991 Stock Plan") and (b) any Shares that are represented by awards under the 1991 Stock Plan which, after the Effective Date, are forfeited, expire, are cancelled without delivery of Shares, or otherwise result in the return of Shares to the Company, minus (c) 100,000,000 Shares (unadjusted for any stock split or stock dividend with respect to the Shares). The Shares may be authorized, but unissued, or reacquired Common Shares.

Subject to the provisions of the following sentence, if an Award should expire or become unexercisable for any reason without having been exercised in full, the undelivered Shares which were subject thereto shall, unless the Plan shall have been terminated, become available for future Awards under the Plan. Notwithstanding anything to the contrary contained herein, any Awards of Options that are transferred to a third party pursuant to a program under which the holder of certain Options may transfer such Options to such third party in exchange for cash or other consideration, shall be removed from the Plan and the Shares subject to such Awards shall not be available for regrant under the Plan regardless of whether the transferred Options are exercised or expire without exercise.

4. Administration of the Plan.

(a) Procedure. The Plan shall be administered by the Board of Directors of the Company.

(i) The Board of Directors may appoint one or more Committees each consisting of not less than two members of the Board of Directors to administer the Plan on behalf of the Board of Directors, subject to such terms and conditions as the Board of Directors may prescribe. Once appointed, such Committees shall continue to serve until otherwise directed by the Board of Directors.

(ii) From time to time the Board of Directors may increase the size of the Committee(s) and appoint additional members thereof, remove members (with or without cause) and appoint new members in substitution therefor, or fill vacancies however caused.

(b) Powers of the Board. Subject to the provisions of the Plan, the Board shall have the authority, in its discretion: (i) to grant Incentive Stock Options, Nonqualified Stock Options, Stock Awards, and SARs; (ii) to determine, in accordance with Section 11(b) of the Plan, the fair market value of the Shares; (iii) to determine, in accordance with Section 11(a) of the Plan, the exercise price per share of Awards to be granted; (iv) to determine the Participants to whom, and the time or times at which, Awards shall be granted and the number of Shares to be represented by each Award; (v) to interpret the Plan; (vi) to prescribe, amend, and rescind rules and regulations relating to the Plan; including the form of Award Agreement, and manner of acceptance of an Award, (vii) to determine the terms and provisions of each Award to be granted (which need not be identical) and, with the consent of the Awardee, modify or amend each Award; (viii) to authorize conversion or substitution under the Plan of any or all Conversion Options; (ix) to accelerate or defer (with the consent of the Awardee) the exercise date of any Option; (x) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Award previously granted by the Board; and (xi) to make all other determinations deemed necessary or advisable for the administration of the Plan.

(c) Effect of Board's Decision. All decisions, determinations, and interpretations of the Board shall be final and binding on all Participants and Awardees.

5. Eligibility.

(a) Awards may be granted to Participants and to persons to whom offers of employment as an Employee have been extended; provided that Incentive Stock Options may only be granted to Employees. For avoidance of doubt, directors are not eligible to participate in the Plan unless they are Employees or Consultants.

(b) The maximum number of Shares with respect to which an Award or Awards may be granted to any Participant in any one taxable year of the Company (the "Maximum Annual Participant Award") shall not exceed 20,000,000 Common Shares (increased, proportionately, in the event of any stock split or stock dividend with respect to the Shares). If an Option is in tandem with an SAR, such that the exercise of the Option or SAR with respect to a Share cancels the tandem SAR or Option right, respectively, with respect to each Share, the tandem Option and SAR rights with respect to each Share shall be counted as covering but one Share for purposes of the Maximum Annual Participant Award.

6. Options.

(a) Each Option shall be designated in the written or electronic option agreement as either an Incentive Stock Option or a Nonqualified Stock Option. However, notwithstanding such designations, to the extent that the aggregate fair market value of the Shares with respect to which Options designated as Incentive Stock Options are exercisable for the first time by any Employee during any calendar year (under all plans of the Company) exceeds \$100,000, such Options shall be treated as Nonqualified Stock Options.

(b) For purposes of Section 6(a), Options shall be taken into account in the order in which they were granted, and the fair market value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

(c) Options converted or substituted under the Plan for any or all outstanding stock options and stock appreciation rights held by employees, consultants, advisors or other option holders granted by entities subsequently acquired by the Company ("Conversion Options") shall be effective as of the close of the respective mergers and acquisitions of such entities by the Company. The Conversion Options may be Incentive Stock Options or Nonqualified Stock Options, as determined by the Committee; provided, however, that stock appreciation rights in the acquired entity shall only be converted to or substituted with Nonqualified Stock Options. The Conversion Options shall be options to purchase the number of Common Shares determined by multiplying the number of shares of the acquired entity's common stock underlying each such stock option or stock appreciation right immediately prior to the closing of such merger or acquisition by the number specified in the applicable merger or acquisition agreement for conversion of each share of such entity's common stock to a Common Share (the "Merger Ratio"). Such Conversion Options shall be exercisable at an exercise price per Common Share (increased to the nearest whole cent) equal to the exercise price per share of the acquired entity's common stock under each such stock option or stock appreciation right immediately prior to closing divided by the Merger Ratio. No fractional Common Shares will be issued upon exercise of Conversion Options. In lieu of such issuance, the Common Shares issued pursuant to each such exercise shall be rounded to the closest whole Share. All other terms and conditions applicable to such stock options and stock appreciation rights prior to closing of the acquisition, including vesting, shall remain unchanged under the Conversion Options.

7. Stock Awards.

(a) Stock Awards may be granted either alone, in addition to, or in tandem with other Awards granted under the Plan. Any Stock Award granted to an Employee who is non-exempt for purposes of the FLSA shall include a vesting period of not less than six (6) months. After the Committee determines that it will offer a Stock Award, it will advise the Awardee in writing or electronically, by means of an Award Agreement, of the terms, conditions and restrictions, including vesting, if any, related to the offer, including the number of Shares that the Awardee shall be entitled to receive or purchase, the price to be paid, if any, and, if applicable, the time within which the Awardee must accept the offer. The offer shall be accepted by execution of an Award Agreement in the manner determined by the Committee.

(b) Unless the Committee determines otherwise, the Award Agreement shall provide for the forfeiture of the non-vested Common Shares underlying such Stock Award upon the Awardee ceasing to be a Participant. To the extent that the Awardee purchased the Shares granted under such Stock Award and any such Shares remain non-vested at the time the Awardee ceases to be a Participant, the cessation of Participant status shall cause an immediate sale of such non-vested Shares to the Company at the original price per Common Share paid by the Awardee.

8. SARs.

(a) The Committee shall have the full power and authority, exercisable in its sole discretion, to grant SARs to selected Awardees. The Committee is authorized to grant both tandem stock appreciation rights ("Tandem SARs") and stand-alone stock appreciation rights ("Stand-Alone SARs") as described below.

(b) Tandem SARs.

(i) Awardees may be granted a Tandem SAR, exercisable upon such terms and conditions as the Committee shall establish, to elect between the exercise of the underlying Section 6 Option for Common Shares or the surrender of the Option in exchange for a distribution from the Company in an amount equal to the excess of (A) the fair market value (on the Option surrender date) of the number of Shares in which the Awardee is at the time vested under the surrendered Option (or surrendered portion thereof) over (B) the aggregate exercise price payable for such vested Shares.

(ii) No such Option surrender shall be effective unless it is approved by the Committee, either at the time of the actual Option surrender or at any earlier time. If the surrender is so approved, then the distributions to which the Awardee shall become entitled under this Section 8(b) may be made in Common Shares valued at fair market value on the Option surrender date, in cash, or partly in Shares and partly in cash, as the Committee shall deem appropriate.

(iii) If the surrender of an Option is not approved by the Committee, then the Awardee shall retain whatever rights he or she had under the surrendered Option (or surrendered portion thereof) on the Option surrender date and may exercise such rights at any time prior to the later of (A) five (5) business days after the receipt of the rejection notice or (B) the last day on which the Option is otherwise exercisable in accordance with the terms of the instrument evidencing such Option, but in no event may such rights be exercised more than ten (10) years after the date of the Option grant.

(c) Stand-Alone SARs.

(i) An Awardee may be granted a Stand-Alone SAR not tied to any underlying Option under Section 6 of the Plan. The Stand-Alone SAR shall cover a specified number of Common Shares and shall be exercisable upon such terms and conditions as the Committee shall establish. Upon exercise of the Stand-Alone SAR, the holder shall be entitled to receive a distribution from the Company in an amount equal to the excess of (A) the aggregate fair market value (on the exercise date) of the Common Shares underlying the exercised right over (B) the aggregate base price in effect for those Shares.

(ii) The number of Common Shares underlying each Stand-Alone SAR and the base price in effect for those Shares shall be determined by the Committee at the time the Stand-Alone SAR is granted. In no event, however, may the base price per Share be less than the fair market value per underlying Common Share on the grant date.

(iii) The distribution with respect to an exercised Stand-Alone SAR may be made in Common Shares valued at fair market value on the exercise date, in cash, or partly in Shares and partly in cash, as the Committee shall deem appropriate.

(d) The Common Shares underlying any SARs exercised under this Section 8 shall not be available for subsequent issuance under the Plan.

9. Term of Plan. The Plan shall become effective as of the Effective Date. It shall continue in effect until terminated under Section 17 of the Plan.

10. Term of Award. The term of each Award shall be no more than ten (10) years from the date of grant. However, in the case of an Incentive Stock Option granted to a Participant who, at the time the Option is granted, owns Shares representing more than ten percent (10%) of the voting power of all classes of shares of the Company or any Parent or Subsidiary, the term of the Option shall be no more than five (5) years from the date of grant.

11. Exercise Price and Consideration.

(a) The per Share exercise price under each Award shall be such price as is determined by the Board, subject to the following:

(i) In the case of an Incentive Stock Option

(A) granted to an Employee who, at the time of the grant of such Incentive Stock Option, owns shares representing more than ten percent (10%) of the voting power of all classes of shares of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the fair market value per Share on the date of grant.

(B) granted to any other Employee, the per Share exercise price shall be no less than 100% of the fair market value per Share on the date of grant.

(ii) Except for Conversion Options under Section 6(c), the per Share exercise price under a Nonqualified Stock Option or SAR shall be no less than seventy-five percent (75%) of the fair market value per Share on the date of grant. Notwithstanding the foregoing (or any other provision of the Plan), Options and SARs that are granted to Employees who are non-exempt for purposes of the FLSA, shall satisfy the requirements for exclusion from regular rate of pay for purposes of the FLSA and shall have an exercise price that is at least eighty-five percent (85%) of the fair market value of the underlying Shares at the time of grant; furthermore, such Options or SARs shall not be exercisable within the six (6) month period immediately following the date of grant, except, if so provided in the Award Agreement, in the event of the Awardee's death, disability, or retirement, upon a change in corporate control of the Company, or under such other circumstances as are permitted under the FLSA or rules and regulations thereunder.

(iii) The maximum aggregate number of Shares underlying all Nonqualified Stock Options and SARs with a per Share exercise price of less than fair market value on any grant date that may be granted under this Plan is 50,000,000 Shares (increased, proportionately, in the event of any stock split or stock dividend with respect to the Shares).

(b) The fair market value per Share shall be the closing price per share of the Common Share on the Nasdaq Stock Market ("Nasdaq") on the date of grant. If the Shares cease to be listed on Nasdaq, the Board shall designate an alternative method of determining the fair market value of the Shares.

(c) The consideration to be paid for the Shares to be issued upon exercise of an Award, including the method of payment, shall be determined by the Board at the time of grant and may consist of cash and/or check. Payment may also be made by delivering a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company the amount of sale proceeds necessary to pay the exercise price. If the Awardee is an officer of the Company within the meaning of Section 16 of the Exchange Act, he may, in addition, be allowed to pay all or part of the purchase price with Shares which, as of the exercise date, the officer has owned for six (6) months or more. If the Awardee is a participant in the 1998 Microsoft Corporation Stock Option Gain And Bonus Deferral Program, he may in addition be allowed to pay all or part of the purchase price of any deferred Option with Shares. Shares used by officers to pay the exercise price shall be valued at their fair market value on the exercise date.

(d) Prior to issuance of the Shares upon exercise of an Award, the Awardee shall pay any federal, state, and local income and employment tax withholding obligations applicable to such Award. If an Awardee is an officer of the Company within the meaning of Section 16 of the Exchange Act, he may elect to pay such withholding tax obligations by having the Company withhold Shares having a value equal to the amount required to be withheld, and any Award under the Plan may permit or require that such withholding tax obligations be paid by having the Company withhold Shares having a value equal to the amount required to be withheld. The value of the Shares to be withheld shall equal the fair market value of the Shares on the day the Award is exercised. The right of an officer to dispose of Shares to the Company in satisfaction of withholding tax obligations shall be deemed to be approved as part of the initial grant of an Award, unless thereafter rescinded, and shall otherwise be made in compliance with Rule 16b-3 and other applicable regulations, and any Award under the Plan may permit or require that such withholding tax obligations be paid by having the Company withhold Shares having a value equal to the amount required to be withheld.

12. Exercise of Award.

(a) Procedure for Exercise; Rights as a Shareholder. Any Award granted hereunder shall be exercisable at such times and under such conditions as determined by the Board at the time of grant, and as shall be permissible under the terms of the Plan.

An Award may not be exercised for a fraction of a Share.

An Award shall be deemed to be exercised when written or electronic notice of such exercise has been given to the Company in accordance with the terms of the Award by the person entitled to exercise the Award and full payment for the Shares with respect to which the Award is exercised has been received by the Company. Full payment may, as authorized by the Board, consist of any consideration and method of payment allowable under Section 11(c) of the Plan. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the share certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Shares subject to the Award, notwithstanding the exercise of the Award. The Company shall issue (or cause to be issued) such share certificate promptly upon exercise of the Award. In the event that the exercise of an Award is treated in part as the exercise of an Incentive Stock Option and in part as the exercise of a Nonqualified Stock Option pursuant to Section 6(a), the Company shall issue a share certificate evidencing the Shares treated as acquired upon the exercise of an Incentive Stock Option and a separate share certificate evidencing the Shares treated as acquired upon the exercise of a Nonqualified Stock Option, and shall identify each such certificate accordingly in its share transfer records. No adjustment will be made for a dividend or other right for which the record date is prior to the date the share certificate is issued, except as provided in Section 14 of the Plan.

Exercise of an Award in any manner and delivery of the Shares subject to such Award shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Award, by the number of Shares as to which the Award is exercised.

(b) Termination of Status as a Participant. In the event of termination of an Awardee's Continuous Status as a Participant, such Awardee may exercise his or her rights under any outstanding Awards to the extent exercisable on the date of termination (but in no event later than the date of expiration of the term of such Award as set forth in the Award Agreement). To the extent that the Awardee was not entitled to exercise his or her rights under such Awards at the date of such termination, or does not exercise such rights within the time specified in the individual Award Agreements, the Awards shall terminate.

(c) Disability of Awardee. Notwithstanding the provisions of Section 12(b) above, in the event of termination of an Awardee's Continuous Status as a Participant as a result of total and permanent disability (i.e., the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of twelve (12) months), the Awardee may exercise the Award, but only to the extent of the right to exercise that would have accrued had the Awardee remained in Continuous Status as a Participant for a period of twelve (12) months after the date on which the Participant ceased performing services as a result of the total and permanent disability. Such exercise must occur within eighteen (18) months (or such shorter time as is specified in the grant) from the date on which the Participant ceased performing services as a result of the total and permanent disability (but in no event later than the date of expiration of the term of such Award as set forth in the Award Agreement). To the extent that the Awardee was not entitled to exercise such Award within the time specified herein, the Award shall terminate.

(d) Death of Awardee. Notwithstanding the provisions of Section 12(b) above, in the event of the death of an Awardee:

(i) who is at the time of death a Participant, the Award may be exercised, at any time within twelve (12) months following the date of death, by the Awardee's estate or by a person who acquired the right to exercise the Award by bequest or inheritance, but only to the extent of the right to exercise that would have accrued had the Awardee continued living and remained in Continuous Status as a Participant twelve (12) months after the date of death; or

(ii) whose Award has not yet expired but whose Continuous Status as a Participant terminated prior to the date of death, the Award may be exercised, at any time within twelve (12) months following the date of death, by the Awardee's estate or by a person who acquired the right to exercise the Award by bequest or inheritance, but only to the extent of the right to exercise that had accrued at the date of termination.

(e) Notwithstanding subsections (b), (c), and (d) above, the Board shall have the authority to extend the expiration date of any outstanding option in circumstances in which it deems such action to be appropriate (provided that no such extension shall extend the term of an Award beyond the date on which the Award would have expired if no termination of the Employee's Continuous Status as a Participant had occurred).

13. Non-Transferability of Awards. An Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Awardee, only by the Awardee; provided that the Board may permit further transferability, on a general or specific basis, and may impose conditions and limitations on any permitted transferability.

14. Adjustments to Shares Subject to the Plan.

The number of Shares covered by each outstanding Award, the Maximum Annual Employee Award and the number of Shares which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per Share covered by each such outstanding Award, shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split, stock dividend, combination, or reclassification of the Shares, or any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding, and conclusive. Except as expressly provided herein, no issuance by the Company of shares of any class, or securities convertible into shares of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to an Award.

In the event of the proposed dissolution or liquidation of the Company, the Award will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board. The Board may, in the exercise of its sole discretion in such instances, declare that any Award shall terminate as of a date fixed by the Board and give each Awardee the right to exercise an Award as to all or any part of the Shares subject to an Award, including Shares as to which the Award would not otherwise be exercisable. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each Award shall be assumed or an equivalent award shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless such successor corporation does not agree to assume the Award or to substitute an equivalent award, in which case the Board shall, in lieu of such assumption or substitution, provide for the Awardee to have the right to exercise the Award as to all of the Shares subject to Awards, including Shares as to which the Award would not otherwise be exercisable. If the Board makes an Award fully exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Board shall notify the Awardee that the Award shall be fully exercisable for a period of fifteen (15) days from the date of such notice, and the Award will terminate upon the expiration of such period.

15. Time of Granting Awards. The date of grant of an Award shall, for all purposes, be the date on which the Company completes the corporate action relating to the grant of such Award and all conditions to the grant have been satisfied, provided that conditions to the exercise of an Award shall not defer the date of grant. Notice of a grant shall be given to each Participant to whom an Award is so granted within a reasonable time after the determination has been made.

16. Substitutions and Assumptions. The Board shall have the right to substitute or assume Awards in connection with mergers, reorganizations, separations, or other transactions to which Section 424(a) of the Code applies, provided such substitutions and assumptions are permitted by Section 424 of the Code and the regulations promulgated thereunder. The number of Shares reserved pursuant to Section 3 may be increased by the corresponding number of Awards assumed and, in the case of a substitution, by the net increase in the number of Shares subject to Awards before and after the substitution.

17. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable (including, but not limited to amendments which the Board deems appropriate to enhance the Company's ability to claim deductions related to stock option exercises); provided that any increase in the number of Shares subject to the Plan, other than in connection with an adjustment under Section 14 of the Plan, shall require approval of or ratification by the shareholders of the Company.

(b) Participants in Foreign Countries. The Board shall have the authority to adopt such modifications, procedures, and subplans as may be necessary or desirable to comply with provisions of the laws of foreign countries in which the Company or its Subsidiaries may operate to assure the viability of the benefits from Awards granted to Participants performing services in such countries and to meet the objectives of the Plan.

(c) Effect of Amendment or Termination. Any such amendment or termination of the Plan shall not affect Awards already granted and such Awards shall remain in full force and effect as if this Plan had not been amended or terminated, unless mutually agreed otherwise between the Awardee and the Board, which agreement must be in writing and signed by the Awardee and the Company.

18. Conditions Upon Issuance of Shares. Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

19. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

20. No Employment/Service Rights. Nothing in the Plan shall confer upon any Participant the right to an Award or to continue in service as an Employee or Consultant for any period of specific duration, or interfere with or otherwise restrict in any way the rights of the Company (or any Parent or Subsidiary employing or retaining such person), or of any Participant or Awardee, which rights are hereby expressly reserved by each, to terminate such person's services at any time for any reason, with or without cause.

21. Shareholder Approval. The Plan, as amended and restated, is subject to approval by the shareholders of the Company.

* All share numbers in the Plan reflect the 2-for-1 stock split effected February 2003.

MICROSOFT CORPORATION
1999 STOCK PLAN FOR NON-EMPLOYEE DIRECTORS
(as amended and restated September 11, 2003)

1. Purpose

The purpose of the Microsoft Corporation 1999 Stock Plan for Non-Employee Directors (the "Plan") is to attract and retain the services of experienced and knowledgeable independent directors of Microsoft Corporation (the "Corporation") for the benefit of the Corporation and its stockholders and to provide additional incentive for such directors to continue to work for the best interests of the Corporation and its stockholders through continuing ownership of its common stock.

2. Shares Subject to the Plan

The total number of shares of common stock of the Corporation ("Shares") for which Awards (as defined in Section 4) may be granted under the Plan shall not exceed 3,500,000 in the aggregate, subject to adjustment in accordance with Section 12 hereof. Within the foregoing limitation, Shares underlying Awards that have been granted pursuant to the Plan but which Awards have lapsed or otherwise terminated without delivery of Shares shall become available for the grant of additional Awards.

3. Administration of Plan

The Board of Directors of the Corporation shall administer the Plan. The Board may delegate responsibility for administration of the Plan to a Board committee (the "Committee") composed solely of two or more directors, each of whom is a "Non-Employee Director" (as that term is defined in Rule 16b-3(b) promulgated by the Securities and Exchange Commission pursuant to its authority under the Securities Exchange Act of 1934 (the "Exchange Act")). The Board or the Committee, as the case may be, shall have the power to construe the Plan, to determine all questions arising thereunder, and to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable. References to the "Board" in this Plan shall be deemed to refer to either the Board or the Committee, whichever is appropriate in the context in which the word is used.

4. Discretionary Award Grants

Pursuant to this Plan, the Board may grant in its discretion an Award (as defined in this Section 4) to any person who (a) is elected a director of the Corporation, and (b) is not, and has not during the immediately preceding 12 month period been, an employee of the Corporation or any subsidiary of the Corporation. An "Award" may be either (i) a grant of a stock option (an "Option") or (ii) a grant of Shares or of a right to receive Shares or their cash equivalent (or both) (a "Stock Award"). No Awards under this Section 4 may be granted to any individual director with respect to more than 10,000 shares for any calendar year or, in the case of a newly elected director, more than 25,000 shares for the year in which the director is first elected. No director shall have any claim or right to be granted an Award under this Plan. Having received an Award under this Plan shall not give a director any right to receive any other Award under this Plan and the Board may determine that any or all director(s) are not eligible to receive an Award under this Plan for an indefinite period or for a specified year or years.

5. Award Agreement

Each Award granted under the Plan shall be evidenced by an Award agreement (the "Agreement") duly executed on behalf of the Corporation and by the director to whom such Award is granted, which Agreements may but need not be identical and which shall (a) comply with and be subject to the terms and conditions of the Plan and (b) provide that the director agrees to continue to serve as a director of the Corporation during the term for which he or she was elected. Any Agreement may contain such other terms, provisions, and conditions not inconsistent with the Plan as may be determined by the Board. No Award shall be deemed granted within the meaning of the Plan and no purported grant of any Award shall be effective, until such Agreement shall have been duly executed on behalf of the Corporation and the director to whom the Award is to be granted.

6. Stock Awards

(a) Stock Awards may be granted either alone, in addition to, or in tandem with other Awards granted under the Plan. After the Board determines that it will offer a Stock Award, it will advise the director in writing or electronically, by means of an Agreement, of the terms, conditions and restrictions, including vesting, if any, related to the offer, including the number of Shares that the director shall be entitled to receive or purchase, the price to be paid, if any, and, if applicable, the time within which the director must accept the offer. The offer shall be accepted by execution of an Agreement in the manner determined by the Board.

(b) Unless the Board determines otherwise, the Agreement shall provide for the forfeiture of the non-vested Shares underlying such Stock Award upon the director ceasing to be a director for any reason, including death. To the extent that the director purchased the Shares granted under such Stock Award and any such Shares remain non-vested at the time the director ceases to be a director, the cessation of director status shall cause an immediate sale of such non-vested Shares to the Company at the original price per Share paid by the director.

7. Options

(a) The Board shall set the exercise price for an Option granted pursuant to Section 4 of the Plan in its discretion.

(b) Each Option shall expire no more than ten years from the date of the granting thereof, but shall be subject to earlier termination as follows:

(i) In the event of the death of an Option holder, the Option granted to such person may be exercised to the extent exercisable on the date of death, within the earlier of (x) 180 days after the date of death of such person and (y) the date on which the Option expires by its terms, by the estate of such person, or by any person or persons who acquired the right to exercise such Option by will or by the laws of descent and distribution.

(ii) In the event that an Option holder ceases to be a director of the Corporation, other than by reason of his or her death, an Option granted to such person may be exercised, to the extent exercisable on the date such person ceases to be a director, within the earlier of (x) 180 days after the date such person ceases to be a director and (y) the date on which the Option expires by its terms.

8. Vesting and Exercise of Awards

(a) The Board shall set the vesting schedule for Awards granted pursuant to Section 4 of the Plan in its discretion.

(b) To the extent that the right to exercise an Option has vested and is in effect, the Option may be exercised from time to time, by giving written notice, signed by the person or persons exercising the Option, to the Corporation, stating the number of whole Shares with respect to which the Option is being exercised, accompanied by payment in full for such Shares, which payment may be in whole or in part in shares of the common stock of the Corporation already owned by the person or persons exercising the Option, valued at fair market value on the date of payment. For purposes hereof, the fair market value of the Shares covered by an Option shall be the closing price of the Shares on the applicable date as reported in the National Market List of the National Association of Securities Dealers Inc. Automated Quotation System or on the principal national securities exchange on which the Shares are then listed for trading.

(c) Upon exercise of the Option, delivery of a certificate for fully paid and non-assessable Shares shall be made at the principal office of the Corporation in the State of Washington to the person or persons exercising the Option as soon as practicable (but in no event more than 30 days) after the date of receipt of the notice of exercise by the Corporation, or at such time, place, and manner as may be agreed upon by the Corporation and the person or persons exercising the Option.

(d) Upon a Stock Award becoming fully vested and nonforfeitable, delivery of a certificate for fully paid and non-assessable Shares shall be made at the principal office of the Corporation in the State of Washington to the person to whom the Stock Award was granted as soon as practicable (but in no event more than 30 days) after the date on which the Stock Award becomes fully vested and nonforfeitable, or at such time, place, and manner as may be agreed upon by the Corporation and the holder of the Stock Award.

(e) Prior to issuance of the Shares in connection with an Award, the director receiving the Award may request the Corporation to withhold and pay on the director's behalf any federal, state, and local income tax obligations applicable to such Award by having the Corporation withhold Shares having a value equal to the amount requested to be withheld, and any Award under the Plan may permit that such withholding tax be paid by having the Corporation withhold Shares having a value equal to the amount requested to be withheld. The value of the Shares to be withheld shall equal the fair market value of the Shares on the day the Award is exercised or granted, as applicable. The right of a director to dispose of Shares to the Corporation in satisfaction of withholding tax obligations shall be deemed to be approved as part of the initial grant of an Award, unless thereafter rescinded, and shall otherwise be made in compliance with Rule 16b-3 and other applicable regulations.

9. Merger, Consolidation, Sale of Assets, etc., Resulting in a Change in Control

(a) In the event of a Change in Control (as hereinafter defined), notwithstanding the vesting provisions contained in the Agreement granting an Option or Stock Award, as applicable, to a director pursuant to this Plan, such Option shall become fully exercisable or Stock Award shall become fully vested and nonforfeitable if, within one year of such Change in Control, such director shall cease for any reason to be a member of the Board. For purposes hereof, a Change in Control of the Corporation shall be deemed to have occurred if (i) there shall be consummated (x) any consolidation or merger of the Corporation in which the Corporation is not the continuing or surviving corporation or pursuant to which shares of the common stock of the Corporation would be converted into cash, securities, or other property, other than a merger of the Corporation in which the holders of the common stock of the Corporation immediately prior to the merger have the same proportionate ownership of common stock of the surviving corporation immediately after the merger, or (y) any sale, lease, exchange, or other transfer (in one transaction or a series of related transactions) of all, or substantially all, of the assets of the Corporation; or (ii) the stockholders of the Corporation approve any plan or proposal for the liquidation or dissolution of the Corporation; or (iii) any person (as such term is used in Sections 13(d) and 14(d)(2) of the Exchange Act), other than William H. Gates III, shall become the beneficial owner (within the meaning of Rule 13d-3 under the Exchange Act) of 30% or more of the Corporation's outstanding common stock; or (iv) during any period of two consecutive years, individuals who at the beginning of such period constitute the entire Board of Directors shall cease for any reason to constitute a majority thereof unless the election, or the nomination for election by the Corporation's stockholders, of each new director was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of the period.

(b) Any exercise of an Option permitted pursuant to this Section 9 shall be made within 180 days of the related director's termination as a director of the Corporation.

10. Awards Not Transferable

An Award granted pursuant to the Plan may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the holder of an Award, only by the holder; provided that the Board may permit further transferability, on a general or specific basis, and may impose conditions and limitations on any permitted transferability.

11. No Rights as Stockholder Until Holder

Neither the recipient of an Award under the Plan nor his successors in interest shall have any rights as a stockholder of the Corporation with respect to any Shares subject to an Award granted to such person until such person becomes a holder of record of such Shares.

12. Adjustments Upon Changes in Capitalization or Merger

Subject to any required action by the stockholders of the Corporation, the number of shares of common stock covered by each outstanding Award, and the number of shares of common stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share of common stock covered by each outstanding Award, shall be proportionately adjusted for any increase or decrease in the number of issued shares of common stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the common stock, or any other increase or decrease in the number of issued shares of common stock effected without receipt of consideration by the Corporation; provided, however, that conversion of any convertible securities of the Corporation shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding, and conclusive. Except as expressly provided herein, no issuance by the Corporation of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of common stock subject to an Award.

In the event of the proposed dissolution or liquidation of the Corporation, an outstanding Award (i.e., an Option that has not been exercised or a Stock Award that has not become fully vested and nonforfeitable) will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board. The Board may, in the exercise of its sole discretion in such instances, declare that any Option shall terminate as of a date fixed by the Board and give each Option holder the right to exercise an Option as to all or any part of the stock covered by such Option, including Shares as to which the Option would not otherwise be exercisable. In the event of a proposed sale of all or substantially all of the assets of the Corporation, or the merger of the Corporation with or into another corporation, each Award shall be assumed or an equivalent Award shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless such successor corporation does not agree to assume each and every Award or to substitute an equivalent Award, in which case the Board shall, in lieu of such assumption or substitution, provide for the immediate full vesting of any Stock Awards not yet fully vested, or provide for the Option holder to have the right to exercise such Option as to all of the stock covered by such Option, including Shares as to which such Option would not otherwise be exercisable, or both. If the Board makes an Option fully exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Board shall notify the Option holder that the Option shall be fully exercisable for a period of fifteen (15) days from the date of such notice, and the Option will terminate upon the expiration of such period.

13. Restrictions on Issue of Shares

Notwithstanding anything in this Plan to the contrary, the Corporation may delay the issuance of Shares covered by any Award and the delivery of a certificate for such Shares until one of the following conditions shall be satisfied:

(a) the Shares to be issued in connection with the grant or exercise of an Award, as applicable, are at the time of the issue of such Shares by the Corporation effectively registered under applicable federal securities laws now in force or hereafter amended; or

(b) counsel for the Corporation shall have given an opinion, which opinion shall not be unreasonably conditioned or withheld, that such Shares are exempt from registration under applicable federal securities laws now in force or hereafter amended.

It is intended that all grants of Stock Awards and exercises of Options shall be effective. Accordingly, the Corporation shall use its best efforts to bring about compliance with the above conditions within a reasonable time, except that the Corporation shall be under no obligation to cause a registration statement or a post-effective amendment to any registration statement to be prepared at its expense solely for the purpose of covering the issuance of Shares in connection with the grant or exercise of any Award.

14. Purchase for Investment

Unless the Shares to be issued in connection with the grant or exercise of an Award granted under the Plan have been effectively registered under the Securities Act of 1933 as now in force or hereafter amended, the Corporation shall be under no obligation to issue any Shares covered by any Award unless the person or persons to whom the Shares are to be issued, in whole or in part, shall give a written representation and undertaking to the Corporation, which is satisfactory in form and scope to counsel to the Corporation and upon which, in the opinion of such counsel, the Corporation may reasonably rely, that he or she is acquiring the shares issued or transferred to him or her for his or her own account as an investment and not with a view to, or for sale in connection with, the distribution of any such Shares, and that he or she will make no transfer of the same except in compliance with any rules and regulations in force at the time of such transfer under the Securities Act of 1933, or any other applicable law, and that if Shares are issued or transferred without such registration a legend to this effect may be placed upon the certificates representing the Shares.

15. Effective Date

The effective date (the "Effective Date") of this Plan is November 10, 1999, the date on which the Plan was approved by stockholders of the Corporation. The Plan is amended and restated as of September 11, 2003, subject to approval by stockholders of the Corporation.

16. Expenses of the Plan

All costs and expenses of the adoption and administration of the Plan shall be borne by the Corporation and none of such expenses shall be charged to any director.

17. Termination and Amendment of Plan

Unless sooner terminated as herein provided, the Plan shall terminate ten years from the Effective Date. The Board may at any time terminate the Plan or make such modification or amendment thereof as it deems advisable; provided, however, that stockholder approval will be required for any amendment that will (a) increase the total number of shares as to which Awards may be granted under the Plan, (b) modify the class of persons eligible to receive Awards, or (c) otherwise require stockholder approval under any applicable law or regulation. In addition, the Board shall not amend the provisions in the Plan regarding the amount, pricing, and timing for grants pursuant to this Plan more than once every six months, other than to comport with changes in the Internal Revenue Code, or the rules thereunder. Termination or any modification or amendment of the Plan shall not, without the consent of an Award holder, affect his or her rights under an Award previously granted to him or her.

* All share numbers in the Plan reflect the 2-for-1 stock split effected February 2003.

February 5, 2004

Microsoft Corporation
One Microsoft Way
Redmond, Washington

We have made a review, in accordance with standards established by the American Institute of Certified Public Accountants, of the unaudited interim financial information of Microsoft Corporation and subsidiaries for the three-month and six-month periods ended December 31, 2003 and 2002, as indicated in our report dated January 30, 2004; because we did not perform an audit, we expressed no opinion on that information.

We are aware that our report referred to above, which is included in your Quarterly Report on Form 10-Q for the quarter ended December 31, 2003, is incorporated by reference in Registration Statement Nos. 33-51583 and 333-06298 (Microsoft Corporation 1991 Stock Option Plan), 333-16665 (Microsoft Corporation 1997 Employee Stock Purchase Plan), 333-75243 (Microsoft Corporation Savings Plus 401(k) Plan), 333-91755 (Microsoft Corporation 1999 Stock Plan for Non-Employee Directors), 333-52852 (Microsoft Corporation 2001 Stock Plan), 333-102240 (Microsoft Corporation 2003 Employee Stock Purchase Plan) and 333-109185 (Microsoft Puerto Rico, Inc. 1165(e) Savings Plan and Microsoft Caribbean 1165(e) Retirement Plan) of Microsoft Corporation on Forms S-8 and Registration Statement Nos. 333-43449 and 333-110107 of Microsoft Corporation on Forms S-3.

We also are aware that the aforementioned report, pursuant to Rule 436(c) under the Securities Act of 1933, is not considered a part of the Registration Statement prepared or certified by an accountant or a report prepared or certified by an accountant within the meaning of Sections 7 and 11 of that Act.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington

CERTIFICATIONS

I, Steven A. Ballmer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microsoft Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 6, 2004

/s/ Steven A. Ballmer

Steven A. Ballmer
Chief Executive Officer

CERTIFICATIONS

I, John G. Connors, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Microsoft Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 6, 2004

/s/ John G. Connors

John G. Connors
Chief Financial Officer

**CERTIFICATIONS PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Microsoft Corporation, a Washington corporation (the "Company"), on Form 10-Q for the quarter ended December 31, 2003, as filed with the Securities and Exchange Commission (the "Report"), Steven A. Ballmer, Chief Executive Officer of the Company and John G. Connors, Chief Financial Officer of the Company, respectively, do each hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to his knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Steven A. Ballmer

Steven A. Ballmer
Chief Executive Officer
February 6, 2004

/s/ John G. Connors

John G. Connors
Chief Financial Officer
February 6, 2004

[A signed original of this written statement required by Section 906 has been provided to Microsoft Corporation and will be retained by Microsoft Corporation and furnished to the Securities and Exchange Commission or its staff upon request.]