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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 March 31, 2000

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 98052-6399
(Address of principal executive office) (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

The number of shares outstanding of the registrant's common stock as of April 30, 2000 was 5,262,405,409.

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MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended March 31, 2000

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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 Mar. 31		Nine Months Ended Mar. 31	
	1999	2000	1999	2000
Revenue	\$4,595	\$5,656	\$13,983	\$17,152
Operating expenses:				
Cost of revenue	708	752	2,145	2,220
Research and development	664	990	2,030	2,735
Sales and marketing	849	1,042	2,331	2,972
General and administrative	144	176	392	825
Other expenses (income)	1	(32)	60	(13)
Total operating expenses	2,366	2,928	6,958	8,739
Operating income	2,229	2,728	7,025	8,413
Investment income	720	885	1,318	2,055
Gains on sales	0	0	160	156
Income before income taxes	2,949	3,613	8,503	10,624
Provision for income taxes	1,032	1,228	2,920	3,612
Net income	\$1,917	\$2,385	\$ 5,583	\$ 7,012
Earnings per share:				
Basic	\$ 0.38	\$ 0.46	\$ 1.11	\$ 1.35
Diluted	\$ 0.35	\$ 0.43	\$ 1.02	\$ 1.27

See accompanying notes.

MICROSOFT CORPORATION

Balance Sheets
(In millions)

	June 30 1999	Mar. 31 2000 (1)
Assets		
Current assets:		
Cash and short-term investments	\$17,236	\$21,205
Accounts receivable	2,245	2,902
Other	752	1,110
Total current assets	20,233	25,217
Property and equipment	1,611	1,835
Equity and other investments	14,372	21,322
Other assets	940	2,521
Total assets	\$37,156	\$50,895
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 874	\$ 1,073
Accrued compensation	396	373
Income taxes payable	1,607	1,931
Unearned revenue	4,239	4,459
Other	1,602	3,267
Total current liabilities	8,718	11,103
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock - shares authorized 100; outstanding 13 and 0	980	0
Common stock and paid-in capital - shares authorized 12,000; outstanding 5,109 and 5,242	13,844	20,975
Retained earnings	13,614	18,817
Total stockholders' equity	28,438	39,792
Total liabilities and stockholders' equity	\$37,156	\$50,895

(1) Unaudited

See accompanying notes.

MICROSOFT CORPORATION

Cash Flows Statements
(In millions)(Unaudited)

	Nine Months Ended	
	1999	2000
Operations		
Net income	\$ 5,583	\$ 7,012
Depreciation and amortization	514	1,040
Gains on sales	(160)	(156)
Unearned revenue	4,139	4,278
Recognition of unearned revenue from prior periods	(2,832)	(4,058)
Other current liabilities	471	(823)
Accounts receivable	(192)	(558)
Other current assets	(104)	(328)
Net cash from operations	7,419	6,407
Financing		
Common stock issued	1,102	1,750
Common stock repurchased	(1,527)	(4,872)
Put warrant proceeds	757	472
Preferred stock dividends	(21)	(13)
Stock option income tax benefits	2,238	4,002
Net cash from financing	2,549	1,339
Investing		
Additions to property and equipment	(291)	(617)
Cash proceeds from sale of Softimage, Inc.	79	0
Purchases of investments	(20,556)	(29,244)
Maturities of investments	3,175	3,086
Sales of investments	9,950	19,182
Net cash used for investing	(7,643)	(7,593)
Net change in cash and equivalents	2,325	153
Effect of exchange rates on cash and equivalents	39	64
Cash and equivalents, beginning of period	3,839	4,975
Cash and equivalents, end of period	6,203	5,192
Short-term investments, end of period	15,558	16,013
Cash and short-term investments, end of period	\$21,761	\$21,205

See accompanying notes.

MICROSOFT CORPORATION

Stockholders' Equity Statements
(In millions)(Unaudited)

	Three Months Ended Mar. 31		Nine Months Ended Mar. 31	
	1999	2000	1999	2000

Convertible preferred stock				
Balance, beginning of period	\$ 980	\$ 0	\$ 980	\$ 980
Conversion of preferred to common stock	0	0	0	(980)

Balance, end of period	980	0	980	0

Common stock and paid-in capital				
Balance, beginning of period	10,443	18,878	8,025	13,844
Common stock issued	901	751	1,771	2,843
Common stock repurchased	(20)	(20)	(45)	(186)
Structured repurchases price differential	(328)	0	(328)	0
Proceeds from sale of put warrants	402	0	757	472
Stock option income tax benefits	1,020	1,366	2,238	4,002

Balance, end of period	12,418	20,975	12,418	20,975

Retained earnings				
Balance, beginning of period	11,155	15,711	7,622	13,614

Net income	1,917	2,385	5,583	7,012
Net unrealized investments gains	46	583	586	2,724
Translation adjustments and other	(52)	138	54	166

Comprehensive income	1,911	3,106	6,223	9,902
Preferred stock dividends	(7)	0	(21)	(13)
Common stock repurchased	(735)	0	(1,500)	(4,686)

Balance, end of period	12,324	18,817	12,324	18,817

Total stockholders' equity	\$25,722	\$39,792	\$25,722	\$39,792
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See accompanying notes.

Notes to Financial Statements
(Unaudited)

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 generally accepted accounting principles. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include provisions for returns and bad debts and the length of product life cycles and buildings' lives. Actual results may differ from these estimates. 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 1999 Form 10-K.

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 preferred shares using the "if-converted" method, assumed net-share settlement of common stock structured repurchases, and outstanding stock options using the "treasury stock" method.

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

Earnings Per Share

(In millions, except earnings per share)

	Three Months Ended Mar. 31		Nine Months Ended Mar. 31	
	1999	2000	1999	2000
Net income (A)	\$1,917	\$2,385	\$5,583	\$7,012
Preferred stock dividends	(7)	0	(21)	(13)
Net income available for common shareholders (B)	\$1,910	\$2,385	\$5,562	\$6,999
Average outstanding shares of common stock (C)	5,055	5,209	5,004	5,167
Dilutive effect of:				
Common stock under structured repurchases	12	0	17	0
Preferred stock	16	0	20	9
Employee stock options	429	334	428	360
Common stock and common stock equivalents (D)	5,512	5,543	5,469	5,536
Earnings per share:				
Basic (B/C)	\$ 0.38	\$ 0.46	\$ 1.11	\$ 1.35
Diluted (A/D)	\$ 0.35	\$ 0.43	\$ 1.02	\$ 1.27

Unearned Revenue

A portion of Microsoft's revenue is earned ratably over the product life cycle or, in the case of subscriptions, over the period of the license agreement.

End users receive certain elements of the Company's products over a period of time. These elements include browser technologies and technical support. Consequently, Microsoft's earned revenue reflects the recognition of the fair value of these elements over the product's life cycle. The percentage of revenue recognized ratably ranges from approximately 15% to 25% of Windows desktop operating systems and approximately 10% to 20% of desktop applications, depending on the terms and conditions of the license and prices of the elements. Product life cycles are currently estimated at three years for Windows operating systems and 18 months for desktop applications. The Company also sells subscriptions to certain products via maintenance and certain organization license agreements. At March 31, 2000, unearned revenue was \$4.46 billion. Windows Platforms products unearned revenue was \$2.49 billion and unearned revenue associated with Productivity Applications and Developer products totaled \$1.78 billion. Unearned revenue for other miscellaneous programs totaled \$191 million.

Stockholders' Equity

During the first three quarters of fiscal 2000, the Company repurchased 54.7 million shares of Microsoft common stock in the open market. In January 2000, the Company announced the termination of its stock buyback program.

To enhance its stock repurchase program, Microsoft sold put warrants to independent third parties. These put warrants entitle the holders to sell shares of Microsoft common stock to the Company on certain dates at specified prices. On March 31, 2000, 163 million warrants were outstanding with strike prices ranging from \$69 to \$78 per share. The put warrants expire between June 2000 and December 2002. The outstanding put warrants permit a net-share settlement at the Company's option and do not result in a put warrant liability on the balance sheet.

During 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable principal-protected preferred stock. Net proceeds of \$980 million were used to repurchase common shares. The Company's convertible preferred stock matured on December 15, 1999. Each preferred share was converted into 1.1273 common shares.

Operational Transactions

In January 2000, the Company merged with Visio Corporation in a transaction that was accounted for as a pooling of interests. Microsoft issued 14 million shares in exchange for the outstanding stock of Visio. Visio's assets and liabilities, which were nominal, are included with those of Microsoft as of March 31, 2000. Operating results for Visio from prior periods were not material to the combined results of the two companies. Accordingly, the financial statements for such periods have not been restated.

In November 1999, Expedia, Inc. completed an initial public offering of its common stock. Expedia, which is majority-owned by Microsoft, is a leading provider of branded online travel services for leisure and small business travelers. Expedia's financial results and financial condition are consolidated with the operations of Microsoft.

In September 1999, the Company sold the entertainment city guide portion of MSN(TM) Sidewalk(R) to Ticketmaster Online-CitySearch, Inc. (TMCS) for a combination of TMCS stock and warrants with a value of \$223 million. The transaction also included a distribution agreement. Microsoft recognized a gain of \$156 million on the sale and will recognize amounts related to the distribution arrangement over the term of the agreement.

In November 1998, Microsoft acquired LinkExchange, Inc., a leading provider of online marketing services to web site owners and small and medium-sized businesses. Microsoft paid \$265 million in stock. The Company did not record an in-process technology write-off in connection with the purchase of LinkExchange.

In August 1998, the Company sold a wholly-owned subsidiary, Softimage, Inc. to Avid Technology, Inc. Microsoft received cash of \$79 million and securities valued at \$85 million. A pretax gain of \$160 million was recognized in the first quarter of fiscal 1999.

Contingencies

On October 7, 1997, Sun Microsystems, Inc. ("Sun") brought suit against Microsoft in the U.S. District Court for the Northern District of California. Sun's complaint alleges several claims against Microsoft, all related to the parties' relationship under a March 11, 1996 Technology License and Distribution Agreement (Agreement) concerning certain Java programming language technology.

On March 24, 1998, the Court entered an order enjoining Microsoft from using the Java Compatibility logo on Internet Explorer 4.0 and the Microsoft Software Developers Kit (SDK) for Java 2.0. Microsoft has taken steps to fully comply with the order.

On November 17, 1998, the Court entered an order granting Sun's request for a preliminary injunction, holding that Sun had established a likelihood of success on its copyright infringement claims, because Microsoft's use of Sun's technology in its products was beyond the scope of the parties' license agreement. The Court ordered Microsoft to make certain changes in its products that include Sun's Java technology and to make certain changes in its Java software development tools. The Court also enjoined Microsoft from entering into any licensing agreements that were conditioned on exclusive use of Microsoft's Java Virtual Machine. Microsoft appealed that ruling to the 9th Circuit Court of Appeals on December 16, 1998. Microsoft filed a motion on February 5, 1999, seeking clarification of the Court's order that Microsoft would not be prevented from engaging in independent development of Java technology under the order. The Court granted that motion. On July 23, 1999 the Court also granted Microsoft's motion to increase the bond on the preliminary injunction from \$15 million to \$35 million.

On August 23, 1999 the 9th Circuit Court of Appeals vacated the November 1998 preliminary injunction and remanded the case to the district Court for further proceedings. Sun immediately filed two motions to reinstate and expand the scope of the earlier injunction on the basis of copyright infringement and unfair competition. On January 25, 2000, the Court issued rulings on the two motions, denying Sun's motion to reinstate the preliminary injunction on the basis of copyright infringement and granting, in part, Sun's motion to reinstate the preliminary injunction based on unfair competition. Microsoft is in compliance with the terms of the partially reinstated preliminary injunction and will not need to undertake any further action to comply with the terms of the injunction. No other hearing or trial dates have been set.

The parties have filed multiple summary judgment motions on the interpretation of the Agreement and on Sun's copyright and trademark infringement claims. On February 25, 2000, the court entered an order denying both parties' motions for summary judgment as to whether the Agreement authorizes Microsoft to distribute independently developed Java Technology. On April 5, 2000, the trial court entered an order denying Sun's motion for summary judgment regarding the interpretation of Section 2.7(a), which sets forth certain requirements that Sun must meet when they deliver Java Technology to Microsoft. On May 9, 2000, the court entered an order granting Microsoft's motion to dismiss Sun's copyright infringement claim.

On May 18, 1998, the Antitrust Division of the U.S. Department of Justice (DOJ) and a group of 20 state Attorneys General filed two antitrust cases against Microsoft in the U.S. District Court for the District of Columbia. The DOJ complaint alleges violations of Sections 1 and 2 of the Sherman Act. The DOJ complaint seeks declaratory relief as to the violations it asserts and preliminary and permanent injunctive relief regarding: the inclusion of Internet browsing software (or other software products) as part of Windows; the terms of agreements regarding non-Microsoft Internet browsing software (or other software products); taking or threatening "action adverse" in consequence of a person's failure to license or distribute Microsoft Internet browsing software (or other software product) or distributing competing products or cooperating with the government; and restrictions on the screens, boot-up sequence, or functions of Microsoft's operating system products. The state Attorneys General allege largely the same claims and various pendent state claims. The states seek declaratory relief and preliminary and permanent injunctive relief similar to that sought by the DOJ, together with statutory penalties under the state law claims. The foregoing description is qualified in its entirety by reference to the full text of the complaints and other papers on file in those actions, case numbers 98-1232 and 98-1233.

On May 22, 1998, Judge Jackson consolidated the two actions. The judge granted Microsoft's motion for summary judgment as to the states' monopoly leverage claim and permitted the remaining claims to proceed to trial. Trial began on October 19, 1998 and ended with closing arguments on September 21, 1999. On November 5, 1999, Judge Jackson issued his Findings of Fact. On April 3, 2000 the Court entered its Conclusions of Law, determining that Microsoft "tied" Internet Explorer and Windows 95/98 in violation of Section 1 of the Sherman Act, that Microsoft violated Section 2 of the Sherman Act by taking actions to maintain its monopoly in the desktop-PC operating system market, and that

Microsoft attempted to monopolize the Internet browser market in violation of
Section 2 of the

Sherman Act. The Court also held that Microsoft did not violate Section 1 of the Sherman Act by entering into a number of contracts challenged by the government. The Court established a schedule for consideration of the remedy to be imposed in a final judgment. On April 28, 2000, the plaintiffs submitted a joint proposed remedy that included a proposed break-up of Microsoft into two companies, an operating systems company, and a company that would own all of Microsoft's other products and businesses. The plaintiffs' proposal also seeks imposition of extensive conduct remedies, applicable for three years after a break-up is completed, or for ten years if Microsoft is not broken up. Microsoft's initial response to this proposal, its proposed remedy, and its proposal for the process the court should adopt in the remedies phase was filed on May 10, 2000. Microsoft also filed a motion asking the court to summarily dismiss break-up as a remedy. Microsoft proposed several schedules for remedy proceedings, depending upon the scope of remedies the court was prepared to consider. The proposed schedules range from entering immediately Microsoft's proposed remedy (conduct restrictions addressing the conduct the court found to violate the law) to a hearing beginning in December, 2000 if the court is going to consider all the remedies sought by the plaintiffs. The plaintiffs will reply on May 17 and the Court will hold a hearing on May 24, 2000. Microsoft intends to appeal from the final judgment when entered. In other ongoing investigations, the DOJ and several state Attorneys General have requested information from Microsoft concerning various issues.

A number of antitrust class action lawsuits have been initiated against Microsoft. Microsoft believes the claims are without merit and will vigorously defend the cases.

The Securities and Exchange Commission is conducting a non-public investigation into the Company's accounting reserve practices. Microsoft is also subject to various legal proceedings and claims that arise in the ordinary course of business.

Management currently believes that resolving these matters will not have a material adverse impact on the Company's financial position or its results of operations.

Segment Information
(In millions)

Three Months Ended Mar. 31	Windows Platforms	Productivity Applications and Developer	Consumer and Other	Reconciling Amounts	Consolidated
1999					
Revenue	\$2,119	\$2,330	\$ 421	\$(275)	\$ 4,595
Operating income (loss)	1,349	1,434	(363)	(191)	2,229
2000					
Revenue	\$2,327	\$2,479	\$ 682	\$ 168	\$ 5,656
Operating income (loss)	1,430	1,127	(316)	487	2,728
Nine Months Ended Mar. 31					
1999					
Revenue	\$6,443	\$6,416	\$1,450	\$(326)	\$13,983
Operating income (loss)	4,275	3,921	(776)	(395)	7,025
2000					
Revenue	\$6,947	\$7,532	\$2,054	\$ 619	\$17,152
Operating income (loss)	4,475	3,909	(677)	706	8,413

The Company's organizational structure and fundamental approach to business reflect the needs of its customers. As such, Microsoft has three major segments: Windows Platforms; Productivity Applications and Developer; and Consumer and Other. Windows Platforms includes the Windows Division, which is primarily responsible for developing and marketing Windows NT, Windows 2000, Windows 98, and Windows 95. Productivity Applications and Developer includes the Business Productivity Division, which is responsible for developing and marketing desktop applications, server applications, and developer tools. Consumer and Other products and services include primarily learning, entertainment, and PC input device products; WebTV and PC online access; and portal and vertical properties. Assets of the segment groups are not relevant for management of the businesses nor for disclosure.

The Company's financial reporting systems present various data for management to run the business, including profit and loss (P&L) statements prepared on a basis not consistent with generally accepted accounting principles. Reconciling items include certain elements of unearned revenue, the treatment of certain channel inventory amounts and estimates, and revenue from product support, consulting, and training and certification of system integrators. Additionally, the internal P&Ls use accelerated methods of depreciation and amortization. In fiscal 2000, the Company's internal P&Ls included the Black-Scholes value of employee stock option grants, amortized over the remaining months of the fiscal year of the grant. Prior year disclosures have been restated for consistent presentation.

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

Results of Operations

Microsoft develops, manufactures, licenses, and supports a wide range of software products for a multitude of computing devices. Microsoft software includes scalable operating systems for intelligent devices, personal computers (PCs), and servers; server applications for client/server environments; knowledge worker productivity applications; and software development tools. The Company's online efforts include the MSN network of Internet products and services and alliances with companies involved with broadband access and various forms of digital interactivity. Microsoft also licenses consumer software programs; sells PC input devices; trains and certifies system integrators; and researches and develops advanced technologies for future software products.

Revenue

Revenue of \$5.66 billion in the March quarter of fiscal 2000 increased 23% over the third quarter of fiscal 1999. The revenue growth was driven by demand for Microsoft(R) Windows(R) 2000 Professional in the retail channel following worldwide availability during the quarter, and licensing of Microsoft Office 2000. Partially offsetting this was slower growth from Windows operating systems sold through the original equipment manufacturer (OEM) channel due to slow demand for business PCs. As described more fully below, reported revenue in the third quarter of fiscal 1999 included adjustments related to the Microsoft Office 2000 Technology Guarantee and the fulfillment of free upgrades to Microsoft SQL Server(TM) 7.0. On a year to date basis, revenue in the first nine months of fiscal 2000 totaled \$17.15 billion, an increase of 23% over the first nine months of fiscal 1999.

Software license volume increases have been the principal factor in the Company's revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and organizational license programs is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, such as Microsoft Office and BackOffice, are less than the sum of the prices for the individual programs included in these suites when such programs are licensed separately. An increased percentage of products and programs included elements that were billed but unearned and recognized ratably, such as Microsoft Windows, Microsoft Office, maintenance, and other subscription models. See accompanying notes to financial statements.

Business Divisions

Microsoft has three major segments: Productivity Applications and Developer; Windows Platforms; and Consumer and Other.

Productivity Applications and Developer products include desktop applications such as Microsoft Office, server applications such as Microsoft Exchange Server and Microsoft SQL Server, and software developer tools. Reported revenue increased 32% to \$2.59 billion in the March quarter. For the first three quarters of fiscal 2000, revenue of \$7.83 billion grew 33% over the first three quarters of fiscal 1999. Revenue growth from Microsoft Office integrated suites, including the Premium, Professional, Small Business, and Standard Editions was healthy. Reported revenue from Microsoft Office integrated suites in the third quarter of fiscal 1999 excluded \$400 million of revenue that was not earned related to the Microsoft Office 2000 Technology Guarantee, of which \$64 million was recognized in the second quarter of fiscal 2000 and \$150 million was recognized in the first quarter of fiscal 2000 due to fulfillment of the guarantee during the fourth quarter of fiscal 1999 and the first two quarters of fiscal 2000. Revenue from server applications remained solid during the third quarter of fiscal 2000, compared to the third quarter in the prior year, which included \$45 million of earned revenue due to the fulfillment of free upgrades to SQL Server 7.0. Software developer tools revenue declined, due to a larger portion of licenses sold through a subscription-based model.

Windows Platforms products include primarily Windows 98, Windows 2000 Professional, Windows 2000 Server, Windows NT Workstation, and Windows NT Server. Revenue of \$2.31 billion in the third quarter represented growth of 14% over the prior year. Windows-based desktop operating systems revenue grew moderately. Revenue growth from Windows-based units licensed through the PC original equipment manufacturer (OEM) channel reflected soft demand for business PCs and a decrease in average earned revenue per licensed operating system. Windows operating systems sold through retail channels reflected stronger than expected demand for the newest version of the desktop operating system, Windows 2000 Professional. Windows Platform Server revenue growth was strong. On a year to date basis, Windows Platforms revenue of \$7.01 billion grew 12% over the

prior year. Second quarter OEM revenue reflected slower growth of corporate PC purchases, moderate consumer PC purchases

through traditional retail channels, and declining revenue from retail versions of Windows 98. Windows NT Workstation and Windows NT Server revenue growth in the second quarter slowed due to customer anticipation of the next version of the operating system, Windows 2000. First quarter OEM revenue of Windows was relatively strong, particularly for Windows NT Workstation. Revenue from retail packaged product versions of Windows 98 decreased in the first quarter, reflecting the strong comparable quarter of the prior year which included significant revenue from Windows 98 after its launch in June 1998. Windows NT Server revenue growth was robust during the first quarter.

Consumer and Other products include Internet access and online services; learning and entertainment software; PC input devices; consulting; and training and certification. Revenue in the March quarter was \$756 million, up 26% from the comparable quarter of fiscal 1999. Online revenue growth was very healthy, but was offset somewhat by the company's lower net prices for Internet access subscriptions compared to the prior year. Hardware product revenue, reflecting strong sales of the Company's new keyboard and PC input device offerings, was robust. Learning and entertainment software revenue grew moderately in the third quarter of fiscal 2000. Consumer and Other revenue of \$2.31 billion grew 26% over the first nine months of the prior year. Learning and entertainment software posted superb growth in the second quarter of fiscal 2000, reflecting strong consumer Holiday demand.

Distribution Channels

Microsoft distributes its products primarily through OEM licenses, organizational licenses, and retail packaged products. OEM channel revenue represents license fees from original equipment manufacturers who pre-install Microsoft products, primarily on PCs. Microsoft has three major geographic sales and marketing organizations: the South Pacific and Americas Region; the Europe, Middle East, and Africa Region; and the Asia Region. Sales of organizational licenses and packaged products via these channels are primarily to and through distributors and resellers.

OEM third quarter revenue of \$1.67 billion represented an increase of 5% over the comparable quarter of fiscal 1999. The relatively low growth rate was due to soft demand for business PCs. Average earned revenue per license also declined, due in part to a mix shift to the lower-priced Windows operating system reflecting the softness in demand for business PCs and lower prices of certain operating systems licensed through the OEM channel, compared to the third quarter of fiscal 1999. Revenue from Windows 2000 Professional in the OEM channel was modest due to mid-quarter availability of the new operating system, coupled with slow PC shipments to corporations, the primary end-users of Windows 2000. OEM revenue of \$5.28 billion in the first three quarters of fiscal 2000 increased 11% over the first three quarters of fiscal 1999. OEM revenue in the second quarter of fiscal 2000 grew 4% over the comparable quarter of fiscal 1999, due to slow growth in business PCs, lower average revenue per license, and slower demand for Windows NT Workstation in anticipation of the launch of Windows 2000 Professional. The OEM revenue grew 27% in the first quarter of fiscal 2000, reflecting strong PC growth and increased penetration of higher-value NT Workstation.

South Pacific and Americas Region revenue in the March quarter increased 32% to \$2.02 billion. Revenue for the first nine months of fiscal 2000 grew 25% over the first nine months of fiscal 1999 to \$6.09 billion. Windows 2000 retail sales and Office integrated suites were the primary drivers of the revenue growth. Organizational licensing activity of server applications was moderate. Revenue growth was particularly strong in Latin America and Australia, moderate in the United States, and modest in Canada.

Europe, Middle East, and Africa Region third quarter revenue of \$1.26 billion was up 28% compared to the third quarter of fiscal 1999. Retail sales of Windows 2000 operating systems and Office licensing produced strong growth in the region. Hardware devices and learning and productivity software exhibited strong results. Revenue growth, measured in constant dollars, was low in the United Kingdom and France, moderate in Germany, and strong in the Middle East. Weakening local currencies negatively impacted translated revenue compared to the prior year quarter. Revenue in the region would have grown 37% if foreign exchange rates were constant with those of the year ago quarter. For the first three quarters of fiscal 2000, revenue in the region totaled \$3.87 billion, an increase of 24% over the prior year.

Asia Region revenue in the third quarter increased 44% to \$709 million from the third quarter of the prior year, reflecting improved local economic conditions and strong revenue from localized versions of Windows 2000 and Office integrated suites, particularly in Japan. Revenue grew strongly in most countries in the Asia region. Strengthening local currencies positively impacted translated revenue compared to the prior year. Revenue in the region would have grown 32% if foreign exchange rates were constant with those of the year ago quarter. On a year to date basis, revenue in the Asia region was \$1.91 billion, up 58% from the comparable period.

Translated international revenue is affected by foreign exchange rates. The net impact of foreign exchange rates on revenue was negative in the March quarter compared to a year ago, due to weaker European currencies versus the U.S. dollar, offset partially by stronger Japanese yen versus the U.S. dollar. Had the rates from the prior year been in effect in the third quarter of fiscal 2000, translated international revenue billed in local currencies would have been \$25 million higher. In the first half of fiscal 2000, the strong Japanese yen more than offset weak European currencies and added \$64 million in the first quarter and \$35 million in the second quarter to translated revenue. 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.

Operating Expenses

Microsoft encourages broad-based employee ownership of Microsoft stock through an employee stock option (ESO) program in which most employees are eligible to participate. Microsoft follows Accounting Principals Board Opinion 25 (APB 25) to account for ESOs, which generally does not require income statement recognition of options granted at the market price on the date of issuance, and discloses the Black-Scholes value of option grants. Payroll taxes associated with stock option exercises are recorded as an expense. Other events can also trigger recording expense, such as using the lowest price in the 30 days following an employee's start date to establish the strike price, accelerating the vesting of options, and converting ESOs from one company to another, as occurred with the initial public offering of Expedia, a majority-owned subsidiary of Microsoft. These costs were reflected in each operating expense line item in the income statement in the March quarter of fiscal 2000 and totaled \$90 million. These costs totaled \$170 million in the second quarter and \$100 million in the first quarter of fiscal 2000.

Cost of revenue as a percent of revenue was 13.3% in the third quarter, down from 15.4% in the third quarter of the prior year. The percentage decrease in the third quarter of fiscal 2000 was impacted by the unearned revenue related to the Office 2000 Technology Guarantee in the year ago quarter. For the first nine months of fiscal 2000, the percentage was 12.9%, down from 15.3% for the first nine months of fiscal 1999. The percentage decrease resulted primarily from the trend in mix shift to organizational licenses and lower costs associated with WebTV(R) Networks' operations.

Research and development expenses increased 49% from the third quarter of the prior year to \$990 million. For the first three quarters of fiscal 2000, research and development expenses increased 35% to \$2.74 billion from the first three quarters of fiscal 1999. These increases were driven primarily by higher development headcount-related costs, including various charges related to employee stock options, and investments in new product initiatives.

Sales and marketing expenses were \$1.04 billion in the March quarter, or 18.4% of revenue, compared to 18.5% in the third quarter of the prior year. Sales and marketing expenses as a percent of revenue decreased slightly due to lower relative sales expenses, partially offset by higher relative marketing costs. On a year to date basis, sales and marketing expenses were \$2.97 billion, up 27% over the comparable period of the prior year, due primarily to both higher relative marketing costs and certain employee stock option expenses.

General and administrative costs were \$176 million in the third quarter compared to \$144 million in the prior year. For the first three quarters of fiscal 2000, general and administrative costs were \$825 million, compared to \$392 million in the first three quarters of fiscal 1999. The second quarter of fiscal 2000 included a charge for the settlement of the lawsuit with Caldera, Inc. General and administrative costs also included increased legal fees and certain stock option-related charges.

Other expenses and income include miscellaneous items, including certain gains and the recognition of Microsoft's share of joint venture activities, including Transpoint, WebTV Networks K.K., and the MSNBC entities.

Investment Income, Gains on Sales, and Income Taxes

Third quarter investment income increased to \$885 million from \$720 million in the third quarter of the prior year. Year to date investment income totaled \$2.06 billion in fiscal 2000, compared to \$1.32 billion in fiscal 1999. The increase was due principally to realized gains of approximately \$440 million in the third quarter, \$400 million in the second quarter and \$50 million in the first quarter. The larger investment portfolio generated by cash from operations also contributed to the increase in investment income. Realized gains in the third quarter of fiscal 1999 were approximately \$350 million.

During the first quarter of fiscal 2000, Microsoft sold the entertainment city guide portion of MSN(TM) Sidewalk(R) to Ticketmaster Online-CitySearch, Inc. (TMCS) for a combination of TMCS stock and warrants. Microsoft recognized a gain

of \$156 million.

During the first quarter of fiscal 1999, Microsoft sold its Softimage, Inc. subsidiary to Avid Technology, Inc for a pretax gain of \$160 million.

The effective tax rate for the first nine months of fiscal 2000 was 34%. Excluding the tax impact of the gain on the sale of Softimage, the effective tax rate for fiscal 1999 was 35%.

Financial Condition

The Company's cash and short-term investment portfolio totaled \$21.21 billion at March 31, 2000. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The portfolio is primarily invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs.

Microsoft also invests in equities, primarily strategic technology companies. The Company has made large-scale investments in access providers, including cable, telephony, and wireless communications companies. During the first quarter of fiscal 2000, the Company purchased \$400 million of Rogers Communications convertible preferred securities and warrants. In connection with AT&T's proposed merger with MediaOne Group, Inc., the Company agreed to acquire MediaOne's interest in Telewest Communications plc, a leading provider of cable television and residential and business cable telephony services in the United Kingdom, subject to certain regulatory approvals and other conditions.

Microsoft and National Broadcasting Company (NBC) operate two MSNBC joint ventures: a 24-hour cable news and information channel, and an online news service. Microsoft is paying \$220 million over a five-year period that ends in 2001 for its interest in the cable venture and one-half of the operational funding of both joint ventures. Microsoft guarantees a portion of MSNBC debt.

Microsoft has no material long-term debt and has \$163 million of standby multicurrency lines of credit to support foreign currency hedging and cash management. Stockholders' equity at March 31, 2000 was \$39.79 billion.

Microsoft will continue to invest in sales, marketing, and product support infrastructure. Additionally, research and development activities will include investments in existing and advanced areas of technology, including using cash to acquire technology. Cash will also be used to fund ventures and strategic opportunities. 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 \$377 million on March 31, 2000.

Since fiscal 1990, Microsoft repurchased 764 million common shares while 1.95 billion shares were issued under the Company's employee stock option and purchase plans. Microsoft enhanced its repurchase program by selling put warrants. In January 2000, the Company announced the termination of its stock buyback program. The market value of all outstanding stock options was \$80 billion as of March 31, 2000. During December 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable preferred stock. Net proceeds of \$980 million were used to repurchase common shares. The Company's convertible preferred stock matured on December 15, 1999. Each preferred share was converted into 1.1273 common shares.

Management believes existing cash and short-term investments together with funds generated from operations will be sufficient to meet operating requirements for the next 12 months. The Company's cash and short-term investments are available for strategic investments, mergers and acquisitions, and other potential large-scale cash needs that may arise.

Microsoft has not paid cash dividends on its common stock.

Part II. Other Information

Item 1. Legal Proceedings

See notes to financial statements.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits

27. Financial Data Schedule

(B) Reports on Form 8-K

The Company filed no reports on Form 8-K during the quarter ended March 31, 2000.

Items 2, 3, 4, and 5 are not applicable and have been omitted.

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Microsoft Corporation

Date: May 12, 2000

By: /s/ John G. Connors

John G. Connors
Senior Vice President, Finance and
Administration;
Chief Financial Officer

(Principal Financial and Accounting Officer
and Duly Authorized Officer)

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE ACCOMPANYING FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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9-MOS	JUN-30-2000	JUL-01-1999	MAR-31-2000
			21,205
			0
		2,902	0
			0
	25,217		4,128
		2,293	
		50,895	
	11,103		0
	0		0
			0
		20,975	
		18,817	
50,895			17,152
	17,152		2,220
		2,220	
	6,519		
		0	
	0		
	10,624		
		3,612	
	7,012		
		0	
		0	
			0
		7,012	
		1.35	
		1.27	