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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED JUNE 30, 1996

|_| 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	91-1144442
(State or other jurisdiction of incorporation or organization)	(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: (206) 882-8080

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK

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

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

The aggregate market value of common stock held by non-affiliates of the registrant as of September 9, 1996 was $45,936,687,455.

The number of shares outstanding of the registrant's common stock as of September 9, 1996 was 596,226,947.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 1996 Annual Report to Shareholders are incorporated by reference into Parts I, II and IV.

Portions of the definitive Proxy Statement dated September 27, 1996 to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held November 12, 1996 are incorporated by reference into Part III.

MICROSOFT CORPORATION

FORM 10-K

FOR THE FISCAL YEAR ENDED JUNE 30, 1996

INDEX

PART I

Item 1. Business

GENERAL

Microsoft Corporation (the "Company" or "Microsoft") was founded as a partnership in 1975 and incorporated in 1981. Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including operating systems for personal computers (PCs) and servers; server applications for client/server environments, business and consumer productivity applications; interactive media programs; and Internet platform and development tools. Microsoft also offers online services, sells personal computer books and input devices, and researches and develops advanced technology software products. Microsoft(R) products are available for most PCs, including Intel microprocessor-based computers and Apple computers.

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

The Platforms Product Group is comprised of three divisions, each responsible for a particular area of platforms software development and marketing. The Desktop and Business Systems Division develops PC and server operating systems and a suite of server applications. The Internet Platform and Tools Division creates software development tools, Internet browser technology, and other Internet and online products and technologies. The Consumer Platforms Division develops system software for non-PC devices, integrated software systems for public networks, and software for the creation of content for digital media productions.

The Applications and Content Product Group creates and markets productivity programs, desktop finance products, PC input devices, and interactive entertainment and information products. The group also includes an advanced technology research division. The Desktop Applications Division creates business productivity applications and products designed for the home, school, and the small business market. The Interactive Media Division develops kids titles, games, information products, and The Microsoft Network (MSN(TM)). The Input Device Division creates PC peripherals. The Desktop Finance Division develops personal finance products. Microsoft Research is a research lab dedicated to creating new technology in support of the Company's vision for the evolution of personal computing.

The Sales and Support Group is responsible for building long-term business relationships with customers. This group is organized to serve three customer types: original equipment manufacturers (OEMs), end-users, and organizations. The group also focuses directly on large enterprises, offering tailored license programs, enterprisewide support, consulting services, and other specialized services. The group manages the channels that serve customers by working with OEMs, distributors, and resellers. In addition to the OEM channel, Microsoft has three major geographic sales organizations: U.S. and Canada, Europe, and Other International. The group supports the Company's products with technical support for end-users, developers, and organizations.

The Operations Group is responsible for managing business operations and overall business planning. This includes the process of manufacturing and delivering finished goods and licenses; the publishing efforts of Microsoft Press; and corporate functions such as finance, administration, human resources, and legal.

PRODUCTS

DESKTOP AND BUSINESS SYSTEMS

The Desktop and Business Systems Division has overall responsibility for the Microsoft Windows(R) and Microsoft BackOffice(TM) product families. Operating system software performs a variety of functions, such as allocating computer memory, scheduling applications software execution, managing information and communication flow among the various PC components, and enabling end-users to access files and information. The division's products are: (Please note: Windows 3.1 and Windows for Workgroups 3.11 are hereafter referred to collectively as "Windows 3.X.")

WINDOWS 95: Microsoft's newest personal operating system, the successor to MS-DOS and Windows 3.X, was released commercially in August 1995; periodic service releases have been made available to hardware OEMs and to end-users via the Internet on www.microsoft.com. Windows 95 is a fully integrated, multitasking 32-bit operating system,

designed to be compatible with most Intel microprocessor-based PCs, hardware devices, and Windows 3.X and MS-DOS applications.

WINDOWS NT WORKSTATION (NTW): Also a fully integrated, multitasking 32-bit operating system, Windows NTW provides greater security, robustness and portability. Given this optimization, Windows NTW is not as fully compatible with as many legacy applications and device drivers as Windows 95. Windows NTW is a multithreaded operating system for mission critical computing which provides the same features and applications programming interfaces (APIs) across four hardware platforms: Intel, Alpha AXP, MIPS, and Power PC.

MS-DOS: MS-DOS is a single-user, single-tasking operating system designed for Intel microprocessor-based PCs. MS-DOS was introduced in 1981 and was preinstalled by OEMs on most PCs shipped prior to the release of Windows 95.

WINDOWS 3.1: Microsoft Windows 3.1 provides a graphical user interface and other enhancements for MS-DOS-based PCs. Windows 3.1 supports high-performance Windows-based applications, and offers ease of use, aesthetic appeal, and straightforward integration into corporate computing environments.

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

WINDOWS NT SERVER (NTS): Windows NTS is a powerful operating system foundation for both server applications and file and print serving, providing extensive network management features, administration tools, security, and fault tolerance, and is a platform for business critical applications and databases, connectivity, system management, and mail servers. Windows NTS integrates Web services such as Microsoft Internet Information Server (IIS), a server used to manage intranet and Internet functionality, Microsoft FrontPage(TM) Web authoring and management tool, and Microsoft Index Server, a content indexing and querying search engine.

MICROSOFT BACKOFFICE: The Microsoft BackOffice family of server applications is an integrated series of software products that work together running on a single server, on multiple servers across a network or intranet, or on the Internet. BackOffice enables desktop users to access and integrate information from a variety of sources inside and outside an organization. Microsoft Exchange Server provides e-mail, group scheduling, and integrated groupware capabilities; Microsoft SQL Server(TM) manages and stores data; Microsoft SNA Server provides connectivity to host data and applications; and Microsoft Systems Management Server centrally manages this distributed environment.

INTERNET PLATFORM AND TOOLS PRODUCTS

The Internet Platform and Tools Division provides Internet browser technology, software development tools, Internet and online server products, and technical information to Windows and Internet applications developers. These products and services empower independent software developers, corporate developers, solutions developers, and Webmasters to create a broad spectrum of applications, primarily for Windows 95 and Windows NT, but also for the platform-independent Internet and intranets.

INTERNET SOFTWARE: The division has overall development and marketing responsibility for Microsoft Internet Explorer, the Company's Internet browser. It also provides products for developing, running, and managing Internet and intranet applications and content, including ActiveX(TM) controls. Formerly known as object linking and embedding (OLE) controls, ActiveX controls are components (or objects) that can be inserted into a Web page or other application which allow packaged functionality programmed elsewhere to be reused and enables realtime, interactive content.

DESKTOP DATABASE PRODUCTS: Database products control the maintenance and utilization of structured data organized into a set of records or files. The Company offers database products which span the needs of a wide variety of users, from individuals to large corporations. Microsoft Access is a relational database management application which provides access to structured business data. Microsoft FoxPro is a desktop database development tool which is compatible with the industry standard xBase development language.

SOFTWARE DEVELOPMENT TOOLS AND COMPUTER LANGUAGES: Software development tools and computer languages allow software developers to write programs in a particular computer language and translate programs into a binary machine-readable set of commands that activate and instruct PC hardware. The Company develops and markets a number of software development environments, language compilers, and software testing tools. Microsoft Visual C++(TM) is the Company's development system for Windows application development. The Microsoft Visual Basic(TM) programming system provides easy access to a wide variety of data sources by integrating the Microsoft Access database engine and the ability to leverage investments in commercial applications through ActiveX controls. Microsoft(R) Visual J++, a development environment for Java applications and Internet applets, contains a high productivity Integrated Development Environment and a collection of integrated components to create, test, tune and deploy Java code on multiple platforms using ActiveX controls.

DEVELOPER INFORMATION: The Company provides third party software developers with a wide range of technical and support information that assists them in developing software products intended to run on Windows operating systems, taking advantage of key technologies such as ActiveX controls and Windows 32-bit APIs. Developers can subscribe to the Microsoft Developer Network (MSDN) information service and receive periodic updates via CD-ROMs, magazines, and several on-line information services.

ELECTRONIC COMMERCE AND INTERNET SERVICES: Microsoft is currently developing software to enable retailing on the Internet. Microsoft Merchant Server, which will run on Windows NTS, will allow merchants to provide online shopping to customers and handle credit card transaction payments. Microsoft is also developing a new platform for commercial Internet services designed for Internet service providers and commercial Web publishers built on Windows NTS and integrated with IIS. The technologies under development include the major components needed to run a commercial, fee-based service, including value-added mail, forum areas, chat, news, indexing, and other content management services.

CONSUMER PLATFORMS

The Consumer Platforms Division is developing software for three distinct platforms: non-PC devices, the Broadcast PC, and Network Multimedia.

NON-PC DEVICES: The division is responsible for Windows CE development, Microsoft's open and scaleable Windows platform for a broad range of communications, entertainment, and mobile computing devices. The Windows CE platform is a new operating system enabling new categories of business and consumer non-PC devices to communicate with each other, share information with Windows PCs, and connect to the Internet. Windows CE devices are based on the Win32 API and build on and extend the Company's technology and tools base. The first non-PC product which will be available is the Handheld PC, designed to be a companion to a Windows-based PC.

BROADCAST PC: The Broadcast PC will extend the Windows family by enabling PCs to be clients of existing and emerging broadcast networks, supporting new content opportunities for Windows-based PCs through the use of data broadcasting technology. Examples of these networks include: satellite television networks, Internet's Multicast backbone, cable television networks that support cable modems, wireless cable networks, and conventional TV networks that broadcast data in the vertical blanking interval (VBI) of the TV.

NETWORK MULTIMEDIA: The division is also developing multicasting tools which will enable network administrators to efficiently deploy rich multimedia content and applications, streaming technology enabling the client to view audio and illustrated audio without downloading anything to the PC, and NT-based server software designed to reliably deliver high-bandwidth video over dedicated networks to a large number of PC clients.

The Consumer Platforms Division is also responsible for Softimage, which develops, markets, and supports a family of interactive software products enabling digital media producers to create and edit two- and three-dimensional content for digital media productions. Softimage supplies 3D visualization software for broadcast, film production, and other high-end animation applications. In addition, Softimage has a product line of 2D visualization software for use on high-end applications, including post production editing and the integration of visual images, text, sound, and special effects technology. These products are designed for the Windows NT and IRIX operating systems.

SOFTIMAGE 3D AND 3D EXTREME: Softimage 3D provides three-dimensional animation software for film and video professionals, animators, and artists who create and produce high-end three-dimensional imagery for traditional and new media. 3D Extreme includes both the features of 3D and advanced special effects for modeling and rendering.

DIGITAL STUDIO: Digital Studio is a fully integrated software-based environment blending 2D and 3D graphics, digital video, and digital audio. Digital Studio accommodates all types of projects for digital multimedia such as high end advertising, entertainment, games, and integrated interactive multimedia, offering all of the tools needed to create every kind of digital media production in a consistent, digital authoring environment.

DESKTOP APPLICATIONS SOFTWARE

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

MICROSOFT OFFICE: Microsoft Office(R) is a suite of software programs featuring seamless integration of the most commonly used desktop applications. Microsoft Office is based upon a document-centric concept, with common commands and extensive use of object linking and embedding (OLE) cross-application capabilities. Microsoft Office is available in several versions, with certain combinations of products available for the various operating system platforms. Products offered in the various versions include Microsoft Word, Microsoft Excel, the Microsoft PowerPoint(R) presentation graphics program, Schedule+, the Microsoft Access(R) database, Bookshelf, and others.

MICROSOFT WORD: The Company's principal word processing program is Microsoft Word. Versions of Microsoft Word provide all the features that users of word processing products expect in a graphical environment, plus the ability to handle graphics, tables, spreadsheet data, charts, and images imported from other software programs.

MICROSOFT EXCEL: The Company's spreadsheet program is Microsoft Excel. It is an integrated spreadsheet with pivot table, database, and business graphics capabilities. Microsoft Excel allows full linking and embedding of objects that permits users to view and edit graphics or charts from other programs in the worksheet in which the object is stored. Microsoft Excel graphics capabilities can be linked to its spreadsheets to allow simultaneous changes to charts as changes are made to the spreadsheets.

MICROSOFT POWERPOINT: Microsoft PowerPoint is a presentation graphics program for producing transparencies, slides, overheads, and prints.

MICROSOFT PROJECT: Microsoft Project is a critical path project scheduling and resource allocation program. The product can perform as a budgeting, monitoring, and cost estimating tool for large business projects and as a critical path and schedule planning tool.

OTHER PRODUCTIVITY PRODUCTS: The Company also offers other productivity products, including Microsoft Works, Microsoft Publisher, and Microsoft FrontPage. Microsoft Works is an integrated software program that contains basic word processing, spreadsheet, and database capabilities that allows the easy exchange of information from one tool to another. Microsoft Publisher is an easy-to-use, entry-level desktop publishing program. Microsoft FrontPage is a Web authoring and management tool for Web sites on the Internet or intranets.

INTERACTIVE MEDIA PRODUCTS

The Microsoft Interactive Media Division develops and markets interactive entertainment and information products across a variety of media, including the Internet, The Microsoft Network, and CD-ROM.

INFORMATION: Reference titles include Microsoft Encarta(TM) and Microsoft Bookshelf(R). The Encarta multimedia encyclopedia database blends text in articles with a wealth of innovative, interactive information presented through animations, videos, maps, charts, sounds, and pictures. Bookshelf is a multimedia reference library that integrates seven well-respected and authoritative works, including a dictionary, world atlas, world almanac, thesaurus, concise encyclopedia, and two books of quotations.

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

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

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

ENTERTAINMENT: The Company also has a line of entertainment products. Microsoft Flight Simulator is a popular aircraft flight simulation product available for MS-DOS and Macintosh operating systems. Games include Space Simulator, Microsoft Golf, Microsoft Fury(3), and Microsoft Arcade. Most games are available for the Windows 95 environment.

THE MICROSOFT NETWORK: The Microsoft Network is an interactive online service. MSN provides easy and inexpensive access for users to a wide range of graphically-rich online content, a compelling business model and platform for independent content providers (ICPs), and rich and powerful development tools. The online service provides access to the Internet, electronic mail, bulletin boards, and a myriad of additional services offered by Microsoft and by ICPs. Content and service providers aligned with MSN have flexibility in creating products and pricing their services, such as subscriptions, online transactions, and ticket events. Services may be supported by advertising and commerce.

MSN is owned by The Microsoft Network L.L.C. Microsoft owns 80% of the entity while a wholly owned subsidiary of Tele-Communications, Inc. (TCI) owns the remaining 20%.

JOINT VENTURES: The Company has entered into joint venture arrangements to leverage creative talent and content from other organizations. Microsoft owns 50% of DreamWorks Interactive L.L.C., a software company that develops interactive and multimedia products. DreamWorks SKG owns the remaining 50%. Microsoft owns 50% of MSNBC Cable L.L.C., a 24-hour cable news and information channel; and 50% of MSNBC Interactive News L.L.C., an interactive online news service. National Broadcasting Company (NBC) owns the remaining 50% of these two joint ventures.

PC INPUT DEVICES

The Company's major input device is the Microsoft Mouse, a hand-held pointing device that facilitates use of a PC. It can be used with MS-DOS and Windows operating systems and works with most applications products from Microsoft and other companies. Microsoft also offers a mouse designed for the home and a mouse for young children. The Company also markets the Microsoft Natural Keyboard(TM), an ergonomically-designed keyboard. Additionally, Microsoft sells two versions of Sidewinder(TM), a joystick for games.

DESKTOP FINANCE

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

MICROSOFT PRESS

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

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

PRODUCT DEVELOPMENT

The PC software industry is characterized by extremely rapid technological change, which requires constant attention to software technology trends and shifting consumer demand, and rapid product innovation. The pace of change has recently become even greater due to the surge of interest in the Internet, other forms of online services, networking generally, and new programming languages, such as Java.

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

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

During fiscal years 1994, 1995, and 1996, the Company spent $610 million, $860 million, and $1,432 million, respectively, on product research and development activities. Those amounts represented 13.1%, 14.5%, and 16.5%, respectively, of net revenues in each of those years. The Company is committed to continued high expenditures for research and product development.

LOCALIZATION

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

MANUFACTURING

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

In recent years the Company's sales mix has shifted to corporate and OEM licenses from packaged products. Online distribution of software may increase in the future. During July 1996, Microsoft sold its domestic manufacturing and distribution operation.

The Company's remaining manufacturing facilities are located in Puerto Rico and Ireland. The Irish manufacturing facility replicates disks, assembles other purchased parts, and packages final product. The Puerto Rican facility manufactures CD-ROMs, assembles other purchased parts, and packages final product. Quality control tests are performed on purchased parts, finished disks and CD-ROMs, and other products. The chief materials and components used in Microsoft products include disks or CD-ROMs, books, and multicolor printed materials. The Company is often able to acquire component parts and materials on a volume discount basis. The Company has multiple sources for raw materials, supplies, and components.

MARKETING AND DISTRIBUTION

Microsoft aligns its sales and marketing people with several customer types, including end-users, organizations and enterprises, and OEMs. The Company's sales and marketing staff seeks to build long-term relationships with customers of Microsoft products. In addition to the OEM channel, Microsoft has three major geographic sales and marketing organizations: the U.S. and Canada, Europe, and elsewhere in the world (Other International).

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

The organization customer unit has responsibility for activities that target groups of users in small and medium organizations. The unit works with channel partners such as distributors, aggregators, value-added resellers, and Solution Providers to provide complete business solutions to this customer segment. The unit's sales and marketing activities include providing technical training of Solution Providers and channel resellers; developing support policies; and supporting and providing seminars, events, and sales training for channel partners.

The enterprise customer unit has responsibility for sales and marketing activities that target large organizations (enterprises). The unit works directly with these organizations, and through large account resellers, to create enterprisewide, mission critical solutions to business computing problems.

Key products for the organization and enterprise customer units are the Company's business systems; applications and Internet developer software; desktop productivity applications; and desktop operating systems.

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

FINISHED GOODS CHANNELS

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

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

SOLUTION PROVIDERS: Microsoft's Solution Providers program is a comprehensive support relationship with independent organizations that provide network and system integration, custom development, training, and technical support for business computing solutions. The program supports value-added resellers (VARs), system integrators, consultants, custom application developers, solution developers, Internet service and hosting organizations, independent content providers, and sitebuilders (companies that build Web sites for other companies), as well as technical support and training organizations. Under this business partnership strategy, the Company provides sales and product information, development services, early access to Microsoft products, and customer support tools including priority telephone support, education, and business development support. To ensure high-quality technical services for the Company's products, Microsoft Solution Providers are required to have Microsoft-certified professionals on staff.

CONSULTING SERVICES: The Company's Consulting Services Division assists customers in using the Company's computer operating systems, applications, and communications products. The group works with Solution Providers and helps create enterprisewide computing solutions for large corporate accounts.

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

INTERNATIONAL SALES SITES: The Company has established marketing and/or support subsidiaries in more than 60 countries. Sales are generally made by the local sales subsidiary, while product is delivered by either the Company's owned or outsourced manufacturing operations. In some locations, sales are made directly by the Company from the U.S.

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

OEM CHANNEL

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

ADVERTISING

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

CUSTOMERS

As described above, Microsoft has four customer types: end-users, organizations, enterprises, and OEMs. Most end-users of Microsoft products are individuals in businesses, government agencies, educational institutions, and at home. These end-users obtain Microsoft products primarily through distributors, resellers, and OEMs, which include certain Microsoft products with their hardware. Notes to Financial Statements (see Item 8) describe customers that represent more than 10% of the Company's revenues. The Company's practice is to ship its products promptly upon receipt of purchase orders from its customers and, consequently, backlog is not significant.

PRODUCT SUPPORT

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

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

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

COMPETITION

The PC software business is intensely competitive and subject to extremely rapid technological change. Microsoft faces formidable competition in all areas of its business activity (including competition from many companies much larger than Microsoft). The extremely rapid pace of technological change constantly creates new opportunities for existing competitors and start-ups and can quickly render existing technologies less valuable. The Company also faces constant competition from software pirates who unlawfully copy and distribute Microsoft's copyrighted software products.

THE INTERNET: The Company faces intense competition in the development and marketing of Internet (and intranet) software from a wide variety of companies and organizations including IBM, Netscape, Novell, Oracle, O'Reilly, Sun Microsystems, Apache Group, the National Center for Supercomputing Applications (NCSA), and the European Laboratory for Particle Physics (CERN).

OPERATING SYSTEMS: Microsoft's operating system products face substantial competition from a wide variety of companies. Major competitors such as IBM, Apple Computer, Digital Equipment Corporation, Hewlett-Packard, Sun Microsystems, and others, are vertically integrated in both software development and hardware manufacturing and have developed operating systems that they preinstall on computers of their own manufacture. Many of these operating system software products are also licensed to third party OEMs for preinstallation on their machines. Microsoft's operating system products compete with UNIX-based operating systems from a wide range of companies including IBM, AT&T, Hewlett-Packard, Sun Microsystems, The Santa Cruz Operation, and others. Variants of UNIX run on a wide variety of computer platforms and have gained increasing acceptance as desktop operating systems. As PC technology increasingly moves toward connectivity and communications, Microsoft's operating system products will face increased competition from network server operating systems such as Novell NetWare, Banyan Vines, the many variants of UNIX, OS/2, "middleware" products such as Lotus Notes from IBM, and intranet servers from Netscape and others. In addition, Netscape is seeking to position its browser software as a computing platform that would perform many of the functions performed by operating systems from Microsoft and other vendors.

BUSINESS SYSTEMS: The Company is a fairly recent entrant into the business of providing enterprisewide computing solutions. Several competitors enjoy a larger share of sales and larger installed bases. Many companies offer operating system software for mainframes and midrange computers, including IBM, DEC, Hewlett-Packard, and Sun Microsystems. Since legacy business systems are typically support-intensive, these competitors also offer substantive support services. Software developers that provide competing server applications for PC-based distributed client/server environments include Oracle, Sybase, and Informix. There are also several software vendors who offer connectivity servers. As mentioned above, there are numerous companies and organizations that offer Internet and intranet server software which compete against the Company's business systems. Additionally, IBM has a large installed base of Lotus Notes and cc:Mail, both of which compete with the Company's workgroup and mail products.

DESKTOP APPLICATIONS: The Company's competitors include many software application vendors, such as IBM (Lotus), Oracle, Apple (Claris), and Corel. IBM and Corel have large installed bases with their spreadsheet and word processor products, respectively, and both appear to have adopted aggressive pricing strategies in recent months. Also, IBM and Apple preinstall certain of their software products on various models of their PCs, competing directly with Microsoft application software.

ONLINE SERVICES: An enormous range of companies, including media conglomerates, telephone companies, cable companies, retailers, hardware manufacturers, and software developers, are competing to make online services widely available to computer users. Microsoft's new online services network, MSN, faces formidable competition from both established online networks, such as America Online, CompuServe, Prodigy, and impending entrants. MSN also faces competition from online services that are offered to users directly via the Internet, including, in particular, the World Wide Web.

INTERACTIVE MEDIA: The Company's Interactive Media division faces many smaller but focused competitors, particularly in the areas of entertainment and education. Many of these competitors have strong brand identification. Consolidation in this area of software development has made certain competitors even stronger. Examples of competitors include Intuit, Broderbund, Electronic Arts, Softkey (including The Learning Company and Compton's), Voyager, Edmark, CUC International (including Sierra On Line and Davidson Associates), and Dorling Kindersley. Still other competitors own branded content, such as Disney and Lucas Arts. Additionally, as platforms become more powerful, PC-based games will compete head-to-head with games created for proprietary systems such as Nintendo and Sega. Input devices face substantial competition from computer manufacturers, since computers are typically sold with a keyboard and mouse, and other manufacturers of these devices.

NEWS SERVICES: The Company's MSNBC joint ventures face formidable competition from another, more established 24-hour cable and Internet news organization, CNN. Additionally, the Fox network has announced plans for its own 24-hour cable news service. MSNBC also competes with traditional news media such as newspapers and broadcast TV, and Internet news services.

DEVELOPER: The Company's developer products compete against offerings from Borland, Oracle, Sun Microsystems, Sybase, Symantec, and many other companies.

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

EMPLOYEES

As of June 30, 1996, the Company employed 20,561 people on a full-time basis, 13,991 domestically and 6,570 internationally. Of the total, 6,861 were in product research and development, 10,097 in sales, marketing, and support, 1,485 in manufacturing and distribution, and 2,118 in finance and administration. Microsoft's success is highly dependent on its ability to attract and retain qualified employees. Competition for employees is intense in the software industry. To date, the Company believes it has been successful in its efforts to recruit qualified employees, but there is no assurance that it will continue to be as successful in the future. None of the Company's employees are subject to collective bargaining agreements. The Company believes relations with its employees are excellent.

Item 2. Properties

The Company's corporate offices consist of approximately 3.1 million square feet of office building space located in King County, Washington. There are two sites that total approximately 300 acres of land. The Company is constructing three office buildings comprising approximately 350,000 square feet of space, which are expected to be completed in the summer of 1997. Additionally, construction is continuing on another series of office buildings with approximately 565,000 square feet of space. Occupancy on this site will be phased starting in the winter of 1997 and completed by spring of 1998. The Company owns all of its corporate campus.

The Company sold its domestic manufacturing and distribution operation in Snohomish County, Washington, in July 1996 but retains a 45,000 square foot disk duplication facility in Humacao, Puerto Rico. The Puerto Rican facility, which began operation in April 1990, is leased under a 10-year lease, with an option to renew for an additional 10 years. The Company's European manufacturing operation consists of a 161,000 square foot facility situated on 12 acres in Dublin, Ireland. The Ireland site also includes office buildings with 157,000 square feet for international localization. The Ireland facilities are fully owned by the Company.

The Company is constructing an office building complex with 225,000 square feet on 33 acres of land near Redding, England. Occupancy is expected in the fall of 1997. In Les Ulis, France, the Company owns a 199,000 square foot office building on four acres of land. In addition, the Company leases office space in numerous locations in the United States and many other countries.

Item 3. Legal Proceedings

In connection with an ongoing investigation, the Antitrust Division of the U.S. Department of Justice requested information from Microsoft in September 1996 concerning Web browsers. Management currently believes that resolution of this matter will not have a material adverse impact on its financial position or results of operations.

Additionally, the information set forth in Notes to Financial Statements--Commitments and Contingencies on page 27 of the 1996 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.4.

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

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 1996.

PART II

Item 5. Market for Registrant's Common Stock and Related Stockholder Matters

The information set forth on page 28 of the 1996 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.1.

Item 6. Selected Financial Data

The information set forth on page 4 of the 1996 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.2.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The information set forth on pages 16-19, 22, and 23 of the 1996 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.3.

Item 8. Financial Statements and Supplementary Data

The following financial statements for the Company and independent auditors' report set forth on pages 14, 15, 20, 21, 24-29, and 31 of the 1996 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.4.

- Income Statements for the three years ended June 30, 1996
- Cash Flows Statements for the three years ended June 30, 1996
- Balance Sheets as of June 30, 1995 and 1996
- Stockholders' Equity Statements for the three years ended June 30, 1996
- Notes to Financial Statements
- Independent Auditors' Report

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

Information with respect to Directors may be found under the caption "Election of Directors and Management Information" on pages 1 and 2 of the Company's Proxy Statement dated September 27, 1996, for the Annual Meeting of Shareholders to be held November 12, 1996 (the "Proxy Statement"). Such information is incorporated herein by reference.

The executive officers of Microsoft as of September 9, 1996 were as follows:

NAME	AGE	POSITION WITH THE COMPANY
William H. Gates	40	Chairman of the Board; Chief Executive Officer
Steven A. Ballmer	40	Executive Vice President, Sales and Support
Robert J. Herbold	54	Executive Vice President; Chief Operating Officer
Frank M. (Pete) Higgins	38	Group Vice President, Applications and Content
Paul A. Maritz	41	Group Vice President, Platforms
Nathan P. Myhrvold	37	Group Vice President, Applications and Content
Jeffrey S. Raikes	38	Group Vice President, Sales and Marketing
James E. Allchin	44	Senior Vice President, Desktop and Business Systems Division
Joachim Kempin	54	Senior Vice President, OEM Sales
Craig J. Mundie	47	Senior Vice President, Consumer Platforms Division
William H. Neukom	54	Senior Vice President, Law and Corporate Affairs; Secretary
Brad A. Silverberg	42	Senior Vice President, Internet Platform and Tools Division
Patricia Q. Stonesifer	40	Senior Vice President, Interactive Media Division
Bernard P. Vergnes	51	Senior Vice President, Microsoft; President, Microsoft Europe
Michael W. Brown	50	Vice President, Finance; Chief Financial Officer

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

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

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

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

Mr. Maritz was named Group Vice President, Platforms in May 1995. He was named Senior Vice President, Product and Technology Strategy in November 1994 and had been Senior Vice President, Systems Division since February 1992. He had been Vice President, Advanced Operating Systems since 1989. Mr. Maritz joined Microsoft in 1986.

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

Mr. Raikes was named Group Vice President, Sales and Marketing in July 1996. He was named Senior Vice President, Microsoft North America in January 1992 and had been Vice President, Office Systems since 1990. Mr. Raikes joined Microsoft in 1981.

Mr. Allchin was named Senior Vice President, Desktop and Business Systems Division in February 1996. He was named Senior Vice President, Business Systems Division in November 1994 and had been Vice President, Business Systems Division, since July 1991. Mr. Allchin joined Microsoft in 1991.

Mr. Kempin was named Senior Vice President, OEM Sales in August 1993. He had been Vice President, OEM Sales since 1987. Mr. Kempin joined Microsoft in 1983.

Mr. Mundie was named Senior Vice President, Consumer Platforms Division in February 1996. He was named Senior Vice President, Consumer Systems Division in May 1995 and had been Vice President, Advanced Consumer Technology since July 1993. He joined Microsoft as General Manager, Advanced Consumer Technology Group in December 1992. Previously, Mr. Mundie had been CEO of Alliant Computer Systems Corporation, which declared bankruptcy on May 25, 1992 and was liquidated.

Mr. Neukom was named Senior Vice President, Law and Corporate Affairs in February 1994. He joined Microsoft in 1985 as Vice President.

Mr. Silverberg was named Senior Vice President, Internet Platform and Tools Division in February 1996. He was named Senior Vice President, Personal Systems Division in November 1994 after joining Microsoft in August 1990 as Vice President, Personal Operating Systems Division.

Ms. Stonesifer was named Senior Vice President, Interactive Media Division in February 1996. She was named Senior Vice President, Consumer Division in November 1994, after having been Vice President, Consumer Division since June 1993. She had been Vice President, Support since 1992 and General Manager of Product Support Services since 1991. Ms. Stonesifer joined Microsoft in 1988.

Mr. Vergnes is a Senior Vice President of Microsoft and was named President, Microsoft Europe in April 1992. He had been Vice President, Europe since 1989. Mr. Vergnes joined Microsoft in 1983.

Mr. Brown was named Chief Financial Officer in August 1994 and Vice President, Finance in April 1993. He was named Treasurer shortly after joining Microsoft in January 1990.

Item 11. Executive Compensation

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

Item 12. Security Ownership of Certain Beneficial Owners and Management

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

Item 13. Certain Relationships and Related Transactions

None.

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Financial Statements and Schedules

The financial statements as set forth under Item 8 of this report on Form 10-K are incorporated herein by reference.

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

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of fiscal 1996.

(c) Exhibit Listing

Exhibit Number	Description
3.1	Restated Articles of Incorporation (1)
3.2	Bylaws (1)
10.1	Microsoft Corporation 1991 Stock Option Plan (1)
10.2	Microsoft Corporation 1981 Stock Option Plan (2)
10.3	Microsoft Corporation Stock Option Plan for Non-Employee Directors (1)
10.4	Microsoft Corporation Stock Option Plan for Consultants and Advisors (1)
10.5	Microsoft Corporation 1991 Employee Stock Purchase Plan (3)
10.6	Microsoft Corporation Savings Plus Plan (1)
10.7	Trust Agreement dated June 1, 1993 between Microsoft Corporation and First Interstate Bank of Washington (4)
10.8	Form of Indemnification Agreement (4)
11.	Computation of Earnings Per Share
13.1	Quarterly and Market Information Incorporated by Reference to Page 28 of 1996 Annual Report to Shareholders ("1996 Annual Report")
13.2	Selected Financial Data Incorporated by Reference to Page 4 of 1996 Annual Report
13.3	Management's Discussion and Analysis of Financial Condition and Results of Operations Incorporated by Reference to Pages 16-19, 22, and 23 of 1996 Annual Report
13.4	Financial Statements Incorporated by Reference to Pages 14, 15, 20, 21, 24-29, and 31 of 1996 Annual Report
21.	Subsidiaries of Registrant (5)
23.	Independent Auditors' Consent
27.	Financial Data Schedule
99.1	Financial Statements for the Microsoft Corporation 1991 Employee Stock Purchase Plan for the Three Years Ended June 30, 1996

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

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

(3) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1995.

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

(5) Incorporated by reference to Exhibit 13.4 filed herein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Redmond, State of Washington, on September 26, 1996.

MICROSOFT CORPORATION

By /s/ Michael W. Brown

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on September 26, 1996.

SIGNATURE	TITLE
/s/ William H. Gates William H. Gates	Chairman of the Board of Directors and Chief Executive Officer
/s/ Paul G. Allen Paul G. Allen	Director
Jill E. Barad	Director
/s/ Richard A. Hackborn Richard A. Hackborn	Director
/s/ David F. Marquardt David F. Marquardt	Director
/s/ Robert D. O'Brien Robert D. O'Brien	Director
/s/ Wm. G. Reed, Jr. Wm. G. Reed, Jr.	Director
/s/ Jon A. Shirley Jon A. Shirley	Director
/s/ Michael W. Brown Michael W. Brown	Vice President, Finance; Chief Financial Officer (Principal Financial and Accounting Officer)

EXHIBIT 11.

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

	Year Ended June 30		
	1994	1995	1996
Weighted average common shares outstanding	571	582	592
Common equivalent shares from stock options	39	45	48
Average common and equivalent shares outstanding (1)	610	627	640
Net income	$1,146	$1,453	$2,195
Earnings per share (1)	$ 1.88	$ 2.32	$ 3.43

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

EXHIBIT 13.1

QUARTERLY INFORMATION
(In millions, except per share data) (Unaudited)

	Quarter Ended				
	Sept. 30	Dec. 31	Mar. 31	June 30	Year
1994					
Net revenues	$ 983	$ 1,129	$ 1,244	$ 1,293	$ 4,649
Operating income	343	415	480	488	1,726
Net income	239	289	256	362	1,146
Earnings per share	0.39	0.48	0.42	0.59	1.88
Common stock price per share:					
High	44-1/4	43-1/4	44-5/8	54-5/8	54-5/8
Low	35-1/8	38	39	41	35-1/8
1995					
Net revenues	$ 1,247	$ 1,482	$ 1,587	$ 1,621	$ 5,937
Operating income	437	520	549	532	2,038
Net income	316	373	396	368	1,453
Earnings per share	0.51	0.60	0.63	0.58	2.32
Common stock price per share:					
High	59-1/4	65-1/8	74-1/8	92-3/8	92-3/8
Low	46-7/8	53-7/8	58-1/4	68-3/4	46-7/8
1996					
Net revenues	$ 2,016	$ 2,195	$ 2,205	$ 2,255	$ 8,671
Operating income	708	786	774	810	3,078
Net income	499	575	562	559	2,195
Earnings per share	0.78	0.90	0.88	0.87	3.43
Common stock price per share:					
High	109-1/4	103-3/8	107-1/16	125-7/8	125-7/8
Low	85	80-3/8	79-7/8	99-5/8	79-7/8

The Company's common stock is traded on The Nasdaq Stock Market under the symbol MSFT. On July 31, 1996, there were 37,883 holders of record of the Company's common stock. The Company has not paid cash dividends on its common stock.

EXHIBIT 13.2

FINANCIAL HIGHLIGHTS
(In millions, except earnings per share)

	Year Ended June 30				
	1992	1993	1994	1995	1996
Net revenues	$2,759	$3,753	$4,649	$5,937	$ 8,671
Net income	708	953	1,146	1,453	2,195
Earnings per share	1.20	1.57	1.88	2.32	3.43
Return on net revenues	25.7%	25.4%	24.7%	24.5%	25.3%
Cash and short-term investments	$1,345	$2,290	$3,614	$4,750	$ 6,940
Total assets	2,640	3,805	5,363	7,210	10,093
Stockholders' equity	2,193	3,242	4,450	5,333	6,908

EXHIBIT 13.3

MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS FOR 1994, 1995, AND 1996

Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including operating systems for personal computers (PCs) and servers, server applications for client/server environments, business and consumer productivity applications, interactive media programs, and Internet platform and development tools. Microsoft also offers online services, sells personal computer books and input devices, and researches and develops advanced technology software products.

NET REVENUES

The Company's net revenues grew 28% in the fiscal year ended June 30, 1995 and 46% in fiscal year 1996. Software license volume increases have been the principal factor in Microsoft'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 corporate license programs, such as Microsoft Select, is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, such as Microsoft Office, are less than the sum of the prices for the individual programs included in these suites when such programs are licensed separately.

PRODUCT GROUPS. Microsoft has a Platforms Product Group and an Applications and Content Product Group.

Platforms Product Group revenues were $1.83 billion, $2.36 billion, and $4.11 billion in 1994, 1995, and 1996.

The Company's principal desktop operating system product in 1996 was Microsoft Windows 95. Released in August 1995, Windows 95 was a successor to MS-DOS(R) and Microsoft Windows 3.X operating systems. Windows 95, and before its release, MS-DOS and Windows 3.X, were preinstalled on PCs by most OEMs. Desktop operating systems increasingly contributed to revenues as new PCs preinstalled with such systems increased rapidly during the three-year period. Additionally, retail sales of Windows 95 were a major factor in the platforms revenue increase in 1996, reflecting the typical sales pattern for operating systems upgrades.

Business systems products offer an enterprise-wide distributed client/server environment based on the Microsoft Windows NT operating system and the server applications in the Microsoft BackOffice family of products. Revenues from these products increased strongly in 1994, 1995, and 1996 due to greater corporate demand for Windows NT Workstation and Windows NT Server.

During 1996, Microsoft implemented its policy of offering customers the latest Internet technology at no additional cost. Given this strategy, and because Internet browsers are a fundamental and integral part of Windows-based operating systems, ratable revenue recognition is required for a portion of all Windows-based operating system license fees, including those licensed through retail and OEM channels. Unearned revenues as of June 30, 1996 on the accompanying balance sheet include $425 million for future support commitments, Internet browser updates, and other unspecified enhancements to Windows-based operating systems that will be recognized ratably over the products' life cycles.

Revenues from developer products increased steadily in all three years, as more independent software vendors, corporate developers, and solutions developers licensed tools such as the Microsoft Visual Basic(R) programming system to develop software for Windows 95, Windows NT, and the Internet.

Applications and Content Product Group revenues were $2.82 billion, $3.58 billion, and $4.56 billion in 1994, 1995, and 1996.

Increases in desktop applications revenues were led by strong sales of 16-bit and 32-bit versions of Microsoft Office. The Microsoft Office Standard product includes the Microsoft Excel spreadsheet; Microsoft Word, a word-processing program; and the Microsoft PowerPoint presentation graphics program. The Microsoft Office for Windows 95 (32-bit) version also includes the Microsoft Schedule+ calendar and scheduling program. Microsoft Office Professional version includes all of the above plus the Microsoft Access database management system. Sales of stand-alone versions of Microsoft Excel and Microsoft Word continued to decrease as the sales mix shifted to integrated product suites. Sales of Microsoft Project and Microsoft Works also increased during the three-year period.

Microsoft licenses a broad range of consumer software products, which also showed continued growth. Products include CD-ROM multimedia reference titles and programs for home and small office productivity, children's creativity, and entertainment.

The Company also markets input devices. Mouse and keyboard sales increased during the three-year period, while the joystick's initial introduction increased revenues in 1996.

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

OEM channel revenues were $1.18 billion in 1994, $1.65 billion in 1995, and $2.50 billion in 1996. The primary source of OEM revenues is the licensing of desktop operating systems. As such, OEM channel revenues are highly dependent on PC shipment volume.

Corporate licenses continued to grow in popularity across all geographic areas during the three-year period. Packaged product volume increased in 1996 due to the release of retail upgrade versions of Windows 95 and 32-bit desktop applications. U.S. and Canadian channel revenues were $1.58 billion, $1.88 billion, and $2.68 billion in 1994, 1995, and 1996. Revenues in Europe were $1.36 billion, $1.49 billion, and $2.02 billion in 1994, 1995, and 1996. Growth rates have been lower in Europe than in other geographic areas due to general economic slowness, higher existing market shares, and a more dramatic shift to corporate licensing programs. Other International channel revenues were $532 million in 1994, $924 million in 1995, and $1.47 billion in 1996. Growth rates continue to be strong due to customers accepting newly localized products, particularly in Japan, and early entrance into emerging markets.

The Company's operating results are affected by foreign exchange rates. Approximately 40%, 37%, and 38% of the Company's revenues were collected in foreign currencies during 1994, 1995, and 1996. Since much of the Company's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates on net income is less than on revenues.

OPERATING EXPENSES

COST OF REVENUES. As a percentage of revenues, cost of revenues was 16.4% in 1994, 14.8% in 1995, and 13.7% in 1996. The percentage decreased due to a greater proportion of licenses to OEMs and corporations, a higher proportion of CD-ROM versions, and manufacturing efficiencies. These factors were offset somewhat by increased sales of lower-margin products such as integrated suites and retail upgrades.

RESEARCH AND DEVELOPMENT. Microsoft invested heavily in the future by funding research and development (R&D). Expense increases of 41% in 1995 and 67% in 1996 resulted primarily from development staff headcount growth and higher levels of third-party development costs in many areas, including development efforts for Windows 95 in 1995 and Windows NT and the Internet in 1996. R&D costs also increased for business systems, consumer systems, desktop applications, and interactive media products such as The Microsoft Network and other online services.

SALES AND MARKETING. The increase in the absolute dollar amount of sales and marketing expenses in the three-year period was due primarily to increased product-specific marketing programs, particularly for Windows 95 during 1996. Also, expenses increased due to higher levels of Microsoft brand advertising and product support.

GENERAL AND ADMINISTRATIVE. Increases in general and administrative expenses were primarily attributable to growth in the number of people and computer systems necessary to support overall increases in the scope of the Company's operations.

NONOPERATING ITEMS

Interest income increased primarily as a result of a larger investment portfolio generated by cash from operations. Other expenses increased in 1996 due to recognition of Microsoft's share of joint venture operational expenses, including DreamWorks Interactive and the MSNBC entities. During 1995, Microsoft paid a $46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger. During 1994, the Company recorded a net pretax charge of $90 million, reflecting the patent litigation settlement with Stac Electronics.

PROVISION FOR INCOME TAXES

The effective tax rate was 33.5% in 1994, 33.0% in 1995, and 35.0% in 1996. The 1996 increase was primarily attributable to the research and experimental credit expiring in the United States.

NET INCOME

Net income as a percent of revenues increased in 1996 due to the lower relative cost of revenues, sales and marketing expenses, general and administrative expenses, and nonoperating expenses, offset by higher relative research and development expenses and the higher tax rate. The net income percentage decreased in 1995 due to increased relative research and development, sales and marketing, and general and administrative expenses, offset by the lower relative cost of revenues and the higher relative net nonoperating income.

FINANCIAL CONDITION

The Company's cash and short-term investments equaled $6.94 billion at June 30, 1996. The portfolio is diversified among security types, industries, and individual issuers. The Company's investments are generally investment grade and liquid. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The Company's 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 has no material long-term debt. The Company has $70 million of standby multicurrency lines of credit that support foreign currency hedging and international cash management.

Stockholders' equity at June 30, 1996 exceeded $6.9 billion.

Cash generated from operations has been sufficient historically to fund the Company's investment in research and development activities and facilities expansion. As the Company grows, investments will continue in research and development in existing and advanced areas of technology. The Company's cash will also be used to acquire technology and to fund ventures and other strategic opportunities. Additions to property, plant, and equipment are expected to continue, including facilities and computer systems for research and development, sales and marketing, product support, and administrative staff. On June 30, 1996, commitments for constructing new buildings approximated $293 million.

Employees exercising stock options provides additional cash. These proceeds have funded the Company's open market stock repurchase program through which Microsoft provides shares for stock option and stock purchase plans. This program will continue in 1997.

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

A subsidiary of Tele-Communications, Inc. (TCI) owns a 20% minority interest in The Microsoft Network. TCI contributed $125 million of TCI common stock, and Microsoft contributed the business assets of this online service.

During 1996, Microsoft and National Broadcasting Company (NBC) established two MSNBC joint ventures: a 24-hour cable news and information channel, and an interactive online news service. Microsoft agreed to pay $220 million over a five-year period for its interest in the cable venture and to pay one-half of operational funding of both joint ventures for a multiyear period.

Management believes existing cash and short-term investments together with funds generated from operations will be sufficient to meet operating requirements in 1997. The Company's cash and short-term investments are also managed to be available for strategic investment opportunities or other potential large-scale cash needs that may arise in pursuing the Company's long-term strategies.

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

OUTLOOK: ISSUES AND UNCERTAINTIES

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

RAPID TECHNOLOGICAL CHANGE. The PC software industry is characterized by rapid change and uncertainty due to new and emerging technologies. The pace of change has recently accelerated due to the Internet, online services, networking, and new programming languages, such as Java.

PC GROWTH RATES. The underlying PC unit growth rate, which may increase at a slower rate in the future, impacts software revenue growth.

CUSTOMER ACCEPTANCE. While the Company performs extensive usability and beta testing of new products, user acceptance and corporate penetration rates ultimately dictate the success of development and marketing efforts.

PRODUCT SHIP SCHEDULES. Delays in new-product releases impact revenue growth rates and can cause operational inefficiencies that impact manufacturing and distribution logistics, independent software vendor (ISV) and OEM relationships, and telephone support staffing.

PRICES. Future prices the Company can obtain for its products may decrease from historical levels, depending on competitive market or cost factors. European and Far Eastern software prices are generally higher than in the United States to cover localization costs and higher costs of distribution. Such price uplifts could erode in the future.

EARNINGS PROCESS. An increasingly higher percentage of the Company's revenues is earned after the initial shipment or licensing of the software product. Microsoft also offers product support, Internet browsers and add-ons, and other unspecified enhancements, so the applicable portion of revenues is recognized over the product's life cycle. This policy may be required for future products such as Microsoft Office 97, depending on specific license terms and conditions.

SATURATION. Product upgrades, which enable users to upgrade from earlier versions of the Company's products or from competitors' products, have lower prices and margins than new products. As the desktop applications market has become saturated, the sales mix has shifted from standard products to upgrade products. This trend is likely to continue.

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

CHANNEL MIX. Average revenue per license is lower from OEM licenses than from retail versions, reflecting the relatively lower direct costs of operations in the OEM channel. An increasingly higher percentage of revenues was achieved through the OEM channel during 1995 and 1996.

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

COST OF REVENUES. Although cost of revenues as a percentage of net revenues decreased in 1995 and 1996, it varies with channel mix and product mix within channels. Such mix factors may increase cost of revenues as a percentage of revenues in 1997.

PAY AND PARTICIPATION MODEL. Microsoft employees currently receive salaries, incentive bonuses, other fringe benefits, and stock options. New government regulations, low stock prices, or other factors could diminish the value of the option program and force the Company into more of a cash compensation model. Had the Company paid employees in cash the grant date Black-Scholes value of options vested in 1994, 1995, and 1996, the pretax expense would have been approximately $360 million, $410 million, and $570 million.

LONG-TERM RESEARCH AND DEVELOPMENT INVESTMENT CYCLE. Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. The Company plans to continue significant investments in software research and development and related product opportunities from which significant revenues are not anticipated for a number of years. Management expects total spending for research and development in 1997 to increase over spending in 1996.

SALES AND MARKETING AND SUPPORT INVESTMENTS. The Company's plans for 1997 include continued investments in its sales and marketing and support groups.

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

INTELLECTUAL PROPERTY RIGHTS. Microsoft diligently defends its intellectual property rights, but unlicensed copying of software represents a loss of revenues to the Company. While this adversely affects U.S. revenues, revenue loss is even more significant outside of the United States, particularly in countries where laws are less protective of intellectual property rights. Throughout the world, Microsoft actively educates consumers on the benefits of licensing genuine products and educates lawmakers on the advantages of a business climate where intellectual property rights are protected. However, continued efforts may not affect revenues positively.

FUTURE GROWTH RATE. The revenue growth rate in the first two quarters of 1997 may not approach the level attained in 1996, which was high due to Windows 95 upgrades. As discussed above, operating expenses are expected to increase in 1997. Because of the fixed nature of a significant portion of such expenses, coupled with the possibility of slower revenue growth, operating margins in 1997 may decrease from those in 1996.

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

EXHIBIT 13.4

MICROSOFT CORPORATION

FINANCIAL STATEMENTS

INCOME STATEMENTS
(In millions, except earnings per share)

	Year Ended June 30		
	1994	1995	1996
Net revenues	$4,649	$5,937	$8,671
Operating expenses:			
Cost of revenues	763	877	1,188
Research and development	610	860	1,432
Sales and marketing	1,384	1,895	2,657
General and administrative	166	267	316
Total operating expenses	2,923	3,899	5,593
Operating income	1,726	2,038	3,078
Interest income	102	191	320
Noncontinuing items	(90)	(46)	--
Other expenses	(16)	(16)	(19)
Income before income taxes	1,722	2,167	3,379
Provision for income taxes	576	714	1,184
Net income	$1,146	$1,453	$2,195
Earnings per share	$ 1.88	$ 2.32	$ 3.43
Weighted average shares outstanding	610	627	640

See accompanying notes.

CASH FLOWS STATEMENTS
(In millions)

	Year Ended June 30		
	1994	1995	1996
CASH FLOWS FROM OPERATIONS			
Net income	$1,146	$1,453	$2,195
Depreciation and amortization	237	269	480
Current liabilities	360	419	1,090
Accounts receivable	(146)	(91)	(71)
Other current assets	(4)	(60)	25
Net cash from operations	1,593	1,990	3,719
CASH FLOWS USED FOR FINANCING			
Common stock issued	280	332	504
Common stock repurchased	(348)	(649)	(1,261)
Stock option income tax benefits	151	179	352
Net cash used for financing	83	(138)	(405)
CASH FLOWS USED FOR INVESTMENTS			
Additions to property, plant, and equipment	(278)	(495)	(494)
Other assets	(64)	(230)	(625)
Short-term investments	(860)	(651)	(1,551)
Net cash used for investments	(1,202)	(1,376)	(2,670)
Net change in cash and equivalents	474	476	644
Effect of exchange rates on cash	(10)	9	(5)
Cash and equivalents, beginning of year	1,013	1,477	1,962
Cash and equivalents, end of year	1,477	1,962	2,601
Short-term investments	2,137	2,788	4,339
Cash and short-term investments	$3,614	$4,750	$6,940

See accompanying notes.

BALANCE SHEETS
(In millions)

	June 30	
	1995	1996
ASSETS		
Current assets:		
Cash and short-term investments	$4,750	$ 6,940
Accounts receivable	581	639
Other	289	260
Total current assets	5,620	7,839
Property, plant, and equipment	1,192	1,326
Other assets	398	928
Total assets	$7,210	$10,093
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 563	$ 808
Accrued compensation	130	202
Income taxes payable	410	484
Unearned revenues	54	560
Other	190	371
Total current liabilities	1,347	2,425
Minority interest	125	125
Put warrants	405	635
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital -- shares authorized 2,000; shares issued and outstanding 588 and 597	2,005	2,924
Retained earnings	3,328	3,984
Total stockholders' equity	5,333	6,908
Total liabilities and stockholders' equity	$7,210	$10,093

See accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS
(In millions)

	Year Ended June 30		
	1994	1995	1996
COMMON STOCK AND PAID-IN CAPITAL			
Balance, beginning of year	$1,086	$1,500	$2,005
Common stock issued	280	332	504
Common stock repurchased	(17)	(30)	(41)
Proceeds from sale of put warrants	--	49	124
Reclassification of put warrant obligation	--	(25)	(20)
Stock option income tax benefits	151	179	352
Balance, end of year	1,500	2,005	2,924
RETAINED EARNINGS			
Balance, beginning of year	2,156	2,950	3,328
Common stock repurchased	(331)	(668)	(1,344)
Reclassification of put warrant obligation	--	(380)	(210)
Net income	1,146	1,453	2,195
Equity adjustments	(21)	(27)	15
Balance, end of year	2,950	3,328	3,984
Total stockholders' equity	$4,450	$5,333	$6,908

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

SIGNIFICANT ACCOUNTING POLICIES

ACCOUNTING PRINCIPLES. The financial statements are prepared on a basis consistent with U.S. generally accepted accounting principles and International Accounting Standards formulated by the International Accounting Standards Committee (IASC).

PRINCIPLES OF CONSOLIDATION. The financial statements include the accounts of Microsoft and its subsidiaries. Significant intercompany transactions and balances have been eliminated. Investments in 50% owned joint ventures are accounted for using the equity method; the Company's share of joint ventures' operating results is reflected in nonoperating expenses.

ESTIMATES AND ASSUMPTIONS. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, 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.

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

REVENUE RECOGNITION. Revenue from sales to distributors and resellers is recognized when related products are shipped. Revenue from corporate license programs generally is recognized when the user installs the product. Revenue attributable to significant support (telephone support and unspecified enhancements such as service packs and Internet browser updates) is recognized ratably over the product's life cycle, which may exceed one year. Costs related to insignificant obligations, which include telephone support for certain products, are accrued.

Revenue from products licensed to original equipment manufacturers is recognized when the OEM ships the licensed products.

Provisions are recorded for returns and bad debts.

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

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

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

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

FINANCIAL INSTRUMENTS. The Company considers all liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents. Short-term investments generally mature between three months and five years from the purchase date. All cash and short-term investments are classified as available for sale and are recorded at market. Cost approximates market for all classifications of cash and short-term investments; realized and unrealized gains and losses are reflected in stockholders' equity and are not material.

Equity securities are recorded at market in other assets; unrealized gains and losses are reflected in stockholders' equity and are not material.

PROPERTY, PLANT, AND EQUIPMENT. Property, plant, and equipment is stated at cost and depreciated using the straight-line method over the shorter of the estimated life of the asset or the lease term, ranging from one to 30 years.

DIVERSIFICATION OF RISK. The Company's investment portfolio is diversified and consists primarily of short-term investment grade securities. At June 30, 1995 and 1996, approximately 38% of accounts receivable represented amounts due from ten channel purchasers. One customer accounted for approximately 13%, 12%, and 13% of revenues while another customer accounted for approximately 13%, 12%, and 8% of revenues in 1994, 1995, and 1996.

Finished goods sales to international customers in Europe, Japan, Australia, and Canada are primarily billed in local currencies. Payment cycles are relatively short, generally less than 90 days. European manufacturing costs and international selling, distribution, and support costs are generally disbursed in local currencies. Local currency cash balances in excess of short-term operating needs are generally converted into U.S. dollar cash and short-term investments upon receipt. Therefore, foreign exchange rate fluctuations generally do not create a risk of material transaction gains or losses. As a result, Microsoft's hedging activities for transaction exposures have been minimal. No material hedge contracts were outstanding at June 30, 1996.

Foreign exchange rates affect the translated results of operations of the Company's foreign subsidiaries. During 1995, 1996, and for 1997, the Company hedged a percentage of planned translated international finished goods revenues by purchasing options on the applicable currencies. Premiums paid for the options were not material.

RECLASSIFICATIONS. Certain reclassifications have been made for consistent presentation.

CASH AND SHORT-TERM INVESTMENTS

	June 30	
	1995	1996
Cash and equivalents:		
Cash	$ 135	$ 64
Commercial paper	1,035	1,447
Money market preferreds	255	105
Certificates of deposit	492	768
Bank loan participations	45	217
Cash and equivalents	1,962	2,601
Short-term investments:		
Municipal securities	1,291	1,357
Corporate notes and bonds	866	1,125
U.S. Treasury securities	444	1,591
Commercial paper	187	266
Short-term investments	2,788	4,339
Cash and short-term investments	$4,750	$ 6,940

PROPERTY, PLANT, AND EQUIPMENT

	June 30	
	1995	1996
Land	$ 206	$ 183
Buildings	607	787
Computer equipment	707	885
Other	387	491
Property, plant, and equipment -- at cost	1,907	2,346
Accumulated depreciation	(715)	(1,020)
Property, plant, and equipment -- net	$1,192	$ 1,326

During 1995 and 1996, depreciation expense, of which the majority related to computer equipment, was $227 million and $363 million; disposals were immaterial.

INCOME TAXES

The provision for income taxes consisted of:

	1994	1995	1996
Current taxes:			
U.S. and state	$470	$518	$1,139
International	94	151	285
Current taxes	564	669	1,424
Deferred taxes	12	45	(240)
Provision for income taxes	$576	$714	$1,184

Income taxes payable were:

	June 30	
	1995	1996
Deferred income tax assets:		
Revenue items	$ 25	$ 193
Expense items	189	322
Deferred income tax assets	214	515
Deferred income tax liabilities:		
International earnings	(201)	(261)
Other	(5)	(6)
Deferred income tax liabilities	(206)	(267)
Current income tax liabilities	(418)	(732)
Income taxes payable	$(410)	$(484)

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

	1994	1995	1996
U.S.	$1,281	$1,549	$2,356
International	441	618	1,023
Income before income taxes	$1,722	$2,167	$3,379

Income taxes have been settled with the Internal Revenue Service for all years through 1989. The IRS concluded its field examination of the Company's U.S. income tax returns for 1990 and 1991 and has assessed taxes that the Company is contesting in Tax Court. Management believes any related adjustments that might be required will not be material to the financial statements. Income taxes paid were $247 million, $430 million, and $758 million in 1994, 1995, and 1996.

COMMON STOCK

Shares of common stock outstanding were as follows:

	1994	1995	1996

Balance, beginning of year	565	581	588
Issued	25	19	22
Repurchased	(9)	(12)	(13)
Balance, end of year	581	588	597

The Company repurchases its common stock in the open market to provide shares for issuing to employees under stock option and stock purchase plans. The Company's Board of Directors authorized continuation of this program in 1997.

PUT WARRANTS

To enhance its stock repurchase program, the Company sold put warrants to independent third parties during 1995 and 1996. These put warrants entitle the holders to sell shares of Microsoft common stock to the Company at specified prices, are exercisable only at maturity, and are settleable in cash at Microsoft's option. On June 30, 1995 and 1996, 8.0 million and 13.0 million warrants were outstanding. The outstanding warrants at June 30, 1996 expire on various dates between December 1996 and December 1997 and have strike prices ranging from $95 per share to $104 per share. The maximum potential repurchase obligations of $405 million and $635 million at June 30, 1995 and 1996 have been reclassified from stockholders' equity to put warrants. There was no impact on earnings per share in 1995 or 1996.

EMPLOYEE STOCK AND SAVINGS PLANS

EMPLOYEE STOCK PURCHASE PLAN. The Company has an employee stock purchase plan for all eligible employees. Under the plan, shares of the Company's common stock may be purchased at six-month intervals at 85% of the lower of the fair market value on the first or the last day of each six-month period. Employees may purchase shares having a value not exceeding 10% of their gross compensation during an offering period. During 1994, 1995, and 1996, employees purchased 1.0 million, 1.1 million, and .9 million shares at average prices of $34.16, $46.76, and $75.44 per share. At June 30, 1996, 1.2 million shares were reserved for future issuance.

SAVINGS PLAN. The Company has a savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. Under the plan, participating U.S. employees may defer up to 15% of their pretax salary, but not more than statutory limits. The Company contributes fifty cents for each dollar a participant contributes, with a maximum contribution of 3% of a participant's earnings. The Company's matching contributions to the savings plan were $9 million, $12 million, and $15 million in 1994, 1995, and 1996.

STOCK OPTION PLANS. The Company has stock option plans for directors, officers, and all employees, which provide for nonqualified and incentive stock options. The Board of Directors determines the option price (not to be less than fair market value for incentive options) at the date of grant. Options granted prior to 1995 generally vest over four and one-half years and expire ten years from the date of grant. Options granted during and after 1995 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest over seven and one-half years and expire after ten years. At June 30, 1996, options for 60.2 million shares were vested and 67.8 million shares were available for future grants under the plans.

Stock options outstanding were as follows:

		Price per Share	
	Number	Range	Weighted Average
Balance, June 30, 1993	114.1	$0.31 - 44.25	$18.06
Granted	26.2	35.50 - 50.13	37.47
Exercised	(20.9)	1.51 - 44.25	11.42
Canceled	(5.5)	5.01 - 44.13	28.67
Balance, June 30, 1994	113.9	0.31 - 50.13	23.29
Granted	21.7	47.75 - 83.13	50.50
Exercised	(17.6)	0.31 - 47.75	15.81
Canceled	(4.2)	5.11 - 75.00	35.40
Balance, June 30, 1995	113.8	1.54 - 83.13	29.12
Granted	28.5	80.19 - 117.88	89.97
Exercised	(19.6)	1.54 - 90.50	21.49
Canceled	(3.6)	5.17 - 110.88	55.70
Balance, June 30, 1996	119.1	2.19 - 117.88	44.14

THE MICROSOFT NETWORK

During 1995, a wholly owned subsidiary of Tele-Communications, Inc. (TCI) purchased a 20% minority interest in The Microsoft Network. TCI contributed $125 million of TCI common stock and Microsoft contributed the business assets of this online service. Microsoft owns 80% of the entity, whose operations have not been material to the financial results of Microsoft.

NONCONTINUING ITEMS

During 1995, Microsoft paid a $46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger. During 1994, the Company recorded a net pretax charge of $90 million, reflecting the settlement of patent litigation with Stac Electronics.

COMMITMENTS AND CONTINGENCIES

The Company has operating leases for most U.S. and international sales and support offices and certain equipment. Rental expense for operating leases was $68 million, $86 million, and $92 million in 1994, 1995, and 1996. Future minimum rental commitments under noncancelable leases, in millions of dollars, are: 1997, $89; 1998, $76; 1999, $58; 2000, $28; 2001, $24; and thereafter, $19.

In connection with the Company's communications infrastructure and the operation of The Microsoft Network, Microsoft has certain communication usage commitments. Future related minimum commitments, in millions of dollars, are: 1997, $65; 1998, $78; 1999, $106; 2000, $80; and 2001, $11. Also, Microsoft has committed to certain volumes of outsourced manufacturing of packaged product in the United States and has committed $293 million for constructing new buildings.

During 1996, Microsoft and National Broadcasting Company (NBC) established two MSNBC joint ventures: a 24-hour cable news and information channel and an interactive online news service. Microsoft agreed to pay $220 million over a five-year period for its interest in the cable venture and to pay one-half of operational funding of both joint ventures for a multiyear period.

Microsoft is 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.

GEOGRAPHIC INFORMATION

	1994	1995	1996
NET REVENUES			
U.S. operations	$3,472	$4,495	$ 6,614
European operations	1,401	1,575	2,241
Other international operations	375	558	965
Eliminations	(599)	(691)	(1,149)
Total net revenues	$4,649	$5,937	$ 8,671
OPERATING INCOME			
U.S. operations	$1,394	$1,709	$ 2,408
European operations	346	412	680
Other international operations	31	91	376
Eliminations	(45)	(174)	(386)
Total operating income	$1,726	$2,038	$ 3,078
IDENTIFIABLE ASSETS			
U.S. operations	$4,397	$5,862	$ 8,193
European operations	1,366	1,806	2,280
Other international operations	423	689	1,042
Eliminations	(823)	(1,147)	(1,422)
Total identifiable assets	$5,363	$7,210	$10,093

Intercompany sales between geographic areas are accounted for at prices representative of unaffiliated party transactions. "U.S. operations" include shipments to customers in the United States, licensing to OEMs, and exports of finished goods directly to international customers, primarily in Canada, South America, and Asia. Exports and international OEM transactions are primarily in U.S. dollars and totaled $787 million, $1,263 million, and $2,148 million in 1994, 1995, and 1996. "Other international operations" primarily include subsidiaries in Australia, Japan, Korea, and Taiwan. International revenues, which include European operations, other international operations, exports, and OEM distribution, were 54%, 55%, and 60% of total revenues in 1994, 1995, and 1996.

SUBSIDIARIES

Microsoft Corporation
One Microsoft Way
Redmond, WA 98052-6399

GraceMac Corporation (NEVADA)
Microsoft FSC Corp. (U.S. VIRGIN ISLANDS)
Microsoft Manufacturing B.V. (THE NETHERLANDS)
Microsoft Puerto Rico, Inc. (Manufacturing) (DELAWARE)
Vermeer Technologies, Inc. (DELAWARE)
Microsoft de Argentina S.A.
Microsoft Pty Limited (AUSTRALIA)
Microsoft Gesellschaft m.b.H. (AUSTRIA)
Microsoft N.V. (BELGIUM)
Microsoft Informatica Limitada (BRAZIL)
Microsoft Canada Inc.
Softimage, Inc. (CANADA)
Microsoft Chile S.A.
Microsoft Colombia Inc. (DELAWARE)
Microsoft De Centroamerica S.A. (COSTA RICA)
Microsoft s.r.o. (CZECH REPUBLIC)
Microsoft Danmark ApS (DENMARK)
CorporacionMicrosoft Del Ecuador S.A.
Microsoft Corporation (Representative Office) (EGYPT)
Microsoft Oy (FINLAND)
Microsoft France S.A.R.L.
Softimage France S.A.R.L.
Microsoft G.m.b.H. (GERMANY)
Softimage G.m.b.H. (GERMANY)
Microsoft Hellas S.A. (GREECE)
Microsoft De Guatemala, S.A.
Microsoft Hong Kong Limited
Microsoft Kft (HUNGARY)
Microsoft Corporation (India) Private Limited
PT. Microsoft Indonesia
Microsoft Israel Ltd.
Microsoft S.p.A. (ITALY)
Microsoft Company, Limited (JAPAN)
Microsoft CH (KOREA)
Microsoft (Malaysia) Sdn. Bhd.
Microsoft Mexico, S.A. de C.V.
Microsoft Maroc S.A.R.L. (MOROCCO)
Microsoft B.V. (THE NETHERLANDS)
Microsoft International B.V. (THE NETHERLANDS)
Microsoft New Zealand Limited
Microsoft Norge AS (NORWAY)
Microsoft De Panama, S.A.
Microsoft (China) Company Limited (THE PEOPLE'S REPUBLIC OF CHINA)
Microsoft Peru, S.A.
Microsoft Philippines, Inc.
Microsoft sp. z.o.o. (POLAND)
MSFT-Software Para Microcomputadores, LDA (PORTUGAL)
Microsoft Caribbean, Inc. (DELAWARE)
Microsoft Taiwan Corporation (REPUBLIC OF CHINA)
Microsoft A.O. (RUSSIA)
Microsoft Singapore Pte Ltd
Microsoft Slovakia s.r.o. (SLOVAK REPUBLIC)
Microsoft d.o.o., Ljubljana (SLOVENIA)
Microsoft (S.A.) (Proprietary) Limited (SOUTH AFRICA)
Microsoft Iberica S.R.L. (SPAIN)
Microsoft Aktiebolag (SWEDEN)
Microsoft AG (SWITZERLAND)
Microsoft (Thailand) Limited
Microsoft Bilgisayar Yazilim Hizmetleri Limited Sirketi (TURKEY)
Microsoft Corporation (Dubai Branch) (UNITED ARAB EMIRATES)
Microsoft Limited (UNITED KINGDOM)
Softimage U.K. Limited
Microsoft Uruguay S.A.
Corporation MS 90 de Venezuela S.A.
The Resident Representative Office of Microsoft Corporation in Hanoi (VIETNAM)
DreamWorks Interactive L.L.C. (WASHINGTON, 50% owned)
The Microsoft Network L.L.C. (DELAWARE, 80% owned)
MSNBC Cable L.L.C. (DELAWARE, 50% owned)
MSNBC Interactive News L.L.C. (DELAWARE, 50% owned)

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Microsoft Corporation:

We have audited the accompanying balance sheets of Microsoft Corporation and subsidiaries as of June 30, 1995 and 1996, and the related statements of income, cash flows, and stockholders' equity for each of the three years ended June 30, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such financial statements present fairly, in all material respects, the financial position of Microsoft Corporation and subsidiaries as of June 30, 1995 and 1996, and the results of their operations and their cash flows for each of the three years ended June 30, 1996 in conformity with accounting principles generally accepted in the United States and International Accounting Standards.

/S/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP

Seattle, Washington
July 22, 1996

EXHIBIT 23.

INDEPENDENT AUDITORS' CONSENT

Microsoft Corporation:

We consent to the incorporation by reference in Registration Statement Numbers 33-06335, 33-18381, 33-25575, 33-33695, and 33-37623 (Microsoft Corporation 1981 Stock Option Plan), 33-44302 and 33-51583 (Microsoft Corporation 1991 Stock Option Plan), 33-37622 (Microsoft Corporation 1991 Employee Stock Purchase Plan), 33-10732 (Microsoft Corporation Savings Plus Plan), 33-36498 (Microsoft Corporation Stock Option Plan for Non-Employee Directors) and 33-45617 (Microsoft Corporation Stock Option Plan for Consultants and Advisors) of Microsoft Corporation on Forms S-8 and 33-29823, 33-34794, 33-36347, 33-46958, 33-49496, 33-56039, 33-57277, 33-57899, 33-58867, 33-62725, 33-63471, 33-64870, 333-857, 333-1177, 333-2759, 333-5961, and 333-8081 of Microsoft Corporation on Forms S-3 of our report dated July 22, 1996 appearing in and incorporated by reference in this Annual Report on Form 10-K of Microsoft Corporation for the year ended June 30, 1996.

/S/ DELOITTE & TOUCHE LLP

Deloitte & Touche LLP

Seattle, Washington
September 25, 1996

This schedule contains summary financial information extracted from the accompanying financial statements and is qualified in its entirety by reference to such financial statements.

YEAR
JUN-30-1996
JUN-30-1996
6,940
0
639
0
0
7,839
2,346
1,020
10,093
2,425
0
0
0
2,924
3,984
10,093
8,671
8,671
1,188
1,188
4,405
0
0
3,379
1,184
2,195
0
0
0
2,195
3.43
3.43

EXHIBIT 99.1

MICROSOFT CORPORATION
1991 EMPLOYEE STOCK PURCHASE PLAN

FINANCIAL STATEMENTS FOR THE
THREE YEARS ENDED JUNE 30, 1996
AND INDEPENDENT AUDITORS' REPORT

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of assets available for benefits of the Microsoft Corporation 1991 Employee Stock Purchase Plan (the Plan) as of June 30, 1996 and 1995, and the related statements of changes in assets available for benefits for each of the three years ended June 30, 1996. These financial statements are the responsibility of the Plan Administrator. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such financial statements present fairly, in all material respects, the assets available for benefits of the Plan as of June 30, 1996 and 1995, and the changes in assets available for benefits for each of the three years ended June 30, 1996 in conformity with generally accepted accounting principles.

/s/ Deloitte & Touche LLP

Deloitte & Touche LLP

Seattle, Washington
August 19, 1996

MICROSOFT CORPORATION
1991 EMPLOYEE STOCK PURCHASE PLAN
STATEMENTS OF ASSETS AVAILABLE FOR BENEFITS
JUNE 30, 1996 AND 1995

	1996	1995
ASSETS:		
Cash	$ 545,574	$ 295,579
ASSETS AVAILABLE FOR BENEFITS	$ 545,574	$ 295,579

See accompanying notes.

MICROSOFT CORPORATION
1991 EMPLOYEE STOCK PURCHASE PLAN
STATEMENTS OF CHANGES IN ASSETS AVAILABLE FOR BENEFITS
YEARS ENDED JUNE 30, 1996, 1995, AND 1994

	1996	1995	1994
ASSETS AVAILABLE FOR BENEFITS, beginning of period	$ 295,579	$ 492,243	$ 961,962
ADDITIONS:			
Employee contributions	67,117,845	48,835,431	38,614,990
DEDUCTIONS:			
Cost of shares purchased	66,867,850	49,032,095	39,084,709
CHANGES IN ASSETS AVAILABLE FOR BENEFITS	249,995	(196,664)	(469,719)
ASSETS AVAILABLE FOR BENEFITS, end of period	$ 545,574	$ 295,579	$ 492,243

See accompanying notes.

MICROSOFT CORPORATION
1991 EMPLOYEE STOCK PURCHASE PLAN
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 1996, 1995, AND 1994

NOTE 1: THE PLAN

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

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

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

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

OPTIONS GRANTED AND WITHDRAWALS: Participants are granted the option to purchase shares of Microsoft Corporation common stock from the Company at 85% of the lesser of the fair market value on the first or last day of each six-month period ending June 30 or December 31. If, prior to the end of any six month period, a participant elects to withdraw from the Plan or has terminated, the Plan refunds any amounts withheld in that period plus any carryover from the previous period. Such withdrawals have been immaterial. The Plan purchased 886,221, 1,049,695, and 1,147,508 shares during the years ended June 30, 1996, 1995, and 1994, respectively. A total of 5,572,281 shares have been purchased under the Plan since inception with 1,177,719 shares reserved for future issue.

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

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

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

- December 31, 1996

- The date of the filing of a statement of intent to dissolve by the Company or the effective date of a merger or consolidation (except with a related company) where the Company is not to be the surviving corporation

- The date the Board acts to terminate the Plan

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

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

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

NOTE 2: REPLACEMENT PLAN

The current Plan terminates on December 31, 1996. The Company's Board of Directors has approved submission of a similar plan to a vote of the shareholders at the 1996 annual shareholders' meeting. If approved, the replacement plan would commence on January 1, 1997 and would terminate December 31, 2001 or earlier under the same provisions of the current Plan (see Note 1, Termination of the Plan).