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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1997

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number 0-14278

MICROSOFT CORPORATION
(Exact name of registrant as specified in its charter)

WASHINGTON
(State or other jurisdiction of
incorporation or organization)

91-1144442
(I.R.S. Employer
Identification No.)

ONE MICROSOFT WAY, REDMOND, WASHINGTON 98052-6399
(Address of principal executive office) (Zip Code)

Registrant's telephone number, including area code: (425) 882-8080

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

The number of shares outstanding of the registrant's common stock as of April 30, 1997 was 1,198,327,269.

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MICROSOFT CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 1997
INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements	Page

a) Income Statements for the Three and Nine Months Ended March 31, 1996 and 1997.....	1
b) Balance Sheets as of June 30, 1996 and March 31, 1997.....	2
c) Cash Flows Statements for the Nine Months Ended March 31, 1996 and 1997.....	3
d) Notes to Financial Statements.....	4
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	6

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.....	9
Item 6. Exhibits and Reports on Form 8-K.....	9
SIGNATURE.....	10

Part I. Financial Information

ITEM 1. FINANCIAL STATEMENTS

MICROSOFT CORPORATION

INCOME STATEMENTS

(In millions, except earnings per share)(Unaudited)

	Three Months Ended March 31		Nine Months Ended March 31	
	1996	1997	1996	1997
Net revenues	\$2,205	\$3,208	\$6,416	\$8,183
Operating expenses:				
Cost of revenues	295	297	947	843
Research and development	364	492	979	1,409
Sales and marketing	685	750	1,996	2,112
General and administrative	87	101	226	268
Total operating expenses	1,431	1,640	4,148	4,632
Operating income	774	1,568	2,268	3,551
Interest income	86	119	228	316
Other income (expense)	4	(84)	23	(179)
Income before income taxes	864	1,603	2,519	3,688
Provision for income taxes	302	561	883	1,291
Net income	562	1,042	1,636	2,397
Preferred stock dividends		7		8
Net income available for common shareholders	\$ 562	\$1,035	\$1,636	\$2,389
Earnings per share (1)	\$ 0.44	\$ 0.79	\$ 1.28	\$ 1.83
Weighted average shares outstanding(1)	1,278	1,322	1,278	1,307

(1) Share and per share amounts for the three and nine months ended March 31, 1996 have been restated to reflect a two-for-one stock split in December 1996.

See accompanying notes.

MICROSOFT CORPORATION

BALANCE SHEETS
(In millions)

	June 30 1996	March 31 1997(1)
ASSETS		
Current assets:		
Cash and short-term investments	\$ 6,940	\$ 9,086
Accounts receivable	639	866
Other	260	272
Total current assets	7,839	10,224
Property, plant, and equipment	1,326	1,371
Equity investments	675	819
Other assets	253	199
Total assets	\$10,093	\$12,613
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 808	\$ 864
Accrued compensation	202	209
Income taxes payable	484	463
Unearned revenues	560	1,285
Other	371	658
Total current liabilities	2,425	3,479
Minority interest	125	
Put warrants	635	
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock - shares authorized 100; outstanding 13		980
Common stock and paid-in capital - shares authorized 4,000; outstanding 1,194 and 1,191	2,924	4,036
Retained earnings	3,984	4,118
Total stockholders' equity	6,908	9,134
Total liabilities and stockholders' equity	\$10,093	\$12,613

(1) Unaudited

See accompanying notes.

CASH FLOWS STATEMENTS
(In millions)(Unaudited)

	Nine Months Ended March 31	
	1996	1997
CASH FLOWS FROM OPERATIONS		
Net income	\$ 1,636	\$ 2,397
Depreciation and amortization	336	414
Current liabilities	959	1,078
Accounts receivable	(154)	(252)
Other current assets	29	(18)
Net cash from operations	2,806	3,619
CASH FLOWS USED FOR FINANCING		
Common stock issued	384	553
Common stock repurchased	(800)	(2,975)
Preferred stock issued		980
Preferred stock dividends		(7)
Stock option income tax benefits	243	482
Net cash used for financing	(173)	(967)
CASH FLOWS USED FOR INVESTMENTS		
Additions to property, plant, and equipment	(336)	(326)
Equity investments and other	(257)	(155)
Short-term investments	(1,045)	(895)
Net cash used for investments	(1,638)	(1,376)
Net change in cash and equivalents	995	1,276
Effect of exchange rates on cash and equivalents	(20)	(25)
Cash and equivalents, beginning of period	1,962	2,601
Cash and equivalents, end of period	2,937	3,852
Short-term investments, end of period	3,833	5,234
Cash and short-term investments, end of period	\$ 6,770	\$ 9,086

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS
(Unaudited)-----
BASIS OF PRESENTATION

In the opinion of management, the accompanying balance sheets and related interim statements of income and cash flows include all adjustments (consisting only of normal recurring items) necessary for their fair presentation in conformity with generally accepted accounting principles. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, 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. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis and financial statements and notes thereto included in the Microsoft Corporation 1996 Form 10-K.

STOCK SPLIT

In December 1996, outstanding shares of common stock were split two-for-one. All prior share and per share amounts have been restated to reflect the stock split.

EARNINGS PER SHARE

Earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effects of outstanding stock options using the "treasury stock" method and preferred shares using the "if-converted" method.

STOCKHOLDERS' EQUITY

Microsoft repurchases common stock on the open market. This program provides shares for issuance to employees under the Company's stock option and stock purchase plans. During the first three quarters of fiscal 1997, the Company repurchased 37 million shares for \$3.10 billion.

To enhance its stock repurchase program, Microsoft sells 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. On March 31, 1997, 30 million warrants were outstanding with strike prices ranging between \$69 and \$78 per share. The warrants expire at various dates between the first quarter of fiscal 1998 and the first quarter of fiscal 1999 and are exercisable only at maturity. These put warrant contracts permit a net-share settlement method in addition to cash settlement or physical delivery at the Company's option, thus Microsoft is no longer required to reflect a put warrant liability on the accompanying balance sheet.

During December 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable principal-protected preferred stock. Dividends are payable quarterly in arrears. In December 1999, each preferred share is convertible into common shares or an equivalent amount of cash determined by a formula that provides a floor price of \$79.875 and a cap of \$102.24 per preferred share. Net proceeds of \$980 million were used to repurchase common shares.

MICROSOFT NETWORK PARTNERSHIP

During October 1996, Microsoft and a subsidiary of Tele-Communications, Inc. (TCI) terminated a partnership under which TCI owned a 20% minority interest in The Microsoft Network, LLC, owner of the business assets of MSN(TM), The Microsoft Network, an online service. Due to the evolving nature of the online industry and MSN's move to a Web-based offering, the original direction of the partnership changed and both Microsoft and TCI agreed to terminate this partnership focused exclusively on MSN. In return for approximately \$125 million of TCI securities, Microsoft became the sole owner of MSN and the minority interest on the accompanying balance sheet was eliminated. There was no other material financial impact of the dissolution.

ACQUISITION AGREEMENT

In April 1997, Microsoft announced its agreement to acquire WebTV Networks, Inc. (WebTV), an online service that enables consumers to experience the Internet through their televisions via set-top terminals based on proprietary technologies. Microsoft will pay \$425 million in stock and cash for WebTV. Microsoft expects an in process R&D write-off of \$300 million will be required in the quarter of acquisition. The agreement has been approved by the Boards of Directors of Microsoft and WebTV and is subject to approval by the shareholders of WebTV and to satisfaction of regulatory requirements.

CONTINGENCIES

In an ongoing investigation, the Antitrust Division of the U.S. Department of Justice requested information from Microsoft concerning various issues. Microsoft is also subject to various legal proceedings and claims that arise in the ordinary course of business. Management currently believes that resolving these matters will not have a material adverse impact on the Company's financial position or its results of operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

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; software development tools; and Internet and intranet software and technologies. The Company has recently expanded its interactive content efforts, including MSN, the Microsoft Network online service, various Internet-based services, and entertainment and information software programs. Microsoft also sells personal computer books and input devices, and researches and develops advanced technologies for future software products.

REVENUES

Revenues were \$3.21 billion in the third quarter of fiscal 1997, an increase of 45% over the comparable quarter of fiscal 1996. Growth was enhanced due to the introduction of Microsoft Office 97 during the March quarter. On a year-to-date basis, revenues were \$8.18 billion, 28% greater than the first three quarters of the prior fiscal year. Revenue growth was particularly strong in the first two quarters of the prior year due to the retail introduction of the Microsoft(R) Windows(R) 95 operating system and Microsoft Office for Windows 95.

Software license volume increases have been the principal factor in the Company's revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and 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.

Microsoft is committed to integrating Internet technology into existing products at no additional cost to its customers. Given this strategy, combined with commitments such as Internet-based technical support, telephone support, and unspecified enhancements, Microsoft recognizes a portion of Windows operating systems revenue over the products' life cycles, currently estimated at two years. Since Office 97 is also tightly integrated with the rapidly evolving Internet, and subsequent delivery of new Internet technologies, enhancements, and other support is likely to be more than minimal, this revenue recognition policy was extended to Office 97 licenses in the March quarter. Associated revenues will be recognized ratably over the estimated 18-month product life cycle.

The portion of the Company's revenues that are earned later than billed is reflected in unearned revenues on the accompanying balance sheet. Of the March 31, 1997 balance of \$1.29 billion, approximately \$765 million represented the unearned portion of Windows desktop operating systems revenues and \$150 million represented the unearned portion of Office 97 revenues. As discussed below, unearned revenues associated with upgrade rights for Microsoft Office 97 were \$190 million. The balance of unearned revenues was primarily attributable to maintenance and other subscription contracts.

PRODUCT GROUPS

Platforms product group revenues were \$1.68 billion in the third quarter of fiscal 1997, compared to \$970 million for the same period of 1996, an increase of 73%. On a year-to-date basis, platforms product group revenues increased to \$4.35 billion from \$3.14 billion. Platforms product group revenues are primarily from licenses of PC operating systems, business systems with client/server architectures, and software development tools.

Windows 95 unit volume continued to build, as units licensed through the OEM channel increased strongly. Additionally, revenues from Windows NT Workstation operating system grew, particularly through retail channels. Business systems, which include servers and server applications, exhibited strong revenues, with the greatest growth in Windows NT Server revenues.

Applications and content product group revenues were \$1.53 billion in the March quarter of fiscal 1997, increasing 24% from \$1.24 billion in the March quarter of fiscal 1996. For the first three quarters of fiscal 1997, applications and content product revenues were \$3.83 billion, compared to \$3.28 billion in the corresponding period of 1996. Applications and content product group revenues include primarily licenses of desktop and consumer productivity applications, interactive media programs, and PC input devices. Integrated suites generate most desktop application revenues. The primary programs in Microsoft Office are Microsoft Word word processor, Microsoft Excel

spreadsheet, and Microsoft PowerPoint(R) presentation graphics program. Various versions of Office, which are available for Windows 32-bit, Windows 16-bit, and Macintosh operating systems, also include applications such as Microsoft Access(R) database management program, Microsoft Outlook(TM) desktop manager, Microsoft Schedule+ calendar and scheduling program, and an email client license.

During the third quarter, Microsoft Office 97 was released in most geographical regions, propelling excellent results. Most versions of Microsoft Office for Windows 95 shipped during the second and third quarters carried a "technological guarantee" that entitled customers to a free upgrade to the corresponding Microsoft Office 97 version of the product. Associated revenues will be recognized when the upgrade delivery obligation is fulfilled.

SALES CHANNELS

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

OEM earned revenues were \$960 million in the third quarter compared to the \$633 million recorded in the comparable quarter of the prior year. On a year-to-date basis, OEM revenues were \$2.49 billion, compared to \$1.85 billion in fiscal 1996. The primary source of OEM revenues is the licensing of desktop operating systems. The percentage of new PCs with Windows 95 preinstalled increased to more than 75% of reported shipments during the third quarter of fiscal 1997, while MS-DOS and Windows 3.x or Windows NT Workstation were preinstalled on many of the remainder of PCs sold by OEMs. The above-mentioned ratable revenue recognition policy was extended to Windows operating systems licensed through the OEM channel in the third quarter of the prior fiscal year.

Revenues in the U.S. and Canada were \$938 million in the third quarter of fiscal 1997 compared to \$620 million in the third quarter of 1996. Revenues in the first three quarters of fiscal 1997 were \$2.51 billion, compared to \$2.00 billion recorded last year. Revenues in Europe were \$799 million in the second quarter of fiscal 1997 compared to \$555 million in the prior year. European revenues were \$1.86 billion in the first three quarters of 1997 compared to \$1.55 billion the prior year. Other International channel revenues increased to \$511 million in the third quarter of fiscal 1997 from \$397 million in the third quarter of fiscal 1996. On a year-to-date basis, Other International revenues were \$1.33 billion in fiscal 1997 compared to \$1.02 billion the prior year.

Excluding the impact of the shipment of retail upgrade versions of Windows 95 in the first half of fiscal 1996, the trend has continued toward a higher percentage of corporate licensing versus packaged products.

Microsoft's operating results are affected by foreign exchange rates. Had the exchange rates in effect during the third quarter of the prior year been in effect during the third quarter of 1997, translated revenues in Europe would have been \$36 million higher and translated Other International revenues would have been \$46 million higher. The relative translation impact of exchange rates on net income is less than these amounts because a portion of local currency denominated revenues is hedged with purchased options and much of Microsoft's international manufacturing costs and operating expenses are also incurred in local currencies.

OPERATING EXPENSES, NONOPERATING ITEMS, AND INCOME TAXES

Cost of revenues as a percentage of revenues was 9.3% in the third quarter of fiscal 1997 compared to 13.4% in the third quarter of 1996, and 10.3% in the first three quarters of fiscal 1997 versus 14.8% in the same period of 1996. The decrease was due to high shipments of retail upgrade versions of Windows 95 in the first half of the prior year and general trends toward more corporate licensing and more shipments of products on CD-ROM, which carry lower cost of goods than floppy disks.

Research and development expenses increased 35% to \$492 million (15.3% of revenues) in the March quarter of fiscal 1997 from \$364 million (16.5% of revenues) in the corresponding quarter of 1996. The continued increase in research and development expenses in fiscal 1997 resulted primarily from planned hiring of software developers and higher levels of third-party development costs.

Sales and marketing expenses were \$750 million in the third quarter of fiscal 1997 compared with \$685 million in 1996. As a percentage of revenues, sales and marketing expenses were 23.4% and 31.1% in the respective third quarters of fiscal 1997 and 1996. Sales and marketing expense as a percentage of revenues decreased due to lower relative sales and support expenses in fiscal 1997 offset somewhat by the marketing of Office 97.

General and administrative expenses were \$101 million (3.1% of revenues) in the third quarter of fiscal 1997 and \$87 million (3.9% of revenues) in the third quarter of 1996. Fiscal 1997 increases were due to growth in the systems and number of people necessary to support overall increases in the scope of the Company's operations.

Interest income increased as a result of a larger investment portfolio generated by cash from operations. Other expenses increased in fiscal 1997 due to recognition of the Company's share of operational expenses of joint ventures, including DreamWorks Interactive and the MSNBC entities.

The effective income tax rate was 35% in all periods.

NET INCOME

Net income for the third quarter of fiscal 1997 was \$1.04 billion, representing 32.5% of revenues compared with 25.5% in the third quarter of 1996. On a year to date basis, net income was 29.3% of revenues in fiscal 1997 compared to 25.5% the prior year. The increase in net income as a percentage of revenues in fiscal 1997 was primarily the result of substantial reductions in relative cost of revenues and sales and marketing expenses, partially offset by the funding of joint ventures.

FINANCIAL CONDITION

Microsoft's cash and short-term investment portfolio totaled \$9.09 billion at March 31, 1997. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The portfolio is primarily invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs.

Microsoft has no material long-term debt and has \$70 million of standby multicurrency lines of credit to support foreign currency hedging and cash management. Stockholders' equity at March 31, 1997 was \$9.13 billion.

Cash generated from operations has been sufficient historically to fund Microsoft's investment in research and development activities and facilities expansion. Research and development investments will continue in existing and advanced areas of technology. Microsoft's cash will be used to acquire technology and to fund ventures and other strategic opportunities. Additions to property, plant, and equipment are expected to continue, including new facilities and computer systems for research and development, sales and marketing, product support, and administrative staff. Commitments for constructing new buildings were \$380 million on March 31, 1997.

Cash will also be used to repurchase common stock to provide shares for employee stock option and purchase plans. Microsoft enhances its repurchase program by selling put warrants. During December 1996, Microsoft issued 12.5 million 2.75% preferred shares. Net proceeds of \$980 million were used to repurchase common shares.

During fiscal 1996, Microsoft and National Broadcasting Company (NBC) established two 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 for the next twelve months. Microsoft's cash and short-term investments are available for strategic investments, mergers and acquisitions, other potential large-scale cash needs that may arise, and to fund an increased stock buyback program over historical levels to reduce the dilutive impact of the Company's employee stock option and purchase programs. Despite recent increases in stock repurchases, the buyback program has not kept pace with employee stock option grants or exercises. Beginning in fiscal 1990, Microsoft has repurchased 154 million common shares for \$6.2 billion while 350 million shares were issued under the Company's employee stock option and purchase plans. The market value of all outstanding stock options was \$23.0 billion as of March 31, 1997.

Microsoft has not paid cash dividends on its common stock. The preferred stock pays \$2.196 per annum per share.

NEW ACCOUNTING PRONOUNCEMENT

Beginning in the second quarter of fiscal 1998, Microsoft will be required to report earnings per outstanding common share in addition to diluted earnings per share. Earnings per common share was \$0.87 in the third quarter of fiscal 1997, compared to \$0.47 in the third quarter of fiscal 1996. See Exhibit 11.

ITEM 1. LEGAL PROCEEDINGS

See notes to financial statements.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS

- 11. Computation of Earnings Per Share is on page 11.
- 27. Financial Data Schedule

(B) REPORTS ON FORM 8-K

Microsoft filed no reports on Form 8-K during the quarter ended March 31, 1997.

ITEMS 2, 3, 4, AND 5 ARE NOT APPLICABLE AND HAVE BEEN OMITTED.

Signature

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

Microsoft Corporation

Date: May 13, 1997

By: /s/ Michael W. Brown

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

(Principal Financial and Accounting
Officer and Duly Authorized Officer)

Exhibits

11.	Computation of Earnings Per Share
27.	Financial Data Schedule

MICROSOFT CORPORATION

COMPUTATION OF EARNINGS PER SHARE

(In millions, except earnings per share) (Unaudited)

	Three Months Ended March 31		Nine Months Ended March 31	
	1996	1997	1996	1997
Weighted average number of common shares outstanding (3)	1,186	1,194	1,180	1,196
Earnings per common share (3)	\$0.47	\$0.87	\$1.39	\$2.00
Common stock equivalents:				
Preferred stock (1)		13		4
Employee stock options (2)	92	115	98	107
Average common and common stock equivalents outstanding (3)	1,278	1,322	1,278	1,307
Diluted earnings per share (3)	\$0.44	\$0.79	\$1.28	\$1.83

(1) Calculated under the "if-converted" method.

(2) Calculated under the "treasury stock" method.

(3) Share and per share amounts for the three and nine months ended March 31, 1996 have been restated to reflect a two-for-one stock split in December 1996.

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128, Earnings Per Share. The new rule will require specific disclosure of both diluted earnings per share and earnings per common share calculated without the dilutive impacts of outstanding stock options or convertible securities such as preferred stock. There was no material difference between reported earnings per share and diluted earnings per share for any period presented.

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

9-MOS	JUN-30-1997	MAR-31-1997
		9,086
		0
	866	0
	0	0
	10,224	2,604
	1,233	
	12,613	
3,479		0
0		0
	980	
	4,036	
	4,118	
12,613		8,183
	8,183	
		843
	843	
	3,789	
	0	
	0	
	3,688	
	1,291	
2,397		
	0	
	0	
		0
	2,397	
	1.83	
	1.83	