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, 1999

[_] 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

Washington	91-1144442
(State of incorporation)	(I.R.S. ID)

One Microsoft Way, Redmond, Washington 98052-6399

(425) 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

2 3/4% Convertible Exchangeable Principal-Protected Preferred Stock

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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 10, 1999 was $375,039,342,820.

The number of shares outstanding of the registrant's common stock as of September 10, 1999 was 5,141,508,124.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 1999 Annual Report to Shareholders are incorporated by reference into Parts I, II, and IV. Portions of the definitive Proxy Statement dated September 10, 1999 to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held November 10, 1999 are incorporated by reference into Part III.

MICROSOFT CORPORATION

FORM 10-K

For The Fiscal Year Ended June 30, 1999

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

Microsoft's business strategy emphasizes the development of a broad line of software products for information technology (IT) professionals, knowledge workers, developers, and consumers, marketed through multiple channels of distribution. The Company is divided into three main areas: the Business Divisions, the Sales and Support Group, and the Operations Group.

The Business Divisions act in parallel, each with responsibility for the product planning and marketing strategies for their respective customer segments. These customer segments are the Windows(R) Platforms segment, the Business Productivity Applications and Developer segment, and the Consumer, Commerce, and Other segment.

The Windows Platforms segment contains three groups. The Business and Enterprise Group develops and markets PC and server operating systems required by large organizations and IT professionals. The Consumer Windows Group oversees and develops operating systems designed primarily for stand-alone PCs used in homes and small businesses. The Streaming Media Division develops a digital media platform for streaming music, video, and synchronized multimedia over the Internet.

The Business Productivity Applications and Developer segment has two primary groups organized around providing software and solutions for knowledge workers and software developers. The Business Productivity Group creates and markets primarily desktop and server applications. The Developer Group builds architecture and software tools for developers.

The Consumer, Commerce, and Other segment includes the Consumer and Commerce Group and the Home and Retail Division. The Consumer and Commerce Group provides services to consumers over the Internet and provides software solutions and services for businesses to conduct commerce on the Internet. The Home and Retail Division creates and markets productivity programs, learning and entertainment products, and hardware peripherals. For financial reporting, revenue from Microsoft Press, consulting, and certification of system integrators is included in this segment.

See notes to financial statements for financial information regarding segment reporting.

Microsoft has a research lab dedicated to creating new technology and converting problems into tangible solutions that Microsoft developers can incorporate into products to meet customers' needs.

The Sales and Support Group is responsible for building long-term business relationships with original equipment manufacturers (OEMs), enterprises, small- and medium-sized businesses, application developers, educational institutions, and consumers. Enterprises are offered tailored license programs, enterprise-wide support, consulting services, and other specialized services. The group also 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: the South Pacific and Americas; Europe, Middle East, and Africa; and Asia. The Sales and Support group supports the Company's products with technical support for end users, developers, and IT departments in 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; corporate functions such as finance, administration, human resources, and legal; and the publishing efforts of Microsoft Press.

Products

Windows Platforms

The Windows Platforms segment is responsible for the development of PC and server platforms, including the Microsoft(R) Windows and Windows NT(R) operating systems. The segment is also responsible for developing the Microsoft Internet Explorer browsing software and Microsoft Windows Media(TM) Technologies. PC operating systems perform 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 from a variety of sources. The Windows NT operating system for servers is an enterprise-wide platform for building and deploying distributed applications for networked PCs. The Windows Platforms segment also provides products for developing, running, and managing Internet and intranet applications and content.

Windows 98. The successor to Windows 95, Windows 98 is a personal computer operating system that provides a Web-oriented user interface, better system performance along with easier system diagnostics and maintenance. Windows 98 supports graphics, sound, and multimedia technologies and provides the ability to easily add and remove peripheral devices and support for Universal Serial Bus (USB). Windows 98 was released in June 1998.

Windows 95. The successor to the MS-DOS(R) operating system and Windows 3.x, Windows 95 was released in August 1995. Windows 95 is a fully integrated, multitasking 32-bit operating system, designed to be compatible with Intel microprocessor-based PCs, most hardware devices, and applications for Windows 3.x and MS-DOS.

Windows NT Workstation. A fully integrated, multitasking 32-bit PC operating system, Windows NT Workstation provides security, robustness, and portability. Windows NT Workstation is designed for mission- critical computing and provides the same features and applications programming interfaces (APIs) for Intel and Alpha AXP microprocessors. Microsoft Windows NT Workstation combines the Windows 98 operating system interface and usability features with the reliability and security of Windows NT for the business environment.

Windows NT Server. Windows NT Server is an operating system foundation for both server applications and file and print sharing, with network management features, administration tools, security, and high availability. Windows NT Server provides a scalable platform for business critical applications and databases, connectivity, system management, and electronic mail (e-mail) servers. The operating system integrates Web services such as Microsoft Internet Information Server, a service used to manage intranet and Internet functionality, and Microsoft FrontPage(R) Web site creation and management tool. Windows NT Server, Terminal Server Edition, an extension to the Windows NT Server, offers the application support of the Windows operating system platform with the centrally managed environment of the mainframe with terminal. Windows NT Server Enterprise Edition provides the means for building and deploying large-scale distributed applications for large and mission-critical servers featuring comprehensive clustering for scalability and availability.

Other Servers. Microsoft Proxy Server creates a single, secure gateway to the Internet; Microsoft SNA Server provides connectivity to host data and applications; and Microsoft Systems Management Server helps centrally manages the distributed environment with integrated features, including hardware inventory, software inventory and metering, software distribution and installation, and remote troubleshooting tools.

Windows Media Technologies. Microsoft Windows Media Technologies provide the ability to create, deliver, and play streaming media files for applications ranging from news and entertainment to e-commerce and corporate training. Windows Media Technologies components include the Windows Media Tools, Windows Media Services streaming server, and Windows Media Player.

Productivity Applications and Developer

The Productivity Applications and Developer segment develops desktop applications, server applications, developer tools, and Web authoring tools.

Business Productivity

The Business Productivity Division delivers integrated business productivity solutions for the knowledge worker, including the Office family of products, other desktop applications, server applications, and the Windows CE operating system for productivity appliances.

Microsoft Office. Microsoft Office 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 cross-application capabilities. Microsoft Office is available in several versions, with certain combinations of products, and available for the Windows and Macintosh operating systems. Microsoft Office 2000 integrates core productivity tools with the Web to simplify publishing Office documents to an intranet or Internet site, simplifies information system support with a self-repairing installation, and has enhanced usability with customizable menus based on IntelliSense(R) technology rules. Products offered in the various versions include the word processor Microsoft Word, Microsoft Excel spreadsheet, Microsoft Outlook(TM) messaging and collaboration client, Microsoft PowerPoint(R) presentation graphics program, Microsoft Access database management application, and others. Microsoft Word is a word-processing program designed to easily create professional-looking documents for the Web, e-mail, and print. Microsoft Excel creates data-rich spreadsheets for universal viewing on the Internet and for collaboration, allows users to analyze data with charts, and incorporates Microsoft PivotTable(R) views and graphs. Microsoft Outlook messaging and collaboration client provides a single location for organizing and managing day-to-day information, including e-mail, calendars, business contacts, and task lists. Microsoft PowerPoint presentation graphics program is a complete set of tools for creating professional presentations. Microsoft Access database management application allows for easy access and retrieval of information and includes pre-packaged solutions to create databases quickly. Microsoft FrontPage is a Web site creation and management tool for Web sites on the Internet or intranets. Microsoft PhotoDraw(TM) business graphics software is a program for creating custom business graphics by editing illustrations and photos.

Other Desktop Application Products. The Company also offers other stand-alone desktop application products. Microsoft Project is a critical path project scheduling and resource allocation program. Microsoft Publisher is an easy-to-use, entry-level desktop publishing program. Most of the applications included in the various productivity suites are also licensed separately.

Server Applications. The Microsoft BackOffice(R) family of server applications is an integrated suite of software products based on Windows NT Server that includes file and print services, applications, database, messaging, groupware, desktop management, Internet access, transaction processing, and host connectivity. The BackOffice suite enables organizations to share information, collaborate, and manage and deploy business-critical applications and includes BackOffice Server, Exchange Server, Proxy Server, Site Server, SQL Server(TM), and others. Microsoft BackOffice Small Business Server is designed for smaller companies of 25 users or less as an integrated solution for sharing files, databases, printers, electronic mail, fax services, applications, and other resources. Microsoft Site Server allows a comprehensive management of sophisticated Web sites and their content. Microsoft Site Server Commerce helps businesses engage customers and partners with creating cost-effective commerce sites and applications, targeted online advertising and marketing, and personalized promotion.

Microsoft Exchange Server. The Company's messaging and collaboration server is Microsoft Exchange Server, which provides e-mail, group scheduling, task management, and document routing capabilities. Exchange Server offers a scalable, reliable, and secure environment for multiple clients, and Internet protocols as part of the core server architecture. It also includes tools to create collaboration applications.

Windows CE. The Company delivers software and platform technologies for a broad range of productivity appliances. Microsoft develops and markets Windows CE, a scaleable Windows platform for communications, entertainment, and mobile computing devices. The Windows CE operating system is built around an API that is consistent with other 32-bit Windows-based operating systems. Windows CE allows productivity appliances to communicate with each other, share information with Windows-based PCs, and connect to the Internet. Microsoft teams up with hardware companies that build Windows CE-based devices.

Developer

The Developer Group provides software development tools and distributed application platforms for developers of Windows-based applications and Internet applications. These products and services empower independent software developers, corporate developers, solutions developers, and Webmasters to create a broad spectrum of applications. Microsoft Windows Distributed interNet Applications (DNA) Architecture is the application development model for the Windows platform. Windows DNA specifies how to develop robust, scalable, distributed applications using the Windows platform; extend existing data and external applications to support the Internet; and support a wide range of client devices. Windows DNA provides for the integration of Web and client/server application development models through the Component Object Model (COM). COM underlies a large majority of the code developed for Windows and Windows NT operating systems. COM+, an extension of COM, builds on COM's integrated services and features, making it easier for developers to create and use software components in any language, using any tool.

Developer Tools. 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 and language compilers. Microsoft Visual C++(R) development system is the Company's development system for Windows-based application development. The Microsoft Visual Basic(R) development system provides easy access to a wide variety of data sources by integrating the Microsoft Access database engine and the ability to take advantage of investments in commercial applications. The Microsoft Visual InterDev(TM) Web development system includes integrated, team-based development tools for building Web-based applications based on HTML, Script, and components written in any language. Microsoft Visual J++(TM) development system for Java contains a high productivity Integrated Development Environment and a collection of integrated components to create, test, tune, and deploy Java code on multiple platforms. Microsoft Visual Studio(R) development system for Windows-based development is a suite of developer tools enabling developers to build components and applications using Visual Basic, Visual C++, Microsoft Visual FoxPro(R) database development system, Visual InterDev, and Visual J++. Developers can subscribe to the Microsoft Developer Network (MSDN)(TM) information service and receive periodic updates via CD-ROMs, magazines, and several on-line information services.

Microsoft SQL Server. Microsoft SQL Server(TM) is a scalable, high-performance database management system designed specifically for distributed client/server computing. SQL Server has built-in data replication, management tools, Internet integration, and online analytical processing (OLAP) to aid in the analysis of information for reporting and data modeling. Its open system architecture provides a Windows NT-based platform for delivering cost-effective information solutions.

Consumer and Commerce

The Consumer and Commerce Group supplies services and content to consumers over the Internet and solutions to businesses by providing software and services to conduct commerce on the Internet. The core business products and services include MSN Internet Access; WebTV(R) Internet Service; MSN Portal and vertical properties; and MSN Commerce Platforms.

The Microsoft Network. MSN Internet Access is a Web-based online service. MSN provides easy and inexpensive access for users to a wide range of graphically rich online content. MSN Internet Access provides dial-up Internet access, free Web-based e-mail through MSN Hotmail, and Microsoft MSN Messenger Service. MSN Hotmail, one of the largest e-mail services with 40 million members, provides members with an e-mail account they can access from any PC with Internet access and has localized versions in French, German, and Japanese. MSN Messenger Service is a free Internet messaging service that enables users to see when other users are online to exchange instant messages.

WebTV. WebTV Networks is an online service that enables consumers to experience the Internet through their televisions via set-top terminals based on WebTV(TM) technologies. WebTV operates the WebTV Network Service and develops the WebTV Internet Terminal and WebTV Plus Receiver, which are available through the Company's licensees. Future versions of the set-top terminals will use the Windows CE operating system.

MSN Portal. The MSN Portal business provides services on the Internet, encompassing the home page as well as the vertical services. The vertical services provide an online decision support infrastructure for end users in many fields such as automobiles, travel, finance, and home purchasing. Microsoft CarPoint(TM) online automotive service provides objective information for new car purchases, including test-drive reviews, dealer invoices, surround videos, and interactive classified advertisements for used car purchasing. Microsoft Expedia(TM) provides one-stop travel shopping and reservation services, providing reliable, real-time access to schedule, pricing, and availability information for airlines, hotels, and major car rental companies. Microsoft HomeAdvisor(TM) online real estate service is a complete guide to the home-buying process and provides comprehensive tools for finding homes and loans on the Internet. MSN MoneyCentral(TM) personal finance online service is a free interactive personal finance resource to track securities by providing company and mutual fund research, an investment finder, daily editorial and market summaries, e-mail notifications and alerts, and access to online trading through leading financial services firms. MSNBC is an Internet news service that complements the MSNBC Cable Network, providing in-depth reporting and information on a wide range of news topics, from local to national to international news.

MSN Commerce. The MSN Commerce business sells platforms that power the MSN vertical services. Microsoft Passport is a platform technology that makes it safer and easier for consumers to access information and buy products and services online. Microsoft Passport allows consumers to create a single sign-in, registration, and electronic wallet that can be shared between all of the sites that support Microsoft Passport. MSN LinkExchange, which the Company acquired in November 1998, provides services to small businesses and Web site owners to increase their online traffic and sales with free advertising banner ads on their site in exchange for placing ads on other network sites. TransPoint is an end-to-end system for Internet bill delivery and payment. TransPoint's service, using existing payment systems, allows consumers to access and pay their bills through the branded home banking services of participating financial institutions and other consumer service providers.

Joint Ventures. The Company has entered into joint venture arrangements to take advantage of creative talent and content from other organizations. Microsoft owns 50 percent of DreamWorks Interactive L.L.C., a software company that develops interactive and multimedia products. DreamWorks SKG owns the remaining 50 percent. Microsoft owns 50 percent of MSNBC Cable L.L.C., a 24-hour cable news and information channel; and 50 percent of MSNBC Interactive News L.L.C., an interactive online news service. National Broadcasting Company (NBC) owns the remaining 50 percent of these two joint ventures. Microsoft is an investor in Transpoint L.L.C., a joint venture between Microsoft, First Data Corporation, and Citibank.

Home and Retail

The Home and Retail Division develops products that are designed to meet the needs of consumers in the home environment, most of which are licensed and sold to and through retail channels to consumers. Major product categories include learning, productivity, personal finance, entertainment, and hardware peripherals.

Learning. Learning titles include Microsoft Encarta(R) multimedia encyclopedia and Microsoft Bookshelf(R) CD-ROM reference library. The Encarta family of products includes a multimedia encyclopedia database with interactive information, an interactive world atlas with three-dimensional maps, a world English dictionary, and an online version with monthly updates. Microsoft Bookshelf is a multimedia reference library that integrates a dictionary, world atlas, world almanac, thesaurus, concise encyclopedia, and two books of quotations. Titles for children include My Personal Tutor, a comprehensive, grade-based learning suite with TutorAssist(TM) learning technology that identifies a child's specific learning needs and offers instruction, and a series of products based on the popular children's book and television series, Scholastic's The Magic School Bus(TM).

Productivity and Finance. Microsoft's productivity offerings include Microsoft Works, 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 Money is a financial organization product that allows users to computerize their finances and provides online home-banking services with numerous different banks in the United States. The Works Suite provides a comprehensive collection of software, including Microsoft Works, Microsoft Word, Microsoft Money, Microsoft Encarta encyclopedia, Microsoft Graphics Studio Greetings, and Microsoft Expedia Streets.

Entertainment. The Company offers a line of entertainment products. Microsoft Flight Simulator is a popular aircraft flight simulation product. Other games include Age of Empires(R), Monster Truck Madness(R), racing simulation, Microsoft Baseball, Microsoft Golf, and other sports and action titles. The Microsoft Internet Gaming Zone is a gaming community on the Internet allowing multiplayer gaming competitions of Microsoft's popular CD-ROM games and classic card, board, and puzzle games.

Hardware Peripherals. The Company develops and markets several PC input devices including the Microsoft Mouse, a hand-held pointing device that facilitates using the PC. The Microsoft IntelliMouse(R) pointing device is an ergonomically designed mouse with a center-positioned wheel that provides scrolling and data zooming. The Company also markets several types of keyboards including the Microsoft Natural(R) keyboard, an ergonomically designed keyboard. Microsoft sells various Microsoft SideWinder(R) game controllers and force feedback joysticks with realistic performance technology to use with PC games. ActiMates(TM) Interactive Barney(TM), Authur(R), D.W.(TM), and Teletubbies(TM) are two-way interactive, talking and moving, wireless plush character peripherals for young children that operate via programming from CD-ROM (PC mode), a VHC (TV mode), and an on-board ROM chip (stand-alone mode).

Microsoft Press

Microsoft Press offers comprehensive learning and training resources to help new users, power users, and professionals get the most from Microsoft technology through books, CDs, self-paced training kits, and videos that are created to accommodate different learning styles and preferences. Microsoft Press(R) books are authored by professional and technical writers, both by Microsoft employees and independent authors.

Microsoft Press contracts with an independent commercial printer for the printing 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 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, Latin 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.

Customer Sales Groups

The Company has several customer sales groups that work with their customers and partners to provide sales and marketing activities.

The enterprise sales group has responsibility for sales and marketing activities that target organizational customer segments by working directly with these organizations to create and support enterprise-wide, mission-critical solutions for business computing needs. The group is divided into the following customer selling teams: depth and breadth enterprise sales, small and medium enterprise sales, and education sales. The enterprise sales group also provides seminars and forums to familiarize enterprises with technology issues and solutions.

The depth and breadth enterprise sales group creates the depth and breadth licensing programs, drives systemic improvements for enterprise customers, and manages key enterprise partners, including USWeb, EDS, AT&T, Computer Sciences Corporation, and others. The small and medium enterprise customer group has responsibility for activities that target groups of users in small and medium organizations. The group works with channel partners such as distributors, aggregators, value-added resellers, and Solution Providers to provide complete business solutions. The group's sales and marketing activities include managing technical training programs for Solution Providers (described below) and channel resellers and supporting and providing seminars, events, and sales training for channel partners.

The small and medium enterprise customer group also runs the Microsoft Certified Professional program, which ensures the quality of Microsoft training for individuals and corporations. The education customer group works with key education institutions and other industry partners to provide programs and technology tools that help them expand and enhance learning opportunities for students. The education customer group has four primary areas, including higher education, K-12, non-profit organizations, and management of the education channel and resellers.

The business solutions customer group targets key line of business partners, including corporate developers and independent software vendors (ISVs) who build business applications with a development platform based on Microsoft Windows and BackOffice architecture. The group's sales and marketing activities include providing industry-specific technical training, seminars, and events for ISVs. The business solutions customer group also focuses on vertical and horizontal industries and their associated software applications. A key focus of the group is Microsoft Developer products, including Developer Tools, Microsoft SQL Server, and Microsoft Windows DNA Architecture.

The network solutions customer group is responsible for introducing the Company's products and technologies to public infrastructure owners and Internet Content Providers (ICPs). The customer group also focuses on embedded and dedicated systems. Infrastructure owners include network operators (telephone companies, cable companies, Internet service providers, etc.) who build, own, and operate the public networks.

The consumer customer group has responsibility for activities that target end users that make individual buying decisions for home PCs. Most sales and marketing activities aimed at end-user customers are performed by this group, including developing and administering reseller relationships; reseller sales terms and conditions; channel marketing and promotions; end-user marketing programs; and seminars, events, and sales training for resellers. The customer group's sub-segments include direct marketing resellers and retailers.

Product Development

The software industry is characterized by extremely rapid technological change, which requires constant attention to computing technology trends, shifting consumer demand, and rapid product innovation. The pace of change is accelerating, as the computing needs of our customers move beyond the PC toward intelligent devices and appliances.

Most of the Company's software products are developed internally. The Company also purchases technology, licenses intellectual property rights, and oversees third-party development and localization of 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 computing devices. 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 intelligent devices, PCs, servers, and the Internet, without compromising product quality. The Company strives to become informed at the earliest possible time about changing usage patterns and hardware advances that may affect software design. Before releasing new software platforms, Microsoft provides to software vendors a range of development, training, testing resources, and guidelines for developing applications to software vendors.

To best serve the needs of users around the world, Microsoft "localizes" many of its products to reflect local languages and conventions and to improve the quality and usability of the product in international markets. Localizing of a product might require modifying the user interface, altering dialog boxes, and translating text. In Japanese versions, for example, all user messages and documentation are in Japanese with monetary references in the Japanese yen. Various Microsoft products have been localized into more than 30 languages.

During fiscal years 1997, 1998, and 1999, the Company spent $1.86 billion, $2.46 billion, and $2.81 billion, respectively, on product research and development activities. Those amounts represented 15.6%, 17.0%, and 15.0%, respectively, of revenue in each of those years, excluding funding of joint venture activity. The Company is committed to continue high expenditures for research and product development.

Manufacturing

Microsoft contracts out most of its manufacturing activity to third parties. Outside manufacturers produce various retail software packaged products and hardware peripherals. There are other custom manufacturers Microsoft could use in the event outsourced manufacturing becomes unavailable from current vendors.

The Company's remaining manufacturing facilities are located in Puerto Rico and Ireland. The Irish facility and the Puerto Rico facilities manufacture CD-ROMs. Microsoft outsources its manufacturing of packaged products. Quality control tests are performed on purchased parts, CD-ROMs, and other products. The chief materials and components used in Microsoft products include CD-ROMs, books, and multicolor printed materials. The Company is often able to acquire component parts and materials on a volume discount basis. The Company has multiple sources for raw materials, supplies, and components.

The Company's sales mix has shifted to OEM and organizational licenses from packaged products. Also, online distribution of software is increasing.

Operations

Microsoft manages all product fulfillment, licensing, and logistics services. The Company has regional operations centers in Ireland, Singapore, and the Greater Seattle area. The regional centers support all operations activities, including information processing, vendor management, logistics, and related supporting functions by geographical regions. The regional center in Dublin, Ireland supports the European, African, and Middle East regions, the center in Singapore supports the Asia Pacific region, and the center in the Greater Seattle area supports North and South America. The Company established Microsoft Licensing Incorporated (MSLI) in Reno, Nevada, a wholly owned subsidiary, which manages the Company's OEM and certain organizational licensing operations.

Marketing and Distribution

The Company's sales and marketing group seeks to build long-term relationships with customers of Microsoft products. The OEM sales group includes the sales force that works with original equipment manufacturers that preinstall Microsoft software on their PCs. In addition to the OEM channel, Microsoft has three major geographic sales and marketing organizations: the South Pacific and Americas; Europe, Middle East, and Africa; and Asia.

Finished Goods Channels

Distributors and Resellers. The Company licenses and sells its products in the finished goods channels primarily to and through independent non-exclusive distributors and resellers. Distributors include Inacom, Ingram Micro, SoftBank, Tech Data, and Merisel. Resellers include Software Spectrum, Corporate Software & Technology, CompUSA, Software House International, Softmart, ASAP Software Express, and Best Buy. 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.

Enterprise Accounts. The Microsoft Select program offers flexible software acquisition, licensing, and maintenance options specially customized 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 large account resellers. The Microsoft Open program is a licensing program that is targeted for small and medium size organizations. It is available through the reseller channel and offers discounts based on initial purchase volumes. The Microsoft Enterprise Agreement program is a licensing program designed to provide a flexible licensing and service solution tailored to customers making a long-term licensing commitment. The agreements are designed to increase customer satisfaction by simplifying license administration, payment terms, and the contract process.

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 system integrators, value-added resellers (VARs), consultants, custom application developers, solution developers, Internet service and hosting organizations, independent content providers, and site builders (companies that build Web sites for other companies), as well as technical support and training organizations. Under this business collaboration 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. Microsoft Direct Access is a comprehensive and open program that allows independent technology providers to actively work with Microsoft through the Microsoft Direct Access program online, quarterly briefings, training, and action packs.

Certified Professionals. Microsoft receives certification fees through the Microsoft Certified Professional (MCP) program, a program that provides credentials for those who have demonstrated in-depth knowledge of at least one Microsoft product. To become an MCP, a candidate must pass a certification exam that provides a valid and reliable measure of technical proficiency and expertise. MCP exams are developed with the input of professionals in the industry and reflect how Microsoft products are used in organizations throughout the world. The exams are administered by independent organizations at more than 1,400 testing centers around the world. MCPs receive access to technical and product information through an MCP Web site, MSDN Online Certified Membership, and invitations to conferences, technical training sessions, and special events. Candidates may pass additional Microsoft certification exams to further qualify their skills with Microsoft BackOffice products, development tools, and desktop applications.

Consulting Services. Microsoft Consulting Services assists customers in deploying and using the Company's computer operating systems, applications, and communications products. The group works with

Solution Providers and helps create enterprise-wide computing solutions for large corporate accounts. Microsoft Consulting Services also works with technology solutions providers to enable them to offer a wide range of Microsoft product-related services backed by high levels of technical skill and knowledge.

International Sales Sites. The Company has established marketing and/or support subsidiaries in more than 70 countries. Product is generally delivered by the Company's owned or outsourced manufacturing operations, which are located in the geographical region in which the product was sold. By organizing geographically, the Company is able to provide service to international channel customers and access to Microsoft professionals located in the same region to serve their specific needs. Subsidiaries have the responsibility for selling products to customers, managing licensing programs, and providing support to all types of customers based in international countries. Notes to Financial Statements--(see Item 8) describe foreign operations and export sales.

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.

Product Support

The Company provides product support coverage options aligned to the customer segments, partner segments, and communities. 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. Support offerings include the Alliance program, tailored for large enterprises running mission-critical applications on Microsoft platforms; the Premier program for enterprises and technical account managers needing regular managed support; the Professional program for small organizations, developers, OEMs, and Microsoft Certified Solution Providers ranging from small organizations to large-account resellers (LARs); and the Personal program for home users, which provides free online self-help resources and phone support. Users have access to troubleshooting "wizards" and Microsoft's KnowledgeBase, an online library of thousands of technical articles that is updated regularly with useful information regarding Microsoft products. Additionally, several support offerings include Microsoft TechNet and Microsoft Developer Network information subscription services.

Support personnel are located in various sites in the United States and around the world. Certain support is also supplied by qualified third-party support organizations.

As a supplement or alternative to direct support, the Company enhances the third-party support channel by providing Microsoft Certified Solution Providers with education, training, tools, and support. Microsoft Certified 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, multi-vendor support, and integration services.

OEM Channel

Microsoft operating systems are licensed primarily to OEMs under agreements that grant the OEMs the right to distribute copies of the Company's products with their computing devices, principally PCs. The Company also markets and licenses certain desktop applications, hardware peripherals, and consumer software programs to OEMs under similar arrangements. 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, Acer, Actebis, Compaq, Dell, Fujitsu/ICL, Gateway 2000, Hewlett-Packard, IBM, Micron, NEC, Packard Bell NEC, Samsung, Siemens, Toshiba, and Vobis. A substantial amount of OEM business is also conducted with system builders, which are low-volume customized PC vendors.

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 uses broad consumer media (television, radio, the Internet, and business publications) and trade publications. Microsoft has programs under which qualifying resellers and OEMs are reimbursed for certain advertising expenditures.

Customers

The Company's customers include consumers, small and medium-sized organizations, enterprises, educational institutions, ISPs, application developers, and OEMs. Most consumers of Microsoft products are individuals in businesses, government agencies, educational institutions, and at home. The consumers and organizations obtain Microsoft products primarily through resellers and OEMs, which include certain Microsoft products with their computing hardware. Notes to Financial Statements (see Item 8) quantify customers that represent more than 10% of the Company's revenue. The Company's practice is to ship its products promptly upon receipt of purchase orders from its customers and, consequently, backlog is not significant.

Competition

The software business is intensely competitive and subject to extremely rapid technological change. The Company is faced with the possibility of paradigm shifts from PC-based applications to server-based applications or Web-based application hosting services, from proprietary software to open source software, and from PCs to Internet-based devices. A number of Microsoft's most significant competitors, including IBM, Sun Microsystems, Oracle, and AOL (Netscape), are collaborating with one another on various initiatives directed at competing with Microsoft. These initiatives relate in part to efforts to move software from individual PCs to centrally managed servers, which would present significant challenges to the Company's historical business model. Collaborative efforts also include the development of new platform technologies that are intended to replicate much of the value of Microsoft Windows operating systems. New computing form factors, including non-PC information devices, are gaining popularity and competing with PCs running Microsoft's software products.

Microsoft faces formidable competition in these new areas and in all areas of its current business activity, including competition from many companies much larger than Microsoft. The rapid pace of technological change, particularly in the area of Internet platforms and services, continually creates new opportunities for existing competitors and start-ups and can quickly render existing technologies less valuable. The Company also faces relentless competition from software pirates who unlawfully copy and distribute Microsoft's copyrighted software products, depriving the Company of large amounts of revenue on an annual basis.

Operating Systems. Microsoft's operating system products face substantial competition from a wide variety of companies. Competitors such as IBM, Apple Computer, Compaq, 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 computers. 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. With an increased attention toward open-source software, the Linux operating system has gained increasing acceptance. Several computer manufacturers preinstall Linux on PCs and many leading software developers have written applications that run on Linux. As PC technology increasingly moves toward connectivity and communications, Microsoft's operating system products face increased competition from network server operating systems such as Novell's NetWare, Banyan's Vines, the many variants of UNIX, IBM's OS/2, "middleware" products such as IBM's Lotus Notes, and intranet servers from Apache, AOL (Netscape), IBM, Sun Microsystems, and others. Microsoft Windows operating systems are also threatened by alternative platforms such as those based on Internet browsing software and Java technology promoted by AOL and Sun Microsystems.

Business Systems. The Company competes in the business of providing enterprise-wide computing solutions with several competitors who enjoy a larger share of sales and larger installed bases. Many companies offer operating system software for mainframes and midrange computers, including IBM, Hewlett-Packard, and Sun Microsystems. Since legacy business systems are typically support-intensive, these competitors also offer substantial support services. Software developers that provide competing server applications for PC-based distributed client/server environments include Oracle, IBM, Computer Associates, 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, that 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 collaboration and e-mail products.

Desktop Applications. The Company's competitors include many software application vendors, such as IBM (Lotus), Oracle, Apple (Filemaker, Inc.), Sun Microsystems, Corel, Qualcomm, and local application developers in Europe and Asia. IBM and Corel have large installed bases with their spreadsheet and word-processor products, respectively, and both have aggressive pricing strategies. Also, IBM and Apple preinstall certain of their application software products on various models of their PCs, competing directly with Microsoft's desktop application software. Additionally, Web-based application hosting services provide an alternative to PC-based applications such as Microsoft Office.

Developer Tools. The Company's developer products compete against offerings from Borland, Macromedia, Oracle, Sun Microsystems, Sybase, Symantec, and other companies.

Consumer Platforms. A wide variety of companies develop operating systems for information appliances, including Apple, Motorola, 3Com, Psion Software, Sun Microsystems, Microworkz, Be, Inc., WindRiver, Symbian and others. The Company's WebTV offerings and other multimedia consumer products face competitors such as Sun Microsystems, Oracle, Liberate Technologies, NetChannel, and others. An enormous range of companies, including media conglomerates, telephone companies, cable companies, retailers, hardware manufacturers, and software developers, are competing to make interactive services widely available to the home.

E-Commerce. Microsoft competes with many companies in the e-commerce business and its major components, including business-to-consumer, business-to-business, procurement, and supply chain integration. In the development and marketing of Internet and intranet solutions, major commerce software competitors provide many different ranges of products and solutions that compete with Microsoft, including IBM, Oracle, AOL (Netscape), Sun Microsystems, Broadvision, and many others.

Online Services. Microsoft's online services network, MSN, faces formidable competition from AOL (including its CompuServe unit), AT&T, and other traditional online services as well as a vast array of Web sites and portals that offer content of all types and email, calendaring, chat, and search and shopping services, among other things. In addition, the ease of entry into Internet services has allowed numerous Web-based service companies to build significant businesses in areas such as e-mail, electronic commerce, Web search engines, directories, and information of numerous types. Competitors include AOL, Yahoo, Excite, Lycos, Infoseek, AltaVista, and many others.

News Services. The Company's MSNBC joint ventures face formidable competition from other 24-hour cable and Internet news organizations such as CNN, CNN Headline News, and Fox News Network. MSNBC also competes with traditional news media such as newspapers, magazines, and broadcast TV.

Home and Retail. The Company's Home and Retail division faces many smaller but focused and branded competitors, particularly in the areas of hardware, learning, and entertainment. Consolidation in this area of software development has made certain competitors even stronger. Competitors include Intuit, Electronic Arts, Mattel (The Learning Company), Hasbro, Logitech, Voyager, Cendant, and Dorling Kindersley. Still other competitors own branded content, such as Disney and Lucas Arts.

Additionally, PC-based games are increasingly competing head-to-head against games created for proprietary systems such as Nintendo, Sony PlayStation, 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.

The Company's competitive position may 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 computing industry.

Employees

As of June 30, 1999, the Company employed 31,396 people on a full-time basis, 21,802 in the United States and 9,594 internationally. Of the total, 12,090 were in product research and development, 15,186 in sales, marketing, and support, 1,270 in manufacturing and distribution, and 2,850 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 is 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 6.7 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 recently completed the construction of two office buildings comprising approximately 420,000 square feet of space and is constructing a building with approximately 145,000 square feet of space. This site will be occupied in the winter of 2000. The Company owns 4.7 million square feet of its corporate campus. The Company leases many buildings in the Puget Sound Region. The Company recently leased four buildings with approximately 420,000 square feet of space, which will be occupied in the fall of 1999.

The Company leases many sites domestically. The Company entered into a build-to-suit lease agreement in the San Francisco, California Bay Area. This campus, when complete, will be approximately 517,000 square feet. It is scheduled to open in the fall of 1999.

The Company's European operations center and localization division consist of a 345,000 square-foot campus situated on 17 acres in Dublin, Ireland. The Ireland facilities are partially owned by the Company. In the United Kingdom, the Company executed a sale/leaseback of three buildings that total 230,000 square feet. In Les Ulis, France, the Company executed a sale/leaseback on a 199,000 square-foot office building. The Company leases a 45,000 square-foot disk duplication facility in Humacao, Puerto Rico. The Company leases a 36,000 square-foot facility in Singapore for its Asia Pacific operations center.

In addition, the Company leases many other sites around the world.

The Company's facilities are fully used for current operations of all segments and suitable additional space is available to accommodate expansion needs.

Item 3. Legal Proceedings

The information set forth in Notes to Financial Statements--Contingencies on page 40-41 of the 1999 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 1999.

Executive Officers of the Registrant

The executive officers of Microsoft as of September 10, 1999 were as follows:

Name	Age	Position with the Company
William H. Gates.........	43	Chairman of the Board; Chief Executive Officer
Steven A. Ballmer........	43	President
Robert J. Herbold........	57	Executive Vice President; Chief Operating Officer
Richard Belluzzo.........	45	Group Vice President, Consumer and Commerce
Frank M. (Pete) Higgins..	41	Group Vice President
Paul A. Maritz...........	44	Group Vice President, Developer
Jeffrey S. Raikes........	41	Group Vice President, Sales and Support
James E. Allchin.........	47	Senior Vice President, Platforms
Orlando Ayala Lozano.....	43	Senior Vice President, South Pacific and Americas
Bradley M. Chase.........	39	Senior Vice President, Consumer and Commerce
John S. DeVaan...........	38	Senior Vice President, Consumer and Commerce
Joachim Kempin...........	57	Senior Vice President, OEM Sales
Michel Lacombe...........	48	Senior Vice President; President, Microsoft Europe, Middle East, and Africa
Gregory B. Maffei........	39	Senior Vice President, Finance and Administration; Chief Financial Officer
Robert L. Muglia.........	39	Senior Vice President, Business Productivity
Craig Mundie.............	50	Senior Vice President, Consumer Strategy
William H. Neukom........	57	Senior Vice President, Law and Corporate Affairs; Secretary
Bernard P. Vergnes.......	54	Senior Vice President; Chairman, Microsoft Europe, Middle East, and Africa

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

Mr. Ballmer was named President in July 1998 and had been Executive Vice President, Sales and Support since 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. Belluzzo joined Microsoft as Group Vice President, Consumer and Commence in September 1999. Mr. Belluzzo had been Chairman of the Board and Chief Executive Officer, Silicon Graphics, Inc. since January 1998. Prior to his employment at Silicon Graphics, Inc., Belluzzo was employed by the Hewlett-Packard Company for twenty-two years, serving since 1995 as Executive Vice President and General Manager of the computer organization. From 1993 to 1995, Mr. Belluzzo was General Manager of the Computer Products Organization.

Mr. Higgins is on leave from Microsoft. Mr. Higgins was named Group Vice President, Interactive Media Group in October 1996. He was named Group Vice President, Applications and Content in May 1995 and Senior Vice President, Desktop Applications Division in March 1993. He had been Vice President, Desktop Applications Division since 1992. Mr. Higgins joined Microsoft in 1983.

Mr. Maritz was named Group Vice President, Developer in March 1999. He had been Group Vice President, Platforms and Applications since October 1996 and before holding that position was Group Vice President, Platforms since May 1995. Mr. Maritz had been Senior Vice President, Product and Technology Strategy since 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. Raikes was named Group Vice President, Sales and Support in July 1998. He had been Group Vice President, Sales and Marketing since 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, Platforms in March 1999. He had been Senior Vice President, Personal and Business Systems since February 1996. He was previously Senior Vice President, Business Systems Division since November 1994 and had been Vice President, Business Systems Division, since July 1991. Mr. Allchin joined Microsoft in 1991.

Mr. Ayala was named Senior Vice President, South Pacific and Americas in February 1998. He had been Vice President of the developing markets of Africa, India, the Mediterranean and Middle East, Latin America, Southeast Asia and the South Pacific. He joined Microsoft in May 1991 as Senior Director of the Latin America Region.

Mr. Chase was named Senior Vice President, Consumer and Commerce in September 1999. Mr. Chase had been Vice President, Consumer and Commerce since March 1999. He was Vice President, Developer Relations and Windows Marketing. Mr. Chase joined Microsoft in July 1987.

Mr. DeVaan was named Senior Vice President, Consumer and Commerce in September 1999. Mr. DeVaan had been Vice President, Consumer and Commerce since March 1999. He had been Vice President, Desktop Applications since 1995. Mr. DeVaan joined Microsoft in 1985.

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. Lacombe is President, Microsoft Europe, Middle East, and Africa. He was named Senior Vice President, Europe, Middle East, and Africa in February 1998. He had been President, Microsoft Europe and Senior Vice President, Microsoft since July 1997. He had been Vice President, Europe since September 1995 and Vice President, End User Customer Unit, Europe since April 1994. Mr. Lacombe had been Regional Director of Southern Europe from May 1991. Mr. Lacombe joined Microsoft in 1983.

Mr. Maffei was named Senior Vice President, Finance and Administration in March 1999. He was named Vice President, Finance and Chief Financial Officer in July 1997. Mr. Maffei was named Vice President, Corporate Development in July 1996 and Treasurer in April 1994. He joined Microsoft in 1993 as Director, Business Development and Investments.

Mr. Muglia is Senior Vice President, Business Productivity. He was named Senior Vice President, Applications and Tools in February 1998. He had been Vice President, Server Applications since 1997 and was Vice President, Developer Tools since 1995. He joined Microsoft in January 1988.

Mr. Mundie is Senior Vice President, Consumer Strategy. He was named Senior Vice President, Consumer Platforms in February 1996. He was named Senior Vice President, Consumer Systems in May 1995 and had been Vice President, Advanced Consumer Technology since July 1993. He joined Microsoft as General Manager, Advanced Consumer Technology in December 1992.

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

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

PART II

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

The information set forth on page 43 of the 1999 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.1.

Reference is also made to the information on sales of put warrants described in the notes to financial statements incorporated herein by reference and filed herewith as Exhibit 13.4. All such transactions are exempt from registration under Section 4 (2) of the Securities Act of 1933. Each transaction was privately negotiated and each offeree and purchaser was an accredited investor/qualified institutional buyer. No public offering or public solicitation was used by the registrant in the placement of these securities.

During the quarter, the Company issued an aggregate of 507,140 of its common shares pursuant to the following transactions: (i) the acquisition by the Company of certain assets of Bruce Carver and Associates, Inc. and Chris J. Jones and Associates Inc., owned by two shareholders, (ii) the merger in exchange for the outstanding capital shares of Jump Networks, Inc., owned by six shareholders, and (iii) the merger in exchange for the outstanding capital shares of OmniBrowse, Inc., owned by five shareholders. All of the Microsoft common shares issued in these transactions were issued pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended (the "1933 Act"), under Section 4(2) of the 1933 Act. These sales were made without general solicitation or advertising. The Company has filed a Registration Statement on form S-3 covering the resale of such securities. All net proceeds from the sale of such securities will go to the selling shareholders who offered and sell their shares. The Company has not received and will not receive any proceeds from the sale of these common shares other than the assets and liabilities of the acquired companies.

Item 6. Selected Financial Data

The information set forth on page 2 of the 1999 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 Results of Operations and Financial Condition

The information set forth on page 18-26 of the 1999 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.3.

Item 7a. Quantitative and Qualitative Disclosures About Market Risk

The information set forth on page 25 of the 1999 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 and supplementary data for the Company and independent auditors' report set forth on pages 17 and 27-44 of the 1999 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, 1999
- Cash Flows Statements for the three years ended June 30, 1999
- Balance Sheets as of June 30, 1998 and 1999
- Stockholders' Equity Statements for the three years ended June 30, 1999
- 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 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 10, 1999, for the Annual Meeting of Shareholders to be held November 10, 1999 (the "Proxy Statement"). Such information is incorporated herein by reference.

Item 11. Executive Compensation

The information in the Proxy Statement set forth under the captions "Information Regarding Executive Officer Compensation" on pages 4 through 6 and "Information Regarding the Board and its Committees" on page 2 is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

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

Item 13. Certain Relationships and Related Transactions

The information set forth under the caption "Certain Relationships and Related Transactions" on page 7 of the Proxy Statement is incorporated herein by reference. The information in Notes to Financial Statements--Operational Transactions on page 39 of the 1999 Annual Report to Shareholders is incorporated herein by reference and is filed herewith as Exhibit 13.4.

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 1999.

(c) Exhibit Listing

Exhibit Number	Description
3.1	Restated Articles of Incorporation of Microsoft Corporation
3.2	Bylaws of Microsoft Corporation
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 (3)
10.4	Microsoft Corporation Stock Option Plan for Consultants and Advisors (3)
10.5	Microsoft Corporation 1997 Employee Stock Purchase Plan (1)
10.6	Microsoft Corporation Savings Plus Plan (3)
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 (5)
13.1	Quarterly and Market Information Incorporated by Reference to Page 43 of 1999 Annual Report to Shareholders ("1999 Annual Report")
13.2	Selected Financial Data Incorporated by Reference to Page 2 of 1999 Annual Report
13.3	Management's Discussion and Analysis of Results of Operations and Financial Condition Incorporated by Reference to Pages 18-26 of 1999 Annual Report
13.4	Financial Statements Incorporated by Reference to Pages 17 and 27-44 of 1999 Annual Report
21.	Subsidiaries of Registrant
23.	Independent Auditors' Consent
27.	Financial Data Schedule

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(1) Incorporated by reference to Annual Report on Form 10-K For The Fiscal Year Ended June 30, 1997.
(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, 1994.
(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 28, 1999.

MICROSOFT CORPORATION

By /s/ Gregory B. Maffei
Gregory B. Maffei
Senior Vice President, Finance and Administration; 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 28, 1999.

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/ Wm. G. Reed, Jr. Wm. G. Reed, Jr.	Director
/s/ Jon A. Shirley Jon A. Shirley	Director
/s/ Gregory B. Maffei Gregory B. Maffei	Senior Vice President, Finance and Administration; Chief Financial Officer (Principal Financial and Accounting Officer)

Exhibit 3.1

RESTATED ARTICLES OF INCORPORATION OF MICROSOFT CORPORATION

Pursuant to RCW 23B.10.070, the following Restated Articles of Incorporation are hereby submitted for filing:

ARTICLE I

NAME

The name of the corporation is Microsoft Corporation.

ARTICLE II

REGISTERED OFFICE AND AGENT

The address of the registered office of the "Corporation" is 5000 Columbia Center, 701 Fifth Avenue, Seattle, Washington 98104-7078, and the name of the registered agent at such address is PTSGE Corp.

ARTICLE III

PURPOSE

The Corporation is organized for the purposes of transacting any and all lawful business for which a corporation may be incorporated under the Washington Business Corporation Act, Title 23B of the Revised Code of Washington, now or hereafter in force (the "Act").

ARTICLE IV

CAPITAL SHARES

4.1 <u>Authorized Shares</u>. The total number of shares of stock which the Corporation shall have authority to issue is 12,100,000,000 shares, which shall consist of 12,000,000,000 shares of common stock, $.0000125 par value per share ("Common Shares") and 100,000,000 shares of preferred stock, $.01 par value per share ("Preferred Shares"). Except as otherwise provided in accordance with these Articles of Incorporation, the Common Shares shall have the unlimited voting rights, with each share being entitled to one vote, and the rights to receive the net assets of the Corporation upon dissolution, with each share participating on a pro rata basis.

4.2 Issuance of Preferred Shares. The Board of Directors is hereby authorized from time to time, without shareholder action, to provide for the issuance of Preferred Shares in one or more series not exceeding in the aggregate the number of Preferred Shares authorized by these Articles of Incorporation, as amended from time to time; and to determine with respect to each such series the voting powers, if any (which voting powers, if granted, may be full or limited), designations, preferences, and relative, participating, option, or other special rights, and the qualifications, limitations, or restrictions relating thereto, including without limiting the generality of the foregoing, the voting rights relating to Preferred Shares of any series (which may be one or more votes per share or a fraction of a vote per share, which may vary over time, and which may be applicable generally or only upon the happening and continuance of stated events or conditions), the rate of dividend to which holders of Preferred Shares of any series may be entitled (which may be cumulative or noncumulative), the rights of holders of Preferred Shares of any series in the event of liquidation, dissolution, or winding up of the affairs of the Corporation, the rights, if any, of holders of Preferred Shares of any series to convert or exchange such Preferred Shares of such series for shares of any other class or series of capital stock or for any other securities, property, or assets of the Corporation or any subsidiary (including the determination of the price or prices or the rate or rates applicable to such rights to convert or exchange and the adjustment thereof, the time or times during which the right to convert or exchange shall be applicable, and the time or times during which a particular price or rate shall be applicable), whether or not the shares of that series shall be redeemable, and if so, the terms and conditions of such redemption, including the date or dates upon or after which they shall be redeemable, and the amount per share payable in case of redemption, which amount may vary under different conditions and at different redemption dates, and whether any shares of that series shall be redeemed pursuant to a retirement or sinking fund or otherwise and the terms and conditions of such obligation.

4.3 Filings and Effectiveness. Before the Corporation shall issue any Preferred Shares of any series, Articles of Amendment or Restated Articles of Incorporation, fixing the voting powers, designations, preferences, the relative, participating, option, or other rights, if any, and the qualifications, limitations, and restrictions, if any, relating to the Preferred Shares of such series, and the number of Preferred Shares of such series authorized by the Board of Directors to be issued shall be filed with the secretary of state in accordance with the Washington Business Corporation Act ("WBCA") and shall become effective without any shareholder action. The Board of Directors is further authorized to increase or decrease (but not below the number of such shares of such series then outstanding) the number of shares of any series subsequent to the issuance of shares of that series.

4.4 Terms of 2 3/4% Convertible Exchangeable Principal-Protected Preferred Shares.

4.4.1 Designation and Amount. The shares of such series shall be designated "2 3/4% Convertible Exchangeable Principal-Protected Preferred Shares, Series A," and the number of shares constituting such series shall initially be a maximum of 12,600,000. The shares of such series shall have a stated par value of $.01 per share. Such series is herein sometimes referred to as the "Series A Preferred Shares. "

4.4.2 Preferred Dividends.

(a) The holders of Series A Preferred Shares shall be entitled to receive, when, as and if declared by the Board of Directors, out of funds of the Corporation legally available therefor, cash dividends ("Preferred Dividends") at the annual rate of $2.196 per share, payable quarterly in arrears on each March 15, June 15, September 15 and December 15 in each year (each a "Dividend Payment Date"), commencing March 15, 1997 (and, in the case of any accrued but unpaid dividends, at such additional times and for such interim periods, if any, as determined by the Corporation's Board of Directors). In the event that any Dividend Payment Date shall fall on any day other than a Business Day (as defined in paragraph (b) of Section 4.4.3), the Preferred Dividend due on such Dividend Payment Date shall be paid on the Business Day immediately following such Dividend Payment Date. Preferred Dividends shall begin to accrue from the date of initial issuance of the Series A Preferred Shares. Preferred Dividends will cease to accrue on Series A Preferred Shares on the Conversion Date (as defined in paragraph (b) of Section 4.4.3) or on the date of their earlier exchange for Convertible Notes (as defined in paragraph (a) of Section 4.4.5). Preferred Dividends shall accrue on a daily basis whether or not in any such quarterly period there shall be funds of the Corporation legally available therefor and whether or not such Preferred Dividends are declared, but Preferred Dividends accrued for any period less than a full quarterly period between Dividend Payment Dates (or, in the case of the first Preferred Dividend, from the date of initial issuance of the Series A Preferred Shares through the first Dividend Payment Date) shall be computed on the basis of a 360-day year consisting of twelve 30-day months. Accrued but unpaid Preferred Dividends shall cumulate as of the Dividend Payment Date on which they first become payable, but no interest shall accrue on accumulated but unpaid Preferred Dividends. Preferred Dividends shall be payable to holders of record as they appear on the stock transfer records of the Corporation on such record dates, which shall be not more than 60 days nor less than 10 days preceding the payment dates, as shall be fixed by the Board of Directors.

(b) So long as any Series A Preferred Shares are outstanding, the Corporation may not (i) declare or pay any dividends (other than dividends payable in Common Shares or other shares of the Corporation ranking junior to the Series A Preferred Shares) to holders of Common Shares or shares of the Corporation of any other class ranking on a parity with or junior to the Series A Preferred Shares, or (ii) make any distributions of assets (directly or indirectly, by purchase, redemption or otherwise) to the holders of Common Shares or shares of the Corporation of any other class ranking on a parity with or junior to the Series A Preferred Shares, unless all accrued and unpaid Preferred Dividends, including the full dividends for the then quarterly dividend period, shall have been paid or declared and funds sufficient for payment thereof set apart.

(c) No dividends may be paid upon or declared or set apart for any Preferred Shares ranking on a parity with the Series A Preferred Shares for any quarterly dividend period, unless at the same time a like proportionate dividend for the same quarterly dividend period, ratably in proportion to the respective annual dividend rates fixed therefor, shall be paid upon or declared or set apart for the Series A Preferred Shares.

4.4.3 Conversion of Series A Preferred Shares.

(a) Automatic Conversion on Conversion Date. On December 15, 1999 (the "Conversion Date"), unless previously exchanged for Convertible Notes, as described in Section 4.4.5 below, each outstanding Series A Preferred Share shall automatically convert into that number of Common Shares of the Corporation determined by multiplying each Series A Preferred Share by the Exchange Rate. However, in lieu of delivering Common Shares on the Conversion Date, the Corporation may, at its option, convert each Series A Preferred Share into an amount of cash (a "Cash Settlement") determined by multiplying the Current Market Price of the Common Shares by the Exchange Rate. In either event, each holder of Series A Preferred Shares will receive in cash any unpaid dividends which have accrued to the Conversion Date. The Exchange Rate is equal to (i) if the Current Market Price of the Common Shares is greater than or equal to $102.24 per share (the "Threshold Price"), a ratio equal to the Threshold Price divided by the Current Market Price, (ii) if the Current Market Price is less than the Threshold Price but greater than the Initial Price, a ratio of 1.0, and (iii) if the Current Market Price is less than or equal to the Initial Price, a ratio equal to the Initial Price divided by the Current Market Price, subject in each case to adjustments in certain events.

(b) Definitions. As used in this Article:

"Business Day" means any day other than a Saturday, Sunday or a day on which banking institutions in the state of New York are authorized or obligated by law or executive order to close.

"Closing Price" of a Common Share on any date of determination means the closing sale price (or, if no closing price is reported, the last reported sale price) of such share as reported by The Nasdaq National Market on such date, or, if it is not so reported, as reported in the composite transactions for the principal United States securities exchange on which the Common Shares are so listed, or, if it is not so listed on a United States national or regional securities exchange, the last quoted bid price of the Common Shares in the over-the-counter market as reported by the National Quotation Bureau or similar organization, or, if such bid price is not available, the market value of a Common Share on such date as determined by a nationally recognized independent investment banking firm retained for this purpose by the Corporation.

"Current Market Prices" except as used in Section 4.4.3(d)(ii) and (iii), means the average Closing Price per Common Share of the Corporation on the 20 Trading Days beginning on the twenty-second Trading Day immediately prior to, but not including, the Conversion Date and ending on the second Trading Day immediately prior to, but not including, the Conversion Date.

"Initial Price" means $79.875 per Common Share.

"Trading Day" means a day on which the Common Shares (i) are not suspended from trading on any national or regional securities exchange or association or over-the-counter market at the close of business and (ii) has traded at least once on the national or regional securities exchange or association or over-the-counter market that is the primary market for the trading of such security.

(c) <u>Notice of Election to Settle in Cash; No Fractional Shares.</u> The Corporation shall mail written notice of its election to settle the conversion of the Series A Preferred Shares in cash to each holder of record of Series A Preferred Shares not less than 30 Trading Days nor more than 45 Trading Days prior to the Conversion Date. Upon surrender of certificates for Series A Preferred Shares to be converted, as required herein (except in the case of a Cash Settlement), the Corporation shall issue the number of full Common Shares issuable upon conversion thereof. No fractional Common Shares will be issued upon conversion, but in lieu thereof, in the sole discretion of the Board of Directors, either such fractional interest shall be rounded up to the next whole share or an amount will be paid in cash by the Corporation for such fractional interest based upon the Current Market Price.

(d) <u>Exchange Rate Adjustments.</u> The Exchange Rate shall be subject to adjustment from time to time as provided below in this paragraph (d). All adjustments to the Exchange Rate shall be calculated to the nearest 1/10,000th of a Common Share.

(i) If the Corporation shall either:

(1) pay a dividend or make a distribution with respect to Common Shares in Common Shares,

(2) subdivide or split its outstanding Common Shares,

(3) combine its outstanding Common Shares into a smaller number of shares, or

(4) issue by reclassification of its Common Shares any capital shares of the Corporation,

then, in any such event, the Exchange Rate in effect immediately prior to the record date for any such dividend or distribution or the effective date of any such subdivision, split, combination or reclassification, as the case may be, shall be adjusted so that the holder of a Series A Preferred Share shall be entitled to receive on the conversion of such Series A Preferred Share, the number of Common Shares of the Corporation which such holder would have owned or been entitled to receive upon the happening of any of the events described above had such Series A Preferred Share been converted at the Exchange Rate in effect at the time of the record date for any such dividend or distribution or of the effective date of any such subdivision, split, combination or reclassification, as the case may be. Such adjustment shall become effective at the opening of business on the Business Day next following the record date for such dividend or distribution in the case of a dividend or distribution, and shall become effective immediately after the effective date in the case of a subdivision, split, combination, or reclassification; and any Common Shares issuable in payment of a dividend shall be deemed to have been issued immediately prior to the close of business on the record date for such dividend for purposes of calculating the number of outstanding Common Shares under clauses (ii) and (iii) below.

(ii) If the Corporation shall, after the date hereof, issue rights or warrants to all holders of its Common Shares entitling them (for a period not exceeding 45 days from the date of such issuance) to subscribe for or purchase Common Shares at a price per share less than the Current Market Price of the Common Shares (determined pursuant to paragraph (d)(v) of this Section 4.4.3) on the record date for the determination of Shareholders entitled to receive such rights or warrants, then in each case the Exchange Rate shall be adjusted by multiplying the Exchange Rate in effect on such record date by a fraction of which the numerator shall be the number of Common Shares outstanding on the date of issuance of such rights or warrants, immediately prior to such issuance, plus the number of additional Common Shares offered for subscription or purchase, and of which the denominator shall be the number of Common Shares outstanding on the date of issuance of such rights or warrants, immediately prior to such issuance, plus the number of Common Shares which the aggregate offering price of the total number of Common Shares so offered for subscription or purchase would purchase at such Current Market Price (determined by multiplying such total number of shares by the exercise price of such rights or warrants and dividing the product so obtained by such Current Market Price). Common Shares owned by the Corporation or by another company of which a majority of the shares entitled to vote in the election of directors are held, directly or indirectly, by the Corporation shall not be deemed to be outstanding for purposes of such computation. Such adjustment shall become effective at the opening of business on the Business Day next following the record date for such rights or warrants. To the extent that Common Shares are not delivered after the expiration of such rights or warrants, the Exchange Rate shall be readjusted to the Exchange Rate which would then be in effect had the adjustment made upon the issuance of such rights or warrants been made upon the basis of the issuance of rights or warrants in respect of only the number of Common Shares actually delivered.

(iii) If the Corporation shall pay a dividend or make a distribution to all holders of its Common Shares consisting of evidences of its indebtedness or other assets (including capital shares of the Corporation other than Common Shares but excluding any cash dividends or any distributions and dividends referred to in clause (i) above), or shall issue to all holders of its Common Shares rights or warrants to subscribe for or purchase any of its securities (other than those referred to in clause (ii) above), then in each such case the Exchange Rate shall be adjusted by multiplying the Exchange Rate in effect on the record date for such dividend or distribution or the determination of shareholders entitled to receive such rights or warrants, as the case may be, by a fraction, of which the numerator shall be the Current Market Price of the Common Shares (determined pursuant to paragraph (d)(v) of this Section 4.4.3) on such record date, and of which the denominator shall be such Current Market Price per Common Share less the fair market value (as determined by the Board of Directors of the Corporation, whose determination shall be conclusive) as of such record date of the portion of the assets or evidences of indebtedness so distributed, or of such subscription rights or warrants, applicable to one Common Share. Such adjustment shall become effective on the opening of business on the Business Day next following the record date for such dividend or distribution or the determination of shareholders entitled to receive such rights or warrants, as the case may be.

(iv) Anything in this paragraph (d) notwithstanding, the Corporation shall be entitled to make such upward adjustments in the Exchange Rate, in addition to those required by this paragraph (d), as the Corporation in its sole discretion shall determine to be advisable, in order that any share dividends, subdivision of shares, distribution of rights to purchase shares or securities, or distribution of securities convertible into or exchangeable for shares (or any transaction which could be treated as any of the foregoing transactions pursuant to Section 305 of the Internal Revenue Code of 1986, as amended) hereafter made by the Corporation to its shareholders shall not be taxable.

(v) As used in this paragraph (d), the "Current Market Price" of the Common Shares on any date shall be the average Closing Price per Common Share of the Corporation on the 20 Trading Days immediately prior to, but not including, the date of determination.

(vi) In any case in which this paragraph (d) shall require that an adjustment as a result of any event become effective at the opening of business on the Business Day next following a record date and the date fixed for conversion pursuant to paragraph (a) of this Section 4.4.3 occurs after such record date, but before the occurrence of such event, the Corporation may in its sole discretion elect to defer the following until after the occurrence of such event: (A) issuing to the holder of any Series A Preferred Shares surrendered for conversion the additional Common Shares issuable upon conversion before giving effect to such adjustment; and (B) paying to such holder any amount in cash in lieu of a fractional Common Share pursuant to paragraph (c) of this Section 4.4.3.

(e) Notice of Adjustments. Whenever the Exchange Rate is adjusted as provided in paragraph (d) hereof, the Corporation will file with the transfer agent for the Series A Preferred Shares a certificate with respect to such adjustment, make a prompt public announcement thereof and mail a notice to holders of the Series A Preferred Shares setting forth the adjusted Exchange Rate, the method of calculation thereof in reasonable detail and the facts requiring such adjustment and upon which such adjustment is based.

(f) Reservation of Common Shares. The Corporation shall reserve and at all times keep available, free from preemptive rights, out of its authorized but unissued Shares, for the purpose of effecting the conversion of the Series A Preferred Shares, such number of shares of its duly authorized Common Shares as will from time to time be sufficient to effect the conversion of all outstanding Series A Preferred Shares; provided, however, that the Corporation shall not be obligated to keep such shares available with respect to any Series A Preferred Shares during any time that the conversion of such Series A Preferred Shares is prohibited under a contract or other agreement between the holder of such Series A Preferred Shares and the Corporation.

(g) Payment of Taxes. The Corporation will pay any and all documentary, stamp or similar issue or transfer taxes payable in respect of the issue or delivery of Common Shares on the conversion of Series A Preferred Shares pursuant to this Section 4.4.3; provided, however, that the Corporation shall not be required to pay any tax which may be payable in respect of any registration of transfer involved in the issue or delivery of Common Shares in a name other than that of the registered holder of Series A Preferred Shares redeemed or converted or to be redeemed or converted, and no such issue or delivery shall be made unless and until the person requesting such issue has paid to the Corporation the amount of any such tax or has established, to the satisfaction of the Corporation, that such tax has been paid.

4.4.4 Adjustment For Certain Consolidations or Mergers. In case of any consolidation or merger to which the Corporation is a party (other than a merger or consolidation in which the Corporation is the continuing corporation and in which the Common Shares outstanding immediately prior to the merger or consolidation remain unchanged), or in case of any sale or transfer to another entity of the property of the Corporation as an entirety or substantially as an entirety, or in case of any statutory share exchange with another entity (other than in connection with an acquisition in which the Common Shares outstanding immediately prior to the share exchange remain unchanged), each Series A Preferred Share shall, after consummation of such transaction, be subject to (i) conversion at the option of the holder into the kind and amount of securities, cash, or other property receivable upon consummation of such transaction by a holder of the number of Common Shares into which such Series A Preferred Shares might have been converted immediately prior to consummation of such transaction and (ii) conversion on the Conversion Date into the kind and amount of securities, cash, or other property receivable upon consummation of such transaction by a holder of the number of Common Shares into which such Series A Preferred Shares would have been converted if the conversion on the Conversion Date had occurred immediately prior to the date of consummation of such transaction assuming in each case that such holder of Common Shares failed to exercise rights of election, if any, as to the kind or amount of securities, cash, or other property receivable upon consummation of such transaction (provided that if the kind or amount of securities, cash, or other property receivable upon consummation of such transaction is not the same for each nonelecting share, then the kind and amount of securities, cash, or other property receivable upon consummation of such transaction for each nonelecting share shall be deemed to be the kind and amount so receivable per share by a plurality of the nonelecting shares). The kind and amount of securities into which the Series A Preferred Shares shall be convertible after consummation of such transaction shall be subject to adjustment as described above under paragraph (d) of Section 4.4.3 following the date of consummation of such transaction. The Corporation may not become a party to any such transaction unless the terms thereof are consistent with the foregoing.

4.4.5 Exchangeability.

(a) The Series A Preferred Shares are exchangeable in whole, or in part, at the option of the Corporation, for the Corporation's 2 3/4% Convertible Subordinated Notes due 1999 (the "Convertible Notes") on any dividend payment date beginning on March 15, 1997 at the rate of $79.875 principal amount of Convertible Notes for each Series A Preferred Share outstanding at the time of exchange. The Corporation may effect such exchange only if accrued and unpaid dividends on the Series A Preferred Shares have been paid in full. An exchange of less than all of the outstanding Series A Preferred Shares is permitted only if, immediately after giving effect to such exchange, (i) the aggregate outstanding principal amount of the Convertible Notes is not less than $250,000,000, (ii) accrued and unpaid interest on the outstanding Convertible Notes has been paid in full and certain other requirements as specified in the related indenture for the Convertible Notes have been satisfied, and (iii) the aggregate liquidating distribution amount for the outstanding Series A Preferred Shares is not less than $250,000,000. The Corporation will mail written notice of its intention to exchange to each holder of record of the Series A Preferred Shares not less than 30 Trading Days or more than 45 Trading Days prior to the date fixed for exchange.

(b) Upon the date fixed for exchange of Series A Preferred Shares for Convertible Notes (the "Exchange Date"), if the Corporation has taken all action required to authorize the issuance of the Convertible Notes in exchange for Series A Preferred Shares, Series A Preferred Shares so exchanged will no longer be deemed outstanding and all rights relating to such shares will terminate, except only the right to receive dividends accrued and unpaid to and including the Exchange Date and the right to receive the Convertible Notes upon surrender of certificates representing the Series A Preferred Shares.

(c) In the event that Series A Preferred Shares have been exchanged for Convertible Notes pursuant to this Section 4.4.5, the provisions set forth under paragraphs (d), (f) and (g) of Section 4.4.3 hereof shall apply with respect to the Convertible Notes to the same extent and to the same effect as they would have applied to the Series A Preferred Shares.

4.4.6 Liquidation Rights. In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, the holders of Series A Preferred Shares are entitled to receive out of the assets of the Corporation, whether such assets are stated capital or surplus of any nature, before any payment is made or any assets are distributed to holders of Common Shares and of any other class of shares of the Corporation ranking junior to the Series A Preferred Shares, liquidating distributions in the amount of $79.875 per Series A Preferred Share plus accrued and unpaid dividends, whether or not declared, without interest. If upon any liquidation, dissolution or winding up of the Corporation, the amounts payable with respect to the Series A Preferred Shares and any other preferred shares ranking as to any such distribution on a parity with the Series A Preferred Shares are not paid in full, the holders of the Series A Preferred Shares and of such other preferred shares shall share ratably in any such distribution of assets in proportion to the full respective preferential amounts to which they are entitled. After payment of the full amount of the liquidating distribution to which they are entitled, the holders of Series A Preferred Shares shall not be entitled to any further participation in any distribution of assets by the Corporation. Neither a consolidation nor merger of the Corporation with another corporation nor a sale or transfer of all or part of the Corporation's assets for cash, securities or other property shall be considered a liquidation, dissolution or winding up of the Corporation for these purposes.

4.4.7 Voting Rights. Except as indicated below or otherwise required by law, holders of Series A Preferred Shares will have no voting rights. If (i) at any time the equivalent of six quarterly dividends payable on the Series A Preferred Shares are accrued and unpaid or (ii) the Corporation fails to make any payment upon mandatory redemption of the Series A Preferred Shares, the number of directors of the Corporation shall be increased by two and the holders of all outstanding Series A Preferred Shares, voting separately as a class, shall be entitled to elect the additional two directors to serve until all dividends accrued and unpaid have been paid or declared and funds set aside to provide for payment in full or the Corporation fulfills its mandatory redemption obligation, as the case may be.

In addition, without the vote or consent of the holders of at least two-thirds of the Series A Preferred Shares then outstanding, the Corporation may not (a) create or issue or increase the authorized number of shares of any class or series of shares ranking prior to the Series A Preferred Shares either as to dividends or upon liquidation, dissolution or winding up, or any security convertible into or exercisable or exchangeable for such Shares, (b) purchase or redeem less than all of the Series A Preferred Shares then outstanding when any dividends on the Series A Preferred Shares are in arrears, or (c) amend, alter or repeal any of the provisions of the Articles of Incorporation so as to affect any right, preference, privilege or voting power of the Series A Preferred Shares or the holders thereof; provided, however, that any increase in the amount of authorized Preferred Shares or the creation and issuance of any other class of Preferred Shares, or any increase in the amount of authorized shares of such class or of any other class of Preferred Shares, in each case ranking on a parity with or junior to the Series A Preferred Shares with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up, shall not be deemed to affect such rights, preferences or voting powers.

ARTICLE V

NO PREEMPTIVE RIGHT'S

Shareholders of the Corporation have no preemptive rights to acquire additional shares of stock or securities convertible into shares of stock issued by the Corporation.

ARTICLE VI

DIRECTORS

6.1 Number. The number of directors of the Corporation shall be fixed in the manner specified by the bylaws of the Corporation.

6.2 Vacancies. Vacancies and newly created directorships resulting from any increase in the authorized number of directors shall be filled only by a majority of the directors then in office, although less than a quorum, or by a sole remaining director, unless for any reason there are no directors in office in which case they shall be filled by a special election by shareholders.

ARTICLE VII

ELECTION OF DIRECTORS

Shareholders of the Corporation shall not have the right to cumulate votes in the election of directors.

ARTICLE VIII

SPECIAL SHAREHOLDER MEETINGS

Special meetings of the shareholders of the Corporation for any purpose or purposes may be called at any time by the Board of Directors, or by a committee of the Board of Directors which has been duly designated by the Board of Directors and whose powers and authority, as provided in a resolution of the Board of Directors or in the bylaws of the Corporation, include the power to call such meetings, but such special meetings may not be called by any other person or persons.

ARTICLE IX

AMENDMENT OF BYLAWS

In furtherance and not in limitation of the powers conferred by statute, the Board of Directors is expressly authorized to make, adopt, repeal, alter, amend, and rescind the bylaws of the Corporation by a resolution adopted by a majority of the directors.

ARTICLE X

LIMITATION OF DIRECTOR LIABILITY

A director of the Corporation shall not be personally liable to the Corporation or its shareholders for monetary damages for conduct as a director, except for:

(a) Acts or omissions involving intentional misconduct by the director or a knowing violation of law by the director;

(b) Conduct violating Section 23B.08.310 of the Act (which involves distributions by the Corporation);

(c) Any transaction from which the director will personally receive a benefit in money, property, or services to which the director is not legally entitled.

If the Washington Business Corporation Act is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent not prohibited by the Washington Business Corporation Act, as so amended. The provisions of this Article shall be deemed to be a contract with each Director of the Corporation who serves as such at any time while such provisions are in effect, and each such Directors shall be deemed to be serving as such in reliance on the provisions of this Article. Any repeal or modification of the foregoing paragraph by the shareholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation with respect to any acts or omissions of such director occurring prior to such repeal or modification.

ARTICLE XI

MERGERS, SHARE EXCHANGES, AND OTHER TRANSACTIONS

A merger, share exchange, sale of substantially all of the Corporation's assets, or dissolution must be approved by the affirmative vote of a majority of the Corporation's outstanding shares entitled to vote, or if separate voting by voting groups is required then by not less than a majority of all the votes entitled to be cast by that voting group.

ARTICLE XII

INDEMNIFICATION

12.1 Definitions. As used in this Article:

a. "Agent" means an individual who is or was an agent of the Corporation or an individual who, while an agent of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise. "Agent" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of an agent.

b. "Corporation" means the Corporation, and any domestic or foreign predecessor entity which, in a merger or other transaction, ceased to exist.

c. "Director" means an individual who is or was a director of the Corporation or an individual who, while a director of the Corporation, is or was serving at the Corporation's request as a director officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan or other enterprise. "Director" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of a director.

d. "Employee" means an individual who is or was an employee of the Corporation or an individual, while an employee of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise- "Employee" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of an employee.

e. "Expenses" include counsel fees.

f. "Indemnitee" means an individual made a party to a proceeding because the individual is or was a Director, Officer, Employee, or Agent of the Corporation, and who possesses indemnification rights pursuant to these Articles or other corporate action. "Indemnitee" includes, unless the context requires otherwise, the spouse, heirs, estate, and personal representative of such individuals.

g. "Liability" means the obligation to pay a judgment, settlement penalty, fine, including an excise tax with respect to an employee benefit plan, or reasonable Expenses incurred with respect to a proceeding.

h. "Officer" means an individual who is or was an officer of the Corporation (regardless of whether or not such individual was also a Director) or an individual who, while an officer of the Corporation, is or was serving at the Corporation's request as a director, officer, partner, trustee, employee, or agent of another foreign or domestic corporation, partnership, joint venture, trust, employee benefit plan, or other enterprise. "Officer" includes, unless the context requires otherwise, the spouse, heirs, estate and personal representative of an officer.

i. "Party" includes an individual who was, is, or is threatened to be named a defendant, respondent or witness in a proceeding.

j. "Proceeding" means any threatened, pending, or completed action, suit, or proceeding, whether civil, derivative, criminal, administrative, or investigative, and whether formal or informal.

12.2 Indemnification Rights of Directors and Officers. The Corporation shall indemnify its Directors and Officers to the full extent not prohibited by applicable law now or hereafter in force against liability arising out of a Proceeding to which such individual was made a Party because the individual is or was a Director or an Officer. However, such indemnity shall not apply on account of:

(a) Acts or omissions of a Director or Officer finally adjudged to be intentional misconduct or a knowing violation of law;

(b) Conduct of a Director or Officer finally adjudged to be in violation of Section 23B.08.310 of the Act relating to distributions by the Corporation; or

(c) Any transaction with respect to which it was finally adjudged that such Director or Officer personally received a benefit in money, property, or services to which the Director or Officer was not legally entitled.

Subject to the foregoing, it is specifically intended that Proceedings covered by indemnification shall include Proceedings brought by the Corporation (including derivative actions) Proceedings by government entities and governmental officials or other third party actions.

12.3 Indemnification of Employees and Agents of the Corporation. The Corporation may, by action of its Board of Directors from time to time, provide indemnification and pay Expenses in advance of the final disposition of a Proceeding to Employees and Agents of the Corporation who are not also Directors, in each case to the same extent as to a Director with respect to the indemnification and advancement of Expenses pursuant to rights granted under, or provided by, the Act or otherwise.

12.4 Partial Indemnification. If an Indemnitee is entitled to indemnification by the Corporation for some or a portion of Expenses, liabilities, or losses actually and reasonably incurred by Indemnitee in an investigation, defense, appeal or settlement but not, however, for the total amount thereof, the Corporation shall nevertheless indemnify Indemnitee for the portion of such Expenses, liabilities or losses to which Indemnitee is entitled.

12.5 Procedure for Seeking Indemnification and/or Advancement of Expenses. The following procedures shall apply in the absence of (or at the option of the Indemnitee, in lieu thereof), specific procedures otherwise applicable to an Indemnitee pursuant to a contract, trust agreement, or general or specific action of the Board of Directors:

12.5.1 Notification and Defense of Claim. Indemnitee shall promptly notify the Corporation in writing of any proceeding for which indemnification could be sought under this

Article. In addition, Indemnitee shall give the Corporation such information and cooperation as it may reasonably require and as shall be within Indemnitee's power.

With respect to any such proceeding as to which Indemnitee has notified the Corporation:

(a) The Corporation will be entitled to participate therein at its own expense; and

(b) Except as otherwise provided below, to the extent that it may wish, the Corporation, jointly with any other indemnifying party similarly notified, will be entitled to assume the defense thereof, with counsel satisfactory to Indemnitee. Indemnitee's consent to such counsel may not be unreasonably withheld.

After notice from the Corporation to Indemnitee of its election to assume the defense, the Corporation will not be liable to Indemnitee under this Article for any legal or other Expenses subsequently incurred by Indemnitee in connection with such defense. However, Indemnitee shall continue to have the right to employ its counsel in such proceeding, at Indemnitee's expense; and if:

(i) The employment of counsel by Indemnitee has been authorized by the Corporation;

(ii) Indemnitee shall have reasonably concluded that there may be a conflict of interest between the Corporation and Indemnitee in the conduct of such defense; or

(iii) The Corporation shall not in fact have employed counsel to assume the defense of such proceeding,

the fees and Expenses of Indemnitee's counsel shall be at the expense of the Corporation.

The Corporation shall not be entitled to assume the defense of any proceeding brought by or on behalf of the Corporation or as to which Indemnitee shall reasonably have made the conclusion that a conflict of interest may exist between the Corporation and the Indemnitee in the conduct of the defense.

12.5.2 Information to be Submitted and Method of Determination and Authorization of Indemnification. For the purpose of pursuing rights to indemnification under this Article, the Indemnitee shall submit to the Board a sworn statement requesting indemnification and reasonable evidence of all amounts for which such indemnification is requested (together, the sworn statement and the evidence constitute an "Indemnification Statement").

Submission of an Indemnification Statement to the Board shall create a presumption that the Indemnitee is entitled to indemnification hereunder, and the Corporation shall, within sixty (60) calendar days thereafter, make the payments requested in the Indemnification Statement to or for the benefit of the Indemnitee, unless: (1) within such sixty (60) calendar day period it shall be determined by the Corporation that the Indemnitee is not entitled to indemnification under this Article; (2) such determination shall be based upon clear and convincing evidence (sufficient to rebut the foregoing presumption); and (3) the Indemnitee shall receive notice in writing of such determination, which notice shall disclose with particularity the evidence upon which the determination is based.

The foregoing determination may be made: (1) by the Board of Directors by majority vote of a quorum of Directors who are not at the time parties to the proceedings; (2) if a quorum cannot be obtained, by majority vote of a committee duly designated by the Board of Directors (in which designation Directors who are parties may participate) consisting solely of two (2) or more Directors not at the time parties to the proceeding; (3) by special legal counsel; or (4) by the shareholders as provided by Section 23B.08.550 of the Act.

Any determination that the Indemnitee is not entitled to indemnification, and any failure to make the payments requested in the Indemnification Statement, shall be subject to judicial review by any court of competent jurisdiction.

12.5.3 Special Procedure Regarding Advance for Expenses. An Indemnitee seeking payment of Expenses in advance of a final disposition of the proceeding must furnish the Corporation, as part of the Indemnification Statement:

(a) A written affirmation of the Indemnitee's good faith belief that the Indemnitee has met the standard of conduct required to be eligible for indemnification; and

(b) A written undertaking, constituting an unlimited general obligation of the Indemnitee, to repay the advance if it is ultimately determined that the Indemnitee did not meet the required standard of conduct.

Upon satisfaction of the foregoing the Indemnitee shall have a contractual right to the payment of such Expenses.

12.5.4 Settlement. The Corporation is not liable to indemnify Indemnitee for any amounts paid in settlement of any proceeding without the Corporation's written consent. The Corporation shall not settle any proceeding in any manner which would impose any penalty or limitation on Indemnitee without Indemnitee's written consent. Neither the Corporation nor Indemnitee may unreasonably withhold its consent to a proposed settlement.

12.6. Contract and related rights.

12.6.1 Contract Rights. The right of an Indemnitee to indemnification and advancement of Expenses is a contract right upon which the Indemnitee shall be presumed to have relied in determining to serve or to continue to serve in his or her capacity with the Corporation. Such right shall continue as long as the Indemnitee shall be subject to any possible proceeding. Any amendment to or repeal of this Article shall not adversely affect any right or protection of an Indemnitee with respect to any acts or omissions of such Indemnitee occurring prior to such amendment or repeal.

12.6.2 Optional Insurance, Contracts, and Funding. The Corporation may:

(a) Maintain insurance, at its expense, to protect itself and any Indemnitee against any liability, whether or not the Corporation would have power to indemnify the individual against the same liability under Section 23B.08.5 10 or .520 of the Act;

(b) Enter into contracts with any Indemnitee in furtherance of this Article and consistent with the Act; and

(c) Create a trust fund, grant a security interest, or use other means (including without limitation a letter of credit) to ensure the payment of such amounts as may be necessary to effect indemnification as provided in this Article.

12.6.3 Severability. If any provision or application of this Article shall be invalid or unenforceable, the remainder of this Article and its remaining applications shall not be affected thereby, and shall continue in full force and effect.

12.6.4 Right of Indemnitee to Bring Suit. If (1) a claim under this Article for indemnification is not paid in full by the Corporation within sixty (60) days after a written claim has been received by the Corporation; or (2) a claim under this Article for advancement of Expenses is not paid in full by the Corporation within twenty (20) days after a written claim has been received by the Corporation, then the Indemnitee may, but need not, at any time thereafter bring suit against the Corporation to recover the unpaid amount of the claim. To the extent successful in whole or in part, the Indemnitee shall be entitled to also be paid the expense (to be proportionately prorated if the Indemnitee is only partially successful) of prosecuting such claim. Neither (1) the failure of the Corporation (including its Board of Directors, its shareholders, or independent legal counsel) to have made a determination prior to the commencement of such proceeding that indemnification or reimbursement or advancement of Expenses to the Indemnitee is proper in the circumstances; nor (2) an actual determination by the Corporation (including its Board of Directors, its shareholders, or independent legal counsel that the Indemnitee is not entitled to indemnification or to the reimbursement or advancement of Expenses, shall be a defense to the proceeding or create a presumption that the Indemnitee is not so entitled.

12.6.5 Nonexclusivity of Rights. The right to indemnification and the payment of Expenses incurred in defending a Proceeding in advance of its final disposition granted in this Article shall not be exclusive of any other right which any Indemnitee may have or hereafter acquire under any statute, provision of this Article or the Bylaws, agreement, vote of shareholders or disinterested directors, or otherwise. The Corporation shall have the express right to grant additional indemnity without seeking further approval or satisfaction by the shareholders. All applicable indemnity provisions and any applicable law shall be interpreted and applied so as to provide an Indemnitee with the broadest but nonduplicative indemnity to which he or she is entitled.

12.7 Contribution. If the indemnification provided in Section 12.2 of this Article is not available to be paid to Indemnitee for any reason other than those set forth in subparagraphs 12.2(a), 12.2(b), and 12.2(c) of Section 12.2 of this Article (for example, because indemnification is held to be against public policy even though otherwise permitted under Section 12.2) then in respect of any proceeding in which the Corporation is jointly liable with Indemnitee (or would be if joined in such proceeding), the Corporation shall contribute to the amount of loss paid or payable by Indemnitee in such proportion as is appropriate to reflect:

The relative benefits received by the Corporation on the one hand and the Indemnitee on the other hand from the transaction from which such proceeding arose, and

The relative fault of the Corporation on the one hand and the Indemnitee on the other hand in connection with the events which resulted in such loss, as well as any other relevant equitable consideration.

The relative benefits received by and fault of the Corporation on the one hand and the Indemnitee on the other shall be determined by a court of appropriate jurisdiction (which may be the same court in which the proceeding took place) with reference to, among other things, the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent the circumstances resulting in such loss. The Corporation agrees that it would not be just and equitable if a contribution pursuant to this Article was determined by pro rata allocation or any other method of allocation which does not take account of the foregoing equitable considerations.

12.8 Exceptions. Any other provision herein to the contrary notwithstanding, the Corporation shall not be obligated pursuant to the terms of these Articles to indemnify or advance Expenses to Indemnitee with respect to any proceeding.

12.8.1 Claims Initiated by Indemnitee. Initiated or brought voluntarily by Indemnitee and not by way of defense, but such indemnification or advancement of Expenses may be provided by the Corporation in specific cases if the Board of Directors finds it to be appropriate. Notwithstanding the foregoing, the Corporation shall provide indemnification including the advancement of Expenses with respect to Proceedings brought to establish or enforce a right to indemnification under these Articles or any other statute or law or as otherwise required under the statute.

12.8.2 Lack of Good Faith. Instituted by Indemnitee to enforce or interpret this Article, if a court of competent jurisdiction determines that each of the material assertions made by Indemnitee in such proceeding was not made in good faith or was frivolous.

12.8.3 Insured Claims. For which any of the Expenses or liabilities for indemnification is being sought have been paid directly to Indemnitee by an insurance carrier under a policy of officers' and directors' liability insurance maintained by the Corporation.

12.8.4 Prohibited by Law. If the Corporation is prohibited by the Act or other applicable law as then in effect from paying such indemnification and/or advancement of Expenses. For example, the Corporation and Indemnitee acknowledge that the Securities and Exchange Commission ("SEC") has taken the position that indemnification is not possible for liabilities arising under certain federal securities laws. Indemnitee understands and acknowledges that the Corporation has undertaken or may be required in the future to undertake with the SEC to submit the question of indemnification to a court in certain circumstances for a determination of the Corporation's right to indemnify Indemnitee.

12.9 Successors and Assigns. All obligations of the Corporation to indemnify any Director or Officer shall be binding upon all successors and assigns of the Corporation (including any transferee of all or substantially all of its assets and any successor by merger or other-wise by operation of law). The Corporation shall not effect any sale of substantially all of its assets, merger, consolidation, or other reorganization, in which it is not the surviving entity, unless the surviving entity agrees in writing to assume all such obligations of the Corporation.

ARTICLE XIII

CORPORATION'S ACQUISITION OF ITS OWN SHARES

The Corporation may purchase, redeem, receive, take or otherwise acquire, own and hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal with and in its own shares. As a specific modification of Section 23B.06.310 of the Act, pursuant to the authority in Section 23B.02.020(5)(c) of the Act, to include provisions related to the management of the business and the regulation of the affairs of the Corporation, shares of the Corporation's stock acquired by it pursuant to this Article shall be considered "Treasury Stock" and so held by the Corporation. The shares so acquired by the Corporation shall not be considered as authorized and unissued but rather as authorized, issued, and held by the Corporation. The shares, so acquired shall not be regarded as cancelled or as a reduction to the authorized capital of the Corporation unless specifically so designated by the Board of Directors in an amendment to these Articles of Incorporation. The provisions of this Article do not alter or effect the status of the Corporation's acquisition of its shares as a "distribution" by the Corporation as defined in Section 23B.01.400(6) of the Act, nor alter or effect the limitations on distributions by the Corporation as set forth in Section 23B.06.400 of the Act. Any shares so acquired by the Corporation, unless otherwise specifically designated by the Board of Directors, at the time of acquisition, shall be considered on subsequent disposition, as transferred rather than reissued. Nothing in this Article limits or restricts the right of the Corporation to resell or otherwise dispose of any of its shares previously acquired for such consideration and according to such procedures as established by the Board of Directors.

The undersigned has signed these Restated Articles of Incorporation as of March 12, 1999.

/s/ Robert A. Eshelman

Robert A. Eshelman
Assistant Secretary

RESTATEMENT CERTIFICATE

The undersigned officer of Microsoft Corporation (the "Corporation") hereby certifies as follows:

1. The name of the Corporation is Microsoft Corporation.

2. The attached Restated Articles of Incorporation of the Corporation contains an amendment to one section, Section 4.1. This section has been replaced in its entirety. The new section increases the number of shares that the Corporation has the authority to issue from 4,100,000,000 to 12,100,000,000 (increasing the number of authorized Common Shares from 4,000,000,000 to 12,000,000,000 but maintaining the number of authorized Preferred Shares at 100,000,000). In addition, the new Section 4.1 halves the par value of the Common Shares from $.000025 to $.0000125. Otherwise, the Amended and Restated Articles of Incorporation restates the Articles of Incorporation of the Corporation in its entirety.

3. The amendment does not provide for an exchange, reclassification or cancellation of issued shares.

4. The amendment was duly adopted by the Board of Directors as of January 23, 1999 in accordance with the provisions of Sections 23B.06.020 and 23B.10.070 of the Washington Business Corporation Act. The shareholders of the Corporation duly approved the amendment on March 12, 1999 in accordance with the provisions of Sections 23B.10.030 and 23B.10.040 of the Washington Business Corporation Act.

MICROSOFT CORPORATION

By /s/ Robert A. Eshelman

Robert A. Eshelman
Assistant Secretary

Exhibit 3.2

BYLAWS

OF

MICROSOFT CORPORATION

ARTICLE I

Shareholders

1.1 Annual Meeting. The annual meeting of the shareholders of the Corporation for the election of Directors and for the transaction of such other business as properly may be submitted to such annual meeting, shall be held at the hour and on the date designated by the Board of Directors or an authorized committee of the Board of Directors, such date to be within 150 days of the end of the fiscal year.

1.2 Special Meetings. Special meetings of the shareholders of the Corporation, for any purpose or purposes, may be called at any time by the Board of Directors or an authorized committee of the Board of Directors.

1.3 Place of Meetings. Meetings of shareholders shall be held at such place within or without the State of Washington as determined by the Board of Directors, or an authorized committee, pursuant to proper notice.

1.4 Notice. Written notice of each shareholders' meeting stating the date, time, and place and, in case of a special meeting, the purpose(s) for which such meeting is called, shall be given by the Corporation not less than ten (10) (unless a greater period of notice is required by law in a particular case) nor more than sixty (60) days prior to the date of the meeting, to each shareholder of record, to the shareholder's address as it appears on the current record of shareholders of the Corporation.

1.5 Quorum of Shareholders. At any meeting of the shareholders, a majority in interest of all the shares entitled to vote on a matter, represented by shareholders of record in person or by proxy, shall constitute a quorum of that voting group for action on that matter.

Once a share is represented at a meeting, other than to object to holding the meeting or transacting business, it is deemed to be present for quorum purposes for the remainder of the meeting and for any adjournment of that meeting unless a new record date is or must be set for the adjourned meeting. At such reconvened meeting, any business may be transacted that might have been transacted at the meeting as originally notified.

If a quorum exists, action on a matter is approved by a voting group if the votes cast within the voting group favoring the action exceed the votes cast within the voting group opposing the action, unless the question is one upon which by express provision of the Washington Business Corporation Act, as amended ("WBCA"), or of the Articles of Incorporation or of these Bylaws a different vote is required.

1.6 Adjournment. A majority of the shares represented at the meeting, even if less than a quorum, may adjourn the meeting from time to time. At such reconvened meeting at which a quorum is present any business may be transacted at the meeting as originally notified. If a meeting is adjourned to a different date, time, or place, notice need not be given of the new date, time, or place if a new date, time, or place is announced at the meeting before adjournment; however, if a new record date for the adjourned meeting is or must be fixed in accordance with the WBCA, notice of the adjourned meeting must be given to persons who are shareholders as of the new record date.

1.7 Record Date and Transfer Books. For the purpose of determining shareholders who are entitled to notice of or to vote at any meeting of shareholders or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the Board of Directors may fix in advance a record date for any such determination of shareholders, such date in any case to be not more than seventy (70) days and, in case of a meeting of shareholders, not less than ten (10) days prior to the date on which the particular action, requiring such determination of shareholders, is to be taken.

If no record date is fixed for such purposes, the date on which notice of the meeting is mailed or the date on which the resolution of the Board of Directors declaring such dividend is adopted, as the case may be, shall be the record date for such determination of shareholders.

When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this section, such determination shall apply to any adjournment thereof, unless the Board of Directors fixes a new record date, which it must do if the meeting is adjourned more than one hundred twenty (120) days after the date is fixed for the original meeting.

1.8 Voting Record. The officer or agent having charge of the stock transfer books for shares of the Corporation shall make at least ten (10) days before each meeting of shareholders a complete record of the shareholders entitled to vote at such meeting or any adjournment thereof, arranged by any applicable voting groups and in alphabetical order, with the address of and the number of shares held by each. Such record shall be produced and kept open at the time and place of the meeting and shall be subject to the inspection of any shareholder or any shareholder's agent during the whole time of the meeting for the purposes thereof.

1.9 Proxies. Shareholders of record may vote at any meeting either in person or by proxy. A shareholder may appoint a proxy to vote for the shareholder by submission of (i) an appointment form signed by the shareholder or the shareholder's attorney-in-fact, or (ii) an electronic transmission which contains or is accompanied by information from which it can be reasonably verified that the transmission was authorized by the shareholder or by the shareholder's attorney-in-fact. As used in this Section 1.9, "electronic transmission" means any process of communication not directly involving the physical transfer of paper that is suitable for the retention, retrieval, and reproduction of information by the recipient. An appointment of proxy is effective when an appointment form or an electronic transmission (or documentary evidence thereof, including verification information) is received by the person authorized to tabulate votes for the Corporation. The proxy has the same power to vote as that possessed by the shareholder, unless the appointment form or electronic transmission contains an express limitation on the power to vote or direction as to how to vote the shares on a particular matter, in which event the Corporation must tabulate the votes in a manner consistent with that limitation or direction. An appointment of proxy is valid for eleven (11) months unless a longer period is expressly provided in the appointment form or electronic transmission.

1.10 Organization of Meeting. The officer designated by the Board of Directors as Chief Executive Office (or in his absence, any other officer designated by the Board of Directors) may call any meeting of shareholders to order and shall be the Chairman thereof. The Secretary of the Corporation, if present at any meeting of its shareholders, shall act as the Secretary of such meeting. If the Secretary is absent from any such meeting, the Chairman of such meeting may appoint a Secretary for the meeting.

1.11 Order of Business. The Chairman of a meeting of shareholders, determined in accordance with Section 1.10, shall have discretion to establish the order of business for such meeting subject to any specific order established by the Board of Directors.

ARTICLE II

Board of Directors

2.1 Number and Qualifications. The business affairs and property of the Corporation shall be managed by a Board of not less than three directors nor more than eleven directors. The number of directors may at any time be increased or decreased by resolution of the Board of Directors or by the shareholders at the annual meeting. Directors need not be shareholders of the Corporation or residents of the state of Washington.

2.2 Election - Term of Office. The directors shall be elected by the shareholders at each annual shareholders' meeting to hold office until the next annual meeting of the shareholders and until their respective successors are elected and qualified. If, for any reason, the directors shall not have been elected at any annual meeting, they may be elected at a special meeting of shareholders called for that purpose in the manner provided by these Bylaws.

2.3 Regular Meetings. Regular meetings of the Board of Directors shall be held at such places, and at such times as the Board may determine, and, if so determined, no notice thereof need be given. A regular meeting of the Board may be held without notice immediately after the annual meeting of shareholders at the same place at which such meeting was held.

2.4 Special Meetings. Special meetings of the Board of Directors may be held at any time or place upon the call of a majority of directors, the Chief Executive Officer or the Chief Operating Officer by oral or written notice, given or mailed to each director not less than two (2) days before such meeting.

2.5 Notice. No notice is required for regular meetings of the Board of Directors. Notice of special meetings of the Board of Directors, stating the date, time, and place thereof, shall be given at least two (2) days prior to the date of the meeting. The purpose of the meeting need not be given in the notice. Such notice may be oral or written.

2.6 Waiver of Notice. A director may waive notice of a special meeting of the Board either before or after the meeting, and such waiver shall be deemed to be the equivalent of giving notice. The waiver must be in writing, signed by the director entitled to the notice and delivered to the Corporation for inclusion in its corporate records. Attendance or participation of a director at a meeting shall constitute waiver of notice of that meeting unless said director attends or participates for the express purpose of objecting to the transaction of business because the meeting has not been lawfully called or convened.

2.7 Quorum of Directors. A majority of the members of the Board of Directors shall constitute a quorum for the transaction of business, but if at any meeting of the Board there shall be less than a quorum present, a majority of those present may adjourn the meeting from time to time until a quorum shall have been obtained. When a quorum is present at any meeting, a majority of the members present shall decide any question brought before such meeting, except as otherwise provided by the Articles of Incorporation or by these Bylaws.

2.8 Adjournment. A majority of the directors present, even if less than a quorum, may adjourn a meeting and continue it to a later time. Notice of the adjourned meeting or of the business to be transacted thereat, other than by announcement, shall not be necessary. At any adjourned meeting at which a quorum is present, any business may be transacted which could have been transacted at the meeting as originally called.

2.9 Resignation. Any director of the Corporation may resign at any time by giving written notice to the Board of Directors, the Chairman, the President, or the Secretary of the Corporation. Any such resignation is effective when the notice is delivered, unless the notice specifies a later effective date.

2.10 Vacancies. Unless otherwise provided by the WBCA, in case of any vacancy in the Board of Directors, including a vacancy resulting from an increase in the number of directors, the remaining directors, whether constituting a quorum or not, may fill the vacancy.

2.11 Compensation. The Board shall have the sole authority to fix the amount of compensation of directors.

2.12 Committees. The Board of Directors, by resolution adopted by a majority of the full Board of Directors, may designate from among its members one or more committees, each of which:

a. Shall have two (2) or more members;

b. Shall be governed by the same rules regarding meetings, action without meetings, notice, and waiver of notice, and quorum and voting requirements as applied to the Board of Directors; and

c. To the extent provided in such resolution, shall have and may exercise all the authority of the Board of Directors, except no such committee shall have the authority to:

(1) Authorize or approve a distribution except according to a general formula or method prescribed by the Board of Directors;

(2) Approve or propose to shareholders action which the WBCA requires to be approved by shareholders;

(3) Fill vacancies on the Board of Directors or on any of its committees;

(4) Amend the Articles of Incorporation;

(5) Adopt, amend, or repeal the Bylaws;

(6) Approve a plan of merger not requiring shareholder approval; or

(7) Authorize or approve the issuance or sale or contract for sale of shares, or determine the designation and relative rights, preferences, and limitations on a class or series of shares, except that the Board of Directors may authorize a committee, or a senior executive officer of the Corporation, to do so within limits specifically prescribed by the Board of Directors.

ARTICLE III

Special Measures Applying to Meetings of Shareholders, the Board of Directors and Committees of the Board

3.1 Action by Written Consent. Any action required or permitted to be taken at a meeting of the Board of Directors or a committee of the Board may be accomplished without a meeting if the action is taken by all the members of the Board or all the members of the committee, as the case may be. The action must be evidenced by one or more written consents describing the action to be taken, signed by all directors or all members of the committee, as the case may be, and delivered to the Corporation for inclusion in the minutes. Directors' consents may be signed either before or after the action taken.

Action taken by unanimous written consent is effective when the last director signs the consent, unless the consent specifies a later effective date.

3.2 Use of Communications Equipment. Meetings of the shareholders, the Board of Directors and committees of the Board may be effectuated by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other during the meeting. Participation by such means shall constitute presence in person at such meeting.

3.3 Oral and Written Notice. Oral notice may be communicated in person or by telephone, wire or wireless equipment that does not transmit a facsimile of the notice. Oral notice is effective when communicated if communicated in a comprehensible manner.

Written notice may be transmitted by mail, private carrier, or personal delivery; telegraph or teletype; or telephone, wire, or wireless equipment that transmits a facsimile of the notice and provides the transmitter with an electronically generated receipt. Written notice is effective at the earliest of the following: (a) when received; (b) five (5) days after its deposit in the US. mail if mailed with first-class postage; (c) on the date shown on the return receipt, if sent by registered or certified mail, return receipt requested, and the receipt is signed by or on behalf of the addressee.

ARTICLE IV

Officers

4.1 Positions. The officers of the Corporation may consist of a Chairman, a President, one or more Vice Presidents (who may be designated as Vice Presidents, Senior Vice Presidents or Executive Vice Presidents), a Secretary and a Treasurer as appointed by the Board of Directors or the Chief Executive Officer. The Corporation may have such additional or assistant officers (sometimes referred to as "additional officers") as the Board of Directors, Chief Executive Officer or Chief Operating Officer may deem necessary for its business and may appoint from time to time. The Board of Directors shall also have the authority, but shall not be required, to designate officers as the Chief Executive Officer, the Chief Operating Officer the Chief Financial Officer or similar such titles. Any two or more offices may be held by the same person.

If a director/officer has not been designated as Chairman, or if the designated Chairman is not present, the Board of Directors shall elect a Chairman from amongst its members to serve as Chairman of the Board of Directors. The Chairman shall preside at all meetings of the Board of Directors, and shall have such other powers as the Board may determine.

4.2 Appointment and Term of Office. The officers of the Corporation shall be appointed annually by the Board of Directors at the first meeting of the Board of Directors held after each annual meeting of the shareholders. If officers are not appointed at such meeting, such appointment shall occur as soon as possible thereafter, or may be left vacant. Each officer shall hold office until a successor shall have been appointed and qualified or until said officer's earlier death, resignation, or removal.

4.3 Authority and Duties of the Chief Executive Officer. The Chief Executive Officer shall have general charge and supervision of the business of the Corporation, shall see that all orders, actions and resolutions of the Board of Directors are carried out, and shall have such other authority and shall perform such other duties as set forth in these bylaws or, to the extent consistent with the bylaws, such other authorities and duties as prescribed by the Board of Directors.

4.4 Authority and Duties of Other Officers. Each officer other than the Chief Executive Officer shall have the authority and shall perform the duties set forth in these bylaws or, to the extent consistent with the bylaws, the duties prescribed by the Board of Directors, by the Chief Executive Officer, or by an officer authorized by the Board of Directors to prescribe the duties of such officer. Any designation of duties by the Chief Executive Officer or other officer shall be subject to review by the Board of Directors but shall be in full force and effect in the absence of such review.

4.5 Compensation and Contract Rights. The Board of Directors shall have authority (a) to fix the compensation, whether in the form of salary, bonus, stock options or otherwise, of all officers and employees of the Corporation, either specifically or by formula applicable to particular classes of officers or employees, and (b) to authorize officers of the Corporation to fix the compensation of subordinate employees. The Board of Directors shall have authority to appoint a Compensation Committee and may delegate to such committee any or all of its authority relating to compensation. The appointment of an officer shall not of itself create contract rights.

4.6 Resignation or Removal. Any officer of the Corporation may resign at any time by giving written notice to the Board of Directors. Any such resignation is effective when the notice is delivered, unless the notice specifies a later date, and shall be without prejudice to the contract rights, if any, of such officer.

The Board of Directors, by majority vote of the entire Board, may remove any officer or agent, with or without cause. An officer or assistant officer, if appointed by another officer, may also be removed by any officer authorized to appoint officers or assistant officers. The removal shall be without prejudice to the contract rights, if any, of the person so removed.

4.7 Vacancies. If any office becomes vacant by any reason, the directors may appoint a successor or successors who shall hold office for the unexpired term or leave such office vacant.

ARTICLE V

Certificates of Shares and Their Transfer

5.1 Issuance; Certificates of Shares. No shares of the Corporation shall be issued unless authorized by the Board. Such authorization shall include the maximum number of shares to be issued, the consideration to be received, and a statement that the Board considers the consideration to be adequate. Shares may but need not be represented by certificates. Certificates for shares of the Corporation shall be in such form as is consistent with the provisions of the WBCA or the law of a predecessor corporation and after the effective date of these Bylaws shall state:

a. The name of the Corporation and that the Corporation is organized under the laws of the State of Washington;

b. The name of the person to whom issued; and

c. The number and class of shares and the designation of the series, if any, which such certificate represents.

The certificate shall be signed by original or facsimile signature of two officers of the Corporation, and the seal of the Corporation may be affixed thereto.

5.2 Transfer of Stock. Shares of stock represented by certificates may be transferred by delivery of the certificate accompanied by either an assignment in writing on the back of the certificate or by a written power of attorney to assign and transfer the same on the books of the Corporation, signed by the record holder of the certificate. The shares shall be transferable on the books of the Corporation upon surrender thereof so assigned or endorsed.

5.3 Rules and Regulations Concerning the Issue, Transfer and Registration of Shares. The Board of Directors shall have power and authority to make all such rules and regulations as the Board may deem proper or expedient concerning the issue, transfer and registration of shares of stock. In case of the loss, mutilation, or destruction of a certificate of stock, a duplicate certificate may be issued upon such terms as the Board shall authorize. The Board shall have power and authority to appoint from time to time one or more transfer agents and registrar of the shares of stock.

5.4 Shares without Certificates. The Board of Directors may authorize the issue of some or all of the shares without certificates. Within a reasonable time after the issue or transfer of shares without certificates, the corporation shall send the shareholder a written statement of the information required on certificates by the WBCA.

ARTICLE VI

Books and Records

6.1 Books of Accounts, Minutes, and Share Register. Except as otherwise provided by law the Corporation:

a. Shall keep as permanent records minutes of all meetings of its shareholders and Board of Directors, a record of all actions taken by the Board of Directors without a meeting, and a record of all actions taken by a committee of the Board of Directors exercising the authority of the Board of Directors on behalf of the Corporation;

b. Shall maintain appropriate accounting records;

c. Or its agent shall maintain a record of its shareholders, in a form that permits preparation of a list of the names and addresses of all shareholders, in alphabetical order by class of shares showing the number and class of shares held by each; and

d. Shall keep a copy of the following records at its principal office:

(1) The Articles or Restated Articles of Incorporation and all amendments to them currently in effect;

(2) The Bylaws or Restated Bylaws and all amendments to them currently in effect;

(3) The minutes of all shareholders' meetings, and records of all actions taken by shareholders without a meeting, for the past three (3) years;

(4) Its financial statements for the past three (3) years, including balance sheets showing in reasonable detail the financial condition of the Corporation as of the close of each fiscal year, and an income statement showing the results of its operations during each fiscal year prepared on the basis of generally accepted accounting principles or, if not, prepared on a basis explained therein;

(5) All written communications to shareholders generally within the past three (3) years;

(6) A list of the names and business addresses of its current directors and officers; and

(7) Its most recent annual report delivered to the Secretary of State of Washington.

6.2 Copies of Resolutions. Any person dealing with the Corporation may rely upon a copy of any of the records of the proceedings, resolutions, or votes of the Board of Directors or shareholders, when certified by the Secretary, an assistant secretary, or other officer authorized by the Board.

Notes:

Section 1.9 was amended in September 1998 to provide for electronic proxy voting.

Exhibit 13.1

Quarterly Information
(In millions, except per share data) (Unaudited)

	Quarter Ended				
	Sept. 30	Dec. 31	Mar. 31	June 30	Year
1997					
Revenue	$2,405	$2,808	$3,365	$3,358	$11,936
Gross profit	1,923	2,250	2,782	2,811	9,766
Net income	614	741	1,042	1,057	3,454
Basic earnings per share	0.13	0.15	0.22	0.22	0.72
Diluted earnings per share	0.12	0.14	0.20	0.20	0.66
Common stock price per share:					
High	17.33	21.54	25.88	33.74	33.74
Low	13.44	16.36	20.19	22.44	13.44
1998					
Revenue	$3,334	$3,792	$3,984	$4,152	$15,262
Gross profit	2,800	3,179	3,344	3,479	12,802
Net income	663	1,133	1,337	1,357	4,490
Basic earnings per share	0.14	0.24	0.27	0.27	0.92
Diluted earnings per share	0.13	0.21	0.25	0.25	0.84
Common stock price per share:					
High	37.69	36.66	45.47	54.28	54.28
Low	30.82	29.50	31.10	40.94	29.50
1999					
Revenue	$4,193	$5,195	$4,595	$5,764	$19,747
Gross profit	3,544	4,407	3,887	5,095	16,933
Net income	1,683	1,983	1,917	2,202	7,785
Basic earnings per share	0.34	0.40	0.38	0.43	1.54
Diluted earnings per share	0.31	0.36	0.35	0.40	1.42
Common stock price per share:					
High	59.81	72.00	94.63	95.63	95.63
Low	47.25	48.13	68.00	75.50	47.25

The Company's common stock is traded on The Nasdaq Stock Market under the symbol MSFT. On July 31, 1999, there were 92,169 registered 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	1995	1996	1997	1998	1999
Revenue	$6,075	$ 9,050	$11,936	$15,262	$19,747
Net income	1,453	2,195	3,454	4,490	7,785
Diluted earnings per share (1)	0.29	0.43	0.66	0.84	1.42
Cash and short-term investments	$4,750	$ 6,940	$ 8,966	$13,927	$17,236
Total assets	7,210	10,093	14,387	22,357	37,156
Stockholders' equity	5,333	6,908	10,777	16,627	28,438

(1) Diluted earnings per share have been restated to reflect a two-for-one stock split in March 1999.

Exhibit 13.3

Management's Discussion and Analysis

Results of Operations for 1997, 1998, and 1999

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

Revenue

The Company's revenue growth rate was 32% in fiscal 1997, 28% in fiscal 1998, and 29% in fiscal 1999. Revenue growth rates reflected the continued adoption of Windows operating systems and Microsoft Office, particularly as Microsoft software is deployed across entire corporate, academic, and governmental organizations. Software license volume increases have been the principal factor in the Company's revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and organizational license programs is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, such as Microsoft Office and BackOffice, are less than the sum of the prices for the individual programs included in these suites when such programs are licensed separately. During each of the three years, an increased percentage of products and programs included elements that were billed but unearned and recognized ratably, such as Microsoft Windows, Microsoft Office, maintenance, and other subscription models. See accompanying notes to financial statements.

As noted above, the Company's business model continues to evolve from selling packaged products to licensing organizational licenses and subscriptions. The Company's products are generally delivered to customers through a multi-tiered channel of distributors and resellers, but the distribution model is also changing for selected retail products that are now being shipped straight to resellers and other selected products that are now being shipped straight to customers. Due to these changes in channel mechanics and the business model, the risk of returns of product from distributors and resellers has declined. Accordingly, the estimate for future product returns was reduced by $250 million in the fourth quarter of fiscal 1999.

The Company changed the way it reports revenue and costs associated with product support, consulting, MSN Internet access, and training and certification of system integrators. Amounts received from customers for these activities have been classified as revenue in a manner more consistent with Microsoft's primary businesses. These amounts had been previously netted in sales and marketing expenses, except for MSN access fees, which had been netted in research and development expenses. Direct costs of these activities are classified as cost of revenue. Prior financial statements and disclosures have been reclassified for consistent presentation. Revenue from these activities was $578 million, $778 million, and $1.06 billion in 1997, 1998, and 1999.

Microsoft also made two changes related to the ratable recognition of revenue for a portion of its revenue for certain products. A new accounting rule that interprets American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, requires companies to use the average sales price of each undelivered element of software arrangements. Prior authoritative guidance allowed a comparison of the total price differential between a licensed product sold through different channels of distribution to derive the value of undelivered elements offered to customers acquiring product from one channel but not the other. Upon adoption of this new rule in the fourth quarter of fiscal 1999, the percentages of the total arrangement treated as unearned decreased. This change in the timing of revenue recognition reduced the amount of Microsoft Windows and Microsoft Office sales treated as unearned and increased the amount of revenue recognized upon shipment. Additionally, as part of the Company's long range planning process and a review of product shipment cycles, it was determined that the life cycle of Windows should be extended from two years to three years. The net impact of these changes was to increase reported revenue $80 million in the fourth quarter of 1999.

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

Windows Platforms revenue was $4.92 billion, $6.28 billion, and $8.50 billion in 1997, 1998, and 1999. Platform revenue is primarily licenses of PC operating systems and business and enterprise server systems with client/server, Internet, and intranet architectures.

The Company's principal PC operating systems are Windows 95, Windows 98, and Windows NT(R) Workstation. Windows 95 was released in August 1995, while its successor, Windows 98, became available at the end of fiscal 1998. Windows NT Workstation version 4.0 was released in fiscal 1997. Although the growth rate of new PC shipments slowed, PC operating systems contributed to revenue growth as shipments of new PCs preinstalled with such systems increased during the three-year period. Additionally, increased penetration of the higher value Windows NT Workstation led to growth in all three years.

Windows NT Server is a comprehensive business and enterprise server operating system, combining application, file and print, communication, and Web services. Windows NT Server version 4.0 was released in fiscal 1997. Revenue from Windows NT Server increased strongly during each of the three years due to greater corporate demand, particularly for intranet computing solutions.

Productivity Applications and Developer revenue was $5.62 billion, $7.04 billion, and $8.82 billion in 1997, 1998, and 1999. Products include primarily desktop applications, server applications, and software developer tools.

Microsoft Office integrated suites, including the Standard, Small Business, Professional, and Premium Editions, are the Company's principal desktop applications and a key driver of revenue growth. Microsoft Office 97 was released in fiscal 1997 and Microsoft Office 2000 was released at the end of fiscal 1999. The primary programs in Microsoft Office are the word processor Microsoft Word, Microsoft Excel spreadsheet, and Microsoft Outlook(R) messaging and collaboration client. Various versions of Office, which are available for the Windows and Macintosh operating systems, also include Microsoft Access database management program, Microsoft PowerPoint(R) presentation graphics program, Microsoft FrontPage(R) Web site creation and management program, or other programs. Revenue from stand-alone versions of Microsoft Excel, Word, and PowerPoint continued to decrease as the sales mix shifted to integrated product suites.

Server applications, based on Microsoft Windows NT Server, offer an enterprise-wide distributed client/server, Internet, and intranet environment. Products include Microsoft Exchange Server, Microsoft SQL Server, and other server applications in the Microsoft BackOffice family of products. Microsoft Exchange is an enterprise messaging and collaboration server while Microsoft SQL Server is a scalable database and data warehouse platform. Revenue from these products increased strongly over the three-year period, albeit with slowing growth rates in 1998 and 1999.

Independent software vendors, corporate developers, and solutions developers license tools such as the Microsoft Visual Studio(R) development system, which includes the Microsoft Visual Basic(R) development system, to develop software for the Windows operating systems and the Internet. Revenue from developer products increased moderately in 1997, was flat in 1998, and increased strongly in 1999.

Although revenue was not significant, preinstallations of Windows CE by OEMs on intelligent devices were strong in 1998 and 1999.

Consumer, Commerce, and Other revenue was $1.40 billion, $1.94 billion, and $2.43 billion in 1997, 1998, and 1999. This category of product revenue includes learning and entertainment software; PC input devices; training and certification fees; consulting; and the online services. The Company's Internet services include the MSN portal, MSN access, WebTV(R), and vertical properties such as MSN Hotmail Web-based email service, Expedia.com(TM) travel site, CarPoint car buying site, and MoneyCentral personal finance site.

Learning and entertainment revenue was relatively flat in all three years. Mouse, gaming device, and keyboard sales increased in 1997 and 1998, but were steady in 1999. Training and certification fees from system integrators, along with consulting services to large enterprise customers and technology solution providers, increased strongly in all three years. Revenue from MSN Internet access fees and WebTV services increased due to higher subscriber levels. Advertising revenue, although relatively small in amount, increased exceptionally well in 1999 for the online portal and vertical properties.

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

OEM channel revenue was $3.49 billion in 1997, $4.72 billion in 1998, and $6.40 billion in 1999. The primary source of OEM revenue is the licensing of desktop operating systems, and OEM revenue is highly dependent on PC shipment volume. Growth was also enhanced by increased penetration of higher-value Windows NT Workstation licenses.

Revenue in the South Pacific and Americas Region was $4.39 billion, $5.57 billion, and $7.25 billion in 1997, 1998, and 1999. Revenue in the Europe, Middle East, and Africa Region was $2.77 billion, $3.50 billion, and $4.33 billion for the three years. Growth rates have been lower in Europe than in other geographic areas due to higher existing market shares and a faster shift to licensing programs. Asia Region revenue was $1.29 billion in 1997, $1.48 billion in 1998, and $1.78 billion in 1999. After strong growth in prior years, revenue was relatively flat in Japan and Southeast Asia in 1998 and the first half of fiscal 1999 due to economic issues and weak currencies.

The Company's operating results are affected by foreign exchange rates. Approximately 32%, 32%, and 29% of the Company's revenue was collected in foreign currencies during 1997, 1998, and 1999. Since a portion of local currency revenue is hedged and much of the Company's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates is partially mitigated.

Operating Expenses

Microsoft encourages broad-based employee ownership of Microsoft stock through an employee stock option (ESO) program in which most employees are eligible to participate. Historically, exercise prices of grants of ESOs were struck at the lowest price in the 30 days following July 1 for annual grants and the 30 days after the start date for new employees. In connection with this practice, which is no longer employed, a charge of $217 million was recorded in the fourth quarter for fiscal 1999 compensation expense, calculated under the provisions of Accounting Principles Board Opinion 25 (APB 25). Charges related to ESO compensation were reflected in 1999 operating expenses as follows (in millions):

Cost of revenue	$ 44
Research and development	105
Sales and marketing	46
General and administrative	22
Total	$217

Cost of revenue. Cost of revenue as a percent of revenue was 18.2% in 1997, 16.1% in 1998, and 14.3% in 1999. The percentage decreases resulted primarily from the trend in mix shift to OEM and organizational licenses. The decrease was also due to the shifts in mix to CD-ROMs (which carry lower cost of goods than disks) and higher-margin Windows NT Server, other servers, and client access licenses in the BackOffice product family. Additionally, cost of revenue in 1999 was positively impacted by a reduction in estimates of obsolete inventory and other manufacturing costs of $67 million. As discussed above, the Company's business model continues to evolve toward licensing from sales of packaged products through distribution channels. Consequently, risks associated with manufacturing and holding physical product have declined.

Research and development. Microsoft continued to invest heavily in the future by funding research and development (R&D). Expense increases in 1997, 1998, and 1999 resulted primarily from development staff headcount growth in many areas, particularly Windows platforms, including PC operating systems, servers, and Internet and intranet technologies. R&D costs also increased for productivity applications, development tools, and online services.

In 1998, the Company acquired WebTV Networks, Inc., an online service that enables consumers to experience the Internet through their televisions via set-top terminals. Microsoft paid $425 million in stock and cash. The accompanying income statement reflects a one-time write-off of in-process technologies under development by WebTV Networks of $296 million.

Sales and marketing. The increase in the absolute dollar amount of sales and marketing expenses in the three-year period was due primarily to expanded product-specific marketing programs, such as Office 97 in 1997, Windows 98 in 1998, and Office 2000 in 1999. Sales and marketing costs as a percentage of revenue decreased primarily due to moderate headcount growth. Microsoft brand advertising expenses rose slightly in 1998, but declined in 1999.

General and administrative. Increases in general and administrative expenses were attributable to higher legal fees, litigation costs, and growth in the number of people and computer systems necessary to support overall increases in the scope of the Company's operations.

Other expenses. Other expenses include the recognition of Microsoft's share of joint venture activities, including DreamWorks Interactive and the MSNBC entities.

Investment Income, Gain on Sale, and Income Taxes

Investment income increased primarily as a result of a larger investment portfolio generated by cash from operations in 1997, 1998, and 1999, coupled with realized gains from the sale of certain bond and equity securities in 1999.

In fiscal 1999, Microsoft sold its Softimage, Inc. subsidiary to Avid Technology, Inc. for a pretax gain of $160 million.

The effective income tax rate was 35.0% in 1997. The effective income tax rate increased to 36.9% in 1998 due to the nondeductible write-off of WebTV in-process technologies. Excluding the impact of the gain on the sale of Softimage, Inc., the effective tax rate for fiscal 1999 was 35.0%.

Net Income

Net income as a percent of revenue increased in 1997, 1998, and 1999 due primarily to the lower relative cost of revenue and sales and marketing expenses, combined with greater investment income.

Financial Condition

The Company's cash and short-term investment portfolio totaled $17.24 billion at June 30, 1999. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The portfolio is primarily invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs.

Microsoft also invests in equities, primarily strategic technology companies. The Company has made large-scale investments in access providers, including cable, telephony, and wireless communications companies. During 1999, the Company purchased $5.0 billion of AT&T convertible preferred securities and warrants, $600 million of Nextel Communications, Inc. common stock, $500 million of NTL, Inc. convertible preferred stock, $330 million of United Pan-Europe Communications common stock, and $200 million of Qwest Communications International Inc. common stock. In connection with AT&T's proposed merger with MediaOne Group, Inc., the Company agreed to acquire MediaOne's interest in Telewest Communications plc, a leading provider of cable television and residential and business cable telephony services in the United Kingdom, subject to certain regulatory approvals and other conditions. During 1997, Microsoft purchased $1.0 billion of Special Class A common stock and convertible preferred stock of Comcast Corporation. Microsoft also owns an interest in MCI WorldCom, Inc.

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

Microsoft has no material long-term debt and has $100 million of standby multicurrency lines of credit to support foreign currency hedging and cash management. Stockholders' equity at June 30, 1999 was $28.44 billion.

Microsoft will continue to invest in sales, marketing, and product support infrastructure. Additionally, research and development activities will include investments in existing and advanced areas of technology, including using cash to acquire technology. Additions to property and equipment will continue, including new facilities and computer systems for R&D, sales and marketing, support, and administrative staff. Commitments for constructing new buildings were $275 million on June 30, 1999. Cash will also be used to fund ventures and other strategic opportunities.

In addition, cash will be used to repurchase common stock to provide shares for employee stock option and purchase plans. The buyback program has not kept pace with employee stock option grants or exercises. Beginning in fiscal 1990, Microsoft has repurchased 710 million common shares while 1.79 billion shares were issued under the Company's employee stock option and purchase plans. The market value of all outstanding stock options was $69 billion as of June 30, 1999. Microsoft enhances its repurchase program by selling put warrants. During December 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable preferred stock. Net proceeds of $980 million were used to repurchase common shares. 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, equivalent to $19.97 and $25.56 per common share.

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

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

Issues and Uncertainties

While Microsoft 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 and competition Rapid change, uncertainty due to new and emerging technologies, and fierce competition characterize the PC software industry. The pace of change continues to accelerate, including "open source" software, new computing devices, new microprocessor architectures, the Internet, and Web-based computing models.

Future initiatives The Company continues to expand its efforts to provide and support mission-critical systems to large enterprises. Microsoft is also developing a Windows Web-centric platform and simpler and new natural interfaces for PC users. Additionally, Microsoft is committed to providing technologies, operating systems, and online services for all types of computing devices, including PCs, televisions, and intelligent appliances. Future revenue from these initiatives may not duplicate historical revenue growth rates.

PC growth rates The underlying PC unit growth rate and percentage of new PCs acquired as replacement units directly impact the Company's software revenue growth. Additionally, inexpensive PCs and specialty devices create less demand for Microsoft software than traditional PCs. The PC shipment growth rate may continue to decrease, the replacement rate may continue to increase, and limited-use PC growth may increase, reducing future software revenue opportunity.

Product ship schedules Potential delays in new product releases, including seminal products such as Windows 2000, could dampen revenue growth rates and cause operational inefficiencies that impact manufacturing and distribution logistics and relationships with customers, OEMs, and independent software vendors.

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.

Prices Future product prices may decrease from historical levels, depending on competitive market and cost factors. European and Asian software prices vary by country and are generally higher than in the United States to cover localization costs and higher costs of distribution. Increased global license agreements, European monetary unification, or other factors could erode such price uplifts in the future.

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. Also, penetration of the Company's desktop applications into large organizations is becoming saturated. These factors are likely to depress future desktop applications revenue growth.

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

Earnings process An increasingly higher percentage of the Company's revenue is subject to ratable recognition, which impacts the timing of revenue and earnings recognition. This policy may be required for additional products, depending on specific license terms and conditions. Also, maintenance and other subscription programs may continue to increase in popularity, particularly with organizations.

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 revenue was achieved through the OEM channel during 1998 and 1999.

Cost of revenue Decreases in cost of revenue as a percentage of revenue in 1998 and 1999 were due to general shifts from packaged products to OEM and organizational licenses, from lower-margin products to higher-margin products, and from disks to CD-ROMs. These shifts may not continue. Direct costs of product support; services such as consulting and training and certification of system integrators; and online operations comprise the majority of cost of revenue and are not likely to decrease. The trend of declining cost of revenue as a percentage of revenue is unlikely to continue in 2000.

Employee compensation Microsoft employees currently receive salaries, incentive bonuses, other benefits, and stock options. Fiscal 2000 salaries will be enhanced, with the mid-point salary range raised from the 50th to the 65th percentile of competitive positions. Additionally, new government regulations, poor stock price performance, or other factors could diminish the value of the option program to current and prospective employees and force the Company into more of a cash compensation model. Had the Company paid employees in cash the equivalent of the Black-Scholes value of options vested in 1997, 1998, and 1999, the incremental pretax expense would have been approximately $620 million, $850 million, and $1.10 billion.

Long-term R&D 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, including online initiatives. Significant revenue from these product opportunities is not anticipated for a number of years. Total spending for R&D in 2000 will increase over spending in 1999.

Sales and marketing investments The Company's plans for 2000 include accelerated investments in its sales groups, customer satisfaction, and marketing activities.

International operations Much of the Company's operations are conducted outside of the United States, and a large percentage of sales, costs of manufacturing, and marketing is transacted in local currencies. As a result, the Company's international results of operations are subject to local economic environments and foreign exchange rate fluctuations.

Market risk The Company is exposed to foreign currency, interest rate, and equity price risks. A portion of these risks is hedged, but fluctuations could impact the Company's results of operations and financial position. The Company hedges the exposure of accounts receivable and a portion of anticipated revenue to foreign currency fluctuations, primarily with option contracts. The Company monitors its foreign currency exposures daily to ensure the overall effectiveness of its foreign currency hedge positions. Principal currencies hedged include the Japanese yen, British pound, German mark, French franc, and Canadian dollar. Fixed income securities are subject to interest rate risk. The portfolio is diversified and consists primarily of investment grade securities to minimize credit risk. The Company routinely hedges its exposure to interest rate risk with options in the event of a catastrophic increase in interest rates. Many securities held in the Company's equity and other investments portfolio are subject to equity price risk. The Company hedges its equity price risk on certain highly volatile equity securities with options.

The Company used a value-at-risk (VAR) model to estimate and quantify its market risks. The VAR model is not intended to represent actual losses in fair value, but is used as a risk estimation and management tool. Assumptions applied to the VAR model at June 30, 1999 include the following: normal market conditions; Monte Carlo modeling with 10,000 simulated market price paths; a 97.5% confidence interval; and a 20-day estimated loss in fair value for each market risk category. Accordingly, 97.5% of the time the estimated 20-day loss in fair value would be nominal for foreign currency denominated investments and accounts receivable, and would not exceed $95 million for interest-sensitive investments or $1.38 billion for equity securities.

Previously, the Company used a sensitivity analysis to estimate interest rate and equity price risk. A 10% increase in interest rates would have reduced the carrying value of interest-sensitive securities by $128 million and $101 million at June 30, 1998 and 1999. A 10% decrease in market values would have reduced the carrying value of the Company's equity securities by $300 million and $1.37 billion at June 30, 1998 and 1999.

Intellectual property rights Microsoft diligently defends its intellectual property rights, but unlicensed copying of software represents a loss of revenue to the Company. While this adversely affects U.S. revenue, 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 revenue positively.

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.

Year 2000 The Year 2000 presents potential concerns for business and consumer computing. In addition to the well-known calculation problems with the use of 2-digit date formats as the year changes from 1999 to 2000, the Year 2000 is a special case leap year and in many organizations using older technology, dates were used for special programmatic functions. The problem exists for many kinds of software and hardware, including mainframes, mini computers, PCs, and embedded systems. The consequences of this issue may include systems failures and business process interruption.

Microsoft has tested more than 3000 versions/languages of its products. The vast majority of these tested products are Year 2000 compliant, as defined by Microsoft. There are a small number of older products that are identified as being non-compliant, and Microsoft will provide recommendations regarding these products. Not all versions of products or all products will be tested. All Year 2000 software updates, resources, and tools are available to customers at no charge from the Microsoft Year 2000 Portal Page or Microsoft Year 2000 Resource CD.

Current information needed to evaluate the impact of the Year 2000 on organizational and home computing environments is available at the Microsoft Year 2000 Portal Page (www.microsoft.com/year2000) and the Microsoft Year 2000 Resource CD, which is released on a quarterly basis. The Web site and Microsoft Year 2000 Resource CD detail specific Year 2000 information concerning Microsoft products and technologies for large organizations. The detailed information available on the Web site and Microsoft Year 2000 Resource CD is presented to assist information technology (IT) professionals in planning their transition to the Year 2000. The Microsoft Year 2000 Portal Page also contains information for small business and home PC users, including in-depth product information, answers to frequently asked questions, and links to other Year 2000 sites.

Variability of definitions of "compliance" with the Year 2000 and of different combinations of software, firmware, and hardware will likely lead to lawsuits against the Company. The outcome of such lawsuits and the impact on the Company are not estimable at this time.

The Year 2000 issue also affects the Company's internal systems, including IT and non-IT systems. Microsoft has assessed the readiness of its mission-critical systems for handling the Year 2000. Although testing and remediation of all systems have not been completed, management currently believes that all mission critical-systems will be compliant by the Year 2000 and that the cost to address the issues is not material. Nevertheless, Microsoft is creating contingency plans for certain internal systems.

Microsoft is addressing the effect this issue will have on its third-party supply chain and has undertaken steps to formulate a system of working with key third parties to understand their ability to continue providing services and products through the change to 2000. Microsoft is working directly with its key vendors, distributors, and resellers to avoid material business interruptions in 2000. Contingency plans are being developed where practicable for these key third parties.

Resolving Year 2000 issues is a worldwide phenomenon that is absorbing a substantial portion of IT budgets and attention. Certain industry analysts believe the Year 2000 issue will accelerate the trend toward distributed PC-based systems from mainframe systems, while others believe a majority of IT resources will be devoted to fixing older mainframe software in lieu of large-scale transitions to systems based on software such as that developed by Microsoft. The impact of the Year 2000 on future Microsoft revenue is difficult to discern, but is a risk to be considered in evaluating the future growth of the Company.

Future growth rate The revenue growth rate in 2000 may not approach the level attained in prior years. As discussed previously, operating expenses are expected to increase in 2000. Because of the fixed nature of a significant portion of such expenses, coupled with the possibility of slower revenue growth, operating margins in 2000 may decrease from those in 1999.

Exhibit 13.4

Microsoft Corporation

Financial Statements

Income Statements
(In millions, except earnings per share)

Year Ended June 30	1997	1998	1999
Revenue	$11,936	$15,262	$19,747
Operating expenses:			
Cost of revenue	2,170	2,460	2,814
Research and development	1,863	2,601	2,970
Acquired in-process technology	--	296	--
Sales and marketing	2,411	2,828	3,231
General and administrative	362	433	689
Other expenses	259	230	115
Total operating expenses	7,065	8,848	9,819
Operating income	4,871	6,414	9,928
Investment income	443	703	1,803
Gain on sale of Softimage, Inc.	--	--	160
Income before income taxes	5,314	7,117	11,891
Provision for income taxes	1,860	2,627	4,106
Net income	$ 3,454	$ 4,490	$ 7,785
Earnings per share (1):			
Basic	$ 0.72	$ 0.92	$ 1.54
Diluted	$ 0.66	$ 0.84	$ 1.42

(1) Earnings per share have been restated to reflect a two-for-one stock split in March 1999.

See accompanying notes.

Cash Flows Statements
(In millions)

Year Ended June 30	1997	1998	1999
Operations			
Net income	$ 3,454	$ 4,490	$ 7,785
Depreciation and amortization	557	1,024	1,010
Write-off of acquired in-process technology	--	296	--
Gain on sale of Softimage, Inc.	--	--	(160)
Unearned revenue	1,601	3,268	5,877
Recognition of unearned revenue from prior periods	(743)	(1,798)	(4,526)
Other current liabilities	321	208	966
Accounts receivable	(336)	(520)	(687)
Other current assets	(165)	(88)	(235)
Net cash from operations	4,689	6,880	10,030
Financing			
Common stock issued	744	959	1,350
Common stock repurchased	(3,101)	(2,468)	(2,950)
Put warrant proceeds	95	538	766
Preferred stock issued	980	--	--
Preferred stock dividends	(15)	(28)	(28)
Stock option income tax benefits	796	1,553	3,107
Net cash from (used for) financing	(501)	554	2,245
Investing			
Additions to property and equipment	(499)	(656)	(583)
Cash portion of WebTV purchase price	--	(190)	--
Cash proceeds from sale of Softimage, Inc.	--	--	79
Purchases of investments	(18,216)	(19,114)	(36,441)
Maturities of investments	1,874	1,890	4,674
Sales of investments	13,752	10,798	21,080
Net cash used for investing	(3,089)	(7,272)	(11,191)
Net change in cash and equivalents	1,099	162	1,084
Effect of exchange rates on cash and equivalents	6	(29)	52
Cash and equivalents, beginning of year	2,601	3,706	3,839
Cash and equivalents, end of year	3,706	3,839	4,975
Short-term investments	5,260	10,088	12,261
Cash and short-term investments	$ 8,966	$ 13,927	$ 17,236

See accompanying notes.

Balance Sheets
(In millions)

June 30	1998	1999
Assets		
Current assets:		
Cash and short-term investments	$13,927	$17,236
Accounts receivable	1,460	2,245
Other	502	752
Total current assets	15,889	20,233
Property and equipment	1,505	1,611
Equity and other investments	4,703	14,372
Other assets	260	940
Total assets	$22,357	$37,156
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 759	$ 874
Accrued compensation	359	396
Income taxes payable	915	1,607
Unearned revenue	2,888	4,239
Other	809	1,602
Total current liabilities	5,730	8,718
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock--shares authorized 100; shares issued and outstanding 13	980	980
Common stock and paid-in capital--shares authorized 12,000; shares issued and outstanding 4,940 and 5,109	8,025	13,844
Retained earnings, including other comprehensive income of $666 and $1,787	7,622	13,614
Total stockholders' equity	16,627	28,438
Total liabilities and stockholders' equity	$22,357	$37,156

See accompanying notes.

Stockholders' Equity Statements
(In millions)

Year Ended June 30	1997	1998	1999
Convertible preferred stock			
Balance, beginning of year	--	$ 980	$ 980
Convertible preferred stock issued	$ 980	--	--
Balance, end of year	980	980	980
Common stock and paid-in capital			
Balance, beginning of year	2,924	4,509	8,025
Common stock issued	744	1,262	2,338
Common stock repurchased	(91)	(165)	(64)
Structured repurchases price differential	--	328	(328)
Proceeds from sale of put warrants	95	538	766
Reclassification of put warrant obligation	45	--	--
Stock option income tax benefits	792	1,553	3,107
Balance, end of year	4,509	8,025	13,844
Retained earnings			
Balance, beginning of year	3,984	5,288	7,622
Net income	3,454	4,490	7,785
Other comprehensive income:			
Net unrealized investment gains	280	627	1,052
Translation adjustments and other	5	(124)	69
Comprehensive income	3,739	4,993	8,906
Preferred stock dividends	(15)	(28)	(28)
Common stock repurchased	(3,010)	(2,631)	(2,886)
Reclassification of put warrant obligation	590	--	--
Balance, end of year	5,288	7,622	13,614
Total stockholders' equity	$10,777	$16,627	$28,438

See accompanying notes.

Notes to Financial Statements

Accounting Policies

Accounting principles. The financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles.

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' activities is reflected in other expenses.

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

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

Revenue recognition. Revenue is recognized when earned. The Company's revenue recognition policies are in compliance with all applicable accounting regulations, including American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, and SOP 98-9, Modification of SOP 97-2, With Respect to Certain Transactions. Revenue from products licensed to original equipment manufacturers is recorded when OEMs ship licensed products while revenue from certain license programs is recorded when the software has been delivered and the customer is invoiced. Revenue from packaged product sales to and through distributors and resellers is recorded when related products are shipped. Maintenance and subscription revenue is recognized ratably over the contract period. Revenue attributable to undelivered elements, including technical support and Internet browser technologies, is based on the average sales price of those elements and is recognized ratably on a straight-line basis over the product's life cycle. When the revenue recognition criteria required for distributor and reseller arrangements are not met, revenue is recognized as payments are received. Costs related to insignificant obligations, which include telephone support for certain products, are accrued. Provisions are recorded for returns and bad debts.

Cost of revenue. Cost of revenue includes direct costs to produce and distribute product and direct costs to provide online services, consulting, product support, and training and certification of system integrators.

Research and development. Research and development costs are expensed as incurred. Statement of Financial Accounting Standards (SFAS) 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed, does not materially affect the Company.

Income taxes. Income tax expense includes U.S. and international income taxes, plus the provision 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.

Stock split. During March 1999, outstanding shares of common stock were split two-for-one. All share and per share amounts have been restated.

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 six years from the purchase date. All cash and short-term investments are classified as available for sale and are recorded at market using the specific identification method; unrealized gains and losses are reflected in other comprehensive income. Cost approximates market for all classifications of cash and short-term investments; realized and unrealized gains and losses were not material.

Equity and other investments include debt and equity instruments. Debt securities and publicly traded equity securities are classified as available for sale and are recorded at market using the specific identification method. Unrealized gains and losses are reflected in other comprehensive income. All other investments, excluding joint venture arrangements, are recorded at cost.

Derivative financial instruments are used to hedge certain investments, international revenue, accounts receivable, and interest rate risks, and are, therefore, held primarily for purposes other than trading. These instruments may involve elements of credit and market risk in excess of the amounts recognized in the financial statements. The Company monitors its positions and the credit quality of counter parties, consisting primarily of major financial institutions, and does not anticipate nonperformance by any counter party.

During June 1999, the Financial Accounting Standards Board (FASB) issued SFAS 137, Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement 133. The Statement defers the effective date of SFAS 133 to fiscal 2001. Management is evaluating SFAS 133 and does not believe that adoption of the Statement will have a material impact on its financial statements.

Property and equipment. Property 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 15 years.

Reclassifications. The Company changed the way it reports revenue and costs associated with product support, consulting, MSN Internet access, and certification and training of system integrators. Amounts received from customers for these activities have been classified as revenue in a manner more consistent with Microsoft's primary businesses. Direct costs of these activities are classified as cost of revenue. Prior financial statements have been reclassified for consistent presentation. Certain other reclassifications have also been made for consistent presentation.

Unearned Revenue

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

End users receive certain elements of the Company's products over a period of time. These elements include browser technologies and technical support. Consequently, Microsoft's earned revenue reflects the recognition of the fair value of these elements over the product's life cycle. Upon adoption of SOP 98-9 during the fourth quarter of fiscal 1999, the Company was required to change the methodology of attributing the fair value to undelivered elements. The percentages of undelivered elements in relation to the total arrangement decreased, reducing the amount of Windows and Office revenue treated as unearned, and increasing the amount of revenue recognized upon shipment. The percentage of revenue recognized ratably decreased from a range of 20% to 35% to a range of approximately 15% to 25% of Windows desktop operating systems. For desktop applications, the percentage decreased from approximately 20% to a range of approximately 10% to 20%. The ranges depend on the terms and conditions of the license and prices of the elements. The impact on fiscal 1999 was to increase reported revenue $170 million. In addition, the Company extended the life cycle of Windows from two to three years based upon management's review of product shipment cycles. The impact on fiscal 1999 was to decrease reported revenue $90 million. Product life cycles are currently estimated at 18 months for desktop applications. The Company also sells subscriptions to certain products via maintenance and certain organizational license agreements. At June 30, 1999, Windows platforms products unearned revenue was $2.17 billion and unearned revenue associated with productivity applications and developer products totaled $1.96 billion. Unearned revenue for other miscellaneous programs totaled $116 million at June 30, 1999.

Financial Risks

The Company's cash and short-term investment portfolio is diversified and consists primarily of investment grade securities. Investments are held with high-quality financial institutions, government and government agencies, and corporations, thereby reducing credit risk concentrations. Interest rate fluctuations impact the carrying value of the portfolio. The Company routinely hedges the portfolio's return with options in the event of a catastrophic increase in interest rates. At June 30, 1999, the notional amount of the options outstanding was $4.0 billion. The fair value and premiums paid for the options were not material. Much of the Company's equity security portfolio is highly volatile, so certain positions are hedged.

Finished goods sales to international customers in Europe, Japan, Canada, and Australia are primarily billed in local currencies. Payment cycles are relatively short, generally less than 90 days. Certain international manufacturing and operational costs are 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 on receipt. Although foreign exchange rate fluctuations generally do not create a risk of material balance sheet gains or losses, the Company hedges a portion of accounts receivable balances denominated in local currencies, primarily with purchased options. At June 30, 1999, the notional amount of options outstanding was $662 million. The fair value and premiums paid for the options were not material.

Foreign exchange rates affect the translated results of operations of the Company's foreign subsidiaries. The Company hedges a portion of planned international revenue with purchased options. The notional amount of the options outstanding at June 30, 1999 was $2.25 billion. The fair value and premiums paid for the options were not material.

At June 30, 1998 and 1999, approximately 40% and 50% of accounts receivable represented amounts due from 10 customers. One customer accounted for approximately 12%, 8%, and 11% of revenue in 1997, 1998, and 1999.

Microsoft lends certain fixed income and equity securities to enhance investment income. Adequate collateral and/or security interest is determined based upon the underlying security and the credit worthiness of the borrower.

Cash and Short-Term Investments

June 30	1998	1999
Cash and equivalents:		
Cash	$ 195	$ 635
Commercial paper	2,771	3,805
Certificates of deposit	419	522
Money market preferreds	454	13
Cash and equivalents	3,839	4,975
Short-term investments:		
Commercial paper	868	1,026
U.S. government and agency securities	3,511	3,592
Corporate notes and bonds	3,998	6,996
Municipal securities	1,361	247
Certificates of deposit	350	400
Short-term investments	10,088	12,261
Cash and short-term investments	$13,927	$17,236

Property and Equipment

June 30	1998	1999
Land	$ 183	$ 158
Buildings	1,259	1,347
Computer equipment	1,182	1,433
Other	428	578
Property and equipment--at cost	3,052	3,516
Accumulated depreciation	(1,547)	(1,905)
Property and equipment--net	$ 1,505	$ 1,611

During 1997, 1998, and 1999, depreciation expense, of which the majority related to computer equipment, was $353 million, $528 million, and $483 million; disposals were not material.

Equity and Other Investments

June 30, 1999	Cost Basis	Net Unrealized Gains	Recorded Basis
Debt securities recorded at market, maturing:			
Within one year	$ 682	$ 8	$ 690
Between 10 and 15 years	533	(3)	530
Beyond 15 years (AT&T)	4,731	347	5,078
Debt securities recorded at market	5,946	352	6,298
Equity securities recorded at market:			
Comcast Corporation common stock	500	1,394	1,894
MCI Worldcom, Inc. common stock	14	1,088	1,102
Other	849	1,102	1,951
Unrealized hedge loss	--	(785)	(785)
Equity securities recorded at market	1,363	2,799	4,162
Equity securities and instruments recorded at cost:			
Nextel Communications, Inc. common stock	600	--	600
Comcast Corporation convertible preferred stock	555	--	555
NTL, Inc. convertible preferred stock	511	--	511
Other	2,179	--	2,179
Equity securities and instruments recorded at cost	3,845	--	3,845
Other investments	67	--	67
Equity and other investments	$11,221	$3,151	$14,372

Debt securities include corporate and government notes and bonds and derivative securities. Debt securities maturing beyond 15 years are composed entirely of AT&T 5% convertible preferred debt with a contractual maturity of 30 years. The debt is convertible into AT&T common stock on or after December 1, 2000, or may be redeemed by AT&T upon satisfaction of certain conditions on or after June 1, 2002. Unrealized gains on equity securities recorded at market were $1.4 billion on June 30, 1998. Equity securities and instruments recorded at cost include primarily preferred stock, common stock, and warrants that are restricted or not publicly traded. At June 30, 1998 and 1999, the estimated fair value of these investments was $2.4 billion and $6.1 billion, based on publicly available market information or other estimates determined by management. The Company hedges the risk of significant market declines on certain highly volatile equity securities with options. The options are recorded at market, consistent with the underlying equity securities. At June 30, 1999, the notional amount of the options outstanding was $2.1 billion; the fair value was $1.0 billion; and premiums paid for the options were not material. Realized gains and losses of equity and other investments in 1997 and 1998 were not material; realized gains were $623 million and losses were not material in 1999.

Income Taxes

The provision for income taxes consisted of:

Year Ended June 30	1997	1998	1999
Current taxes:			
U.S. and state	$1,710	$2,518	$4,027
International	412	526	281
Current taxes	2,122	3,044	4,308

Deferred taxes	(262)	(417)	(202)
Provision for income taxes	$1,860	$2,627	$4,106

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

Year Ended June 30	1997	1998	1999
U.S.	$3,775	$5,072	$10,649
International	1,539	2,045	1,242
Income before income taxes	$5,314	$7,117	$11,891

The effective income tax rate was 35.0% in 1997 and increased to 36.9% in 1998 due to the nondeductible write-off of WebTV in-process technologies. In 1999, the effective tax rate was 35.0%, excluding the impact of the gain on the sale of Softimage, Inc. The components of the differences between the U.S. statutory tax rate and the Company's effective tax rate were not significant.

Income taxes payable were:

June 30	1998	1999
Deferred income tax assets:		
Revenue items	$ 713	$ 1,145
Expense items	613	648
Deferred income tax assets	1,326	1,793
Deferred income tax liabilities:		
Unrealized gain on investments	(479)	(1,046)
International earnings	(373)	(647)
Other	(26)	(16)
Deferred income tax liabilities	(878)	(1,709)
Current income tax liabilities	(1,363)	(1,691)
Income taxes payable	$ (915)	$(1,607)

Income taxes have been settled with the Internal Revenue Service (IRS) for all years through 1989. The IRS has assessed taxes for 1990 and 1991, which the Company is contesting in U.S. Tax Court. The IRS is examining the Company's U.S. income tax returns for 1992 through 1994. Management believes any related adjustments that might be required will not be material to the financial statements. Income taxes paid were $1.1 billion in 1997, $1.1 billion in 1998, and $874 million in 1999.

Convertible Preferred Stock

During 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable principal-protected preferred stock. Dividends are payable quarterly in arrears. Preferred stockholders have preference over common stockholders in dividends and liquidation rights. 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, equivalent to $19.97 and $25.56 per common share. Net proceeds of $980 million were used to repurchase common shares.

Common Stock
Issued and outstanding. Shares of common stock outstanding were as follows:

Year Ended June 30	1997	1998	1999
Balance, beginning of year	4,776	4,816	4,940
Issued	188	202	213
Repurchased	(148)	(78)	(44)
Balance, end of year	4,816	4,940	5,109

Repurchase program. 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 2000.

During 1998, the Company executed two forward settlement structured repurchase agreements with an independent third party totaling 42 million shares of stock and paid cash for a portion of the purchase price. In 1999, the Company settled the agreements by returning 28 million shares of stock, based upon the stock price on the date of settlement. The timing and method of settlement were at the discretion of the Company. The differential between the cash paid and the price of Microsoft common stock on the date of the agreement was originally reflected in common stock and paid-in capital.

Put Warrants

To enhance its stock repurchase program, Microsoft sells 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 June 30, 1999, 163 million warrants were outstanding with strike prices ranging from $59 to $65 per share. The put warrants expire between September 1999 and March 2002. The outstanding put warrants permit a net-share settlement at the Company's option and do not result in a put warrant liability on the balance sheet.

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 1997, 1998, and 1999, employees purchased 5.6 million, 4.4 million, and 2.7 million shares at average prices of $14.91, $27.21, and $52.59 per share. At June 30, 1999, 70.9 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. Participating employees may contribute 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. Matching contributions were $28 million, $39 million, and $49 million in 1997, 1998, and 1999.

Stock option plans The Company has stock option plans for directors, officers, and employees, which provide for nonqualified and incentive stock options. Options granted prior to 1995 generally vest over four and one-half years and expire 10 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 10 years. At June 30, 1999, options for 406 million shares were vested and 998 million shares were available for future grants under the plans.

Stock options outstanding were as follows:

		Price per Share	
	Shares	Range	Weighted Average
Balance, June 30, 1996	952	$ 0.28 - $14.74	$ 5.52
Granted	220	13.83 - 29.80	14.58
Exercised	(180)	0.28 - 14.74	3.32
Canceled	(36)	4.25 - 24.29	9.71
Balance, June 30, 1997	956	0.56 - 29.80	7.86
Granted	138	16.56 - 43.63	31.28
Exercised	(176)	0.56 - 31.24	4.64
Canceled	(25)	4.25 - 41.94	14.69
Balance, June 30, 1998	893	0.56 - 43.63	11.94
Granted	78	45.59 - 83.28	54.62
Exercised	(175)	0.56 - 53.63	6.29
Canceled	(30)	4.25 - 74.28	21.06
Balance, June 30, 1999	766	0.56 - 83.28	17.28

For various price ranges, weighted average characteristics of outstanding stock options at June 30, 1999 were as follows:

	Outstanding Options			Exercisable Options	
Range of Exercise Prices	Shares	Remaining Life (Years)	Weighted Average Price	Shares	Weighted Average Price
$0.56-$5.97	242	2.9	$ 4.31	230	$ 4.24
5.98-13.62	158	3.9	10.85	89	10.62
13.63-29.80	173	4.7	14.92	66	14.67
29.81-43.62	117	5.5	32.06	21	31.83
43.63-83.28	76	6.2	55.04	--	--

The Company follows Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees, to account for stock option and employee stock purchase plans. Historically, exercise prices of grants of ESOs were struck at the lowest price in the 30 days following July 1 for annual grants and the 30 days after the start date for new employees. In connection with this practice, which is no longer employed, a charge of $217 million was recorded in the fourth quarter for fiscal 1999 compensation expense.

An alternative method of accounting for stock options is SFAS 123, Accounting for Stock-Based Compensation. Under SFAS 123, employee stock options are valued at grant date using the Black-Scholes valuation model, and compensation cost is recognized ratably over the vesting period. Had compensation cost for the Company's stock option and employee stock purchase plans been determined based on the Black-Scholes value at the grant dates for awards, pro forma income statements for 1997, 1998, and 1999 would have been as follows:

Year Ended June 30	1997		1998		1999	
	Reported	Pro forma	Reported	Pro forma	Reported	Pro forma
Revenue	$11,936	$11,936	$15,262	$15,262	$19,747	$19,747
Operating expenses:						
Cost of revenue	2,170	2,290	2,460	2,628	2,814	3,024
Research and development	1,863	2,168	2,601	3,023	2,970	3,504
Acquired in-process technology	--	--	296	296	--	--
Sales and marketing	2,411	2,539	2,828	3,003	3,231	3,448
General and administrative	362	424	433	520	689	822
Other expenses	259	259	230	230	115	115
Total operating expenses	7,065	7,680	8,848	9,700	9,819	10,913
Operating income	4,871	4,256	6,414	5,562	9,928	8,834
Investment income	443	443	703	703	1,803	1,803
Gain on sale of Softimage, Inc.	--	--	--	--	160	160
Income before income taxes	5,314	4,699	7,117	6,265	11,891	10,797
Provision for income taxes	1,860	1,646	2,627	2,325	4,106	3,723
Net income	3,454	3,053	4,490	3,940	7,785	7,074
Preferred stock dividends	15	15	28	28	28	28
Net income available for common shareholders	$ 3,439	$ 3,038	$ 4,462	$ 3,912	$ 7,757	$ 7,046
Diluted earnings per share	$ 0.66	$ 0.58	$ 0.84	$ 0.73	$ 1.42	$ 1.29

The pro forma disclosures in the previous table include the amortization of the fair value of all options vested during 1997, 1998, and 1999, regardless of the grant date. If only options granted after 1996 were valued, as prescribed by SFAS 123, pro forma net income would have been $3,179 million, $4,019 million, and $7,109 million, and earnings per share would have been $0.61, $0.75, and $1.30 for 1997, 1998, and 1999.

The weighted average Black-Scholes value of options granted under the stock option plans during 1997, 1998, and 1999 was $5.86, $11.81, and $20.90. Value was estimated using an expected life of five years, no dividends, volatility of .32 in 1999 and 1998 and .30 in 1997, and risk-free interest rates of 6.5%, 5.7%, and 4.9% in 1997, 1998, and 1999.

Earnings Per Share

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Diluted earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding preferred shares using the "if-converted" method, assumed net-share settlement of common stock structured repurchases, and outstanding stock options using the "treasury stock" method.

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

Year Ended June 30	1997	1998	1999
Net income	$3,454	$4,490	$7,785
Preferred stock dividends	15	28	28
Net income available for common shareholders	$3,439	$4,462	$7,757
Weighted average outstanding shares of common stock	4,782	4,864	5,028
Dilutive effect of:			
Common stock under structured repurchases	--	6	13
Preferred stock	26	34	16
Employee stock options	436	458	425
Common stock and common stock equivalents	5,244	5,362	5,482
Earnings per share:			
Basic	$ 0.72	$ 0.92	$ 1.54
Diluted	$ 0.66	$ 0.84	$ 1.42

Operational Transactions

In August 1997, Microsoft acquired WebTV Networks, Inc., an online service that enables consumers to experience the Internet through their televisions via set-top terminals based on proprietary technologies. A director of the Company owned 10% of WebTV. Microsoft paid $425 million in stock and cash for WebTV. The Company recorded an in-process technologies write-off of $296 million in the first quarter of fiscal 1998.

In August 1998, the Company sold a wholly-owned subsidiary, Softimage, Inc. to Avid Technology, Inc. and recorded a pretax gain of $160 million. As part of a transitional service agreement, Microsoft agreed to make certain development tools and management systems available to Avid for use in the Softimage business.

In November 1998, Microsoft acquired LinkExchange, Inc., a leading provider of online marketing services to Web site owners and small and medium-sized businesses. Microsoft paid $265 million in stock. During fiscal 1999, Microsoft also acquired several other entities primarily providing online technologies and services. The Company did not record significant in-process technology write-offs in connection with these transactions.

In July 1999, Ticketmaster Online CitySearch, Inc. agreed to purchase certain online properties of Sidewalk in exchange for stock and warrants at a price to be determined upon closing.

Commitments

The Company has operating leases for most U.S. and international sales and support offices and certain equipment. Rental expense for operating leases was $92 million, $95 million, and $135 million in 1997, 1998, and 1999. Future minimum rental commitments under noncancelable leases, in millions of dollars, are: 2000, $133; 2001, $121; 2002, $97; 2003, $83; 2004, $75; and thereafter, $194.

In connection with the Company's communications infrastructure and the operation of online services, Microsoft has certain communication usage commitments. Future related minimum commitments, in millions of dollars, are: 2000, $125 and 2001, $22. Also, Microsoft has committed to certain volumes of outsourced telephone support and manufacturing of packaged product and has committed $275 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, to pay one-half of operational funding of both joint ventures for a multiyear period, and to guarantee a portion of MSNBC debt.

Contingencies

On October 7, 1997, Sun Microsystems, Inc. brought suit against Microsoft in the U.S. District Court for the Northern District of California. Sun's complaint alleges several claims against Microsoft, all related to the parties' relationship under a March 11, 1996 Technology License and Distribution Agreement (Agreement) concerning certain Java programming language technology. The Complaint seeks: a preliminary and permanent injunction against Microsoft distributing certain products with the Java Compatibility logo, and against distributing Internet Explorer 4.0 browser technology unless certain alleged obligations are met; an order compelling Microsoft to perform certain alleged obligations; an accounting; termination of the Agreement; and an award of damages, including compensatory, exemplary, and punitive damages, and liquidated damages of $35 million for the alleged source code disclosure.

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

On November 17, 1998, the court entered an order granting Sun's request for a preliminary injunction, holding that Sun had established a likelihood of success on its copyright infringement claims, because Microsoft's use of Sun's technology in its products was beyond the scope of the parties' license agreement. The court ordered Microsoft to make certain changes in its products that include Sun's Java technology and to make certain changes in its Java software development tools. The court also enjoined Microsoft from entering into any licensing agreements that were conditioned on exclusive use of Microsoft's Java Virtual Machine. Microsoft appealed that ruling to the 9th Circuit on December 16, 1998. Oral argument on that appeal was held on June 16, 1999. In the interim, Microsoft is complying with the ruling and has not sought a stay of the injunction pending appeal. On December 18, 1998, Microsoft filed a motion requesting an extension of the 90-day compliance period for certain Microsoft products, which was granted in part in January 1999. Microsoft filed a motion on February 5, 1999, seeking clarification of the court's order that Microsoft would not be prevented from engaging in independent development of Java technology under the order. The court granted that motion. On July 23, 1999 the court also granted Microsoft's motion to increase the bond on the preliminary injunction from $15 million to $35 million.

On January 22, 1999, Microsoft and Sun filed a series of summary judgment motions regarding the interpretation of the contract and other issues. On May 20, 1999, the court issued tentative rulings on three of the motions. In the preliminary rulings, the court (1) granted Sun's motion for summary judgment that prior versions of Internet Explorer 4.0, Windows 98, Windows NT, Visual J++ (R) 6.0 development system, and the SDK for Java infringe Sun's copyrights, because they contain Sun's program code but do not pass Sun's compatibility tests and, therefore, Microsoft's use of Sun's technology is outside the scope of the Agreement and unlicensed; (2) granted Microsoft's motion that the Agreement authorizes Microsoft to distribute independently developed Java Technology that is not subject to the compatibility obligations in the Agreement; and (3) denied Sun's motion for summary judgment on the meaning of certain provisions of the Agreement, tentatively adopting Microsoft's interpretation that Sun is required to deliver certain new Java Technology, called "Supplemental Java Classes," in working order on Microsoft's then existing and commercially distributed virtual machine. On June 24, 1999, the court heard oral argument on the three tentative rulings. No final orders have been issued. At the hearing, the court also directed the parties to identify other pending summary judgment motions that the court should next consider. There are no other hearing or trial dates set.

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

On May 22, 1998, Judge Jackson consolidated the two actions. The judge granted Microsoft's motion for summary judgment as to the states' monopoly leverage claim and permitted the remaining claims to proceed to trial. Trial began on October 19, 1998. Microsoft believes the claims are without merit and is defending against them vigorously. In other ongoing investigations, the DOJ and several state Attorneys General have requested information from Microsoft concerning various issues.

Caldera, Inc. filed a lawsuit against Microsoft in July 1996. It alleges Sherman Act violations relating to Microsoft licensing practices of the MS-DOS(R) operating system and Windows in the late 80s and early 90s --essentially the same complaints that resulted in the 1994 DOJ consent decree. Caldera claims to own the rights of Novell, Inc. and Digital Research, Inc. relating to DR-DOS and Novell DOS products. It also asserts a claim that Windows 95 is a technological tie of Windows and MS-DOS. Trial is scheduled for January 2000. Some partial summary judgment motions are pending. Microsoft believes the claims are without merit and is vigorously defending the case.

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

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

Segment Information

Year Ended June 30	Windows Platforms	Productivity Applications and Developer	Consumer, Commerce, and Other	Reconciling Amounts	Consolidated
1997					
Revenue	$5,213	$5,992	$ 1,129	$ (398)	$11,936
1998					
Revenue	$6,236	$7,458	$ 1,765	$ (197)	$15,262
Operating income	3,661	4,824	(1,050)	(1,021)	6,414
1999					
Revenue	$8,590	$8,686	$ 1,784	$ 687	$19,747
Operating income	6,007	5,568	(1,072)	(575)	9,928

The Company's organizational structure and fundamental approach to business reflect the needs of its customers. As such, Microsoft has three major segments: Windows Platforms; Productivity Applications and Developer; and Consumer, Commerce, and Other. Windows Platforms includes the Business and Enterprise Division, which is primarily responsible for Windows NT and developing Windows 2000. Windows Platforms also includes the Consumer Windows Division, which oversees Windows 98 and Windows 95. Productivity Applications and Developer includes the Business Productivity Division, which is responsible for developing and marketing desktop applications, server applications, and developer tools. Consumer, Commerce, and Other products and services include primarily learning, entertainment, and PC input device products; WebTV and PC online access; and portal and other Internet services. Assets of the segment groups are not relevant for management of the businesses nor for disclosure. In addition, it is not practicable to discern operating income for 1997 for the above segments due to previous internal reorganizations.

Segment information is presented in accordance with SFAS 131, Disclosures about Segments of an Enterprise and Related Information. This standard is based on a management approach, which requires segmentation based upon the Company's internal organization and disclosure of revenue and operating income based upon internal accounting methods. The Company's financial reporting systems present various data for management to run the business, including profit and loss statements (P&Ls) prepared on a basis not consistent with generally accepted accounting principles. Reconciling items include certain elements of unearned revenue, the treatment of certain channel inventory amounts and estimates, and revenue from product support, consulting, and training and certification of system integrators. Additionally, the internal P&Ls use accelerated methods of depreciation and amortization, but do not reflect the charge for the ESO exercise price methodology previously employed by the Company.

Revenue attributable to U.S. operations includes shipments to customers in the United States, licensing to OEMs and certain multinational organizations, and exports of finished goods, primarily to Asia, Latin America, and Canada. Revenue from U.S operations totaled $7.8 billion, $10.1 billion, and $13.7 billion in 1997, 1998, and 1999. Revenue from outside the United States, excluding licensing to OEMs and certain multinational organizations and U.S. exports, totaled $4.1 billion, $5.2 billion, and $5.9 billion in 1997, 1998, and 1999.

Long-lived assets totaled $1.2 billion and $1.5 billion in the United States in 1998 and 1999 and $287 million and $154 million in other countries in 1998 and 1999.

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, 1998 and 1999, and the related statements of income, cash flows, and stockholders' equity for each of the three years ended June 30, 1999. 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, 1998 and 1999, and the results of their operations and their cash flows for each of the three years ended June 30, 1999 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP
Seattle, Washington
July 19, 1999

Exhibit 21

Subsidiaries

Microsoft Corporation
One Microsoft Way
Redmond, WA 98052-6399

Microsoft FSC Corporation. (U.S. VIRGIN ISLANDS)
Microsoft Investments, Inc. (NEVADA)
Microsoft Ireland Operations Limited (IRELAND)
Microsoft Licensing, Inc. (NEVADA)
MSLI L.L.C. (NEVADA)
Microsoft Operations Pte Ltd. (SINGAPORE)
Microsoft Regional Sales Corporation (NEVADA-Singapore Branch)
Microsoft Puerto Rico, Inc. (Manufacturing) (DELAWARE)
The Microsoft Network L.L.C. (DELAWARE)
Microsoft Treasury, Inc (NEVADA)
GraceMac Corporation (NEVADA)
Microsoft de Argentina S.A.
Microsoft Pty. Limited (AUSTRALIA)
Microsoft Gesellschaft m.b.H. (AUSTRIA)
Microsoft N.V. (BELGIUM)
Microsoft Informatica Limitada (BRAZIL)
Microsoft Bulgaria EOOD
Microsoft Canada Co.
Microsoft Chile S.A.
Microsoft Colombia Inc. (DELAWARE)
Microsoft de Centroamerica S.A. (COSTA RICA)
Microsoft Hrvatska d.o.o. (CROATIA)
Microsoft s.r.o. (CZECH REPUBLIC)
Microsoft Danmark ApS (DENMARK)
Microsoft Dominicana, S.A. (DOMINICAN REPUBLIC)
Microsoft Del Ecuador S.A.
Microsoft El Salvador S.A. de C.V.
Microsoft Egypt L.L.C.
Microsoft Oy (FINLAND)
Microsoft France S.A.R.L.
Microsoft G.m.b.H. (GERMANY)
Microsoft Hellas S.A. (GREECE)
Microsoft de Guatemala, S.A.
Microsoft Hong Kong Limited
Microsoft Hungary Kft.
Microsoft Corporation (India) Private Limited
Microsoft India (R&D) Private Limited
PT. Microsoft Indonesia
Microsoft Israel Ltd.
Microsoft SRL (ITALY)
Microsoft Cote d'Ivoire (IVORY COAST)
Microsoft Company, Limited (JAPAN)
Microsoft Asia Ltd (NEVADA-JAPAN BRANCH)
Microsoft Product Development Ltd (NEVADA-JAPAN BRANCH)
East Africa Software Limited (KENYA)
Microsoft CH (KOREA)
Microsoft Kuwait Representative Office
SIA Microsoft Latvija
Microsoft Corporation Lebanon Representative Office
Microsoft (Malaysia) Sdn. Bhd.
Microsoft Mexico, S.A. de C.V.
Microsoft Indian Ocean Islands Limited (MAURITIUS)

Microsoft Maroc S.A.R.L. (MOROCCO)
Microsoft B.V. (THE NETHERLANDS)
Microsoft Manufacturing 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.R.L.
Microsoft Philippines, Inc.
Microsoft sp. z.o.o. (POLAND)
MSFT-Software Para Microcomputadores, LDA (PORTUGAL)
Microsoft Caribbean, Inc. (DELAWARE)
Microsoft Romania SRL
Microsoft ZAO (RUSSIA)
Moscow Microsoft Ireland Operations Limited (Representative Office)(RUSSIA)
Microsoft Arabia Limited (SAUDI ARABIA, 60% owned)
Microsoft Singapore Pte Ltd.
Microsoft Slovakia s.r.o.
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 Taiwan Corporation
Microsoft (Thailand) Limited
Microsoft Bilgisayar Yazilim Hizmetleri Limited Sirketi (TURKEY)
Microsoft Corporation (UNITED ARAB EMIRATES)
Microsoft Limited (UNITED KINGDOM)
Microsoft Research Limited (UNITED KINGDOM)
Microsoft Uruguay, S.A.
Microsoft Venezuela, S.A.
The Resident Representative Office of MICROSOFT Corporation in Hanoi (VIETNAM)
Microsoft Corporation, Zimbabwe Liaison Office
WebTV Networks, Inc. (California)
DreamWorks Interactive L.L.C. (WASHINGTON, 50% owned)
MSBET L.L.C. (DELAWARE, 50% owned)
MSFDC L.L.C. (DELAWARE, 50% owned)
MSFDC International, Inc. (DELAWARE, 50% owned)
MSNBC Cable, L.L.C. (DELAWARE, 50% owned)
MSNBC Interactive News, L.L.C. (DELAWARE, 50% owned)
Ninemsn Pty. Limited (AUSTRALIA)
WebTV Networks K.K. (JAPAN)
Microsoft HomeAdvisor, LLC (NEVADA)
Transpoint L.L.C. (DELAWARE, 95% owned by MSFDC L.L.C.)
Wireless Knowledge L.L.C. (DELAWARE, 50% owned)

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, 33-51583, and 333-06298 (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), 33-45617 (Microsoft Corporation Stock Option Plan for Consultants and Advisors), 333-16665 (Microsoft Corporation 1997 Employee Stock Purchase Plan), 333-61729 (Microsoft Corporation 1998 Special Stock Award Program), 333-75243 (Microsoft Corporation Savings Plus 401(k) Plan) and 33-06298 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, 333-00857, 333-01177, 333-02759, 333-05961, 333-8081, 333-12441, 333-17143, 333-18055, 333-18195, 333-23621, 333-31803,333-37841, 333-41387, 333-43449, 333-45989, 333-52377, 333-61507, 333-65813, 333-69027, 333-75389, 333-79461 of Microsoft Corporation on Forms S-3, and 333-26411 of Microsoft Corporation on Form S-4 of our report dated July 19, 1999 appearing in and incorporated by reference in this Annual Report on Form 10-K of Microsoft Corporation for the year ended June 30, 1999.

/s/ Deloitte & Touche LLP
Deloitte & Touche LLP
Seattle, Washington
September 28, 1999

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-30-1999
JUL-01-1998
JUN-30-1999
17,236
0
2,245
0
0
20,233
3,516
1,905
37,156
8,718
0
0
980
13,844
13,614
37,156
19,747
19,747
2,814
2,814
7,005
0
0
11,891
4,106
7,785
0
0
0
7,785
1.54
1.42