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

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 1994

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

FOR THE TRANSITION PERIOD FROM ____ TO ____

Commission File Number 0-14278

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

WASHINGTON
(State or other jurisdiction of
incorporation or organization)

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

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

Registrant's telephone number, including area code: (206) 882-8080

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

The number of shares outstanding of the registrant's common stock
as of February 7, 1995 was 581,228,389.

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MICROSOFT CORPORATION
FORM 10-Q
FOR THE QUARTER ENDED DECEMBER 31, 1994
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Part I. Financial Information

ITEM 1. FINANCIAL STATEMENTS

MICROSOFT CORPORATION

Income Statements

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

	Three Months Ended December 31		Six Months Ended December 31	
	1993	1994	1993	1994
Net revenues	\$1,129	\$1,482	\$2,112	\$2,729
Costs and expenses:				
Cost of revenues	185	222	344	408
Research and development	150	199	284	377
Sales and marketing	337	479	649	874
General and administrative	42	62	77	113
Total costs and expenses	714	962	1,354	1,772
Operating income	415	520	758	957
Interest income - net	25	42	48	78
Other expenses	(2)	(5)	(6)	(7)
Income before income taxes	438	557	800	1,028
Provision for income taxes	149	184	272	339
Net income	\$ 289	\$ 373	\$ 528	\$ 689
Earnings per share(1)	\$ 0.48	\$ 0.60	\$ 0.87	\$ 1.10
Weighted average shares outstanding(1)	608	625	607	624

(1) Share and per share amounts for the three and six months ended December 31, 1993 have been restated to reflect a two-for-one stock split in May 1994.

See accompanying notes.

MICROSOFT CORPORATION

Balance Sheets
(In millions)

	June 30 1994	Dec. 31 1994(1)
	-----	-----
ASSETS		
Current assets:		
Cash and short-term investments	\$3,614	\$3,839
Accounts receivable - net	475	591
Inventories	102	117
Other	121	149
	-----	-----
Total current assets	4,312	4,696
Property, plant, and equipment - net	930	977
Other assets	121	288
	-----	-----
Total assets	\$5,363	\$5,961
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 324	\$ 431
Accrued compensation	96	110
Income taxes payable	305	364
Other	188	191
	-----	-----
Total current liabilities	913	1,096
	-----	-----
Minority interest	--	125
	-----	-----
Put warrants	--	297
	-----	-----
Stockholders' equity:		
Common stock and paid-in capital--		
shares authorized 2,000;		
shares outstanding 581	1,500	1,699
Retained earnings	2,950	2,744
	-----	-----
Total stockholders' equity	4,450	4,443
	-----	-----
Total liabilities and stockholders' equity	\$5,363	\$5,961
	=====	=====

(1) Unaudited

See accompanying notes.

MICROSOFT CORPORATION

Cash Flows Statements
(In millions)(Unaudited)

	Six Months Ended December 31	
	1993	1994
	-----	-----
CASH FLOWS FROM OPERATIONS		
Net income	\$ 528	\$ 689
Depreciation and amortization	88	133
Current liabilities	187	194
Accounts receivable	(130)	(134)
Inventories	(5)	(17)
Other current assets	(3)	(30)
	-----	-----
Net cash from operations	665	835
	-----	-----
CASH FLOWS FROM FINANCING		
Common stock issued	90	140
Common stock repurchased	(164)	(560)
Stock option income tax benefits	64	78
	-----	-----
Net cash from financing	(10)	(342)
	-----	-----
CASH FLOWS USED FOR INVESTMENTS		
Additions to property, plant, and equipment	(122)	(170)
Other assets	(19)	(90)
Short-term investments	(568)	(785)
	-----	-----
Net cash used for investments	(709)	(1,045)
	-----	-----
Net change in cash and equivalents	(54)	(552)
Effect of exchange rates on cash and equivalents	(8)	(8)
Cash and equivalents, beginning of period	1,013	1,477
	-----	-----
Cash and equivalents, end of period	951	917
Short-term investments, end of period	1,845	2,922
	-----	-----
Cash and short-term investments, end of period	\$2,796	\$3,839
	=====	=====

See accompanying notes.

MICROSOFT CORPORATION

Notes to Financial Statements
(Unaudited)-----
BASIS OF PRESENTATION

In the opinion of management, the accompanying balance sheets and related interim statements of income and cash flows include all adjustments (consisting only of normal recurring items) necessary for their fair presentation. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the Management's Discussion and Analysis and financial statements and notes thereto included in the Microsoft Corporation 1994 Annual Report.

EARNINGS PER SHARE

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

STOCK SPLIT

Effective May 6, 1994, outstanding shares of common stock were split two-for-one. All fiscal 1994 share and per share amounts have been restated for the stock split.

PUT WARRANTS

In connection with the Company's stock repurchase program, put warrants were sold to independent third parties during the first two quarters of fiscal 1995. The put warrants entitle the holders to sell shares of Microsoft common stock to the Company at specified prices. On December 31, 1994, 6.4 million warrants were outstanding, with prices ranging from \$49.49 to \$59.04 per share. The warrants expire at various dates between February 1995 and May 1996, are exercisable only at maturity, and are settleable in cash at the Company's option. The maximum potential repurchase obligation of \$297 million has been reclassified from stockholders' equity to put warrants as of December 31, 1994. There was no impact on earnings per share for the first two quarters of fiscal 1995.

AGREEMENT TO MERGE

On October 13, 1994, Microsoft announced its agreement to merge with Intuit Inc., a leading developer of personal finance, tax preparation, and small business accounting software. Under the terms of the reorganization agreement, Microsoft will exchange approximately 27 million shares of its common stock for all of the outstanding shares of Intuit. The transaction is anticipated to be accounted for as a pooling of interests. The agreement is subject to approval by the shareholders of Intuit and satisfaction of regulatory requirements.

MICROSOFT ONLINE SERVICES PARTNERSHIP

During November 1994, a wholly owned subsidiary of Tele-Communications, Inc. (TCI) purchased a 20% minority interest in the newly formed Microsoft Online Services Partnership. TCI contributed \$125 million of TCI common stock and Microsoft contributed the business assets of its online service, which is in development. Microsoft owns 80% of the entity, whose operations have not been material to the financial results of Microsoft.

CONTINGENCIES

On July 15, 1994, Microsoft entered into an undertaking with the Commission of the European Communities ("European Commission") resolving a complaint submitted by Novell, Inc. claiming that certain practices of Microsoft violated Articles 85 and 86 of the Treaty of Rome. The undertaking is effective immediately, requires no further approval, and closes the investigation of Novell's complaint by the European Commission's Directorate-General for Competition. In the undertaking, which involves no admission of wrongdoing on Microsoft's part, Microsoft agreed to make certain changes in its OEM licensing practices. Microsoft also agreed to employ a uniform duration in its nondisclosure agreements for precommercial versions of certain operating system products, and clarified the rights and responsibilities of those signing such nondisclosure agreements. The European Commission has the right to monitor Microsoft's compliance during the 6-1/2 year term of the settlement agreement.

On July 15, 1994, Microsoft and the U.S. Department of Justice ("DOJ") entered

into a consent decree resolving the DOJ's non-public investigation of Microsoft. The consent decree contained the same provisions as the undertaking between Microsoft and the European Commission. To become final, the consent decree must be approved by the U.S. District Court for the District of Columbia. The Court has held three status conferences as well as a hearing on January 20, 1995. The Court is currently considering submissions by the DOJ, Microsoft, and a third party that has requested the opportunity to intervene.

Microsoft does not expect the undertaking with the European Commission or the consent decree with the DOJ to affect its OEM revenues materially.

On March 17, 1988, Apple Computer, Inc. (Apple) brought suit against Microsoft and Hewlett-Packard Company for alleged copyright infringement in the U.S. District Court, Northern District of California. The complaint included allegations that the visual displays of Microsoft Windows version 2.03 (and Windows version 3.0, which was added to the complaint later) infringed Apple's copyrights and exceeded the scope of a 1985 Settlement Agreement between Microsoft and Apple. The complaint sought to enjoin Microsoft from marketing Microsoft Windows versions 2.03 and 3.0 or any derivative work based on Windows 2.03 or 3.0 and from otherwise infringing Apple's copyrights and sought damages resulting from the alleged infringement.

Microsoft answered the complaint, raising affirmative defenses including its claim that the 1985 Settlement Agreement entitled it to use the visual displays in question, denying Apple's allegations that the visual displays in Microsoft Windows version 2.03 and 3.0 infringe any protectible right of Apple, and asserting counterclaims.

On August 24, 1993, the U.S. District Court entered final judgment dismissing all of Apple's claims. Apple appealed a number of the U.S. District Court's decisions in the case to the Ninth Circuit Court of Appeals, which on September 19, 1994 issued a decision affirming the rulings of the U.S. District Court. On December 19, 1994, Apple filed a petition with the U.S. Supreme Court to grant review of the Ninth Circuit Court's decision.

On July 30, 1993 Wang Laboratories, Inc. (Wang) filed suit in U.S. District Court for the District of Massachusetts against Microsoft and Watermark Software, Inc., alleging that unspecified Microsoft products infringe two patents owned by Wang concerning object management and the handling of compound documents (United States Patents 5,206,951 issued on April 27, 1993, and 5,129,061 issued on July 7, 1992, respectively). The suit also alleges that Microsoft induced and continues to induce others, including Watermark Software, Inc., to infringe the Wang patents. Microsoft's OLE technology appears to be the subject of Wang's allegations against Microsoft. The complaint seeks a determination that Microsoft's alleged infringement is willful, an award of treble damages, an award of attorneys' fees, and to preliminarily and permanently enjoin Microsoft from continuing the alleged infringement. In its answer Microsoft denied that any of its products infringe the Wang patents and asked the Court for a declaratory judgment that those patents are invalid and unenforceable for failing to meet patent law requirements. The suit is currently in the early stages of discovery.

Although there is no assurance that these matters will be resolved favorably and that Microsoft's future financial statements will not be adversely affected, Microsoft currently believes that resolution of the undertaking, consent decree, and the lawsuits will not have material adverse effects on its financial condition or results of operations.

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

RESULTS OF OPERATIONS

OVERVIEW

Microsoft Corporation develops, manufactures, markets, licenses, and supports a wide range of software products, including operating systems for personal computers (PCs), workstations, and servers; business and consumer programs for productivity, reference, education, and entertainment; and software development tools. Microsoft also markets personal computer books and hardware; and is engaged in the research and potential development of advanced technology software products.

REVENUES

Revenues for the second quarter of fiscal 1995 increased 31% over revenues for the second quarter of fiscal 1994, while revenues for the first half of 1995 grew 29% compared to the prior year.

Software license volume (as opposed to price) increases have been the principal factor in Microsoft's revenue growth. The average selling price per license has decreased, primarily because of general shifts in sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications programs to the Microsoft(®) Office integrated suite. Average revenue per license from OEM licenses and corporate license programs (such as Microsoft Select) is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. The price of Microsoft Office is less than the sum of the prices for the individual application programs included in this product when such programs are sold separately.

PRODUCT GROUPS

Systems product group revenues are primarily from licenses of personal operating systems and business systems with client-server architectures. Systems revenues were \$519 million in the second quarter of 1995, compared to \$369 million recorded in the same period of 1994, an increase of 41%. Systems revenues were \$963 million in the first half of 1995 compared to \$724 million in the first half of 1994. Revenues generated by both Microsoft MS-DOS(®) and Microsoft Windows(®) operating systems increased from the prior year, primarily through the original equipment manufacturer channel. During the second quarter of 1995, more than 80% of Windows units were licensed through the OEM channel. Revenues from the Company's business system division's BackOffice line of products also increased, due to greater corporate demand for Windows NT(®) Server and Windows NT Workstation.

Applications product group revenues include primarily licenses of desktop productivity, consumer, and developer programs. Applications revenues were \$889 million in the second quarter of 1995, increasing 26% from \$707 million in the second quarter of 1994. For the first two quarters of 1995, applications revenues were \$1.64 billion, compared to \$1.28 billion in 1994. Increases in applications revenues were led by sales of Microsoft Office. Microsoft Office Standard includes Microsoft Excel, Microsoft Word, a Microsoft Mail license, and the Microsoft PowerPoint(®) presentation graphics program. Microsoft Office Professional for Windows includes all of the above plus the Microsoft Access(®) database management program.

Microsoft Home, a broad range of products in the Company's consumer applications group, continued to show strong growth, particularly during the cyclically higher Christmas season. New titles and new versions of existing titles both contributed to the growth.

The hardware product group's principal products are the Microsoft Mouse and BallPoint(®) mouse pointing devices. Hardware revenues were \$74 million and \$53 million in the second quarters of 1995 and 1994. On a year to date basis, hardware revenues increased 18% to \$123 million from \$104 million.

SALES CHANNELS

The Company has four major channels of distribution: OEM; U.S. and Canada; Europe; and Other International. OEM channel revenues are license fees from original equipment manufacturers. Sales in the retail channels are primarily to distributors and resellers.

Microsoft Select was introduced in 1993 and continues to grow in popularity. Select is a corporate license program under which large accounts download a

contracted number of copies of specified software products. Average revenue per license under Select is lower than average revenue per retail copy of the same product shipped through the retail channels, reflecting lower costs of distribution.

OEM revenues (primarily personal operating systems) grew 44% to \$385 million from the \$268 million recorded in the comparable quarter of the prior year. In the first half of 1995, OEM revenues were \$733 million, up 40% from \$523 million in the first half of 1994. MS-DOS continues to be preinstalled on many PCs sold by original equipment manufacturers. In addition, many major OEMs are also preinstalling the Microsoft Windows operating system on PCs. Higher levels of PC shipments have led to increased revenues through the OEM channel.

Revenues in the U.S. and Canada were \$491 million in the second quarter of 1995 compared to \$423 million in 1994, an increase of 16%. The latest version of Microsoft Office for Windows was introduced in the U.S. during the comparable quarter of the prior year. On a year to date basis, U.S. and Canada channel revenues increased 22%, to \$914 million in 1995 from \$751 million in 1994.

Revenues in Europe were \$399 million in the second quarter of 1995 compared to \$324 million the prior year. European revenues for the first two quarters of 1995 were \$688 million, compared to \$598 in 1994. Rates of growth for the European channel have been lower than other retail channels of distribution due to general economic slowness and a more dramatic shift to corporate licensing in Europe.

Other International channel revenues showed strong growth, increasing to \$207 million in the second quarter of 1995 from \$114 million in the second quarter of 1994. Revenues increased 64% to \$394 million for the first half of 1995, compared to \$240 million the prior year. Growth rates continue to be strong due to customer acceptance of newly localized products and early entrance into emerging markets.

The Company's operating results are affected by foreign exchange rates. Since much of the Company's international manufacturing costs and operating expenses are also incurred in local currencies, the relative translation impact of exchange rates on net income is less than on revenues.

COST OF REVENUES, OPERATING EXPENSES, AND INCOME TAXES

Cost of revenues as a percentage of revenues was 15.0% in the second quarter of 1995, compared to 16.4% in the second quarter of 1994. Contributing to the decrease were lower disk prices from vendors and a shift to more revenues from OEM and corporate license programs, offset by greater sales of lower-margin Microsoft Office and upgrade products. While license programs carry lower prices per license than retail versions shipped through the retail channels, there is little cost of revenues associated with such programs.

Research and development expenses increased 33% to \$199 million, or 13.4% of revenues in the second quarter of 1995 from \$150 million, or 13.3% of revenues in the corresponding quarter of 1994. The increases in research and development expenses in both the second quarter and first half of 1995 resulted primarily from planned hiring of software developers and higher levels of third-party development costs.

Sales and marketing expenses increased 42% to \$479 million from \$337 million in the comparable quarter. As a percentage of revenues, sales and marketing expenses were 32.3% and 29.9% in the respective second quarters of 1995 and 1994. The increases in sales and marketing expenses in both the second quarter and first half of 1995 were due to increased personnel related expenses, product support costs, Microsoft brand advertising, and marketing costs.

General and administrative expenses were 4.2% of revenues in the second quarter of 1995 and 3.7% of revenues in the second quarter of 1994. Increases in both the second quarter and first half of 1995 were due to higher legal costs and growth in the systems and people necessary to support overall increases in the scope of Microsoft's operations.

Net interest income increased as a result of a larger investment portfolio generated by cash from operations combined with higher interest rates.

The effective income tax rate was 33% in the second quarter and first half of 1995, compared to 34% in the same periods of 1994.

NET INCOME

Net income for the second quarter of 1995 was \$373 million. Net income as a percentage of revenues was 25.2% in the second quarter of 1995, compared with 25.6% in the second quarter of 1994. The slight decrease was the result of higher levels of operating expenses offset by the lower cost of revenues and higher interest income percentages.

FINANCIAL CONDITION

The Company's cash and short-term investment portfolio totaled \$3.84 billion at December 31, 1994 and represented 64% of total assets. The portfolio is diversified among security types, industries, and individual issuers. The Company's investments are liquid and primarily investment grade. The portfolio, while invested predominantly in U.S. dollar denominated securities, also includes foreign currency positions in anticipation of local currency funding needs. The Company's portfolio is invested in short-term securities to minimize interest rate risk and to facilitate rapid deployment in the event of immediate cash needs.

Microsoft has no material long-term debt. The Company has available \$70 million of standby multicurrency lines of credit. These lines support foreign currency hedging and international cash management. Stockholders' equity at December 31, 1994 exceeded \$4 billion.

Cash generated from operations has been sufficient to fund the Company's investment in research and development activities and facilities expansion. As the Company grows, investments will continue in research and development in existing and advanced areas of technology. The Company's cash will be used to acquire technology or to fund strategic ventures. Additions to property, plant, and equipment are expected to continue, including new facilities and computer systems for research and development; sales and marketing; product support; and administrative staff. On December 31, 1994, commitments related to the construction of new buildings approximated \$235 million.

The exercise of stock options by employees provides additional cash. These proceeds have funded the Company's open market stock repurchase program through which Microsoft provides shares for stock option and stock purchase plans. This practice is continuing in 1995. Additionally, the Company enhanced its stock repurchase program by selling put warrants during the first half of 1995. See Notes to Financial Statements.

Management believes existing cash and short-term investments together with funds generated from operations should be sufficient to meet the Company's operating requirements for the next 12 months. The Company's cash and short-term investments are also managed so as to be available for such other strategic investment opportunities or other potential large-scale cash needs as might arise in pursuit of the Company's long-term strategies. Additionally, on October 28, 1994, Microsoft shareholders authorized the Company to issue up to 100 million shares of preferred stock, which may be used by the Company for any proper corporate purpose.

Part II. Other Information

ITEM 1. LEGAL PROCEEDINGS

On July 15, 1994, Microsoft and the U. S. Department of Justice (DOJ) entered into a consent decree resolving the DOJ's nonpublic investigation of Microsoft. To become final, the consent decree must be approved by the U.S. District Court for the District of Columbia. The Court has held three status conferences as well as a hearing on January 20, 1995. Under the Tunney Act, which defines the scope of the Court's review of a consent decree, the Court must determine whether the relief provided in the consent decree is adequate to remedy the antitrust violations alleged in the complaint. The Court may either approve or not approve the consent decree, but cannot require Microsoft or the DOJ to alter any of its terms. The Company is also currently involved in litigation with Apple Computer, Inc., and Wang Laboratories, Inc. See Notes to Financial Statements.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

11. Computation of Earnings Per Share is on page 11.

(b) Reports on Form 8-K

No reports on Form 8-K were filed by the Company during the quarter ended December 31, 1994.

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

Signature

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

Microsoft Corporation

Date: February 14, 1995

By: /s/ Michael W. Brown

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

(Principal Financial and
Accounting Officer and Duly
Authorized Officer)

MICROSOFT CORPORATION
 Computation of Earnings Per Share
 (In millions, exzcept earnings per share)

	Three Months Ended December 31		Six Months Ended December 31	
	1993	1994	1993	1994
Weighted average number of common shares outstanding	568	581	568	581
Common stock equivalents from outstanding stock options	40	44	40	43
Average common and common stock equivalents outstanding	608	625	608	624
Net Income	\$ 289	\$ 373	\$ 528	\$ 689
Earnings per share(1)(2)	\$0.48	\$0.60	\$0.87	\$1.10

(1) Share and per share amounts for the three and six months ended December 31, 1993 have been restated to reflect a two-for-one stock split in May 1994.

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

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6-MOS

JUN-30-1995

JUL-01-1994

DEC-31-1994

3,839

0

706

115

117

4,696

1,577

600

5,961

1,096

0

1,699

0

0

2,744

5,961

2,729

2,729

408

1,339

7

25

0

1,028

339

689

0

0

0

689

1.10

1.10