

PROXY STATEMENT PURSUANT TO SECTION 14(A) OF THE  
SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant /X/  
Filed by a Party other than the Registrant / /

Check the appropriate box:

- / / Preliminary Proxy Statement
- /X/ Definitive Proxy Statement
- / / Definitive Additional Materials
- / / Soliciting Material Pursuant to sec. 240.14a-11(c) or sec. 240.14a-12

MICROSOFT CORPORATION

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(Name of Registrant as Specified in Its Charter)

MICROSOFT CORPORATION

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(Name of Person(s) Filing Proxy Statement)

Payment of Filing Fee (Check the appropriate box):

- /X/ \$125 per Exchange Act Rules 0-11(c)(1)(ii), 14a-6(i)(1), or 14a-6(i)(2).
- / / \$500 per each party to the controversy pursuant to Exchange Act Rule 14a-6(i)(3).
- / / Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(2) Aggregate number of securities to which transaction applies:

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(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:(1)

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(4) Proposed maximum aggregate value of transaction:

/ / Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

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(2) Form, Schedule or Registration Statement No.:

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(3) Filing Party:

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(4) Filing Date:

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(1) Set forth the amount on which the filing fee is calculated and state how it was determined.

(LOGO)

September 25, 1995

Dear Shareholder:

You are cordially invited to attend the annual meeting of shareholders of Microsoft Corporation which will be held at the Hyatt Regency Bellevue, 900 Bellevue Way N.E., Bellevue, Washington, on October 27, 1995, at 8:00 a.m. I look forward to greeting as many of our shareholders as possible.

Details of the business to be conducted at the annual meeting are given in the attached Notice of Annual Meeting and Proxy Statement.

Whether or not you attend the annual meeting it is important that your shares be represented and voted at the meeting. Therefore, I urge you to sign, date, and promptly return the enclosed proxy in the enclosed postage-paid envelope. If you decide to attend the annual meeting and vote in person, you will of course have that opportunity.

On behalf of the Board of Directors, I would like to express our appreciation for your continued interest in the affairs of the Company.

Sincerely,

(SIGNATURE)

Robert J. Herbold  
Executive Vice President and Chief  
Operating Officer

MICROSOFT CORPORATION  
NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
OCTOBER 27, 1995

To The Shareholders:

The annual meeting of the shareholders of Microsoft Corporation will be held at the Hyatt Regency Bellevue, 900 Bellevue Way N.E., Bellevue, Washington, on October 27, 1995, at 8:00 a.m. for the following purposes:

1. To elect directors.
2. To ratify the selection of Deloitte & Touche LLP as the independent public auditors of the Company for the current fiscal year.
3. To transact such other business as may properly come before the meeting.

Only shareholders of record at the close of business on September 8, 1995 are entitled to notice of, and to vote at, this meeting.

BY ORDER OF THE BOARD OF DIRECTORS

(SIGNATURE)

William H. Neukom, Secretary

Redmond, Washington  
September 25, 1995

IMPORTANT

WHETHER OR NOT YOU EXPECT TO ATTEND IN PERSON, WE URGE YOU TO SIGN, DATE, AND RETURN THE ENCLOSED PROXY AT YOUR EARLIEST CONVENIENCE. THIS WILL ENSURE THE PRESENCE OF A QUORUM AT THE MEETING. PROMPTLY SIGNING, DATING, AND RETURNING THE PROXY WILL SAVE THE COMPANY THE EXPENSES AND EXTRA WORK OF ADDITIONAL SOLICITATION. AN ADDRESSED ENVELOPE FOR WHICH NO POSTAGE IS REQUIRED IF MAILED IN THE UNITED STATES IS ENCLOSED FOR THAT PURPOSE. SENDING IN YOUR PROXY WILL NOT PREVENT YOU FROM VOTING YOUR STOCK AT THE MEETING IF YOU DESIRE TO DO SO, AS YOUR PROXY IS REVOCABLE AT YOUR OPTION.

MICROSOFT CORPORATION  
ONE MICROSOFT WAY  
REDMOND, WASHINGTON 98052

PROXY STATEMENT FOR ANNUAL MEETING  
OF SHAREHOLDERS  
TO BE HELD OCTOBER 27, 1995

This Proxy Statement, which was first mailed to shareholders on September 25, 1995, is furnished in connection with the solicitation of proxies by the Board of Directors of Microsoft Corporation (the "Company"), to be voted at the annual meeting of the shareholders of the Company, which will be held at 8:00 a.m. on October 27, 1995, at the Hyatt Regency Bellevue, 900 Bellevue Way N.E., Bellevue, Washington, for the purposes set forth in the accompanying Notice of Annual Meeting of Shareholders. Shareholders who execute proxies retain the right to revoke them at any time prior to the exercise of the powers conferred thereby by delivering a signed statement to the Secretary of the Company at or prior to the annual meeting or by executing another proxy dated as of a later date. The cost of solicitation of proxies is to be borne by the Company.

Shareholders of record at the close of business on September 8, 1995 will be entitled to vote at the meeting on the basis of one vote for each share held. On September 8, 1995, there were 589,952,132 shares of common stock outstanding, held of record by 35,643 shareholders.

#### 1. ELECTION OF DIRECTORS AND MANAGEMENT INFORMATION

Seven directors are to be elected at the annual meeting, to hold office until the next annual meeting of shareholders and until their successors are elected and qualified. It is intended that the accompanying proxy will be voted in favor of the following persons to serve as directors unless the shareholder indicates to the contrary on the proxy. Management expects that each of the nominees will be available for election, but if any of them is not a candidate at the time the election occurs, it is intended that such proxy will be voted for the election of another nominee to be designated by the Board of Directors to fill any such vacancy.

#### NOMINEES

William H. Gates, 39, co-founded Microsoft in 1975 and has been its Chief Executive Officer and Chairman of the Board since the original partnership was incorporated in 1981.

Paul G. Allen, 42, has been a director of the Company since 1990, and also served on the Board from 1981 to 1984. Mr. Allen was a founder of the Company and worked at Microsoft from 1975 to 1984. Mr. Allen owns and invests in a suite of companies exploring the potential of multimedia digital communications. His wholly-owned companies include Asymetrix Corporation, Starwave Corporation, Vulcan Ventures Inc., and the Paul Allen Group of Bellevue, Washington, Interval Research Corp. of Palo Alto, California, and Ticketmaster Corporation of Los Angeles, California. He is also the owner of the Portland Trail Blazers basketball team, a partner in the entertainment studio DreamWorks SKG, and holds investments in more than 25 technology companies. He also serves on the Board of Directors of Egghead Inc.

Richard A. Hackborn, 58, has been a director of the Company since 1994. Mr. Hackborn retired in 1993 from Hewlett-Packard Company, which designs, manufactures, and services electronic products and systems for measurement, computation, and communications, and currently serves on that company's Board of Directors. From 1990 to 1993, he was Hewlett-Packard's Executive Vice President, Computer Products Organization, and from 1984 through 1990, he was its Vice President and General Manager, Peripherals Group.

David F. Marquardt, 46, has served as a director of the Company since 1981. Mr. Marquardt has been a general partner of various Technology Venture Investors entities, which are private venture capital limited partnerships, since August 1980. He is a director of Auspex Systems, Inc. and various privately held companies.

Robert D. O'Brien, 81, has been a director of the Company since 1986. He was Chairman of the Board of PACCAR, Inc. between 1965 and 1978. Between 1974 and 1983, Mr. O'Brien was Chairman of the Board of Univar Corporation and he served on that Board between 1966 and 1985.

William G. Reed, Jr., 56, has been a director of the Company since 1987. From 1971 to 1986, Mr. Reed was Chairman of the Board of Simpson Timber Company, a forest products company. Since 1986, Mr. Reed has served as Chairman of the Board of Simpson Investment Company, a forest products holding company which is the parent of Simpson Timber Company. He is also a director of Safeco Corporation, Washington Mutual Savings Bank, and The Seattle Times Company.

Jon A. Shirley, 57, served as President and Chief Operating Officer of Microsoft from 1983 to 1990. He has been a director of the Company since 1983. Mr. Shirley also serves as Chairman of the Board of Directors of Mentor Graphics Corporation.

#### INFORMATION REGARDING THE BOARD AND ITS COMMITTEES

The Company's Board of Directors has an Audit Committee, a Compensation Committee, and a Finance Committee. There is no standing nominating committee. Messrs. O'Brien, Reed, and Shirley serve on the Audit Committee, which meets with financial management, the internal auditors, and the independent auditors to review internal accounting controls and accounting, auditing, and financial reporting matters. Messrs. Hackborn, Marquardt, O'Brien, and Reed serve on the Compensation Committee, which reviews the compensation of the Chief Executive Officer and other officers of the Company, reviews executive bonus plan allocations, and has granted stock options to officers of the Company under its stock option plan. Messrs. Hackborn, Marquardt, and Shirley serve on the Finance Committee, which reviews and provides guidance to the Board of Directors and management with respect to major financial policies of the Company.

The Audit Committee met three times during fiscal 1995. The Compensation Committee met four times. The Finance Committee met once. The entire Board of Directors met six times during the last fiscal year. All directors attended 75% or more of the aggregate number of Board meetings and committee meetings.

Messrs. Gates and Allen receive no cash compensation for serving on the Board except for reimbursement of reasonable expenses incurred in attending meetings. Messrs. Hackborn, Marquardt, O'Brien, Reed, and Shirley are each paid \$8,000 per year plus \$1,000 for each Board meeting and \$500 for each committee meeting they attend. During fiscal 1995, Messrs. Allen, Marquardt, O'Brien, Reed, and Shirley each received options to purchase 5,000 shares of the Company's common stock. Mr. Hackborn received an option to purchase 15,000 shares of the Company's common stock when he was appointed to the Board in August 1994. The exercise price of the foregoing options was the market price of the underlying common stock on the date of grant.

INFORMATION REGARDING BENEFICIAL OWNERSHIP OF PRINCIPAL SHAREHOLDERS, DIRECTORS,  
AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of the Company's common shares by the nominees for directors, the Company's Chief Executive Officer and the four other highest paid executive officers, and the directors and executive officers as a group.

NAMES -----	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP OF COMMON SHARES AS OF 9/8/95(1) -----	PERCENT OF CLASS -----
William H. Gates.....	141,159,990(2)(3)	23.9%
Paul G. Allen.....	55,893,020(4)	9.5
Richard A. Hackborn.....	5,000(5)	*
David F. Marquardt.....	336,244(6)	*
Robert D. O'Brien.....	155,517(7)	*
William G. Reed, Jr. ....	100,000(8)	*
Jon A. Shirley.....	1,776,638(9)	*
Steven A. Ballmer.....	29,952,764(2)	5.1
Robert J. Herbold.....	175	*
Michael J. Maples.....	50,209	*
Bernard R. Vergnes.....	465,250(10)	*
Executive Officers and Directors as a group (22 persons).....	234,167,557(11)	39.4

\* Less than 1.0%.

(1) Beneficial ownership represents sole voting and investment power. To the Company's knowledge, the only shareholders who beneficially owned more than 5% of the outstanding common shares as of September 8, 1995, were Messrs. Gates, Allen, and Ballmer.

(2) The business address for Messrs. Gates and Ballmer is: Microsoft Corporation, One Microsoft Way, Redmond, Washington 98052.

(3) Includes 1,210 shares currently owned by and 51,680 shares which may be purchased within 60 days of September 8, 1995, pursuant to outstanding stock options ("Vested Options") by Mr. Gates' wife, as to which he disclaims beneficial ownership.

(4) Includes 145,000 Vested Options. Mr. Allen's business address is: The Paul Allen Group, 110 -- 110th Avenue N.E., Suite 530, Bellevue, Washington 98004.

(5) Includes 5,000 Vested Options.

(6) Includes 100,000 Vested Options.

(7) Includes 56,264 shares held by RDOB Limited Partnership, a family limited partnership, of which Mr. O'Brien is one of three general partners, and 70,000 Vested Options.

(8) Includes 100,000 Vested Options.

(9) Includes 10,680 shares held by Mr. Shirley as trustee under trusts for two grandsons and 100,000 Vested Options.

(10) Includes 18,750 Vested Options.

(11) Includes 3,698,265 Vested Options.

## INFORMATION REGARDING EXECUTIVE OFFICER COMPENSATION

## CASH COMPENSATION

The following table discloses compensation received for the three fiscal years ended June 30, 1995, by the Company's Chief Executive Officer and the four most highly paid executive officers ("Named Executive Officers").

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	YEAR	ANNUAL COMPENSATION		LONG-TERM COMPENSATION AWARDS	ALL OTHER COMPENSATION(2)
		SALARY	BONUS(1)	SECURITIES UNDERLYING OPTIONS(#)	
William H. Gates	1995	\$275,000	\$140,580	0	0
Chairman of the Board;	1994	275,000	182,545	0	0
Chief Executive Officer, Director	1993	266,660	151,580	0	0
Steven A. Ballmer	1995	249,174	162,800	0	\$ 4,770
Executive Vice	1994	238,750	188,112	0	4,722
President, Sales and Support	1993	220,916	146,520	0	5,099
Robert J. Herbold	1995	286,442	453,691	325,000	99,241
Executive Vice President; Chief Operating Officer					
Michael J. Maples(3)	1995	249,174	197,675	0	4,650
Executive Vice	1994	238,750	253,112	0	4,722
President, Products	1993	223,333	211,520	200,000	4,664
Bernard P. Vergnes	1995	356,660	169,785	150,000	0
Senior Vice President,	1994	300,481	196,885	40,000	0
Microsoft; President of Microsoft Europe	1993	322,433	91,523	50,000	0

(1) The amounts disclosed in the Bonus column were all awarded under the Company's Executive Bonus Plan. Amounts disclosed for Mr. Maples also include payments of \$65,000 each year pursuant to a signing bonus arranged upon employment with the Company. The amount disclosed for Mr. Herbold includes a payment of \$250,000 pursuant to a signing bonus.

(2) The amounts disclosed in this column consist only of Company contributions under the Company's 401(k) plan, except that Mr. Herbold's amount also includes \$4,758 for term life insurance premiums and \$93,358 related to the Company's purchase and subsequent sale of his former home in Ohio (which includes the loss on resale plus related transactional costs and service fees).

(3) Mr. Maples retired from the Company effective July 15, 1995.

## COMPENSATION PURSUANT TO STOCK OPTIONS

## OPTION GRANTS IN LAST FISCAL YEAR

The following table sets forth certain information on option grants in fiscal 1995 to the Named Executive Officers.

NAME	INDIVIDUAL GRANTS				POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM(2)		
	NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED(#)(1)	PERCENT OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE PRICE (\$/SHARE)	EXPIRATION DATE	0%(\$)	5%(\$)	10%(\$)
William H. Gates.....	0	0.00%	0	N/A	0	0	0
Steven A. Ballmer....	0	0.00%	0	N/A	0	0	0
Robert J. Herbold....	100,000 225,000	0.46% 1.04%	\$ 62.25 62.25	Nov. 2001 Nov. 2004	0	\$2,534,200 8,808,455	\$ 5,905,764 22,322,355
Michael J. Maples....	0	0.00%	0	N/A	0	0	0
Bernard P. Vergnes...	150,000	0.69%	47.75	Jul. 2004	0	4,504,458	11,415,180

(1) All options listed were granted pursuant to the 1991 Stock Option Plan. Option exercise prices are generally at the market price when granted. The options have terms of 7 years (4 1/2-year vesting) or 10 years (7 1/2-year vesting). The exercise price and federal tax withholding may be paid in cash or with shares of Microsoft stock already owned.

(2) Potential realizable values are based on assumed annual rates of return specified by the Securities and Exchange Commission. By way of comparison, using the same assumed annual rates of stock price appreciation over the ten-year term of the July 1994 stock option set forth above, all Microsoft shareholders would realize the following increases in the market value of their stock: \$0 (0% appreciation); \$17.7 billion (5% annual appreciation); and \$44.8 billion (10% annual appreciation). Microsoft management has consistently cautioned shareholders and option holders that such increases in values are based on speculative assumptions and should not inflate expectations of the future value of their holdings.

## AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

The following table provides information on option exercises in fiscal 1995 by the Named Executive Officers and the value of such officers' unexercised options at June 30, 1995.

NAME	SHARES ACQUIRED ON EXERCISE (#)	VALUE REALIZED (\$)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FISCAL YEAR-END(#)		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FISCAL YEAR-END(\$)	
			EXERCISABLE	UNEXERCISABLE	EXERCISABLE	UNEXERCISABLE
William H. Gates.....	0	0	0	0	0	0
Steven A. Ballmer.....	0	0	0	0	0	0
Robert J. Herbold.....	0	0	0	325,000	0	\$ 9,140,625
Michael J. Maples.....	130,000	\$4,631,250	0	115,000	0	6,684,375
Bernard P. Vergnes.....	170,000	7,891,250	0	220,000	0	10,451,250



## ROBERT J. HERBOLD EMPLOYMENT AGREEMENT

Microsoft offered Mr. Herbold an attractive compensation package in order to convince him to leave Procter & Gamble after over 25 years at that company. His base salary is \$450,000, and he was guaranteed a minimum bonus of \$200,000 in each of his first two years. He also received \$250,000 upon hiring, and will receive \$250,000 per year for three years, payable at each of the first three anniversaries of his hire date. He received the stock options set out in the table entitled "Option Grants in Last Fiscal Year." He will not be eligible for additional stock options until 1999. He receives enhanced health and disability benefits during and after his employment. Microsoft agreed to purchase a \$650,000 whole life policy and a \$1.35 million term life policy to replace policies he had at P&G.

In the event Mr. Herbold's employment is terminated prior to the fourth anniversary of his hire date, for any reason other than Misconduct or voluntary resignation, Microsoft will provide him the following severance benefits: (i) an immediate lump sum payment equal to the greater of (a) all compensation that would have been paid to him if he had continued in Microsoft's employ for four years following his hire date, or (b) the sum of his annual base salary at the time of termination plus the Executive and Merit Bonuses awarded to him for the most recently completed fiscal year, multiplied by two; and (ii) immediate vesting of all unvested options under his 100,000-share option (4 1/2-year vesting schedule) and immediate vesting of that portion of his 225,000-share option (7 1/2-year vesting schedule) which would have vested during the four years following his hire date. If Mr. Herbold's employment is terminated after the fourth anniversary of his hire date, for any reason other than Misconduct or voluntary resignation, the parties will negotiate in good faith a reasonable severance package with a minimum of 18 months' base salary. For severance purposes, Misconduct is limited to the commission of a felony or any other intentional misconduct that has a material adverse effect upon the business or reputation of Microsoft.

REPORT OF THE COMPENSATION COMMITTEE  
OF THE BOARD OF DIRECTORS

Microsoft's employee compensation policy is to offer a package including a competitive salary, an incentive bonus based upon individual performance goals, competitive benefits, and an efficient workplace environment. The Company also encourages broad-based employee ownership of Microsoft stock through a stock option program in which all employees are eligible to participate.

The Company's compensation policy for officers is similar to that for other employees, and is designed to promote continued performance and attainment of corporate and personal goals.

The Compensation Committee of the Board of Directors (comprised entirely of non-employee directors) reviews and approves individual officer salaries, bonus financial performance goals, bonus plan allocations, and stock option grants. The Committee also reviews guidelines for compensation, bonus, and stock option grants for non-officer employees.

Officers of the Company are paid salaries in line with their responsibilities. These salaries are structured to be within the median range of salaries paid by competitors in the computer industry. In the performance graph which immediately follows this report, the Company's performance is compared to that for NASDAQ Computer & Data Processing Stocks (C&DPS). Competitors considered relevant for salary comparison purposes do not include some companies included in the C&DPS index and include some companies that are not in the index. Officers also participate in the Executive Bonus Plan. Each officer is eligible to receive a discretionary bonus of up to 15% of base salary based upon individually established performance goals. Officers are also eligible for financial performance bonuses of up to 90% of base salary, with amounts based on a graduated formula which takes into account predetermined corporate revenue and profit goals and, in the case of officers with profit and loss responsibility, group revenue and profit goals. The maximum total bonus under the Executive Bonus Plan is 105% of base salary. The Compensation Committee establishes aggressive revenue and profit goals as an incentive for superior individual, group, and corporate performance. Likewise, stock option grants to officers (and other employees) promote success by aligning employee financial interests with long-term shareholder value. Stock option grants are based on various subjective factors primarily relating to the responsibilities of the individual officers, and also to their expected future contributions and prior option grants.

As noted above, the Company's compensation policy is primarily based upon the practice of pay-for-performance. Section 162(m) of the Internal Revenue Code imposes a limitation on the deductibility of nonperformance-based compensation in excess of \$1 million paid to Named Executive Officers. The Company's stock option plan was amended in 1993 with the intent that all compensation attributable to stock option exercises should qualify as deductible performance-based compensation. The Committee currently believes that the Company should be able to continue to manage its executive compensation program to preserve federal income tax deductions.

The Compensation Committee annually reviews and approves the compensation of William H. Gates, the Chief Executive Officer. Mr. Gates also participates in the Executive Bonus Plan, with his bonus tied to corporate revenue and profit goals, but does not participate in the individual performance portion of the Executive Bonus Plan. His maximum possible bonus is 90% of his base salary. The Committee believes Mr. Gates is paid a reasonable salary, and his bonus is based on the same corporate financial goals as the other officers of the Company. Mr. Gates is the only employee of the Company not eligible for stock options. Since Mr. Gates is a significant shareholder in the Company, his rewards as CEO reflect increases in value enjoyed by all other shareholders.

## COMPENSATION COMMITTEE

Richard A. Hackborn

David F. Marquardt

Robert D. O'Brien

William G. Reed, Jr.

## PERFORMANCE GRAPH

Note: Microsoft management consistently cautions that the stock price performance shown in the graph below should not be considered indicative of potential future stock price performance.

COMPARISON OF FIVE YEAR CUMULATIVE TOTAL RETURN AMONG MICROSOFT CORPORATION, S&P 500 INDEX, AND NASDAQ COMPUTER & DATA PROCESSING SERVICES (C&DPS) INDEX

MEASUREMENT PERIOD (FISCAL YEAR COVERED)	MICROSOFT CORPORATION	NASDAQ C&DPS INDEX	S&P 500 INDEX
1990	100	100	100
1991	134	106	104
1992	207	146	114
1993	261	186	126
1994	306	186	124
1995	535	305	152

## CERTAIN TRANSACTIONS

Craig J. Mundie, an officer of the Company, was loaned \$250,000 when he accepted employment with the Company in February 1993, in order to assist him in relocating to Redmond. On June 9, 1995, the note was repaid in full, including \$36,558 of accrued interest at 6.5% per annum.

## STOCK OWNERSHIP AND TRADING REPORTS

John Neilson and Steven Schiro became officers of the Company in fiscal 1995, and their Form 3 filings were made two months late. August 1994 Form 5 filings for Richard Fade, Joachim Kempin, Michel Lancombe, Rolf Skoglund, and Charles Stevens were filed on time, but each report had to be later amended to include omitted information. Messrs. Fade and Kempin's reports failed to report their June 30, 1994 purchases under the Company's Employee Stock Purchase Plan. Messrs. Lancombe, Skoglund, and Stevens' reports each failed to report a single stock option grant they received in fiscal 1994. David Fulton, a former officer of the Company, filed a late Form 4 for August 1994, which reported seven sale transactions over a two-day period.

## 2. RATIFICATION OF SELECTION OF AUDITORS

The Board of Directors will request that the shareholders ratify its selection of Deloitte & Touche LLP, Certified Public Accountants, as independent public auditors for the Company for the current fiscal year. If the shareholders do not ratify the selection of Deloitte & Touche LLP, another firm of certified public accountants will be selected as independent public auditors by the Board of Directors.

Representatives of Deloitte & Touche LLP will be present at the Annual Meeting, will have an opportunity to make a statement, and will be available to respond to appropriate questions.

## SOLICITATION OF PROXIES

The proxy accompanying this Proxy Statement is solicited by the Board of Directors of the Company. Proxies may be solicited by officers, directors, and regular supervisory and executive employees of the Company, none of whom will receive any additional compensation for their services. Also, W.F. Doring & Co. may solicit proxies at an approximate cost of \$12,500 plus reasonable expenses. Such solicitations may be made personally, or by mail, facsimile, telephone, telegraph, or messenger. The Company will pay persons holding shares of common stock in their names or in the names of nominees, but not owning such shares beneficially, such as brokerage houses, banks, and other fiduciaries, for the expense of forwarding solicitation materials to their principals. All of the costs of solicitation of proxies will be paid by the Company.

## VOTING TABULATION

Vote Required: Under the Washington Business Corporation Act, the election of the Company's Directors requires a plurality of the votes represented in person or by proxy at the meeting and the ratification of the selection of auditors requires that the votes in favor exceed the votes against. Votes cast by proxy or in person at the meeting will be tabulated by First Interstate Bank of Washington, N.A.

Effect of an Abstention and Broker Non-Votes: A shareholder who abstains from voting on any or all proposals will be included in the number of shareholders present at the meeting for the purpose of determining the presence of a quorum. Abstentions will not be counted either in favor of or against the election of the nominees or other proposals. Under the rules of the National Association of Securities Dealers, brokers holding stock for the accounts of their clients who have not been given specific voting instructions as to a matter by their clients may vote their clients' proxies in their own discretion.

## OTHER MATTERS

The Board of Directors does not intend to bring any other business before the meeting, and so far as is known to the Board, no matters are to be brought before the meeting except as specified in the notice of the meeting. However, as to any other business which may properly come before the meeting, it is intended that proxies, in the form enclosed, will be voted in respect thereof in accordance with the judgment of the persons voting such proxies.

DATED: Redmond, Washington, September 25, 1995.

A COPY OF THE COMPANY'S FORM 10-K REPORT FOR FISCAL YEAR 1995, CONTAINING INFORMATION ON OPERATIONS, FILED WITH THE SECURITIES AND EXCHANGE COMMISSION, IS INCLUDED IN THIS BOOKLET, BEGINNING ON THE NEXT PAGE. TO OBTAIN ADDITIONAL COPIES, PLEASE WRITE TO:

INVESTOR RELATIONS DEPARTMENT  
MICROSOFT CORPORATION  
ONE MICROSOFT WAY  
REDMOND, WASHINGTON 98052

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 -----  
 UNITED STATES  
 SECURITIES AND EXCHANGE COMMISSION  
 WASHINGTON, D.C. 20549  
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## 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, 1995

/ / 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  
 (ADDRESS OF PRINCIPAL EXECUTIVE OFFICE)

98052-6399  
 (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (206) 882-8080

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: COMMON STOCK

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

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

The aggregate market value of the common stock held by non-affiliates of the registrant as of September 8, 1995 was \$34,330,611,220.

The number of shares outstanding of the registrant's common stock as of September 8, 1995 was 589,952,132.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement dated September 25, 1995 to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held October 27, 1995 are incorporated by reference into Part III.  
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MICROSOFT CORPORATION  
FORM 10-K  
FOR THE FISCAL YEAR ENDED JUNE 30, 1995

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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, sells, 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 development tools. Microsoft also markets personal computer books and input devices and is engaged in the research and development of online and advanced technology software products. Microsoft(R) products are available for most PCs, including Intel-type microprocessor-based computers and Apple computers.

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

The Platforms Product Group is comprised of four divisions, each responsible for a particular area of platforms software development and marketing. The Personal Systems Division designs and develops operating systems and technologies (such as multimedia, user interface, and online browsers) for general and home PC users. The Business Systems Division is responsible for computing solutions for corporate and enterprise use, including client-server operating systems, networking products, and server and workgroup applications. The Developer Division creates database products, as well as programming language products and software development tools. The Consumer Systems Division is developing software products and technologies for use on the emerging public networks, including future interactive television networks, and for creating advanced multimedia applications, such as 3D titles.

The Applications and Content Product Group has two divisions that create and market productivity programs for PCs and multimedia content titles. The group also includes online systems and research. The Desktop Applications Division creates productivity applications. The Consumer Division develops products designed for the home, school, and small business market, including multimedia consumer products and PC input devices. The MSN Division is responsible for an online and Internet service. Microsoft Research is a research lab dedicated to creating new technology in support of the Company's vision for the evolution of personal computing.

The Sales and Support Group is responsible for building long-term business relationships with customers. This group is organized to serve three customer types: OEMs (original equipment manufacturers), end users, and organizations. The Sales and Support Group manages the channels that serve those customers. These include the OEM channel and the following geographic channels: U.S. and Canada, Europe, and Other International. The group also provides support for the Company's products through Product Support Services, Consulting Services, and Solutions Providers.

The Operations Group is responsible for managing business operations and overall business planning. This includes the process of manufacturing and delivering finished goods, licenses, subscriptions, and fulfillment orders; the publishing efforts of Microsoft Press; and other corporate functions.

## PRODUCTS

## PERSONAL SYSTEMS

The Personal Systems Division develops desktop operating systems software, which performs operations such as allocating computer memory, scheduling the execution of applications software, and managing the flow of information and communication among the various components of the PC. The division's primary desktop operating systems for PCs are: Microsoft Windows(R) 95, Microsoft MS-DOS(R), Microsoft Windows 3.1, and Microsoft Windows for Workgroups. (Windows 3.1 and Windows for Workgroups 3.11 are hereafter referred to collectively as "Windows 3.x.")

Windows 95: Microsoft's new personal operating system, designed to be the successor to MS-DOS and Windows 3.x, was released commercially on August 24, 1995. Windows 95 is a fully integrated, multitasking 32-bit operating system, compatible with mainstream PCs and most Windows 3.x and MS-DOS software applications. Windows 95 was also designed for the next generation of applications, games, PCs, and peripherals.

MS-DOS: Microsoft MS-DOS is a single-user, single-tasking operating system designed for PCs that utilize Intel microprocessor chips. Since the introduction of MS-DOS in 1981, the Company has enhanced MS-DOS as new technologies have developed and new user needs have arisen. MS-DOS has been preinstalled by OEMs on most PCs.

Windows 3.1: Microsoft Windows 3.1 is a graphical operating system for MS-DOS-based PCs. Microsoft Windows 3.1 supports high-performance Windows-based applications, and offers ease of use and aesthetic appeal, scalable TrueType(R) fonts, built-in multimedia functionality, and straightforward integration into corporate computing environments.

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

## BUSINESS SYSTEMS

The Business Systems Division is focused on delivering a broad range of business computing solutions for organizations. The division develops and markets an integrated product line of software for creating business solutions, including foundation operating systems for servers and workstations, as well as applications for business servers. Server applications development is divided into the areas of databases, connectivity, systems management, and workgroup applications. Server software products are marketed separately or as a part of an integrated family of products, the Microsoft BackOffice(TM). The BackOffice family includes the following key products.

Windows NT Workstation and Server: Microsoft Windows NT(TM) Workstation is a powerful desktop operating system designed for demanding business needs. It is a 32-bit, multithreaded operating system for mission critical computing which provides the same feature and applications programming interface (API) set across four hardware platforms: Intel, Alpha AXP, MIPS, and Power PC. The operating system provides integrated mail and networking with remote access, pre-emptive multitasking, and support for background communication sessions. The Windows NT Server is designed to be the network foundation for a new generation of business applications. It provides extensive network management features, administration tools, security, and fault tolerance. It is a platform for business critical applications and database, connectivity, system management, and mail servers.

SQL Server: Microsoft SQL Server is a high-performance relational database management system designed specifically for distributed computing. SQL Server supports the Structured Query Language, which is a commonly used language through which application programs communicate with relational databases. The Company provides SQL Server for Windows NT systems. This product is developed in the Developer Division and marketed as part of BackOffice by the Business Systems Division.

SNA Server: Microsoft SNA Server is a robust, highly fault-tolerant, and easy-to-maintain gateway product that connects PC local area networks (LANs) with IBM host systems using SNA protocols.

Systems Management Server: Microsoft Systems Management Server is a software tool that helps information technology departments centrally manage distributed-computing environments. With Systems Management Server, system administrators can distribute and install software to PCs throughout an enterprise, meter software licenses, conduct remote diagnostics, and perform a detailed inventory of hardware and software resources.

Mail Server: Microsoft Mail Server for PC networks is a system for distributing messages and information. It provides administrative utilities for managing message files, addresses, and mail system



capabilities. Microsoft Mail Server supports users of popular desktop platforms, including Windows 95, Windows 3.x, MS-DOS, Macintosh, and OS/2.

Mail: Microsoft Mail for PC networks includes client-access software for Windows 95, Windows 3.x, MS-DOS, Macintosh, and OS/2 platforms. In addition, this workgroup application offers large corporate users support for multiple network environments. A companion product, Microsoft Mail for AppleTalk networks, is used by companies with Macintosh servers. Microsoft Mail Remote for Windows offers software for remote clients used by travelers or those working at home to stay in touch with the office mail system.

Schedule+: Microsoft Schedule+ is a calendar and scheduling program that helps individuals and groups manage their time and resources. The program can search other workgroup members' schedules to determine meeting availability times, provide invitees the means to accept, decline, or tentatively accept invitations to meetings, and automatically notify attendees if a meeting is canceled or rescheduled.

#### DEVELOPER PRODUCTS

The Developer Division provides software development tools, database products, and technical information to Windows developers worldwide. These products and services help independent software developers, corporate developers, solutions developers, and hobbyists create a wide variety of applications, primarily for Windows 95, Windows 3.x, and Windows NT.

Database Products: Database products control the maintenance and utilization of structured data organized into a set of records or files. The Company offers database products which span the needs of a wide variety of users, from individuals to large corporations. These products include Microsoft Access, Microsoft FoxPro(R), Microsoft SQL Server, and a variety of database connectivity technologies. Microsoft Access is a relational database management application, also offered in conjunction with Microsoft Office, which provides access to structured business data. Microsoft FoxPro is a desktop database development tool which is compatible with the industry standard xBase development language. FoxPro supports xBase applications on MS-DOS, Windows 3.x, Windows 95, Windows NT, Macintosh, and UNIX. The Open Database Connectivity (ODBC) product provides access and connectivity to read and write to various databases from other computer industry vendors from within Microsoft Windows applications.

Software Development Tools and Computer Languages: Software development tools and computer languages allow software developers to write programs in a particular computer language and translate programs into a binary machine-readable set of commands that activate and instruct the hardware. The Company develops and markets a number of software development environments, language compilers, and software testing tools. Microsoft Visual C++(TM) is the Company's development system for 16- and 32-bit application development on Windows 3.x, Windows 95, and Windows NT. The Microsoft Visual Basic(TM) programming system for Windows 95, Windows 3.x, and Windows NT operating systems provides easy access to a wide variety of data sources by integrating the Microsoft Access database engine and the ability to leverage investments in commercial applications through OLE 2.0. Additionally, the Company offers professional, highly-integrated development environments in the FORTRAN language for MS-DOS, Windows 3.x, and Windows NT.

Developer Information Products: The Company provides third party software developers with a wide range of technical and support information that assists them in developing software products intended to run on Windows 3.x, Windows 95, and Windows NT. Developers subscribe to the Microsoft Developer Network (MSDN) information service and receive periodic updates via CD-ROMs, magazines, and several on-line information services.

#### CONSUMER SYSTEMS

The Consumer Systems Division is developing advanced system software. Core technologies under development include broadband networking and multimedia operating system architecture, advanced video and graphics, and new authoring system technologies for interactive television. The group is also responsible

for the development and marketing activities of the Company's SoftImage products, which include authoring and editing systems for film and video.

#### DESKTOP APPLICATIONS SOFTWARE

The Desktop Applications Division develops applications software, which provides the PC with instructions for the performance of end user tasks. The Company's desktop applications software is designed for use by a broad class of end users, regardless of business, industry, or market segment. Primary examples of desktop applications software are word processing, spreadsheet, and presentation graphics programs. The Company's desktop applications programs are developed principally for Windows 95, Windows 3.x, and Macintosh operating systems.

**Microsoft Office:** Microsoft Office(R) is a suite of software programs featuring seamless integration of the most commonly used desktop applications. Microsoft Office is based upon a document-centric concept, with common commands and extensive use of object linking and embedding (OLE) cross-application capabilities. Microsoft Office is available in two editions, Standard and Professional. The Standard Edition includes Microsoft Word, Microsoft Excel, and the Microsoft PowerPoint(R) presentation graphics program. The Microsoft Office for Windows 95 version also includes Schedule+, while earlier versions of the Standard Edition included a client-access license for Microsoft Mail. The Standard Edition is available for Windows 95, Windows 3.x, and Macintosh operating systems. The Microsoft Office Professional Edition for Windows adds the Microsoft Access(R) database.

**Microsoft Word:** The Company's principal word processing program is Microsoft Word. Versions of Microsoft Word for Windows 95 and for Windows 3.x provide all the features that users of word processing products expect in the Windows graphical environment, plus the ability to handle graphics, tables, spreadsheet data, charts, and images imported from other Windows-based software programs. The Company also has Windows NT and Macintosh versions of Microsoft Word.

**Microsoft Excel:** The Company's spreadsheet program is Microsoft Excel, which is available for Windows 95, Windows 3.x, Windows NT, and Macintosh operating systems. It is an integrated spreadsheet with pivot table, database, and business graphics capabilities. Microsoft Excel allows full linking and embedding of objects that permits users to view and edit graphics or charts from other Windows-based programs from the worksheet in which the object is stored. Microsoft Excel graphics capabilities can be linked to its spreadsheets to allow simultaneous changes to charts as changes are made to the spreadsheets.

**Microsoft PowerPoint:** Microsoft PowerPoint is a presentation graphics program for producing slides, overheads, transparencies, and prints. The Company markets versions of PowerPoint for Windows 95, Windows 3.x, and the Macintosh.

**Microsoft Project:** Microsoft Project is a critical path project scheduling and resource allocation program that runs on Windows 95, Windows 3.x, and Macintosh operating systems. The product can perform as a budgeting, monitoring, and cost estimating tool for large business projects and as a critical path and schedule planning tool.

#### ONLINE SERVICES

The MSN Division manages MSN, The Microsoft Network, a new, interactive online service. MSN provides easy and inexpensive access for users to a wide range of graphically-rich online content, a compelling business model and platform for independent content providers (ICPs), and rich and powerful development tools.

**The Microsoft Network:** Client-access software for MSN is included as a feature of Windows 95, which was released commercially on August 24, 1995. The online service provides access to the Internet, electronic mail, bulletin boards, and myriad additional services offered by Microsoft and by independent content providers. The Microsoft Internet Explorer, an Internet browser, takes advantage of various technical advances in Windows 95 and includes real-time audio capabilities. Content and service providers aligned with MSN

have flexibility in creating products and pricing their services, such as subscriptions, online transactions, and ticket events. Services may be supported by advertising and commerce.

MSN is owned by The Microsoft Network, LLC (formerly the Microsoft Online Services Partnership). Microsoft owns 80% of the entity and a wholly owned subsidiary of Tele-Communications, Inc. (TCI) owns the remaining 20%.

#### CONSUMER PRODUCTS

The Microsoft Consumer Division develops and markets useful, enjoyable, and fundamental software and services for small businesses, schools, and homes. The division is developing and managing a synergistic product line focusing on the following categories of consumer usage: Information, Productivity, Kids, Personal Finance, Entertainment, and PC Input Devices. Many of the titles are available on CD-ROM.

Information: Reference titles include Microsoft Encarta(TM) and Microsoft Bookshelf(R), which are both available for Windows 3.x and Macintosh operating systems. The Encarta multimedia encyclopedia database blends text in articles with a wealth of innovative, interactive information presented through animations, videos, maps, charts, sounds, and pictures. Bookshelf is a multimedia reference library that integrates seven well-respected and authoritative works on one compact disc, including a dictionary, world atlas, world almanac, thesaurus, concise encyclopedia, and two books of quotations.

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

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

Productivity: The Company's leading consumer productivity products are Microsoft Works and Microsoft Publisher. The Company markets versions of Microsoft Works that run on Windows 95, Windows 3.x, MS-DOS, and Macintosh operating systems. Microsoft Works is an integrated software program that contains basic word processing, spreadsheet, and database capabilities that allows the easy exchange of information from one tool to another. Microsoft Publisher is an easy-to-use, entry-level desktop publishing tool for Windows 95 and Windows 3.x operating systems. Publisher features an interactive tool that automates the design process of 12 custom publications, including newsletters, calendars, greeting cards, and invitations.

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

Personal Finance: Microsoft Money is a financial organization product that allows users to computerize their household finances. Microsoft Money is available for systems running Windows 95 and became available August 24, 1995. It is visually appealing, easy to use, and focuses on the financial tasks that people do most often. Microsoft Money provides enhanced online home-banking services with 17 different banks in the U.S. Users who are customers of participating banks will be able to pay bills online, access up-to-date statements and balances, transfer funds, and send email messages and inquiries to their banks.

Entertainment: The Company also has a line of entertainment products. Microsoft Flight Simulator, which was developed by Bruce Artwick Organization Ltd., is a popular airplane-flying game available for MS-DOS and Macintosh operating systems. Microsoft Golf, licensed from Access Software, Inc., is a realistic simulation of the sport of golf for Windows 95 and Windows 3.x operating systems.

PC Input Devices: The Company's major input device is the Microsoft Mouse, a hand-held pointing device that facilitates use of a PC. It can be used with MS-DOS, Windows 95, and Windows 3.x operating systems and works with many applications products from Microsoft and other companies. The Microsoft BallPoint(R) Mouse is designed especially for use with laptop and notebook computers. The BallPoint Mouse is shipped with a universal clamp that fits on the keyboards of most laptop computers and a positioner that allows

the user to adjust the angle of the mouse to the keyboard. The Company also designed and markets the Microsoft Natural Keyboard(TM), an ergonomically-designed keyboard.

#### MICROSOFT PRESS

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

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

#### PRODUCT DEVELOPMENT

The PC software industry is characterized by extremely rapid technological change, which requires a continuous and high level of expenditures for enhancing existing products and developing new products. The Company is committed to continued high expenditures for research and product development.

Most of the Company's software products are developed internally. The Company also purchases technology, licenses intellectual property rights, and oversees third party development for certain products. Product documentation is also created internally. 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 a development methodology for creating and enhancing its products. These tools and methodology are also designed to simplify a product's portability among different operating systems or computers.

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 hardware design, without compromising product quality. The Company strives to become as informed as possible at the earliest possible time about changing usage patterns and hardware advances that may affect software design.

During fiscal years 1993, 1994, and 1995, the Company spent \$470 million, \$610 million, and \$860 million, respectively, on product research and development activities. Those amounts represented 12.5%, 13.1%, and 14.5%, respectively, of net revenues in each of those years.

#### LOCALIZATION

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

#### MANUFACTURING

The Company has manufacturing facilities located in the United States, Puerto Rico, and Ireland. The Company's manufacturing operations involve disk replication, assembly of purchased parts, and final packaging. Quality control tests are performed on purchased parts, finished disks, and other products. The

chief materials and components used in Microsoft products include disks or CD-ROMs, books, and multicolor printed materials. The Company is often able to acquire component parts and materials on a volume discount basis. The Company has multiple sources for raw materials, supplies, and components.

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

#### MARKETING AND DISTRIBUTION

Microsoft aligns its sales and marketing people with three customer types: end users, organizations, and OEMs. The Company's sales and marketing staff seeks to build long-term relationships with these customers of Microsoft products. Microsoft has four major channels of distribution which deliver product to end users: finished goods in the U.S. and Canada, Europe, and Other International; and OEM.

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

The organization customer unit has responsibility for activities that target groups of users in organizations of all sizes. The unit works with Solutions Providers, the Microsoft Consulting Services division, and directly with organizations to create enterprise-wide solutions to business computing problems. The unit's sales and marketing activities include providing technical training of Solutions Providers and channel resellers; developing support policies; and supporting and providing seminars, events, and sales training for resellers and Solutions Providers. Key products are the Company's business systems, developer software, and software sold via volume licensing programs. In the U.S., the organization customer unit is further segregated into an enterprise customer unit, which services only large organization customers, and a more specialized unit which services small and medium customers.

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

#### FINISHED GOODS CHANNELS

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

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

**Solutions Providers:** Microsoft's Solutions Providers program is a comprehensive support relationship with independent organizations that provide network and system integration, custom development, training, and technical support for business computing solutions. The program supports value-added resellers (VARs), system integrators, consultants, and developers, as well as technical support and training organizations. Under this business partnership strategy, the Company provides sales and product information, development services, early access to Microsoft products, and customer support tools including priority telephone support, education,

and business development support. To ensure high-quality technical services for the Company's products, Microsoft Solutions Providers are required to have Microsoft-certified professionals on staff.

**Consulting Services:** The Company's Consulting Services Division assists customers in using the Company's computer operating systems, applications, and communications products. The group works with Solutions Providers and helps create enterprise-wide computing solutions for large corporate accounts.

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

**International Sales Sites:** The Company has established marketing, support, and/or distribution subsidiaries in Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Colombia, Costa Rica, the Czech Republic, Denmark, Ecuador, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Ireland, Israel, Italy, Japan, Malaysia, Mexico, Morocco, the Netherlands, New Zealand, Norway, the People's Republic of China, Peru, the Philippines, Poland, Portugal, Puerto Rico, Russia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Arab Emirates, the United Kingdom, and Venezuela.

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

#### OEM CHANNEL

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

#### ADVERTISING

The Company works closely with large advertising and direct marketing firms. Advertising, direct marketing, worldwide packaging, and marketing materials are targeted to various end-user segments. The Company utilizes broad consumer media (television, radio, and business publications) and trade publications. Microsoft has programs under which qualifying resellers and OEMs are reimbursed for certain advertising expenditures. Microsoft also invests heavily in direct marketing and customer satisfaction areas. In 1996, the Company plans to spend more than \$150 million on a broad campaign emphasizing the Microsoft brand identity.

#### CUSTOMERS

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

## PRODUCT SUPPORT SERVICES

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

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

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

## COMPETITION

The microcomputer software business is intensely competitive and subject to extremely rapid technological change. Microsoft faces formidable competition in all areas of its business activity, including competition from many companies whose revenues and resources are much larger than Microsoft's.

**Operating systems.** Microsoft's operating systems products face substantial competition from a number of sources. Major competitors such as IBM, Apple Computer, Digital Equipment Corporation, and others, which are vertically integrated in both software development and hardware manufacture, have developed operating systems that they preinstall on computers of their own manufacture. Many of these operating system software products are also licensed to third party OEMs for preinstallation on their machines. Microsoft's operating systems products compete with UNIX-based operating systems from a wide range of companies including IBM, AT&T, Hewlett Packard, Sun Microsystems, Novell, The Santa Cruz Operation, and others. Variants of UNIX run on a wide variety of computer platforms and are gaining increasing acceptance as desktop operating systems. As microcomputer technology increasingly moves toward connectivity and communications, Microsoft's operating systems products will face increased competition from network server operating systems, such as Novell NetWare, and "middleware" products such as Lotus Notes from IBM. Microsoft's operating systems products also face constant competition from software pirates who unlawfully copy and distribute Microsoft's copyrighted software products.

**Business systems.** The Company is a fairly recent entrant into enterprise-wide computing solutions. As such, competitors enjoy larger market shares and installed bases. Software developers that provide competing server applications include Oracle, Sybase, and Informix. There are also several software vendors who offer connectivity servers. Additionally, Lotus Development (now owned by IBM) has a large installed base of Lotus Notes and cc:Mail, which compete with the Company's workgroup products.

**Desktop applications.** The Company's competitors include many software application vendors, such as Lotus, Oracle, Claris, and Novell. Some of the competitors in this arena do not offer products in every major desktop application category (e.g., spreadsheet, word processors, databases, etc.) and as a result may be able to more effectively focus their efforts on enhancing particular product offerings.

**Online services.** An enormous range of companies, including media conglomerates, telephone companies, cable companies, retailers, hardware manufacturers, and software developers, are competing to make online services widely available to computer users. Microsoft's new online services network, MSN, faces

formidable competition from both established online networks, such as CompuServe (owned by H&R Block), Prodigy (owned by IBM and Sears), America Online, and others, and impending entrants, such as a number of new online networks that will be offered by AT&T. MSN and other online networks also face competition from online services that are offered to users directly via the Internet, including, in particular, the World Wide Web portion of the Internet. Additionally, Netscape, Adobe, Sun Microsystems, and many other companies offer software for Internet servers and for user navigation of the Internet.

Developer. The Company's developer products compete against offerings from Sybase, Borland, and many other companies.

Consumer. Microsoft's Consumer division faces many smaller but focused competitors, particularly in the areas of entertainment and education. Examples include Intuit, Broderbund, Electronic Arts, Softkey, The Learning Company, Davidson Associates, Voyager, Comptons, Edmark, Sierra On-Line, and Dorling Kindersley. Still other competitors own branded content, such as Walt Disney and Lucas Arts. Additionally, as platforms become more powerful, PC-based games will compete head-to-head with games created for proprietary systems such as Nintendo and Sega. The Consumer Division's input devices face substantial competition from computer manufactures, since computers are typically sold with a keyboard and mouse, and other manufacturers of these devices.

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

#### EMPLOYEES

As of June 30, 1995, the Company employed 17,801 people, 12,193 domestically and 5,608 internationally. Of the total, 5,397 were in product research and development, 9,166 in sales, marketing, and support, 1,639 in manufacturing and distribution, and 1,599 in finance and administration. Microsoft's success is highly dependent on its ability to attract and retain qualified employees. Competition for employees is intense in the software industry. To date, the Company believes it has been successful in its efforts to recruit qualified employees, but there is no assurance that it will continue to be as successful in the future. None of the Company's employees are subject to collective bargaining agreements. The Company believes that relations with its employees are excellent.

#### ITEM 2. PROPERTIES

The Company's corporate offices consist of approximately 2.2 million square feet of office building space located in Redmond, Washington. There are two sites that total approximately 300 acres of land. The Company is constructing a 225,000 square foot office building, which is expected to be completed in the spring of 1996. Additionally, construction is continuing on another series of office buildings with approximately 685,000 square feet of space. Occupancy on this site will be phased starting in the fall of 1995 and completed by spring of 1996. The Company owns all of its corporate campus.

The Company's domestic manufacturing and distribution operation consists of a 265,000 square foot facility situated on 23 acres in nearby Snohomish County, Washington, and a 45,000 square foot disk duplication facility in Humacao, Puerto Rico. The Puerto Rican facility, which began operation in April 1990, is leased under a 10-year lease, with an option to renew for an additional 10 years. The Company's European manufacturing operation consists of a 155,000 square foot facility situated on 12 acres in Dublin, Ireland. The Ireland site also includes a 25,000 square foot office building for international localization. An additional 80,000 of square feet of office space for localization is being constructed in Ireland.

The Company owns a 65,000 square foot office building on seven acres of land plus another 33 acres near London, England. In Les Ulis, France, the Company owns a 110,000 square foot office building on four acres of land.



In addition, the Company leases office space in numerous locations in the United States and many other countries.

### ITEM 3. LEGAL PROCEEDINGS

See Notes to Financial Statements -- Contingencies.

### 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 1995.

### ITEM E.O. EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of Microsoft as of September 8, 1995 were as follows:

NAME	AGE	POSITION WITH THE COMPANY
----	---	-----
William H. Gates	39	Chairman of the Board; Chief Executive Officer
Steven A. Ballmer	39	Executive Vice President, Worldwide Sales and Support
Robert J. Herbold	53	Executive Vice President; Chief Operating Officer
Frank M. (Pete) Higgins	37	Group Vice President, Applications and Content Group
Paul A. Maritz	40	Group Vice President, Platforms Group
Nathan P. Myhrvold	36	Group Vice President, Applications and Content Group
James E. Allchin	43	Senior Vice President, Business Systems Division
Roger J. Heinen, Jr.	44	Senior Vice President, Developer Division
Joachim Kempin	53	Senior Vice President, Worldwide OEM Sales
Craig J. Mundie	46	Senior Vice President, Consumer Systems Division
William H. Neukom	53	Senior Vice President, Law and Corporate Affairs; Secretary
Jeffrey S. Raikes	37	Senior Vice President, North America
Brad A. Silverberg	41	Senior Vice President, Personal Systems Division
Patricia Q. Stonesifer	39	Senior Vice President, Consumer Division
Bernard P. Vergnes	50	Senior Vice President, Microsoft; President, Microsoft Europe
Michael W. Brown	49	Vice President, Finance; Chief Financial Officer

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

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

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

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

Mr. Maritz was named Group Vice President, Platforms Group in May 1995. He was named Senior Vice President, Product and Technology Strategy in November 1994 and had been Senior Vice President, Systems

Division since February 1992. He had been Vice President, Advanced Operating Systems since 1989. Mr. Maritz joined Microsoft in 1986.

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

Mr. Allchin was named Senior Vice President, Business Systems Division in November 1994. He had been Vice President, Business Systems Division, since July 1991. Prior to joining Microsoft in 1991, Mr. Allchin spent seven years at Banyan Systems, Inc., where he held numerous positions, most recently Senior Vice President and Chief Technology Officer.

Mr. Heinen joined Microsoft as Senior Vice President, Developer Division in January 1993. He had been Senior Vice President and General Manager of the Macintosh Software Division at Apple Computer, Inc. from 1990 to 1993. Prior to 1990, Heinen was a corporate consulting engineer for software at Digital Equipment Corporation.

Mr. Kempin was named Senior Vice President, Worldwide OEM Sales in August 1993. He had been Vice President, OEM Sales since 1987. Mr. Kempin had served as General Manager of Microsoft's German subsidiary since its inception in 1983.

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

Mr. Neukom was named Senior Vice President, Law and Corporate Affairs in February 1994. He joined Microsoft in 1985 as Vice President. Mr. Neukom formerly was a member of the Seattle law firm of Shidler McBroom Gates & Lucas (now Preston Gates & Ellis), Microsoft's primary outside law firm.

Mr. Raikes was named Senior Vice President, Microsoft North America in January 1992. He had been Vice President, Office Systems since 1990. Mr. Raikes came to Microsoft in 1981.

Mr. Silverberg was named Senior Vice President, Personal Systems Division in November 1994. He joined Microsoft in August 1990 as Vice President, Personal Operating Systems Division. From 1987 until joining Microsoft, Mr. Silverberg served as Vice President, Engineering for Borland International, Inc.

Ms. Stonesifer was named Senior Vice President, Consumer Division in November 1994, after having been Vice President, Consumer Division since June 1993. She had been Vice President, Support since 1992 and General Manager of Product Support Services since 1991. Previously, she was General Manager of Microsoft Canada and before that, General Manager for Microsoft Press. Prior to joining Microsoft in 1988, Ms. Stonesifer was with Que Corporation, a publisher of books for computer users.

Mr. Vergnes is a Senior Vice President of Microsoft and was named President, Microsoft Europe in April 1992. He had been Vice President, Europe since 1989. Mr. Vergnes served as General Manager of Microsoft's French subsidiary since its inception in 1983.

Mr. Brown was named Chief Financial Officer in August 1994 and Vice President, Finance in April 1993. He had been Treasurer since February 1990, after joining Microsoft in January 1990. Previously, Mr. Brown was a partner in the accounting firm Deloitte & Touche, Microsoft's independent auditors.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Company's common stock is traded on The Nasdaq Stock Market under the symbol MSFT. On September 8, 1995, there were 35,643 holders of record of the Company's common stock. The Company has not paid cash dividends on its common stock.

QUARTERLY FINANCIAL AND STOCK PRICE INFORMATION  
(IN MILLIONS, EXCEPT PER SHARE DATA)

	QUARTER ENDED				YEAR
	SEPTEMBER 30	DECEMBER 31	MARCH 31	JUNE 30	
<b>1993</b>					
Net revenues.....	\$ 818	\$ 938	\$ 958	\$1,039	\$3,753
Operating income.....	289	326	338	373	1,326
Net income.....	209	236	243	265	953
Earnings per share.....	0.35	0.39	0.40	0.43	1.57
Common stock price per share:					
High.....	41	47 1/2	47 1/8	49	49
Low.....	32 3/4	37 7/8	38 3/8	39 7/8	32 3/4
<b>1994</b>					
Net revenues.....	\$ 983	\$1,129	\$ 1,244	\$1,293	\$4,649
Operating income.....	343	415	480	488	1,726
Net income.....	239	289	256	362	1,146
Earnings per share.....	0.39	0.48	0.42	0.59	1.88
Common stock price per share:					
High.....	44 1/4	43 1/4	44 5/8	54 5/8	54 5/8
Low.....	35 1/8	38	39	41	35 1/8
<b>1995</b>					
Net revenues.....	\$ 1,247	\$1,482	\$ 1,587	\$1,621	\$5,937
Operating income.....	437	520	549	532	2,038
Net income.....	316	373	396	368	1,453
Earnings per share.....	0.51	0.60	0.63	0.58	2.32
Common stock price per share:					
High.....	59 1/4	65 1/8	74 1/8	92 3/8	92 3/8
Low.....	46 7/8	53 7/8	58 1/4	68 3/4	46 7/8

## ITEM 6. SELECTED FINANCIAL DATA

FINANCIAL HIGHLIGHTS  
(IN MILLIONS, EXCEPT EARNINGS PER SHARE)

	YEAR ENDED JUNE 30				
	1991	1992	1993	1994	1995
Net revenues.....	\$1,843	\$2,759	\$3,753	\$4,649	\$5,937
Net income.....	463	708	953	1,146	1,453
Earnings per share.....	0.82	1.20	1.57	1.88	2.32
Return on net revenues.....	25.1%	25.7%	25.4%	24.7%	24.5%
Cash and short-term investments.....	\$ 686	\$1,345	\$2,290	\$3,614	\$4,750
Total assets.....	1,644	2,640	3,805	5,363	7,210
Stockholders' equity.....	1,351	2,193	3,242	4,450	5,333

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## RESULTS OF OPERATIONS FOR 1993, 1994, AND 1995

Microsoft develops, manufactures, licenses, sells, and supports a wide range of software products, including operating system platforms for personal computers (PCs), workstations, and servers; business and consumer applications for productivity, reference, education, and entertainment; and development tools. Microsoft also sells personal computer books and input devices, and is engaged in the research and development of online and advanced technology software products.

## NET REVENUES

Microsoft's net revenues grew 24% in the fiscal year ended June 30, 1994 and 28% in fiscal year 1995. Software license volume (as opposed to price) increases have been the principal factor in Microsoft revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and corporate license programs, such as Microsoft Select, is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, e.g., Microsoft Office, are less than the sum of the prices for the individual programs included in these products when such programs are licensed separately.

Product groups. Microsoft has a platforms product group and an applications and content product group.

Platforms product group revenues were \$1.52 billion, \$1.83 billion, and \$2.36 billion in 1993, 1994, and 1995.

Principal personal systems products have been the MS-DOS and Microsoft Windows operating systems. MS-DOS is preinstalled on PCs by most OEMs, and revenues from such licenses increased steadily in both 1994 and 1995. Revenues from retail upgrade versions of MS-DOS decreased in both 1994 and 1995 after a strong increase in 1993 when the MS-DOS 6 Upgrade was released. There were no major upgrades of MS-DOS in 1994 or 1995. The Microsoft Windows operating system was an increasingly strong contributor to revenues as the number of new PCs preinstalled with Windows increased rapidly during the three-year period. Windows units licensed to new users were 15 million, 30 million, and 40 million in 1993, 1994, and 1995.

Business systems products offer an enterprise-wide distributed client/server environment based on the Microsoft Windows NT operating system and the server applications in the Microsoft BackOffice family of products. Revenues from these products increased strongly in 1994 and 1995.

Revenues from developer products increased steadily in all three years, as more independent software vendors, corporate developers, and solutions developers licensed tools to develop software for Windows and Windows NT.

Applications and content product group revenues were \$2.24 billion, \$2.82 billion, and \$3.58 billion in 1993, 1994, and 1995.

Increases in desktop applications revenues were led by strong sales of Microsoft Office. The Microsoft Office Standard product includes the Microsoft Excel spreadsheet, the Microsoft Word word processor, the Microsoft PowerPoint presentation graphics program, and a Microsoft Mail client-access license, while the Microsoft Office Professional version also includes the Microsoft Access database management system. Sales of stand-alone versions of Microsoft Excel and Microsoft Word decreased in 1994 and 1995 as the sales mix continued to shift to integrated product suites.

Microsoft Home, a broad range of consumer products, also showed continued growth. The Microsoft Home brand includes CD-ROM multimedia reference titles and software products for home and small office productivity, children's creativity, and entertainment. Microsoft also markets the Microsoft Mouse and Microsoft Natural Keyboard. Mouse sales were flat during the three-year period, while the initial introduction of the keyboard increased revenues in 1995.

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

OEM channel revenues were \$731 million in 1993, \$1.18 billion in 1994, and \$1.65 billion in 1995. The primary source of OEM revenues is the licensing of operating systems, particularly MS-DOS and Microsoft Windows. As such, OEM channel revenues are highly dependent on PC shipment volume.

U.S. and Canada channel revenues were \$1.37 billion, \$1.58 billion, and \$1.88 billion in 1993, 1994, and 1995.

Revenues in Europe were \$1.26 billion, \$1.36 billion, and \$1.49 billion in 1993, 1994, and 1995. Growth rates have been lower in Europe than in other geographic areas due to general economic slowness, higher existing market shares, and a more dramatic shift to corporate licensing programs.

Other International channel revenues were \$392 million in 1993, \$532 million in 1994, and \$924 million in 1995. Growth rates continue to be strong due to customer acceptance of newly localized products, particularly in Japan, and early entrance into emerging markets.

Microsoft's operating results are affected by foreign exchange rates. Approximately 44%, 40%, and 37% of Microsoft's revenues were collected in foreign currencies during 1993, 1994, and 1995. Since much of Microsoft's international manufacturing costs and operating expenses are also incurred in local currencies, the impact of exchange rates on net income is less than on revenues.

#### OPERATING EXPENSES

Cost of revenues. As a percentage of revenues, cost of revenues was 16.9% in 1993, 16.4% in 1994, and 14.8% in 1995. The percentage decreased due to a greater proportion of licenses to OEMs and corporations, lower disk prices from vendors, and a higher proportion of CD-ROM versions. These factors were offset somewhat by increased sales of lower-margin products such as integrated suites and upgrades.

Research and development. Microsoft made substantial investments in R&D in 1994, and the rate of growth accelerated in 1995. Expense increases resulted primarily from development staff headcount growth and higher levels of third-party development costs in many areas, including development efforts for Windows 95 and The Microsoft Network. R&D costs also increased for business systems, consumer systems, desktop applications, and consumer products.

Sales and marketing. The increase in the absolute dollar amount of sales and marketing expense in 1995 was due primarily to increased product-specific marketing programs, a Microsoft brand advertising campaign, and continued expansion of Product Support Services. In 1994, sales and marketing expenses increased at a slower rate than revenues due to a concerted performance orientation at all sales sites.

General and administrative. Increases in general and administrative expenses in 1994 and 1995 were primarily attributable to higher legal costs and growth in the computer systems and the number of people necessary to support overall increases in the scope of Microsoft's operations.

#### NONOPERATING ITEMS

Interest income, which was \$83 million, \$104 million, and \$193 million in 1993, 1994, and 1995, increased primarily as a result of a larger investment portfolio generated by cash from operations.

In the fourth quarter of 1995, Microsoft paid a \$46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger.

In the third quarter of 1994, Microsoft recorded a \$120 million charge to reflect the estimated impact of a jury verdict in the Stac Electronics patent litigation and related expenses. In June 1994, Microsoft reached an agreement with Stac to settle the litigation and adjusted its estimate accordingly, resulting in a credit of \$30 million in the fourth quarter and a net pretax charge of \$90 million for 1994.

#### PROVISION FOR INCOME TAXES

The effective tax rate increased from 32.0% in 1993 to 33.5% in 1994 and 33.0% in 1995 primarily because of an increase in the U.S. statutory income tax rate.

#### NET INCOME

Net income as a percent of revenues decreased in 1995 due to increased relative research and development, sales and marketing, and general and administrative expenses, offset by the lower relative cost of revenues and the higher relative net nonoperating income. The net income percentage decreased in 1994, primarily due to the patent litigation charge and increased research and development expenses, offset by the lower relative level of sales and marketing expenses.

#### FINANCIAL CONDITION

Microsoft's cash and short-term investments totaled \$4.75 billion at June 30, 1995. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are investment grade and liquid. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. Microsoft's portfolio is invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs. Microsoft has no material long-term debt. Microsoft has \$70 million of standby multicurrency lines of credit that support foreign currency hedging and international cash management.

Stockholders' equity at June 30, 1995 exceeded \$5.3 billion.

Cash generated from operations has been sufficient historically to fund Microsoft's investment in research and development activities and facilities expansion. As Microsoft grows, investments will continue in research and development in existing and advanced areas of technology. Microsoft's cash will also be used to acquire technology and to fund ventures and other strategic opportunities. Additions to property, plant, and equipment are expected to continue, including facilities and computer systems for research and development, sales and marketing, product support, and administrative staff. For example, on June 30, 1995, commitments related to the construction of new buildings approximated \$150 million.

The exercise of stock options by employees provides additional cash. These proceeds have been used in Microsoft's open market stock repurchase program through which Microsoft provides shares for stock option and stock purchase plans. This program will continue in 1996.

During 1995, to enhance its stock repurchase program, Microsoft sold equity put warrants to independent third parties. These put warrants entitle the holders to sell shares of Microsoft common stock to Microsoft on certain dates at specified prices.

Also during 1995, a 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, The Microsoft Network, which was in development.

Management believes existing cash and short-term investments together with funds generated from operations will be sufficient to meet operating requirements in 1996. Microsoft's cash and short-term investments are also managed to be available for strategic investment opportunities or other potential large-scale cash needs that may arise in pursuit of Microsoft's long-term strategies.

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

Microsoft has not paid cash dividends on its common stock.

#### OUTLOOK AND UNCERTAINTIES

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

Rapid technological change. The personal computer software industry is characterized by rapid technological change and uncertainty as to the impact of emerging areas such as the Internet and online services, the information highway, networked collaboration products, and electronic commerce.

Long-term investment cycle. Developing and localizing software is expensive and the investment in product development often involves a long payback cycle. Microsoft's plans for 1996 include significant investments in software research and development and related product opportunities from which significant revenues are not anticipated for a number of years. Management expects total spending for research and development in 1996 to increase over spending in 1995.

Customer acceptance. While Microsoft performs extensive usability and beta testing of new products, user acceptance and corporate penetration rates ultimately dictate the success of development and marketing efforts of products such as Windows 95, Microsoft Office for Windows 95, or the Microsoft BackOffice family of products.

Product ship schedules. Delays in the release of new products can cause operational inefficiencies that impact manufacturing and distribution logistics, independent software vendor (ISV) and OEM relationships, and telephone support staffing.

Prices. Future prices Microsoft is able to obtain for its products may decrease from historical levels depending on competitive market or cost factors. Prices of software in Europe are generally higher than in the U.S. to cover localization costs and higher costs of distribution. Such price uplifts could erode in the future.

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

Saturation. Product upgrades, enabling users to upgrade from earlier versions of Microsoft's products or from competitors' products, have lower prices and margins than new products. As the desktop applications market becomes saturated, the sales mix shifts from standard products to upgrade products. This trend is expected to continue.

Channel mix. Average revenue per license is lower from OEM licenses than from retail versions, reflecting the relatively lower direct costs of operations in the OEM channel. An increasingly higher percentage of revenues was achieved through the OEM channel during 1994 and 1995.

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

Cost of revenues. Although cost of revenues as a percentage of net revenues decreased in 1994 and 1995, it varies with channel mix and product mix within channels. Changes in channel and product mix, including the potential retail upgrade cycle of Windows 95, may increase cost of revenues as a percentage of net revenues in 1996.

Sales and marketing and support investments. Microsoft's plans for 1996 include continued investments in its sales and marketing and support groups. Microsoft brand advertising is also expected to increase.

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

Intellectual property rights. Microsoft diligently defends its intellectual property rights, but unlicensed copying of software represents a loss of revenues to Microsoft. While this adversely affects U.S. revenues, revenue loss is even more significant outside of the U.S., particularly in certain 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. There can be no assurance that continued efforts will affect revenues positively.

Future growth rates. If a substantial number of users upgrade to Windows 95, revenue growth rates in the initial shipping quarters of 1996 could be at relatively high levels. Revenue growth rates in the comparable quarters of 1997 may not approach such levels. As discussed above, operating expenses are expected to increase in 1996. Because of the fixed nature of a significant portion of such expenses, coupled with the possibility of slower revenue growth, operating margins in 1997 may decrease from those in 1996.

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

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

##### INDEX TO FINANCIAL STATEMENTS

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#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.



INCOME STATEMENTS  
(IN MILLIONS, EXCEPT EARNINGS PER SHARE)

	YEAR ENDED JUNE 30		
	1993	1994	1995
Net revenues.....	\$3,753	\$4,649	\$5,937
Operating expenses:			
Cost of revenues.....	633	763	877
Research and development.....	470	610	860
Sales and marketing.....	1,205	1,384	1,895
General and administrative.....	119	166	267
Total operating expenses.....	2,427	2,923	3,899
Operating income.....	1,326	1,726	2,038
Interest income -- net.....	82	102	191
Noncontinuing items.....	--	(90)	(46)
Other expenses.....	(7)	(16)	(16)
Income before income taxes.....	1,401	1,722	2,167
Provision for income taxes.....	448	576	714
Net income.....	\$ 953	\$1,146	\$1,453
Earnings per share.....	\$ 1.57	\$ 1.88	\$ 2.32
Weighted average shares outstanding.....	606	610	627

See accompanying notes.

CASH FLOWS STATEMENTS  
(IN MILLIONS)

	YEAR ENDED JUNE 30		
	1993	1994	1995
<b>CASH FLOWS FROM OPERATIONS</b>			
Net income.....	\$ 953	\$ 1,146	\$ 1,453
Depreciation and amortization.....	151	237	269
Current liabilities.....	177	360	419
Accounts receivable.....	(121)	(146)	(91)
Inventories.....	(51)	23	15
Other current assets.....	(35)	(27)	(75)
Net cash from operations.....	1,074	1,593	1,990
<b>CASH FLOWS FROM FINANCING</b>			
Common stock issued.....	229	280	332
Common stock repurchased.....	(250)	(348)	(649)
Stock option income tax benefits.....	207	151	179
Net cash from financing.....	186	83	(138)
<b>CASH FLOWS USED FOR INVESTMENTS</b>			
Additions to property, plant, and equipment.....	(236)	(278)	(495)
Other assets.....	(17)	(64)	(230)
Short-term investments.....	(723)	(860)	(651)
Net cash used for investments.....	(976)	(1,202)	(1,376)
Net change in cash and equivalents.....	284	474	476
Effect of exchange rates on cash.....	(62)	(10)	9
Cash and equivalents, beginning of year.....	791	1,013	1,477
Cash and equivalents, end of year.....	1,013	1,477	1,962
Short-term investments.....	1,277	2,137	2,788
Cash and short-term investments.....	\$2,290	\$ 3,614	\$ 4,750

See accompanying notes.

BALANCE SHEETS  
(IN MILLIONS)

	JUNE 30	
	1994	1995
<b>ASSETS</b>		
Current assets:		
Cash and short-term investments.....	\$3,614	\$4,750
Accounts receivable -- net of allowances of \$92 and \$139.....	475	581
Inventories.....	102	88
Other.....	121	201
Total current assets.....	4,312	5,620
Property, plant, and equipment -- net.....	930	1,192
Other assets.....	121	398
Total assets.....	\$5,363	\$7,210
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable.....	\$ 324	\$ 563
Accrued compensation.....	96	130
Income taxes payable.....	305	410
Other.....	188	244
Total current liabilities.....	913	1,347
Minority interest.....	--	125
Put warrants.....	--	405
Commitments and contingencies		
Stockholders' equity:		
Common stock and paid-in capital -- shares authorized 2,000; issued and outstanding 581 and 588.....	1,500	2,005
Retained earnings.....	2,950	3,328
Total stockholders' equity.....	4,450	5,333
Total liabilities and stockholders' equity.....	\$5,363	\$7,210
	=====	=====

See accompanying notes.

STOCKHOLDERS' EQUITY STATEMENTS  
(IN MILLIONS)

	YEAR ENDED JUNE 30		
	1993	1994	1995
<b>COMMON STOCK AND PAID-IN CAPITAL</b>			
Balance, beginning of year.....	\$ 657	\$1,086	\$1,500
Common stock issued.....	229	280	332
Common stock repurchased.....	(7)	(17)	(30)
Proceeds from sale of put warrants.....	--	--	49
Reclassification of put warrant obligation.....	--	--	(25)
Stock option income tax benefits.....	207	151	179
	-----	-----	-----
Balance, end of year.....	1,086	1,500	2,005
	-----	-----	-----
<b>RETAINED EARNINGS</b>			
Balance, beginning of year.....	1,536	2,156	2,950
Common stock repurchased.....	(243)	(331)	(668)
Reclassification of put warrant obligation.....	--	--	(380)
Net income.....	953	1,146	1,453
Translation adjustment.....	(90)	(21)	(27)
	-----	-----	-----
Balance, end of year.....	2,156	2,950	3,328
	-----	-----	-----
Total stockholders' equity.....	\$3,242	\$4,450	\$5,333
	=====	=====	=====

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS  
(IN MILLIONS)

## SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation. The financial statements include the accounts of Microsoft and its subsidiaries. Significant intercompany transactions and balances have been eliminated.

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

Revenue recognition. Revenue from sales to distributors and resellers is recognized when related products are shipped. Revenue from corporate license programs generally is recognized when the product is installed by the user. Finished goods revenue attributable to significant support (telephone support and specified and unspecified enhancements) is recognized when such obligations are fulfilled. Costs related to insignificant obligations, which includes telephone support for certain products, are accrued.

Revenue from products licensed to original equipment manufacturers is recognized when the licensed products are shipped by the OEM.

Revenue from software maintenance, service, and support contracts is recognized ratably over the contract period.

Provisions are recorded for returns and bad debts.

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

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

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

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

Financial instruments. The Company considers all liquid 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 three years from the purchase date. All cash and short-term investments are classified as available for sale. Cost approximates market value for all classifications of cash and short-term investments; realized and unrealized gains and losses are not material.

Statement of Financial Accounting Standard Accounting for Certain Investments in Debt and Equity Securities was adopted in 1995 and did not have a material impact on the financial statements.

Inventories. Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Property, plant, and equipment. Property, plant, and equipment is stated at cost and depreciated using the straight-line method. Estimated lives are as follows: buildings, 30 years; leasehold improvements, the lease term; computer equipment and other, principally three years.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

Diversification of risk. The Company's investment portfolio is diversified and consists of short-term investment grade securities. At June 30, 1994 and 1995, approximately 40% of accounts receivable represented amounts due from ten channel purchasers. Two of these each accounted for approximately 10%, 13%, and 12% of revenues in 1993, 1994, and 1995.

Finished goods sales to international customers in Europe, Japan, Australia, and Canada are primarily billed in local currencies. Payment cycles are relatively short, generally less than 90 days. European manufacturing costs and international selling, distribution, and support costs are generally disbursed in local currencies. Local currency cash balances in excess of short-term operating needs are generally converted into U.S. dollar cash and short-term investments upon receipt. Therefore, foreign exchange rate fluctuations generally do not create a risk of material transaction gains or losses. As a result, Microsoft's hedging activities for transaction exposures have been minimal. No material hedge contracts were outstanding at June 30, 1995.

Translated results of operations of the Company's foreign subsidiaries are affected by foreign exchange rates. During 1995 and for 1996, the Company hedged a percentage of planned translated international finished goods revenues by purchasing options on the applicable currencies. Premiums paid for the options, which were not material, are being amortized over the lives of the options. Any gains will be recognized when and if realized.

Reclassifications. Certain reclassifications have been made for consistent presentation.

CASH AND SHORT-TERM INVESTMENTS

	JUNE 30	
	1994	1995
	-----	-----
Cash and equivalents:		
Cash.....	\$ 263	\$ 135
Commercial paper.....	619	1,035
Money market preferreds.....	180	255
Certificates of deposit.....	218	492
Bank loan participations.....	197	45
	-----	-----
Cash and equivalents.....	1,477	1,962
	-----	-----
Short-term investments:		
Municipal securities.....	1,245	1,291
Corporate notes and bonds.....	423	866
U.S. Treasury securities.....	417	444
Commercial paper.....	52	187
	-----	-----
Short-term investments.....	2,137	2,788
	-----	-----
Cash and short-term investments.....	\$3,614	\$4,750
	=====	=====

PROPERTY, PLANT, AND EQUIPMENT

	JUNE 30	
	1994	1995
	-----	-----
Land.....	\$ 162	\$ 206
Buildings.....	440	607
Computer equipment.....	532	707
Other.....	311	387
	-----	-----
Property, plant, and equipment -- at cost.....	1,445	1,907
Accumulated depreciation.....	(515)	(715)
	-----	-----
Property, plant, and equipment -- net.....	\$ 930	\$1,192
	=====	=====



NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

## INCOME TAXES

The provision for income taxes was composed of:

	1993	1994	1995
	-----	-----	-----
Current taxes:			
U.S. and state.....	\$352	\$470	\$518
International.....	123	94	151
	----	----	----
Current taxes.....	475	564	669
Deferred taxes.....	(27)	12	45
	----	----	----
Provision for income taxes.....	\$448	\$576	\$714
	=====	=====	=====

Differences between the U.S. statutory and effective tax rates were:

	1993	1994	1995
	-----	-----	-----
U.S. statutory rate.....	34.0%	35.0%	35.0%
Tax exempt income.....	(0.6)	(0.9)	(1.1)
Foreign sales corporation.....	(1.0)	(1.0)	(0.7)
Tax credits.....	(0.9)	(2.1)	(1.6)
State taxes and other -- net.....	0.5	2.5	1.4
	----	----	----
Effective tax rate.....	32.0%	33.5%	33.0%
	=====	=====	=====

Deferred income tax balances were:

	JUNE 30	
	1994	1995
	-----	-----
Deferred income tax assets:		
Revenue items.....	\$ 61	\$ 68
Expense items.....	143	221
	----	----
Deferred income tax assets.....	204	289
	----	----
Deferred income tax liabilities:		
International earnings.....	(147)	(276)
Other.....	(4)	(5)
	----	----
Deferred income tax liabilities.....	(151)	(281)
	----	----
Net deferred income tax asset.....	\$ 53	\$ 8
	=====	=====

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

	1993	1994	1995
	-----	-----	-----
U.S.....	\$ 960	\$1,281	\$1,549
International.....	441	441	618
	----	----	----
Income before income taxes.....	\$1,401	\$1,722	\$2,167
	=====	=====	=====

The Internal Revenue Service is examining the Company's U.S. income tax returns for 1990 and 1991. The Company believes any adjustments from the



examination will not be material to the financial statements. Income taxes paid were \$187 million, \$247 million, and \$430 million in 1993, 1994, and 1995.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

## COMMON STOCK

Shares of common stock outstanding were as follows:

	1993	1994	1995
	----	----	----
Balance, beginning of year.....	544	565	581
Issued.....	27	25	19
Repurchased.....	(6)	(9)	(12)
	---	---	---
Balance, end of year.....	565	581	588
	===	===	===

The Company repurchases its common stock in the open market to provide shares for issuance to employees under stock option and stock purchase plans. The Company's Board of Directors authorized continuation of this program in 1996.

## PUT WARRANTS

In connection with the Company's stock repurchase program, put warrants were sold to independent third parties during 1995. The put warrants entitle the holders to sell shares of Microsoft common stock to the Company at specified prices. On June 30, 1995, 8.0 million warrants were outstanding with a strike price of \$69.75 per share. The warrants expire at various dates between February 1996 and November 1996, are exercisable only at maturity, and are settleable in cash at Microsoft's option. The maximum potential repurchase obligation of \$405 million has been reclassified from stockholders' equity to put warrants as of June 30, 1995. There was no impact on earnings per share in 1995.

## 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 1993, 1994, and 1995, employees purchased 1.0 million, 1.1 million, and 1.0 million shares at average prices of \$33.29, \$34.16, and \$46.76 per share. At June 30, 1995, 2.1 million shares were reserved for future issuance.

Savings plan. The Company has a savings plan, which qualifies under Section 401(k) of the Internal Revenue Code. Under the plan, participating U.S. employees may defer up to 15% of their pretax salary, but not more than statutory limits. The Company contributes fifty cents for each dollar contributed by a participant, with a maximum contribution of 3% of a participant's earnings. The Company's matching contributions to the savings plan were \$7 million, \$9 million, and \$12 million in 1993, 1994, and 1995.

Stock option plans. The Company has stock option plans for directors, officers, and all employees, which provide for nonqualified and incentive stock options. The Board of Directors determines the option price (not to be less than fair market value for incentive options) at the date of grant. Options granted prior to 1995 generally vest over four and one-half years and expire ten years from the date of grant. Options granted during and after 1995 generally vest over four and one-half years and expire seven years from the date of grant, while certain options vest over seven and one-half years and expire after ten years. At June 30, 1995, options for 58.5 million shares were vested and 92.8 million shares were available for future grants under the plans.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

Stock options outstanding were as follows:

	NUMBER	PRICE PER SHARE	
		RANGE	WEIGHTED AVERAGE
Balance, June 30, 1992.....	120.3	\$ 0.31-39.79	\$12.44
Granted.....	24.4	30.88-44.25	34.30
Exercised.....	(26.2)	0.31-36.92	7.95
Canceled.....	(4.4)	4.97-44.13	14.23
-----			
Balance, June 30, 1993.....	114.1	0.31-44.25	18.06
Granted.....	26.2	35.50-50.13	37.47
Exercised.....	(20.9)	1.51-44.25	11.42
Canceled.....	(5.5)	5.01-44.13	28.67
-----			
Balance, June 30, 1994.....	113.9	0.31-50.13	23.29
Granted.....	21.7	47.75-83.13	50.50
Exercised.....	(17.6)	0.31-47.75	15.81
Canceled.....	(4.2)	5.11-75.00	35.40
-----			
Balance, June 30, 1995.....	113.8	1.54-83.13	29.12
=====			

#### LEASES

The Company has operating leases for most U.S. and international sales and support offices and certain equipment. Rental expense for operating leases was \$54 million, \$68 million, and \$86 million in 1993, 1994, and 1995. Future minimum rental commitments under noncancelable leases, in millions of dollars, are: 1996, \$78; 1997, \$65; 1998, \$56; 1999, \$44; 2000, \$28; and thereafter, \$13.

#### THE MICROSOFT NETWORK

During 1995, 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, The Microsoft Network, which was in development. Microsoft owns 80% of the entity, whose operations have not been material to the financial results of Microsoft. The entity was subsequently reorganized into The Microsoft Network, LLC.

#### NONCONTINUING ITEMS

In the fourth quarter of 1995, the Company paid a \$46 million breakup fee to Intuit Inc. in connection with the termination of a planned merger.

In the third quarter of 1994, the Company recorded a \$120 million charge to reflect the estimated impact of a jury verdict in the Stac Electronics patent litigation and related expenses. In June 1994, the Company reached an agreement with Stac to settle the litigation and adjusted its estimate accordingly, resulting in a credit of \$30 million in the fourth quarter and a net pretax charge of \$90 million for 1994.

#### CONTINGENCIES

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. In the consent decree, 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 agreement for precommercial versions

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
(IN MILLIONS)

of certain operating system products, and clarified the rights and responsibilities of those signing such nondisclosure agreements. The consent decree was approved by the U.S. District Court for the District of Columbia on August 21, 1995.

The Antitrust Division of the DOJ has stated that it is conducting an investigation concerning Microsoft's inclusion of client-access software for The Microsoft Network in Windows 95. Although there is no assurance that this matter will be resolved favorably and that Microsoft's future financial statements will not be adversely affected, Microsoft currently believes that resolution of this matter will not have a material adverse effect on its financial condition or results of operations.

INFORMATION BY GEOGRAPHIC AREA

	1993	1994	1995
	-----	-----	-----
Net revenues			
U.S. operations.....	\$2,655	\$3,472	\$4,495
European operations.....	1,289	1,401	1,575
Other international operations.....	395	375	558
Eliminations.....	(586)	(599)	(691)
	-----	-----	-----
Total net revenues.....	\$3,753	\$4,649	\$5,937
	=====	=====	=====
Operating income			
U.S. operations.....	\$ 961	\$1,394	\$1,709
European operations.....	360	346	412
Other international operations.....	18	31	91
Eliminations.....	(13)	(45)	(174)
	-----	-----	-----
Total operating income.....	\$1,326	\$1,726	\$2,038
	=====	=====	=====
Identifiable assets			
U.S. operations.....	\$2,944	\$4,397	\$5,862
European operations.....	1,133	1,366	1,806
Other international operations.....	310	423	689
Eliminations.....	(582)	(823)	(1,147)
	-----	-----	-----
Total identifiable assets.....	\$3,805	\$5,363	\$7,210
	=====	=====	=====

Intercompany sales between geographic areas are accounted for at prices representative of unaffiliated party transactions. "U.S. operations" include shipments to customers in the U.S., licensing to OEMs, and exports of finished goods directly to international customers, primarily in Canada, South America, and Asia. Exports and international OEM transactions are primarily in U.S. dollars and totaled \$426 million, \$787 million, and \$1,263 million in 1993, 1994, and 1995. "Other international operations" primarily include subsidiaries in Australia, Japan, Korea, and Taiwan. International revenues, which include European operations, other international operations, exports, and OEM distribution, were 55.3%, 54.0%, and 55.3% of total revenues in 1993, 1994, and 1995.

## 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, 1994 and 1995, the related statements of income, cash flows, and stockholders' equity for each of the three years ended June 30, 1995. Our audits also included the financial statement schedule listed in the Index at Item 8. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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, 1994 and 1995, and the results of their operations and their cash flows for each of the three years ended June 30, 1995 in conformity with generally accepted accounting principles. Also, in our opinion the financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington  
July 17, 1995  
(August 21, 1995 as to  
Contingencies Note)

## PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to Directors may be found under the caption "Election of Directors and Management Information" on pages 1 and 2 of the Company's Proxy Statement dated September 25, 1995, for the Annual Meeting of Shareholders to be held October 27, 1995 (the "Proxy Statement"). Such information is incorporated herein by reference. Information with respect to Executive Officers may be found on pages 11 and 12 hereof, under the caption "Executive Officers of the Registrant."

## ITEM 11. EXECUTIVE COMPENSATION

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

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

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

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth under the caption "Certain Transactions" on page 8 of the Proxy Statement is incorporated herein by reference.

## PART IV

## ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

## (a) Financial Statements and Schedules

The financial statements of Microsoft as set forth under Item 8 are filed as part of this report.

Supplemental Schedule II -- Valuation and Qualifying Accounts is filed on page 32 of this report.

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

The independent auditors' report with respect to the above-listed financial statements and schedule appears on page 29 of this report.

## (b) Reports on Form 8-K

No reports on Form 8-K were filed during the last quarter of fiscal 1995.

## (c) Exhibit Listing

EXHIBIT NUMBER -----	DESCRIPTION -----
3.1	Restated Articles of Incorporation(1)
3.2	Bylaws(1)
10.1	Microsoft Corporation 1991 Stock Option Plan(1)
10.2	Microsoft Corporation 1981 Stock Option Plan(2)
10.3	Microsoft Corporation Stock Option Plan for Non-Employee Directors(1)
10.4	Microsoft Corporation Stock Option Plan for Consultants and Advisor(1)
10.5	Microsoft Corporation 1991 Employee Stock Purchase Plan
10.6	Microsoft Corporation Savings Plus Plan(1)
10.7	Trust Agreement dated June 1, 1993 between Microsoft Corporation and First Interstate Bank of Washington(3)
10.8	Form of Indemnification Agreement(3)
11.	Computation of Earnings Per Share
21.	Subsidiaries
23.	Independent Auditors' Consent
27.	Financial Data Schedule
99.1	Financial Statements for the Microsoft Corporation 1991 Employee Stock Purchase Plan for the Three Years Ended June 30, 1995
99.2	Financial Statements for the Microsoft Corporation Savings Plus Plan for the Two Years Ended December 31, 1994 and the Nine Months Ended December 31, 1992

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

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

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

## SCHEDULE II -- VALUATION AND QUALIFYING ACCOUNTS

ALLOWANCE FOR DOUBTFUL ACCOUNTS  
(IN MILLIONS)

	YEAR ENDED JUNE 30		
	1993	1994	1995
Balance, beginning of year.....	\$ 57	\$ 76	\$ 92
Additions charged to expense.....	47	27	51
Deductions.....	(28)	(11)	(4)
Balance, end of year.....	\$ 76	\$ 92	\$139



## 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 13, 1995.

## MICROSOFT CORPORATION

By /s/ MICHAEL W. BROWN

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

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on September 13, 1995.

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
/s/ RICHARD A. HACKBORN ----- Richard A. Hackborn	Director
/s/ DAVID F. MARQUARDT ----- David F. Marquardt	Director
/s/ ROBERT D. O'BRIEN ----- Robert D. O'Brien	Director
----- Wm. G. Reed, Jr.	Director
/s/ JON A. SHIRLEY ----- Jon A. Shirley	Director
/s/ MICHAEL W. BROWN ----- Michael W. Brown	Vice President, Finance; Chief Financial Officer (Principal Financial and Accounting Officer)

The undersigned hereby appoints WILLIAM H. GATES and ROBERT J. HERBOLD, and each of them, with full power of substitution, as proxies to vote the shares which the undersigned is entitled to vote at the Annual Meeting of the Company to be held at the Hyatt Regency Bellevue, 900 Bellevue Way N.E., Bellevue, Washington on October 27, 1995 at 8:00 a.m. and at any adjournments thereof.

(Continued and to be signed on other side)

This proxy when properly signed will be voted in the manner directed herein by the undersigned shareholder.

IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED FOR PROPOSALS 1 AND 2.

1. ELECTION OF DIRECTORS:		NOMINEES: William H. Gates, Paul G. Allen, Richard A. Hackborn, David F. Marquardt, Robert D. O'Brien, William G. Reed, Jr., and Jon A. Shirley
FOR all nominees listed (except as marked to the contrary)	WITHHOLD AUTHORITY to vote for all nominees listed.	Except vote withheld from following nominee(s) listed in space below:
<input type="checkbox"/>	<input type="checkbox"/>	-----

2. Proposal to ratify the selection of Deloitte & Touche LLP as the independent public auditors of the Company for the current fiscal year.

3. In their discretion, the proxies are authorized to vote upon such other business as may properly come before the meeting.

FOR      AGAINST      ABSTAIN  
           

IMPORTANT - PLEASE SIGN AND RETURN PROMPTLY. When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee, or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by an authorized person.

Dated: \_\_\_\_\_, 1995

-----  
 (Signature)

-----  
 Signature (if held jointly)

PLEASE MARK, SIGN, DATE AND RETURN THE PROXY CARD PROMPTLY,  
 USING THE ENCLOSED ENVELOPE.

