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

FORM 10-Q

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

For the Quarterly Period Ended December 31, 1999

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

For the Transition Period From _____ to ____

Commission File Number 0-14278

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

Washington	91-1144442
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Microsoft Way, Redmond, Washington 98052-6399
(Address of principal executive office) (Zip Code)

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

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

The number of shares outstanding of the registrant's common stock as of January 31, 2000 was 5,204,853,333.

MICROSOFT CORPORATION

FORM 10-Q

For the Quarter Ended December 31, 1999

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Part I. Financial Information

Item 1. Financial Statements

MICROSOFT CORPORATION

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

	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	1998	1999	1998	1999
Revenue	$5,195	$6,112	$9,388	$11,496
Operating expenses:				
Cost of revenue	788	756	1,437	1,468
Research and development	715	911	1,366	1,745
Sales and marketing	794	1,027	1,482	1,930
General and administrative	149	506	248	649
Other expenses (income)	35	(6)	59	19
Total operating expenses	2,481	3,194	4,592	5,811
Operating income	2,714	2,918	4,796	5,685
Investment income	337	773	598	1,170
Gains on sales	0	0	160	156
Income before income taxes	3,051	3,691	5,554	7,011
Provision for income taxes	1,068	1,255	1,888	2,384
Net income	$1,983	$2,436	$3,666	$ 4,627
Earnings per share (1):				
Basic	$ 0.40	$ 0.47	$ 0.73	$ 0.90
Diluted	$ 0.36	$ 0.44	$ 0.67	$ 0.84

(1) Earnings per share amounts for the three and six months ended December 31, 1998 have been restated to reflect a two-for-one stock split in March 1999.

See accompanying notes.

MICROSOFT CORPORATION

Balance Sheets
(In millions)

	June 30 1999	Dec. 31 1999 (1)
Assets		
Current assets:		
Cash and short-term investments	$17,236	$17,843
Accounts receivable	2,245	3,284
Other	752	893
Total current assets	20,233	22,020
Property and equipment	1,611	1,739
Equity and other investments	14,372	19,801
Other assets	940	1,533
Total assets	$37,156	$45,093
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 874	$ 1,233
Accrued compensation	396	533
Income taxes payable	1,607	2,103
Unearned revenue	4,239	4,259
Other	1,602	2,376
Total current liabilities	8,718	10,504
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock - shares authorized 100; outstanding 13 and 0	980	0
Common stock and paid-in capital - shares authorized 12,000; outstanding 5,020 and 5,177	13,844	18,878
Retained earnings	13,614	15,711
Total stockholders' equity	28,438	34,589
Total liabilities and stockholders' equity	$37,156	$45,093

(1) Unaudited

See accompanying notes.

MICROSOFT CORPORATION

Cash Flows Statements
(In millions)(Unaudited)

	Six Months Ended Dec. 31 1998	1999
Operations		
Net income	$ 3,666	$ 4,627
Depreciation and amortization	356	765
Gains on sales	(160)	(156)
Unearned revenue	2,371	2,638
Recognition of unearned revenue from prior periods	(1,707)	(2,618)
Other current liabilities	719	61
Accounts receivable	(486)	(1,030)
Other current assets	(24)	(149)
Net cash from operations	4,735	4,138
Financing		
Common stock issued	614	913
Common stock repurchased	(772)	(4,852)
Put warrant proceeds	355	472
Preferred stock dividends	(14)	(13)
Stock option income tax benefits	1,218	2,636
Net cash from (used for) financing	1,401	(844)
Investing		
Additions to property and equipment	(241)	(371)
Cash proceeds from sale of Softimage, Inc.	79	0
Purchases of investments	(10,220)	(18,759)
Maturities of investments	1,199	950
Sales of investments	5,263	14,923
Net cash used for investing	(3,920)	(3,257)
Net change in cash and equivalents	2,216	37
Effect of exchange rates on cash and equivalents	58	20
Cash and equivalents, beginning of period	3,839	4,975
Cash and equivalents, end of period	6,113	5,032
Short-term investments, end of period	13,124	12,811
Cash and short-term investments, end of period	$19,237	$17,843

See accompanying notes.

Stockholders' Equity Statements
(In millions)(Unaudited)

	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	1998	1999	1998	1999
Convertible preferred stock				
Balance, beginning of period	$ 980	$ 980	$ 980	$ 980
Conversion of preferred to common stock	0	(980)	0	(980)
Balance, end of period	980	0	980	0
Common stock and paid-in capital				
Balance, beginning of period	9,161	15,878	8,025	13,844
Common stock issued	536	1,525	870	2,092
Common stock repurchased	(11)	(128)	(25)	(166)
Proceeds from sale of put warrants	130	182	355	472
Stock option income tax benefits	627	1,421	1,218	2,636
Balance, end of period	10,443	18,878	10,443	18,878
Retained earnings				
Balance, beginning of period	8,983	14,482	7,622	13,614
Net income	1,983	2,436	3,666	4,627
Net unrealized investments gains	390	2,485	540	2,141
Translation adjustments and other	63	4	106	28
Comprehensive income	2,436	4,925	4,312	6,796
Preferred stock dividends	(7)	(6)	(14)	(13)
Common stock repurchased	(257)	(3,690)	(765)	(4,686)
Balance, end of period	11,155	15,711	11,155	15,711
Total stockholders' equity	$22,578	$34,589	$22,578	$34,589

See accompanying notes.

MICROSOFT CORPORATION

Notes to Financial Statements
(Unaudited)

Basis of Presentation

In the opinion of management, the accompanying balance sheets and related interim statements of income, cash flows, and stockholders' equity include all adjustments (consisting only of normal recurring items) necessary for their fair presentation in conformity with generally accepted accounting principles. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. Examples include provisions for returns and bad debts and the length of product life cycles and buildings' lives. Actual results may differ from these estimates. Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis and financial statements and notes thereto included in the Microsoft Corporation 1999 Form 10-K.

Stock Split

In March 1999, outstanding shares of common stock were split two-for-one. All prior share and per share amounts have been restated to reflect the stock split.

Earnings Per Share

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

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

EARNINGS PER SHARE

(In millions, except earnings per share)

	Three Months Ended Dec. 31		Six Months Ended Dec. 31	
	1998	1999	1998	1999
Net income (A)	$1,983	$2,436	$3,666	$4,627
Preferred stock dividends	(7)	(6)	(14)	(13)
Net income available for common shareholders (B)	$1,976	$2,430	$3,652	$4,614
Average outstanding shares of common stock (C)	4,998	5,163	4,978	5,146
Dilutive effect of:				
Common stock under structured repurchases	22	0	19	0
Preferred stock	20	12	22	13
Employee stock options	420	363	428	374
Common stock and common stock equivalents (D)	5,460	5,538	5,447	5,533
Earnings per share:				
Basic (B/C)	$ 0.40	$ 0.47	$ 0.73	$ 0.90
Diluted (A/D)	$ 0.36	$ 0.44	$ 0.67	$ 0.84

Unearned Revenue

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

End users receive certain elements of the Company's products over a period of time. These elements include browser technologies and technical support. Consequently, Microsoft's earned revenue reflects the recognition of the fair value of these elements over the product's life cycle. The percentage of revenue recognized ratably ranges from approximately 15% to 25% of Windows desktop operating systems and approximately 10% to 20% of desktop applications, depending on the terms and conditions of the license and prices of the elements. Product life cycles are currently estimated at three years for Windows operating systems and 18 months for desktop applications. The Company also sells subscriptions to certain products via maintenance and certain organization license agreements. At December 31, 1999, unearned revenue was $4.26 billion. Windows Platforms products unearned revenue was $2.40 billion and unearned revenue associated with Productivity Applications and Developer products totaled $1.70 billion. Unearned revenue for other miscellaneous programs totaled $161 million at December 31, 1999.

Stockholders' Equity

During the first half of fiscal 2000, the Company repurchased 54.7 million shares of Microsoft common stock in the open market. In January 2000, the Company announced the termination of its stock buyback program.

To enhance its stock repurchase program, Microsoft sold put warrants to independent third parties. These put warrants entitle the holders to sell shares of Microsoft common stock to the Company on certain dates at specified prices. On December 31, 1999, 163 million warrants were outstanding with strike prices ranging from $69 to $78 per share. The put warrants expire between June 2000 and December 2002. The outstanding put warrants permit a net-share settlement at the Company's option and do not result in a put warrant liability on the balance sheet.

During 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable principal-protected preferred stock. Net proceeds of $980 million were used to repurchase common shares. The Company's convertible preferred stock matured on December 15, 1999. Each preferred share was converted into 1.1273 common shares.

Operational Transactions

In November 1999, Expedia, Inc. completed an initial public offering of its common stock. Expedia, which is majority-owned by Microsoft, is a leading provider of branded online travel services for leisure and small business travelers. Expedia's financial results and financial condition are consolidated with the operations of Microsoft.

In September 1999, the Company sold the entertainment city guide portion of MSN(TM) Sidewalk(R) to Ticketmaster Online-CitySearch, Inc. (TMCS) for a combination of TMCS stock and warrants with a value of $223 million. The transaction also included a distribution agreement. Microsoft recognized a gain of $156 million on the sale and will recognize amounts related to the distribution arrangement over the term of the agreement.

In November 1998, Microsoft acquired LinkExchange, Inc., a leading provider of online marketing services to web site owners and small and medium-sized businesses. Microsoft paid $265 million in stock. The Company did not record an in-process technology write-off in connection with the purchase of LinkExchange.

In August 1998, the Company sold a wholly-owned subsidiary, Softimage, Inc. to Avid Technology, Inc. Microsoft received cash of $79 million and securities valued at $85 million. A pretax gain of $160 million was recognized in the first quarter of fiscal 1999.

Subsequent Events

In January 2000, the Company merged with Visio Corporation in a transaction that will be accounted for as a pooling of interests. Microsoft issued 14 million shares in exchange for the outstanding stock of Visio.

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Contingencies

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

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

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

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

On August 23,1999 the 9th Circuit Court of Appeals vacated the November 1998 preliminary injunction and remanded the case to the district Court for further proceedings. Sun immediately filed two motions to reinstate and expand the scope of the earlier injunction on the basis of copyright infringement and unfair competition. Oral argument on these motions was held on October 16, 1999. On January 25, 2000, the Court issued rulings on the two motions, denying Sun's motion to reinstate the preliminary injunction on the basis of copyright infringement and granting, in part, Sun's motion to reinstate the preliminary injunction based on unfair competition. Microsoft is in compliance with the terms of the partially reinstated preliminary injunction and will not need to undertake any further action to comply with the terms of the injunction. No other hearing or trial dates have been set.

On May 18, 1998, the Antitrust Division of the U.S. Department of Justice (DOJ) and a group of 20 state Attorneys General filed two antitrust cases against Microsoft in the U.S. District Court for the District of Columbia. The DOJ complaint alleges violations of Sections 1 and 2 of the Sherman Act. The DOJ complaint seeks declaratory relief as to the violations it asserts and preliminary and permanent injunctive relief regarding: the inclusion of Internet browsing software (or other software products) as part of Windows; the terms of agreements regarding non-Microsoft Internet browsing software (or other software products); taking or threatening "action adverse" in consequence of a person's failure to license or distribute Microsoft Internet browsing software (or other software

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product) or distributing competing products or cooperating with the government; and restrictions on the screens, boot-up sequence, or functions of Microsoft's operating system products. The state Attorneys General allege largely the same claims and various pendent state claims. The states seek declaratory relief and preliminary and permanent injunctive relief similar to that sought by the DOJ, together with statutory penalties under the state law claims. The foregoing description is qualified in its entirety by reference to the full text of the complaints and other papers on file in those actions, case numbers 98-1232 and 98-1233.

On May 22, 1998, Judge Jackson consolidated the two actions. The judge granted Microsoft's motion for summary judgment as to the states' monopoly leverage claim and permitted the remaining claims to proceed to trial. Trial began on October 19, 1998 and ended with closing arguments on September 21, 1999. The Court will first rule on factual issues, and will then rule on legal conclusion On November 5, 1999, Judge Jackson issued his Findings of Fact. The Conclusions of Law in the case are not expected until sometime in 2000. The judge also directed the parties to participate in a mediation process, which is ongoing. Microsoft believes the claims are without merit and is defending against them vigorously. In other ongoing investigations, the DOJ and several state Attorneys General have requested information from Microsoft concerning various issues.

A number of antitrust class action lawsuits have been initiated against Microsoft. Microsoft believes the claims are without merit and will vigorously defend the cases.

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

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

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Segment Information
(In millions)

Three Months Ended Dec. 31	Windows Platforms	Productivity Applications and Developer	Consumer and Other	Reconciling Amounts	Consolidated
1998					
Revenue	$2,271	$2,277	$587	$ 60	$5,195
Operating income (loss)	1,538	1,392	(201)	(15)	2,714
1999					
Revenue	$2,412	$2,624	$721	$355	$6,112
Operating income (loss)	1,584	1,376	(300)	258	2,918

Six Months Ended Dec. 31	Windows Platforms	Productivity Applications and Developer	Consumer and Other	Reconciling Amounts	Consolidated
1998					
Revenue	$4,315	$4,095	$1,029	$(51)	$ 9,388
Operating income (loss)	2,944	2,471	(415)	(204)	4,796
1999					
Revenue	$4,609	$5,054	$1,382	$451	$11,496
Operating income (loss)	3,068	2,796	(398)	219	5,685

The Company's organizational structure and fundamental approach to business reflect the needs of its customers. As such, Microsoft has three major segments: Windows Platforms; Productivity Applications and Developer; and Consumer and Other. Windows Platforms includes the Business and Enterprise Division, which is primarily responsible for developing and marketing Windows NT and Windows 2000. Windows Platforms also includes the Consumer Windows Division, which develops and markets Windows 98 and Windows 95. Productivity Applications and Developer includes the Business Productivity Division, which is responsible for developing and marketing desktop applications, server applications, and developer tools. Consumer and Other products and services include primarily learning, entertainment, and PC input device products; WebTV and PC online access; and portal and vertical properties and e-commerce platforms. Assets of the segment groups are not relevant for management of the businesses nor for disclosure.

The Company's financial reporting systems present various data for management to run the business, including profit and loss (P&L) statements prepared on a basis not consistent with generally accepted accounting principles. Reconciling items include certain elements of unearned revenue, the treatment of certain channel inventory amounts and estimates, and revenue from product support, consulting, and training and certification of system integrators. Additionally, the internal P&Ls use accelerated methods of depreciation and amortization. In fiscal 2000, the Company's internal P&Ls included the Black-Scholes value of employee stock option grants, amortized over the remaining months of the fiscal year of the grant. Prior year disclosures have been restated for consistent presentation.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

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

Revenue

Revenue of $6.11 billion in the December quarter of fiscal 2000 increased 18% over the second quarter of fiscal 1999. The revenue growth reflected strong licensing of Microsoft(R) Office 2000. Partially offsetting this growth was moderate growth for Windows(R) operating systems, due to soft corporate demand for PCs and software combined with the expected slowness of demand for Windows NT(R) Server and Windows NT Workstation in anticipation of the launch of Windows 2000. On a year to date basis, revenue in the first half of fiscal 2000 totaled $11.50 billion, an increase of 22% over the first two quarters of fiscal 1999.

Software license volume increases have been the principal factor in the Company's revenue growth. The average selling price per license has decreased, primarily because of general shifts in the sales mix from retail packaged products to licensing programs, from new products to product upgrades, and from stand-alone desktop applications to integrated product suites. Average revenue per license from original equipment manufacturer (OEM) licenses and organizational license programs is lower than average revenue per license from retail versions. Likewise, product upgrades have lower prices than new products. Also, prices of integrated suites, such as Microsoft Office and BackOffice, are less than the sum of the prices for the individual programs included in these suites when such programs are licensed separately. An increased percentage of products and programs included elements that were billed but unearned and recognized ratably, such as Microsoft Windows, Microsoft Office, maintenance, and other subscription models. See accompanying notes to financial statements.

Business Divisions

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

Productivity Applications and Developer products include desktop applications such as Microsoft Office, server applications such as Microsoft Exchange Server and Microsoft SQL Server(TM), and software developer tools. Revenue increased 28% to $2.80 billion in the December quarter. For the first half of fiscal 2000, revenue of $5.25 billion grew 34% over the first half of fiscal 1999. Revenue from Microsoft Office integrated suites, including the Premium, Professional, Small Business, and Standard Editions was very strong, reflecting healthy demand for Microsoft Office 2000. Revenue included the recognition of $64 million in the second quarter and $150 million in the first quarter of previously unearned revenue, due to fulfillment of the Microsoft Office 2000 Technology Guarantee. Microsoft SQL Server 7.0 revenue continued to be robust. Revenue from Microsoft Exchange Server and software developer tools was steady.

Windows Platforms products include primarily Windows 98, Windows NT Workstation, and Windows NT Server. Revenue of $2.44 billion in the second quarter represented growth of 6% over the prior year. Windows-based desktop operating systems revenue grew slightly. Units licensed through the PC OEM channel reflected slower growth of corporate PC purchases. Additionally, consumer PC purchases through traditional retail channels were moderate and revenue from retail versions of Windows 98 decreased. This decrease reflected the strong comparable quarter of the prior year which included significant revenue from Windows 98 after its launch in June 1998. Windows NT Workstation and Windows NT Server revenue growth slowed, reflecting customer anticipation of the next version of the operating system, Windows 2000. On a year to date basis, Windows Platforms revenue of $4.69 billion grew 11% over the prior year. First quarter OEM revenue of Windows was relatively strong, particularly for Windows NT Workstation. Revenue from retail packaged product versions of Windows 98 decreased in the first quarter, reflecting the strong comparable quarter of the prior year which included significant revenue from Windows 98 after its launch in June 1998. Windows NT Server revenue growth was robust during the first quarter.

Consumer and Other products include learning and entertainment software; PC input devices; training and certification fees; consulting; and online services such as Expedia. Revenue in the December quarter was $872

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million, up 23% from the comparable quarter of fiscal 1999. Consumer and Other revenue of $1.56 billion grew 26% over the first half of the prior year. Learning and entertainment software posted superb growth, reflecting strong consumer Holiday demand. Hardware product revenue grew moderately. Online advertising and access revenue rose substantially.

Distribution Channels

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

OEM second quarter revenue of $1.87 billion represented an increase of 4% over the comparable quarter of fiscal 1999. There were several reasons for the relatively low growth rate. The second quarter of fiscal 1999 was an unusually high-growth quarter for OEM revenue, having grown 48% over the comparable quarter of fiscal 1998. PC shipment growth was moderate in the December quarter of fiscal 2000, with particular slowness in corporate PC demand. Average revenue per license declined slightly, due in part to a mix shift to high-volume multi-national PC manufacturers from low-volume system builders. Additionally, demand for Windows NT Workstation moderated in anticipation of the launch of Windows 2000 Professional Version. OEM revenue of $3.61 billion in the first two quarters of fiscal 2000 increased 14% over the first two quarters of fiscal 1999. OEM revenue grew 27% in the first quarter of fiscal 2000, reflecting strong PC growth and increased penetration of higher-value NT Workstation.

South Pacific and Americas Region revenue in the December quarter increased 26% to $2.21 billion. Revenue for the first half of fiscal 2000 grew 21% over the first half of fiscal 1999 to $4.08 billion. Several products had strong revenue growth, including Office; SQL Server; learning and entertainment software; and online services. Organizational licensing activity was moderate. Revenue growth was moderate in the South Pacific, the United States and Canada, and Latin America.

Europe, Middle East, and Africa Region second quarter revenue of $1.43 billion was up 14% compared to the second quarter of fiscal 1999. For the first two quarters of fiscal 2000, revenue in the region totaled $2.61 billion, an increase of 22% over the prior year Microsoft Office exhibited the highest absolute revenue growth of the Company's products in the region. Revenue growth, measured in constant dollars, was moderate in the United Kingdom, France, and Germany. Weakening local currencies negatively impacted translated revenue compared to the prior year. Second quarter revenue in the region would have grown 22% if foreign exchange rates were constant with those of a year ago. First quarter revenue in the region would have grown 35% if foreign exchange rates were constant with those of a year ago.

Asia Region revenue in the December quarter of $606 million increased 56% from the second quarter of the prior year. On a year to date basis, revenue in the Asia region was $1.20 billion, up 68% from the comparable period. The growth in the region reflected improved local economic conditions and strong revenue from localized versions of Microsoft Office 2000, particularly in Japan. Revenue grew strongly in most countries in the Asia Region.

Translated international revenue is affected by foreign exchange rates. The impact of foreign exchange rates on revenue was negative in the December quarter compared to a year ago, as European currencies were very weak versus the U.S. dollar, offset partially by stronger Japanese yen versus the U.S. dollar. Had the rates from the prior year been in effect in the second quarter of fiscal 2000, translated international revenue billed in local currencies would have been $35 million higher. In the September quarter, the strong Japanese yen more than offset weak European currencies and added $64 million to translated revenue. Certain manufacturing, selling, distribution, and support costs are disbursed in local currencies, and a portion of international revenue is hedged, thus offsetting a portion of the translation exposure.

Operating Expenses

Microsoft encourages broad-based employee ownership of Microsoft stock through an employee stock option (ESO) program in which most employees are eligible to participate. Microsoft follows Accounting Principals Board Opinion 25 (APB 25) to account for ESOs, which generally does not require income statement recognition of options granted at the market price on the date of issuance, and discloses the Black-Scholes value of option grants. A new interpretation of APB 25 requires recognition of the FICA and Medicare expense paid on option exercises. Other

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events can also trigger recording expense, such as using the lowest price in the 30 days following an employee's start date to establish the strike price, accelerating the vesting of options, and converting ESOs from one company to another, as occurred with the initial public offering of Expedia, a majority-owned subsidiary of Microsoft. These costs were reflected in each operating expense line item in the income statement and totaled $170 million in the second quarter and $100 million in the first quarter of fiscal 2000.

Cost of revenue as a percent of revenue was 12.4% in the second quarter, down from 15.2% in the second quarter of the prior year. For the first half of fiscal 2000, the percentage was 12.8%, down from 15.3% for the first half of fiscal 1999. The percentage decrease resulted primarily from the trend in mix shift to organizational licenses and lower costs associated with WebTV(R) Networks' operations.

Research and development expenses increased 27% from the second quarter of the prior year to $911 million. For the first two quarters of fiscal 2000, research and development expenses increased 28% to $1.75 billion from the first two quarters of fiscal 1999. These increases were driven primarily by higher development headcount-related costs, including various charges related to employee stock options.

Sales and marketing expenses were $1.03 billion in the December quarter, which represented 16.8% of revenue, compared to 15.3% in the second quarter of the prior year. On a year to date basis, sales and marketing expenses were $1.93 billion, up 30% over the comparable period of the prior year. Sales and marketing expenses as a percent of revenue increased due primarily to both higher relative marketing costs and certain employee stock option expenses.

General and administrative costs were $506 million in the second quarter compared to $149 million in the December quarter of the prior year. For the first two quarters of fiscal 2000, general and administrative costs were $649 million, compared to $248 million in the first two quarters of fiscal 1999. The second quarter of fiscal 2000 included a charge for the settlement of the lawsuit with Caldera, Inc. General and administrative costs also included increased legal fees and certain stock option-related charges.

Other expenses and income include miscellaneous items, including gains on foreign exchange and the recognition of Microsoft's share of joint venture activities, including Transpoint and the MSNBC entities.

Investment Income, Gains on Sales, and Income Taxes

Second quarter investment income increased to $773 million from $337 million in the second quarter of the prior year. Year to date investment income totaled $1.17 billion in fiscal 2000, compared to $598 million in fiscal 1999. The increase was due principally to realized gains of approximately $400 million in the second quarter and $50 million in the first quarter. The larger investment portfolio generated by cash from operations also contributed to the increase in investment income. Realized gains in the second quarter of fiscal 1999 were approximately $70 million.

During the first quarter of fiscal 2000, Microsoft sold the entertainment city guide portion of MSN(TM) Sidewalk(R) to Ticketmaster Online-CitySearch, Inc. (TMCS) for a combination of TMCS stock and warrants. Microsoft recognized a gain of $156 million.

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

The effective tax rate for fiscal 2000 is 34%. Excluding the tax impact of the gain on the sale of Softimage, the effective tax rate for fiscal 1999 was 35%.

Financial Condition

The Company's cash and short-term investment portfolio totaled $17.84 billion at December 31, 1999. The portfolio is diversified among security types, industries, and individual issuers. Microsoft's investments are generally liquid and investment grade. The portfolio is invested predominantly in U.S. dollar denominated securities, but also includes foreign currency positions in anticipation of continued international expansion. The portfolio is primarily invested in short-term securities to minimize interest rate risk and facilitate rapid deployment in the event of immediate cash needs.

Microsoft also invests in equities, primarily strategic technology companies. The Company has made large-scale investments in access providers, including cable, telephony, and wireless communications companies. During the first quarter of fiscal 2000, the Company purchased $400 million of Rogers Communications convertible preferred securities and warrants. In connection with AT&T's proposed merger with MediaOne Group, Inc., the Company agreed to acquire MediaOne's interest in Telewest Communications plc, a leading provider of cable television and

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residential and business cable telephony services in the United Kingdom, subject to certain regulatory approvals and other conditions.

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

Microsoft has no material long-term debt and has $100 million of standby multicurrency lines of credit to support foreign currency hedging and cash management. Stockholders' equity at December 31, 1999 was $34.59 billion.

Microsoft will continue to invest in sales, marketing, and product support infrastructure. Additionally, research and development activities will include investments in existing and advanced areas of technology, including using cash to acquire technology. Cash will also be used to fund ventures and strategic opportunities. Additions to property and equipment will continue, including new facilities and computer systems for R&D, sales and marketing, support, and administrative staff. Commitments for constructing new buildings were $300 million on December 31, 1999.

Since fiscal 1990, Microsoft repurchased 764 million common shares while 1.90 billion shares were issued under the Company's employee stock option and purchase plans. Microsoft enhanced its repurchase program by selling put warrants. In January 2000, the Company announced the termination of its stock buyback program. The market value of all outstanding stock options was $81 billion as of December 31, 1999. During December 1996, Microsoft issued 12.5 million shares of 2.75% convertible exchangeable preferred stock. Net proceeds of $980 million were used to repurchase common shares. The Company's convertible preferred stock matured on December 15, 1999. Each preferred share was converted into 1.1273 common shares.

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

Microsoft has not paid cash dividends on its common stock.

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Part II. Other Information

Item 1. Legal Proceedings

See notes to financial statements.

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

At the Annual Meeting of Shareholders held on November 10, 1999, the following proposals were adopted by the margins indicated:

1. To elect a Board of Directors to hold office until their successors are elected and qualified.

	Number of Shares For	Number of Shares Withheld
William H. Gates	4,488,312,569	21,695,760
Paul G. Allen	4,488,088,199	21,920,130
Richard A. Hackborn	4,488,518,818	21,489,511
David F. Marquardt	4,383,706,485	126,301,844
William G. Reed, Jr.	4,488,313,322	21,695,007
Jon A. Shirley	4,481,013,698	28,994,631

2. To approve the adoption of the 1999 Stock Option Plan for Non-Employee Directors, including the reservation of 2,000,000 shares of common stock thereunder.

For	3,235,830,137
Against	1,251,971,667
Abstain	22,203,713
Broker Non-vote	2,812

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits

27. Financial Data Schedule

(B) Reports on Form 8-K

The Company filed no reports on Form 8-K during the quarter ended December 31, 1999.

Items 2, 3, and 5 are not applicable and have been omitted.

Signature

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

Microsoft Corporation

Date: February 11, 2000

By: /s/ John G. Connors

John G. Connors
Senior Vice President, Finance and Administration; Chief Financial Officer

(Principal Financial and Accounting Officer and Duly Authorized Officer)

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

6-MOS
JUN-30-2000
JUL-01-1999
DEC-31-1999
17,843
0
3,284
0
0
22,020
3,897
2,158
45,093
10,504
0
0
0
18,878
15,711
45,093
11,496
11,496
1,468
1,468
4,343
0
0
7,011
2,384
4,627
0
0
0
4,627
0.90
0.84