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The following is a question and answer session with Bill Gates, Steve Ballmer, Pete Higgins, Paul Maritz and Bob Herbold. Greg Maffei is the moderator. In some cases, the questioner is not identified.

Question: Rick Sherlund, Goldman Sachs. I didn't really hear much today about the apps business. I'm wondering if you'd comment on the next version of Office, whether that's -- we could think of that as evolutionary, whether there might be some departure from the evolutionary track, and also an idea of timing on that.

Paul Maritz: Well, in one sense we clearly want it to be an easy upgrade for current Office customers. We're putting a lot of work into making sure that compatibility is great, et cetera, and there's no problems with people upgrading. We have a lot of exciting new features going into that. If you'd come yesterday you might have seen some of those features. (Laughter.) Particularly in the area first of all of doing a great job of integrating with the Internet, including even deeper support for HTML publishing standards, collaboration, unifying a lot of interesting concepts around collaboration, the one that we demonstrated yesterday of being able to have a symmetrical view of a discussion group and adaptations inside a document is one particular feature that we're working on in that area. And then, of course, cost of ownership, basically making the applications self-repairing. If you accidentally delete files they're repaired, they notify you of the new service packs and features that are available.

So we feel Office 97 is the first of the intelligent generation of office applications. You might think of fairly medium sized features in terms of the grammar checker in Office 97, but it's based upon very deep technology. But that technology is going to be extended forward in very interesting ways in the future. In terms of release dates, we're not commenting on that at this point in time. It's not, you know, within the next six months.

Bill Gates: The next fiscal year.

Question: David Readerman, Montgomery Securities. Thank you. Bill, I guess through the course of FY97 I have a little difficulty understanding the rather aggressive investment program you've made in your areas of interactive media, simply because it has such a long, long, long payback period for you. Could you maybe explain, sort of take stock of what you've invested in to date? Do you have all the bets and sort of the accelerators in place to sort of grow the way you want to grow it? And why haven't you seen a similar sort of enthusiasm for what I call the enterprise side of the market, where potentially from the size of the potential market, corporate spending, it may even be a little bit larger in the little bit near term?

Bill Gates: Well, when you say the enterprise side of the market, what kind of products do you think we're not doing that we'd be doing if we were going after that? I mean, we think of in terms of platform technology, Transaction Server, what we're doing with the tools, Merchant Server, Site Server as getting people the raw materials to do everything they want at an enterprise level.

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At the consumer level, you know, I think we are investing a lot of money in that. I think the total size of the investment won't go up from where it was last year. Obviously those -- as things start to do better that gives us some room to try out some additional things. So we are believers in that, and you will see some new initiatives.

MSN is substantially the largest (financially). And that's been a tough business model, because we don't have the scale yet to really drive some of the new revenue sources there. We think that we'll get there. But we've got a bit of a challenge in that one. And we hope we make more progress in the next year.

Then if you step down from that you get to things like the news area where it's all based on advertising revenue; you get into Sidewalk which is local information, again largely based on advertising revenue, which is going quite well but when you're building a central structure that's to support lots and lots of cities, and then those cities are all just bootstrapping up, it's very much an investment.

So, the big new markets are consumer-related markets. And, if you think we're missing anything, you know, send us a piece of mail, maybe we'll do that as well.

Steve Ballmer: The only other thing I'd just add is our focus on the enterprise I don't think we could be much stronger, quite frankly. The level of interest, particularly in the press, in that versus interactive media certainly doesn't scale to revenue or profitability. (Laughter.) The press interest is definitely dominated for whatever set of reasons in the interactive media side of our business. There's no relationship to revenue, profit, investment or anything else.

Question: Hello. I wondered if there is a system to the investments in Comcast, Web TV, progressive networks, and I might throw in Dreamworks as well?

Bill Gates: Well, those are all fairly different. Web TV. We're buying 100 percent of Web TV and that becomes part of Microsoft. Actually, the mission of doing software that runs in intelligent TVs, all of that work will be done out of that group down in California. So we're going to leave them there and build on the great base of people that they have. That's very different from something like Progressive Networks where we license some technology, made a modest investment in the company, and that technology goes into an existing Microsoft product. It's the current Microsoft team that takes that and adds it to mostly what we've been doing in Netshow and make that a richer product. So it's a bit different.

Dreamworks is actually a joint venture called Dreamworks Interactive and it's an investment that I feel very confident in because you've got so much creativity on the animation side and the character creation film side coming out of Dreamworks as a whole; to be their partner in doing interactive properties is a real privilege. They've done some really neat creative things.

Pete Higgins: We've made the decision that having branded properties in kids and certain game areas was critical. In fact, if you look at the Dreamworks Interactive product line this year there will be three properties based on Lost World.

Bill Gates: So that's the focus there. And it fits in with the overall view that entertainment software is going to continue to be a very big part of what consumers want to buy when they work with a PC.

Comcast is a tiny bit different because if you believe that it's a good investment just on a financial basis, then we get the relationship on top of that for free, and that relationship is very important to us. And I'd say even these last, what has it been, just over a month since we started working with them --

Greg Maffei: We closed on June 30th.

Bill Gates: Okay. We're getting their insight and talking to them about what's going on with set top boxes, what's going on with the cable industry and the kind of content things they're involved in. I found that quite valuable. And so, you know, you just have to look at the analysts report on Comcast to judge how that compares with the kind of returns we get with the other capital that we've got on our balance sheet.

Greg Maffei: I would add just one small point; we are also a 1 percent investor, a very small investor in the Dreamworks parent company mostly as a move of being a good partner. We also think it's a good investment, but it was mostly a partnership bonding thing as we did the JV. How about in the back, way back there, Bruce?

Question. Bruce Francis, CNBC. Bill, you said that over time developing on two kernels is not feasible. Is Windows 98 the last of a breed then? And if not, when does that happen, that the consumers get NT as their focus too?

Paul Maritz: It's our goal to build the next major version of Windows for the general purpose PC, home PC user on a technology device from the Windows NT base. So we'll probably do some minor releases after Windows 98 just to keep up with hardware. But our goal is -- as I said yesterday -- before the year 2000, rebuilding all of the members of the Windows family for the PC from a common technology basis. It will be NT derived. And that's actually not new news; we've been saying that for some time now.

Steve Ballmer: It's also not any new financial news though to be clear. The kernel is not relevant to the royalty we will derive on consumer PCs versus business PCs, in case somebody thought ahead of themselves.

Bill Gates: Yeah, to be clear, there will be a flavor of NT someday.

Paul Maritz: Our strategy is still to have at least the following major price points in our product line which is Windows for the server, Windows for the workstation, serious desktop user and Windows for the general purpose home user. And those are tailored for those people and they're quite supporting it. And the underlying technology that's used is not -- is independent of that decision.

Question: Yeah, you talked about the digital nervous system. Can you give a little flavor to are you viewing that as a suite of products that's going to be an actual offering or is it just to try to get the mindset of businesses shifted around? And what are you considering your greatest barriers to really breakthrough in a much bigger way on those large accounts?

Steve Ballmer: I would think I'd characterize it not as a product, but more as a framework to help customers appreciate the value. I mean, in fact, what it means is for a very good customer we'd do a license where we'd license over a period of years their desktop for our full suite, essentially a product at the desktop level and appropriate numbers of servers.

To really break through at the enterprise level? Was that the second part of your question? I think that requires three things. Number one, we need to continue to do the great work we've done on our products, improving them. We need to get the kind of continued breakthrough work which we just expect. I don't think it's hard, but we'll get it out of Intel and the hardware community in terms of building up very powerful servers. And three I think more and more when we have customers that we can really show as references not just on a piece part basis, but the customers who really have these working digital nervous systems, you start to really feel bad if you're one of the guys that doesn't have one. Bill talked about this at our CEO summit. And I'd say there were

probably seven guys who came up to us, CEOs, by the end of the conference who said please send in your consulting guys; we want to really talk to you about what we do for the digital nervous system inside our organization. And that provides a framework then to really work on a broad set of projects with our core infrastructure.

Question: Hi. Can you just address the relationship between your Web TV business and then what -- essentially what you own in your @Home business via Comcast, and how is that going to impact your Comcast investment versus your WebTV investment?

Bill Gates: Well, those are two fairly separate things. @Home is a brand in play where they've gotten an exclusive, for a period of time, for a number of cable operators, to go out and do rich productivity. And we think that's a good thing because we want those PCs connected up at high speed. In fact, we're spending time with @Home not only in terms of infrastructure software, but also to take this idea of a managed PC service and use electronic activities they'll have to offer that kind of capability.

What we're doing with WebTV is focus on a new generation of intelligent digital set top boxes. And can Microsoft provide a set of software both at the client level and the server level that makes that a more flexible, richer device than it would be if you didn't have a company with software expertise coming in to do that.

And so, @Home is definitely one of the people we've talked to, although because it's a TV scenario you have to talk directly with the cable company because they're still in control of what they do with TV, even though they've given for a period of time the kind of high-speed connectivity they do to PCs over to this other end.

So it will end up being a mix. A lot of the technical skills are building up the networking at home and yet the destiny of what they want to do with PC interactive – TV-based interactive content -- is still in the hands of those cable operators. And so there have been a lot of meetings with various players there looking at what is the possibility.

Question: This is more of a macro question. As you go over the next couple of years, the year 2000 is looming on the horizon. What impact do you think there might be on spending patterns in large enterprises, particularly at a point in time when you're scaling up, to meet their needs in terms of your staffing, etc? What impact might that have on spending on traditional Microsoft products, desktops, NT servers, etc., as they start maybe throwing dollars at solving -- (inaudible) -- problem on the mainframe or on legacy systems?

Steve Ballmer: I'd say a couple things. Number one, if you look at aggregate spending on IT in large accounts, it's already a very big number. And the notion that year 2000 or anything else in the world frankly is going to ripple that up again significantly I think would be naive. On the other hand, you could say, okay, how will people evolve their infrastructure? The year 2000 in some senses is a great thing for us because it puts pressure on people to re-think the way they're doing things. It is another pressure point for quantum change as opposed to incremental change, which can only be good as we are trying to sort of talk to people about doing things in new ways.

In terms of our revenue, the whole thing, I think, is largely a non-issue. Some people can get concerned, "oh my God, the budget will be cannibalized away for supporting these mainframe applications." But you've got to remember for an excellent customer today we represent between 1.5 percent, maybe 2, maybe 1 percent of total IT spending. I think we may surge in some accounts, and I think in no accounts should we shrink because we're such a small, small piece as it is today.

Bob Herbold: That's interesting to look internal, because one of the ways we're getting around that issue within Microsoft is the use of the SAP modules that I cited earlier that we'll be tackling

in FY 98 that solves a 2000 problem for us in terms of some of the systems that we had been using. So that means more NT, that means more Sequel Server. So you can look at that both ways.

Question: You've been mimicking your desktop strategy on the server with first NT and then Back Office. I'm curious about when you think and how you're going to get Back Office to mimic the success that Office has had in market share and contributions to revenues and earnings.

Steve Ballmer: Well, it took a while. If you actually think back historically to what happened on Office, you at the years '86, '87, '88, '89 when Excel and Word first came out, it was a slow burn from there, standing start, no market share basically in desktop productivity applications, to the introduction of the Office suite, to the kind of revenue that we see today. In some senses I think you could consider that, you know, a nine-year, eight-year, seven-year type of activity.

In terms of the Back Office suite as opposed to NT Server itself, I mean, in some senses in earnest we've only been in the ballgame for a year, maybe two years; a year ago Exchange came out, Sequel Server a little bit before that. So we're early on even versus any schedule that you might predict. I happen to think our competitors could shoot themselves in the foot as badly as our other competitors did. We have the very vivid recognizable thing of graphical user interface versus no graphical interface. And from an IT administrator's perspective we're starting to get there. Things like the NT directory are so super important in terms of the integration across the suite that it will take some of those kinds of breakthrough technologies and taking advantage of those things, some of the TCO things across Sequel and Exchange for us to get there.

And, you know, unless somebody screws up badly, it could take even a little bit longer. That still means we have a lot of years of growing revenue, even if we're not the dominant guy in that business within the next couple of years.

Question. About the interactive media activities of Microsoft; when is Expedia and/or the Microsoft travel technology going to be coming to Europe?

Pete Higgins: We have launched Expedia in Canada, and I think in the next 12 to 18 months you'll see the technology being offered by, you know, airlines around the world and we'll even be introducing it in a couple of countries as a consumer product 12 to 18 months from now.

Question: It seems as though you have some vulnerability in the consumer side of the market, specifically the personal productivity applications, which is your bread and butter. How do you prevent yourselves from having consumers save a couple hundred dollars and renting applications -- renting word processing, spreadsheet applications from ISPs?

Bill Gates: The fact is the consumers are a very tiny part of our office revenue stream. I mean, it's not a very meaningful.

Steve Ballmer: It's a big upside potential, but it's not a big revenue source today. I mean, I think one of the top priorities that the Office guys have is figuring out what the right product is to target consumer PCs, not only talking about people who want to work at home now. People who work at home are going to pay money; they're not going to try to do some weird crazy thing. But for that at-home market, people who really are just starting to use these things, the key question is capitalizing them to buy it all. I don't think the price point even today is the biggest thing. Yes, it's nice if it's $99 instead of $200, which is what our Office product is, but if you're really thinking of pure home users, do they really need our PowerPoint product at home? Maybe not. There may be another mix of things that they do need. And so I think the bigger thing is getting the product right and at reasonable price point as opposed to dirt cheap pricing. I don't think that's the breakthrough in terms of home productivity. People are perfectly glad to pirate before they, you know, buy something that's bad just because it has a dirt-cheap price.

Bill Gates: The notion of renting from an ISP, if you want a very full-blown productivity application, it comes with your PC; it's called Microsoft Word. And we get a teensy-weensy royalty in return for that. And that's more powerful than anybody's talking about, certainly not across the Internet, as a set of applications.

So the question is do they want the same rich applications they've had in the office environment?

Steve Ballmer: And just to add, they can't utilize -- the ISP can't be buying Microsoft Office and renting it to the consumer. That violates our EULA, End User License Agreement, so it's, you know, if they're pirating it they're likely to be pirating it directly rather than having the ISP pirate it for them. (Laughter.)

Question: Thanks. Marty Wolk of Reuters. I was just wondering if maybe Bill Gates could talk a little bit more about how much of a business opportunity you see in the Web TV acquisition, where does it fit in the overall family of products, and ultimately do you hope to get a Windows type royalty out of TVs or set top boxes that could have a real high penetration rate?

Bill Gates: Well, we're certainly spending a lot of money, particularly as we pick up the Web TV engineering team, doing software that can make an interactive TV better. It's a very competitive field; the number of people who are doing that is rather dramatic. And it's a completely unproven business, both in terms of volume and the royalty that might come along there. So, you know, if there's any part of your business -- we don't do forecasts on any part of our business, but if there's any part that is certainly the most speculative, it's the investments we're making in that arena. I happen to believe in it. Personally I think that given the right patience, someone will come along to do that software well enough to create some very neat scenarios and get a revenue stream for it. And I think there's some chance that could be us.

Question: It seems to me you've got a huge deferred revenue stream in pirated software, if you can get paid for that at some point in the future. Once your product is firmly entrenched in developing countries and pirated, are you going to address that issue technologically so you can get paid for that at some point?

Steve Ballmer: Technologically? Unlikely. We are doing some things technically to reduce the ease of copying. On the other hand, we've taken a pretty strong view that says we shouldn't do things which actually penalize the legitimate user at the expense of the illegitimate user. And there are some things we've done with disk formats and other things that we're experimenting with that are very clever. But we tended to err on the side there of being cautious about offending the real paying user. Also, if you look at the percentage of our business that goes through licenses today, it's quite high. So all you really need to do is get one of those master disks and the Chinese, you know, the Department of X would all then be fully taken care of, shall we say, no matter what the technical restriction would have been. I don't mean to pick on China, but it's a particularly high piracy country. You're right, if you're going to get pirated, we want them to pirate our stuff, not competitors' stuff. (Laughter.) I mean, in developing countries it is important to have a high share of the pirated software. (Laughter.)

We have seen, for example, in Italy about two or three years ago, in the last year or two we've seen bubbles in some of the Eastern European countries, where you get these legalization waves, which are -- I mean, they're not deferred revenue in the accounting sense, but they're a form of deferred revenue as people legalize. But there are waves. They come and then they go. It's particularly hard to predict your way through those legalization waves from a revenue-planning standpoint through those legalization waves.

Greg Maffei: I'm glad you called those deferred revenues because those are the only deferred revenues that we have. The other ones are unearned. (Laughter.)

Question: Bill, you've been reported to be thinking about spending all $9 billion of Microsoft's cash reserves in the PC TV conversion arena. If you did and the Justice Department didn't care, where would you start? How would you spend that money?

Bill Gates: It's pretty random -- (laughter) --

Greg Maffei: Bill, it's a quote some cable guy attributed to you.

Bill Gates: I'm sorry?

Greg Maffei: It's a quote that some anonymous cable guy attributed to you that you would be willing to spend all $9 billion. I think it's an exaggeration of a comment that you might have made.

Bill Gates: Oh, great. (Laughter.)

Bill Gates: I think when you talk about spending money, that's R&D. And I think with the acquisition of Web TV and growing R&D a bit but not too dramatically, we'll have plenty of resources to take our best shot at providing some software for interactive TV. That is the big cost that we're taking on there, along with the base work for Windows, which is still done at our Seattle development center. So there's no other spending there related to that that we're thinking about. We couldn't. There are cases where we might invest in partners who say, "Hey, we want to accelerate doing infrastructure; please help us do that." But I'd be surprised if we ever came up with anything as dramatic as a Comcast relationship there. Remember, it's our role to work very neutrally with all the parties. We want to work closely with the telephone companies, we want to work with the cable companies or anybody else who comes along and is providing those high-speed connections. I don't think it will be necessary to spend a lot of money in order to work together because we've got a strong mutual interest.

Question: A question for Bob. From the moments when the first disk arrived from Waldorf until the last consultant leaves, how long will it have taken you to implement SAP and how many consultants will you have used to do so?

Bob Herbold: Let's focus on procurement and finance modules, because those are usually the ones that organizations tackle first. We started that project in August of '95 and we closed the books in August of '96, so 12 months is the answer from a timing standpoint. With respect to the other modules, we've decided one by one as to whether we wanted to go that route. We started the HR implementation about five months ago and we just had the announcement this week that the thing is completed on a worldwide basis.

The manufacturing or, shall we say, materials management part of that, and sales and distribution, which we'll tackle next year, we expect to be able to do that in about 12 to 15 months, which is fast relative to other companies. Now, you might say, 'wow, those are quick times,' and they really are compared to other companies that implement SAP. We have one thing going for us that they don't, and that is fantastic discipline in implementing SAP. So we don't build a lot of bridges to old systems, we don't build a lot of bridges to old reports so that general managers can use the excuse of I don't want to see the SAP reports, I want my own special reports.

The way to do SAP efficiently is to drive the standard, no compromises in terms of special things that you're building for people. I learned that the hard way at Proctor and Gamble in terms of spending three times the amount of money that we're spending at Microsoft to do it, and it took three times as long. You can do it that way and allow the individual general managers to rule the roost. We're blessed in that this organization here, when they decide to do something, will bind

together and stand behind one another, and that's how you implement standards.

Question. Bill and Steve, you both referred to the importance of building browser share over the coming year. Can you be more explicit about why browser share is important to various aspects of your business and maybe talk about some of the initiatives you're going to be undertaking to increase it?

Steve Ballmer: I would argue that the browser has the potential, as does the Sun middleware – it's another form of middleware OS in a certain sense. It's something that applications get married up to or can get married up to in a variety of ways, the content can get married up to, and our goal with Windows is to be the leadership platform with the leadership market share that developers really invest their energy in. And all of these middleware OSs built on top of our OS in some senses are competitors to the core operating system, because over time developer interest and loyalty gets weaned away. That's why it's so important to us, whether we're talking about the Sun middleware OS, whether we're talking about the browser. It's important for us to keep developer focus. And market share is an important part of that. If you don't have good market share, you're going to lose developer interest.

There are a lot of things we're investing in over the course of the next year in marketing. Of course the new browser is the key thing – IE 4.0. But if you take a look at the initiatives, the content partnership that Paul's teams have formed, the things that we're doing with ISP, the work we're doing with large accounts on digital nervous systems, where the IE browser -- IE 3 today, IE 4 tomorrow -- is fairly fundamental to what we're doing on browser share, the way we're trying to get large accounts, and large and small accounts to author their content to use our dynamic HTML stuff; all of those actions should help, I think, drive up our browser share.

Bill Gates: Yeah, along with the integration --

Steve Ballmer: Oh, under the product, I mean, the -- product, our Windows 98 product itself.

Question: The issue of middleware is kind of important. It seems that many of your competitors attack you by saying, "Well, they're not pure, or something or other." And you have to spend a lot of money to conform to them and to put the hooks in. It would seem like you could build a marketing campaign about perhaps a pure Microsoft environment and deliver those benefits to your users. What do you think of that as a strategy or does that just involve opening up too many APIs to the outside world and the Justice Department?

Bill Gates: I'm not sure exactly what you're saying. I mean, the world is not going to be pure. Even we would say that. As much Windows is out there, there will be UNIX systems connecting in, Macs connecting in, mainframes connecting in. So to have somebody who is purifying things the most. Actually, using the term "pure" probably would offend people because they know the world is heterogeneous. The more it's getting homogenous, that simplifies things and helps them, but it's never going to be absolutely pure.

And, you know, customers like Westinghouse, Intel – many have talked about as they've taken desktop environments that had a variety of application software and operating systems, including many different versions – as they went through and became more and more uniform in that, they got massive costs of ownership savings because of uniformity. And particularly as the directory gets built into the operating system that brings the benefits of that uniformity to a new level.

So, we like people to take advantage of Windows and have Windows applications, and we see the trendline in terms of the increase that's there, but I don't think labeling that pure would necessarily be a realistic marketing slogan for anyone.

Question: Thanks. You talked about the small business market and you've been very, very

successful there with NT, and now you were talking about a small business server. Can you talk about the size of that market and where you see that market going over the next several years?

Steve Ballmer: Today - rough cut - large accounts are roughly 30, maybe 33 percent of PCs. The small business market is another 40-odd percent. So it is the biggest single segment of that market. It's an unusual market. It, in some sense, is the hardest to market to because the best way to reach small businesses turned out to be through the people who I'll just call the computer guy. Every small business has a computer guy. There's maybe 150,000 of them. Twenty-five percent of them will be out of business next year, and another 25 percent will have started up.

They have a different set of interests. So the lion's share of what they sell are computers that were assembled by other computer guys. Small assemblers probably have 80 percent of the small business market. It's a hard market to get software into because once the computer guys put something in, most small business owners won't go down to CompUSA and muck with it unless they feel competent and proficient.

But if we can figure out a way to get more of a regular recurring upgrade stream on a small business, that's good upside. There's still a lot of netware. NT Server's got a good upside in that business. And then selling the add-on componentry, the database, mail, etcetera, to the small business server is upside.

So it's the biggest market. We do have some upsides in that market. But it's incredibly difficult to attack, and has incredibly high piracy. Even though there's a lot of opportunity, you can get excited about it, you can invest in it; it's hard to predict rapid change in revenue through the small business segment.

Question: You've come to win in a lot of markets, and there have to be a lot of similarities in the different game plans that you've used in each of those markets. But as you look at the enterprise market, do you think that the opponents that you face are familiar enough with your game plan to somehow have a little bit more of an advantage this time, or do you think they're making the same mistakes as your former opponents have historically?

Bill Gates: Well, we are the volume model, and that's our secret. We sell software in very high volume. (Laughter.)

Steve Ballmer: At a pretty good price, too.

Bill Gates: And I think people know that secret. I mean, don't tell them if they don't, but -- (laughter) -- but you don't just wake up some morning and say, "Okay, I've got it, I'll be the high volume software guy." You can be jealous of it; you can do stupid things to try and deal with that fact, but, you know, that is the position we're in. And so we're able to invest a pretty massive amount in R&D. Hiring good people; once you start doing it, it helps you to hire other good people. There's no secret about that. You have to build the relationships with the universities over time, get the top researchers to come in. You know, nothing at all secret about it, but it's taken us several decades to get to where we are today.

So, you know, if it was just something tricky, like, you know, page three of the contract, and that's been our whole secret of our success, whoops, somebody saw page three this time -- (laughter) -- I suppose we'd be pretty vulnerable. But the notion of partnering up with the high volume PC manufacturing, partnering up with Intel, partnering up with Cisco, all those things are hard to duplicate.

Steve Ballmer: And to be fair, you could say the other guys don't get it or they just can't do it. I mean, Oracle's model is antithetical to what Bill just described, and we'll see who's right. We'll see whether it's right to bet on these huge price premiums on this expensive hardware and build an

incredibly overblown field organization or not. (Laughter.) We'll have a chance to see. (Applause, laughter.)

IBM is so weird I don't want to talk about them. (Laughter.) But Oracle's at least a clean comparison.

Question: Earlier during Greg's talk we heard how one of the risks to Microsoft is that over time the percentage of new PCs that ship are actually replacement machines. Can you discuss what opportunity there might be to increase the revenue per machine at the OEM level, because it seems like the Small Business Edition of Office may be a step in that direction, since like Dell and some others bundle it with every machine.

Steve Ballmer: I'm a little bit unclear of the question. The question is what we can do with the OEM specifically in the small business market, or just OEMs overall?

Question: Just in general at the OEM level to increase Microsoft's revenue per machine?

Steve Ballmer: Our basic strategy has a few aspects. Number one, we're trying to make sure that we sell as much NT workstation as we can. That's important to us. Number two, we're trying to avoid the OEM doing things which basically clutter the market and add no value. There was a wave where, on consumer machines for example, people were bundling a lot of applications, but the bundling of the application at very low price did more to take money out of the consumer base than to really put new money into the consumer base. And, of course, the OEMs make their own decisions, but we communicated to them the impact that has on our business.

The small business thing is wonderful. Because of the piracy problems that I talked about, to the degree that you have guys who are good at selling in the small business, like Gateway, and they do want to bundle our Small Business Edition of Office on every machine, that's a very positive thing for us in terms of overall revenue. So you have to look by machine type, by customer segment. But there's certainly to the contrary not a view that bundling is good from OEMs outside the operating system. It's good in select and targeted spots, and we have a lot of discussion with OEMs about that.

Question: If you think about your long-term business model, how quickly can Microsoft over the long term move to a pure subscription model, if that's what you want to do, particularly in the desktop applications space? And when will we have enough network bandwidth so that you can ship all those big Office bits to all those small offices who are going to be connected to the internet, and, you know, is this something feasible within the next three to five years?

Bill Gates: It's all a matter of degree. With the large accounts we're moving pretty quickly to something that looks like an annuities model where we give them immense flexibility in deploying our software wisely and how they use it, and then for a period of years they know exactly what our licensing relationship will look like. And we've been pleased with the reaction to that kind of program.

For small and medium-sized business, I don't think you'll get, even in the United States, a high percentage of them connected up with ADSL or high speed connections in three to five years. I think it's more like 10 to 15 years. The benefit of it though is that they can actually have a stage server, where even if their server in their premise is basically a black box server that they don't administer, all the administration and software updating is done by somebody else who's doing that posting off their premises. But once you get the high-speed line, the ability to leverage it, not only for their Internet presence and their digital connectivity, but just for all their backing up and systems' expertise, it's pretty great.

So if you think ADSL prices will come down, then you could say in five to 10 years a lot of small

businesses will have that type of connection, and then will be able to mirror the same relationship we have with large businesses.

Steve Ballmer: There are pioneers in that field, like the relationship we have with British Telecom in the UK, where we really are going to start pioneering the concept of providing computing services down to small businesses to help manage their environment. So it's clearly a win. It's not an "if" issue, not so much in the licensing model, but the idea of having a service partner, have a relationship with a small business to manage their environment using high speed productivity.

Question: A question for Bill. How excited are you about the revenue potential for Windows 98? And secondly, is fiscal '99 likely to be a huge product release year with NT 5.0 and Office 98 likely to ship?

Bill Gates: Well, I think Windows 98 is a product where there's still a lot of discussion internally, because it's a little bit different than Windows 95. It's a lot better in the sense that it doesn't change your device drivers, it doesn't force you to learn as much in terms of the new user interface. And the benefits are easy to receive; the extra speed is easy to receive, the extra reliability. Everybody will find some of the neat new features that are in there that really appeal to their particular usage scenario. So it doesn't have the same revolutionary nature, and yet you can say that's a much better thing about the product.

Steve Ballmer: It doesn't have the same dislocation, but because of I.E. 4.0 and Active Desktop, from the user interface standpoint, it's got some of that revolution. It's got the revolutionary excitement without some of the downsides. Of course, IE 4.0 will be available in some other ways and so we're really trying to sort through some of what that might mean from the business opportunities.

Bill Gates: Yeah, I think in terms of product cycles we'll have more new releases in fiscal year '99. That doesn't mean they take off all that rapidly. Remember, upgrade revenue is a small part of Microsoft's revenue stream. We still get virtually all our revenue from new uses. If we take NT, the revenue is new servers running NT, not upgrades of servers that had NT before then.

So if you think it grows the market or gives us a chance to in some fashion raise our prices, then it gets to be pretty significant. If it's just selling into the install base, then I wouldn't say it's dramatic. But certainly it's a little bit more of a product cycle year than '98 is.

Greg Maffei: We don't want to give you too much excitement because we don't want to make next year's meeting any harder than it has to be. I think with that we're going to end the question session. Thank you very much.