UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, Plaintiff, v. MICROSOFT CORPORATION, Defendant.	)	Civil Action No. 98-1232 (TPJ)
STATE OF NEW YORK, ex rel. Attorney General ELIOT SPITZER, et al., Plaintiffs and Counterclaim-Defendants, v. MICROSOFT CORPORATION, Defendant and Counterclaim-Plaintiff.	)	Civil Action No. 98-1233 (TPJ)

STATE OF NEW YORK :

COUNTY OF NEW YORK:

1. ROBERT F. GREENHILL and JEFFREY P. WILLIAMS, being sworn, state:

2. We are respectively the Chairman and Chief Executive Officer and a Managing Director of Greenhill & Co., LLC, a strategic and financial advisory firm with experience in valuing, negotiating and executing corporate transactions, including mergers and acquisitions, divestitures, joint ventures, management buyouts, recapitalizations, restructurings and hostile or defensive strategies.

3. We have been advised by the Antitrust Division of the United States Department of Justice ("DOJ") that the Government's Proposed Final Judgment in the above-captioned case includes the separation of Microsoft Corporation ("Microsoft" or "the Company") into two businesses, with a subsequent spin-off or separation of one of the businesses to the Company's shareholders. One business would consist of the Company's operating systems software business. Such business would also receive a license to license and distribute certain intellectual property, and except with respect to intellectual property related to the Internet browser, which would be limited to

unmodified versions, to develop, license and distribute current and modified versions of such intellectual property. The other would consist of the Company's applications software business as well as the consumer and Internet business. We understand that it will be the responsibility of the Company under the Proposed Final Judgment to propose a plan to the Court to accomplish the separation. We have been asked to give our opinion from a corporate, financial and capital markets perspective on the feasibility of the proposed separation and the potential intermediate to longer-term impact on the Company and its shareholders.

4. We believe that such a separation is feasible from a corporate, financial and capital markets perspective. We make this judgment based on review of the publicly available information on the Company, including Microsoft's own securities filings and press releases, research reports and other published materials, and our experience and judgment in corporate, financial and capital markets issues. Our views are predicated on our understanding of the analytical methods typically used by professionals in the investment community to evaluate separate business units and/or a separation process. The proposed separation is similar to a number of transactions that have been successfully accomplished in recent business history, and we believe it can be accomplished with Microsoft.

5. Although complex, if properly performed, the proposed separation can be accomplished in a timely manner. Proper planning and execution will, of course, be important. If appropriately executed, the two separate and independent companies each will be among the leading companies in the information technology industry by most standard business metrics including revenue, operating income and market capitalization. Each company will have a strong market position as a leading franchise in its respective segment of the software industry. Each will be well positioned for continued high growth, and each will be highly profitable and produce sizable cash flow. The financial viability of these two companies will not be in question.

6. It is our view, for reasons detailed herein, that in the intermediate to longer-term, there will not be a material decrease in the market value of the current Microsoft shareowners' holdings, as a result of the proposed separation of the Company (as opposed to macroeconomic, general market or industry effects). Indeed, depending on management's execution of the separation, the performance of the two independent companies, market conditions and a number of other factors, the impact of the proposed separation on the market value of the current Microsoft shareowners' holdings could be positive.

Biography of Robert F. Greenhill

7. Mr. Greenhill is the Chairman and Chief Executive Officer of Greenhill & Co., LLC ("Greenhill & Co." or the "Firm"), a strategic and financial advisory firm founded in January 1996. Mr. Greenhill has 38 years of global investment banking, corporate management and private equity experience. Since its inception, Greenhill & Co. has advised on over 55 transactions, collectively valued in excess of $140 billion.

8. Greenhill & Co. has experience in a range of corporate transactions, including mergers and acquisitions, divestitures, joint ventures and cross-border transactions. Greenhill & Co. also has expertise in providing strategic advice and execution services for leveraged and management buyouts, recapitalizations, restructurings and hostile or defensive strategies.

9. The major transactions on which Mr. Greenhill has worked at Greenhill & Co. include the purchase of PanAmSat Corporation by Hughes Electronics Corporation in 1996; the purchase of Tandem Computers Incorporated by Compaq Computer Corporation in 1997; the purchase of Digital Equipment Corporation by Compaq Computer Corporation in 1998; the sale of Chancellor Media Corporation's Outdoor Advertising division to Lamar Advertising Co. in 1999; the sale of a majority stake of AltaVista Company to CMGI Inc. in 1999; the sale of AMFM Inc. to Clear Channel Communications, Inc. in 1999; and the pending sale of Cable & Wireless HKT Ltd. to Pacific Century Cyberworks Ltd. in 2000.

10. In addition to his current position at Greenhill & Co., Mr. Greenhill has also been a Managing Member of Greenhill Capital Partners since its inception earlier this year. Greenhill Capital Partners is a private equity fund formed by the Managing Directors and a Senior Advisor of Greenhill & Co., LLC. Mr. Greenhill is involved in all aspects of the partnership's investment activities.

11. Immediately prior to founding Greenhill & Co., Mr. Greenhill served as Chairman and Chief Executive Officer of Smith Barney Inc. from 1993 to 1996. In his three years at the firm, Mr. Greenhill's work resulted in Smith Barney's participation in a number of high profile transactions, most notably Viacom Inc.'s acquisitions of Paramount Communications, Inc. and Blockbuster Entertainment Corporation in 1993 and 1994, respectively.

12. Prior to joining Smith Barney, Mr. Greenhill enjoyed a 31-year career at Morgan Stanley & Co. Mr. Greenhill joined Morgan Stanley in 1962 and became a partner in 1970. In 1972, he took the responsibility for building the firm's newly formed Mergers and Acquisitions Department. In 1980, he was elevated to Director of Morgan Stanley's Investment Banking Division, with responsibility for domestic and international corporate finance, mergers and acquisitions, merchant banking, capital markets services and real estate. Mr. Greenhill was also elected to the Management Committee. In 1989, he was promoted to Vice Chairman of Morgan Stanley and later served as the company's President from 1991 to 1993.

13. While at Morgan Stanley, Mr. Greenhill's projects included the sale of Conoco Inc. to E.I. du Pont de Nemours and Company in 1981; the purchase of Shell Oil Company by Royal Dutch Petroleum Company in 1984; the sale of Superior Oil Company to Mobil Corporation in 1984; the sale of Hughes Aircraft Corp. to General Motors Corp. in 1985; the sale of Nabisco Brands Inc. to R.J. Reynolds Industries Inc. in 1985; the purchase of RJR Nabisco Inc. by Kohlberg Kravis Roberts & Co. in 1988; and the sale of Squibb Corporation to Bristol-Myers Corporation in 1989.

14. Mr. Greenhill is also affiliated with a number of not-for-profit organizations. He is currently a member of the Harvard Business School Visiting Committee and also serves as a Trustee of the American Enterprise Institute for Public Policy.

15. Mr. Greenhill earned his Bachelor of Arts from Yale University in 1958. Upon graduation, he served on active duty in the U.S. Navy stationed in the Pacific until June 1960, with a final rank of Lieutenant Junior Grade. Mr. Greenhill entered Harvard Business School in 1960 and received his Master of Business Administration with high distinction as a Baker Scholar in 1962.

Biography of Jeffrey P. Williams

16. Mr. Williams joined Greenhill & Co. as a Managing Director in May of 1998 and is a leading advisor in the Media, Technology and Telecommunications industries. Mr. Williams brings more than 20 years of investment banking, private equity and corporate management experience to Greenhill & Co. While at Greenhill & Co., he has served as the principal financial advisor on transactions valued in excess of $5.2 billion for a number of leading media and technology clients including Compaq Computer Corporation, AltaVista Company, Opus360 Corporation and Chancellor Media Corporation.

17. Mr. Williams has been a member of the Supervisory Board of Greenhill Capital Partners since its inception and plays an active role in all of the partnership's investment activities.

18. Immediately prior to joining Greenhill & Co., Mr. Williams was Executive Vice President, Strategic Development and Global Markets, for The McGraw-Hill Companies, Inc. ("McGraw-Hill") from September 1996 to January 1998. McGraw-Hill is a global multimedia publishing and information company that operates in the finance, business, education, construction, medical and health, aerospace, and defense markets. While at McGraw-Hill, Mr. Williams was responsible for leading strategy development for all of the company's businesses.

19. Prior to joining McGraw-Hill, Mr. Williams had a 17-year career at Morgan Stanley & Co. in the Mergers and Acquisitions and Corporate Finance Departments. He was a Managing Director at Morgan Stanley for nine years and served as the head of the company's Telecommunications and Media Group from 1984 to 1996. While at Morgan Stanley, he advised clients throughout North America, Europe and South East Asia, serving as principal financial advisor on transactions valued in excess of $200 billion.

20. Of particular relevance to the assessment of potential remedies in *United States v. Microsoft Corporation* is Mr. Williams' role in two landmark transactions for AT&T Corp. ("AT&T"). In 1983 and 1984, while at Morgan Stanley he was a member

of that firm's professional team that advised AT&T on the mandated divestiture of its regional Bell operating companies. Completed as part of the settlement of the *United States v. AT&T* antitrust suit, this transaction saw AT&T spin-off its local operating subsidiaries to its shareholders in one of the largest and most complicated corporate restructurings accomplished up to that time. The Morgan Stanley team advised the company on the appropriate capital structures for the constituent entities, the appropriate initial dividend policy of the various companies and the planning and implementation of the eventual separation.

21. More recently, Mr. Williams was the principal financial advisor to AT&T on its 1996 separation into five separate business entities. This series of transactions included the creation, public flotation and spin-off of Lucent Technologies, Inc., the spin-off of NCR Corporation as an independent company, and the sales of AT&T Credit Corporation and Universal Card Services Company.

22. Over the course of 18 months, Mr. Williams led the AT&T transaction team that structured the transactions which allowed the resulting companies to address their commercial challenges most effectively and to optimize their reception in the public securities markets. He was responsible for the implementation of each separating step except the sale of the two financial services subsidiaries.

23. While at Morgan Stanley, Mr. Williams also worked on the sale of Metromedia Communications to Southwestern Bell Company in 1986; the acquisition of the telecommunications equipment assets of International Telephone and Telegraph by Compagnie Generale d' Electricite to create Alcatel SA in 1986; the acquisition of a controlling interest in LIN Broadcasting Corporation by McCaw Cellular Communications in 1989; the acquisition of McCaw Cellular Communications by AT&T Corp. in 1994; and the acquisition of the balance of LIN Broadcasting Corporation by AT&T Corp. in 1995.

24. Aside from his responsibilities at Greenhill & Co., Mr. Williams holds positions as a director and board member of various corporations and public institutions. He serves as a director and Audit Committee member of Leap Wireless International, Inc. ("Leap"), a publicly traded wireless communications carrier that deploys, owns, operates and participates in wireless networks throughout the Western Hemisphere. He also serves as a founding director of Cricket Communications, Leap's domestic wireless subsidiary. Mr. Williams is also a member of the Executive Committee of the University of Cincinnati Foundation Board of Trustees.

25. Mr. Williams earned his Bachelor of Architecture in 1975 from the University of Cincinnati and his Master of Business Administration from Harvard Business School (with distinction) in 1979.

Form of Proposed Separation

26. The form of the proposed separation would consist of a division of the current operations of Microsoft into two separate entities: an Operating Systems

Company ("OS Co.") and an Applications and Internet Company ("Apps Co") .[1] While Apps Co. would receive the intellectual property for the Internet browser and other middleware products currently shipped with the Windows Operating System (and the employees and facilities used to produce that code), OS Co. would receive a license to that intellectual property and, with exception to the Internet browser, which would be limited to unmodified versions, would enjoy the right to distribute current and modified versions of that intellectual property. We based this outline on publicly available information on Microsoft, including Microsoft's own securities filings and press releases, research reports and other published materials.

OS Co.

27. OS Co. would consist principally of the Windows Division that currently resides within Microsoft's Windows Platforms segment. OS Co. would continue to develop personal computer ("PC") and server platforms, including the Microsoft Windows and Windows NT operating systems. OS Co. would include the operations of Windows CE and other mobile computing platforms. Finally, OS Co. would receive a license to the Internet browser intellectual property and would enjoy the right to distribute unmodified versions of that intellectual property, and would receive a license to develop, modify and distribute current and modified versions of certain other intellectual property in overlap products.

28. The Windows Division would continue to develop and market operating systems used on PCs and servers for large organizations and IT professionals. It would also continue to develop operating systems for standalone desktop PCs used in homes and small businesses. Its products include: Windows 2000 (server and PC versions), Windows NT Workstation, Windows NT Server, Windows 95, Windows 98, Windows 3.x, MS-DOS and other enterprise and PC operating system platforms.

29. OS Co. would continue to develop Windows CE and other operating system platforms used for communications, entertainment and mobile computing devices.

Apps Co.

30. Apps Co. would consist principally of the activities of the two business groups within Microsoft's Business Productivity Applications and Developer segment: the Business Productivity Group and the Developer Group. Apps Co. would continue to develop and market applications and middleware products for the desktop and server markets. Apps Co. would also consist principally of the activities of the Consumer Group segment, including Internet and consumer-oriented products and services, as well as the Streaming Media Division and other digital media platforms. Finally, Apps Co. would receive the intellectual property to develop Internet Explorer and other middleware products currently shipped with the Windows Operating System (and the employees and

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1. The business divisions described herein take into account the structure of the Company as of its June 30, 1999 Form 10-K and incorporate additional realignments to the corporate structure undertaken by the Company on March 29, 1999 and December 3, 1999.

facilities used to produce that intellectual property), and would enjoy the right to develop, license and distribute current and modified versions of that intellectual property.

31. The Business Productivity Group would continue to create and market desktop and server applications, as well as deliver integrated business productivity solutions to the market. Its key products include: Microsoft Office (and its principal component desktop products, including Microsoft Word, Microsoft Excel, Microsoft Outlook, Microsoft Power Point, and Microsoft Access) and its constituent products, Microsoft FrontPage, Microsoft Project, Microsoft Publisher, Microsoft BackOffice, Microsoft Exchange Server and other business and server applications.

32. The Developer Group would continue to provide software development tools, distributed application platforms and middleware products for developers of operating systems, both Windows-based and Internet applications. Its key products include: Microsoft Windows Distributed Internet Application Architecture, Microsoft Developer Tools, Microsoft SQL Server, Internet Information Server, Microsoft Proxy Server, Microsoft SNA Server, Microsoft Systems Management Server and other developer application and middleware platforms.

33. The Consumer Group segment would continue to supply services and content to consumers over the Internet and software and services to businesses for conducting commerce over the Internet. The activities of the Consumer Group would continue to be comprised of the following divisions: Home & Retail, MSN.com, Consumer Services, TV Service and Platform, Transpoint, CG International and Consumer Strategy and Partnerships.

34. The Home and Retail Division would continue to develop products for use by consumers in the home environment. Its key products include: Microsoft Encarta, Microsoft Bookshelf, Microsoft Money, Microsoft Flight Simulator, Microsoft Mouse and other consumer-oriented products and applications. Microsoft Press, as well as other learning or training resources, would continue to be developed by this division.

35. MSN.com would continue to manage all of the activities of Microsoft Network Internet properties and services. Its key products include: The Microsoft Network, MSN Portal, MSN Commerce, MSNBC and other Internet properties.

36. The Consumer Services Division would continue to manage the activities of providing high-quality Internet access to consumers.

37. The TV Service and Platforms Business would continue to manage the activities related to developing and marketing WebTV, but would not have the right to distribute nor have access to the code for Microsoft CE.

38. The Transpoint division would continue to manage the activities related to developing and managing an end-to-end system for Internet bill delivery and payment.

39. CG International would continue to manage international Internet initiatives.

40. Consumer Strategy and Partnerships would continue to manage Microsoft's joint ventures, which include: DreamWorks Interactive, MSNBC Cable, MSNBC Interactive News and other joint ventures.

41. The Streaming Media Division would continue to develop digital media platforms for streaming music, video and synchronized multimedia over the Internet. Its key products include: Microsoft Windows Media and other media enabling components.

Execution of Proposed Separation

42. We understand that, if the Court accepts the Proposed Final Judgment, it will be the obligation of the Company under the Proposed Final Judgment to propose a plan to the Court to accomplish the separation of OS Co. and Apps Co. In connection with evaluating the feasibility of the proposed separation, we considered one possible plan for illustrative purposes that has proven successful in executing other, similar business separations. We do not suggest that this is the only plan that the Company could propose nor do we suggest that it is the only one that would work. But we do believe that it is a plan that is feasible, if executed with the appropriate level of care.

43. Based on precedent transactions, the proposed separation could be executed by way of a three-step process to (i) structurally realign OS Co. and Apps Co. within Microsoft, (ii) create a publicly-traded equity security for the separated entity ("New Co.") and (iii) execute the final separation of New Co. from the remaining business of Microsoft ("Old Co."). In other words, the three steps within the proposed separation process would be (i) Structural Realignment, (ii) Initial Public Offering of New Co.'s equity and (iii) Separation. It is anticipated that the entire process of implementation would take approximately twelve months to complete. We believe that New Co. could be either OS Co. or Apps Co. without any impact on execution or feasibility.

Structural Realignment

44. The Structural Realignment phase would occur within Microsoft as a consolidated entity. Microsoft would effect an internal separation of the Company into two distinct legal and functional entities (comprised of the predecessor units to OS Co. and Apps Co. and appropriate support functions). The process of separating the Company would commence with the appointment of independent boards of directors for each entity. The board of each entity would be responsible for overseeing the structural realignment plan within that entity. The structural realignment plan, which would be designed and executed by the senior management team within each entity, would describe and specify the steps necessary to create two distinct and functional entities. Some of the usual steps within a typical structural realignment plan would include: determining corporate identity, such as corporate headquarters and company name, forming core business functions, such as executive operations, sales and marketing,

general and administrative, research and development, technology, finance, human resources and facilities management, allocating and/or assigning employees, distributing intellectual property and creating corporate services functions, such as shareholder relations, communications and public relations. The objective of the structural realignment is to create two separate and distinct entities that can be viable in the commercial marketplace, functioning autonomously and independently. It is anticipated that the Structural Realignment phase would take up to three months to complete.

Initial Public Offering

45. The Initial Public Offering ("IPO") phase would begin at the same time as the Structural Realignment phase. The Company and its advisors would prepare the financial, legal and marketing documents required by the Securities and Exchange Commission ("SEC") and public investors to effect an IPO of New Co. Microsoft could sell up to 20% of the equity in New Co. to the public, while still protecting the tax-free status of the ultimate distribution of New Co. shares to Microsoft's shareholders. The appropriate size of the offering would be determined by the market conditions at the time. After completion of the IPO of New Co., Microsoft shareholders would own 80% or more of New Co. and 100% of Old Co., while new public shareholders would own the remaining portion, up to 20% of New Co. As a result of the IPO, New Co. and Old Co. shares would be traded separately on a major stock exchange or an equivalent market-making system and would establish separate publicly traded market values. It is anticipated that completion of the IPO phase would take approximately one to three months in addition to the period required for the structural realignment to be completed.

Separation

46. The final phase of the separation process would be the Separation phase. Planning of the separation would begin concurrently with the IPO phase. Once the IPO of New Co. was completed, Old Co. and its advisors would prepare the financial, legal and marketing documents required by the SEC and public investors to effect the distribution of the remaining 80% or more of New Co. held by Old Co. During the Separation phase, New Co. and Old Co. would work to finalize the inter-company, financial, legal, management and administrative agreements necessary to effect a full separation of New Co. from Old Co. Old Co. would request an IRS tax ruling to ensure that the distribution of the New Co. equity could be accomplished as a tax-free exchange to the various shareholder groups. Upon approval from the IRS and clearance from the SEC regarding the separation, Old Co. would prepare the marketing documents required by the public markets to effect a full separation of New Co. from Old Co.

47. The separation would function as a distribution of the shares of New Co. held by Old Co., by way of either a split-off or spin-off, to existing Old Co. shareholders. Old Co. would either exchange its shares in New Co. for its publicly held shares or provide a pro rata distribution of its New Co. shares to effect the separation of its entire 80% or more interest in New Co. Upon completion of the share exchange or pro rata distribution, New Co. would be separated from Old Co. and operate as a distinct and

separate entity. It is anticipated that the Separation phase would be completed approximately six months after the IPO of New Co.

48. Given the large percentage of inside ownership at Microsoft held by Covered Shareholders (as defined in the Proposed Final Judgment), the separation could be used, if desired, to reconstitute the ownership of these Covered Shareholders. We understand that the purpose of this would be to preserve the independence of the entities and eliminate potential conflicts created by cross ownership in OS Co. and Apps Co. by Covered Shareholders. The split-off or spin-off separation mechanisms could be used in a way to properly address these cross ownership issues.

Feasibility of Proposed Separation

49. We believe the proposed separation is executable and feasible from a corporate, financial and capital markets perspective. In recent years, a number of public companies have successfully utilized the IPO/split-off or IPO/spin-off structure to separate a business unit to accomplish operational or commercial objectives. There are a number of perceived benefits that may accrue to both a parent and a separated business unit as a result of a separation, which include: allowing the management teams of each entity to focus on its core operations, creating standalone financial statements for the separated entity, generating investment community coverage of the separated entity and achieving separate public market values for each entity. Corporations undertake separations of a business for these perceived benefits that may accrue to the separated business and the remaining business as a result of a separation. These potential benefits can positively impact a number of constituents, including the companies, their employees, and their shareholders.

50. A separation may be beneficial to each company, since it would allow the respective management teams to focus on their core operations, which could enhance innovation. The separated business may have a greater opportunity to grow its operations outside the constraints typically imposed by being a business unit within a larger entity. The remaining business may be able to enact corporate initiatives and set strategy without having to factor in the objectives of an unrelated or non-core business unit. Moreover, the separation may give both entities a more focused platform to expand and develop their core business competencies. As a result, both entities may have a greater opportunity to innovate to the benefit of consumers. In addition, both entities may be able to react more nimbly to the competitive landscape.

51. A separation may benefit employees. With a more focused business model and a clearer, incentive-based compensation structure, employees at both entities may have a clearer sense of their respective short-term corporate objectives and long-term strategic goals.

52. A separation may benefit shareholders by giving them expanded ownership potential in two separate entities that are better understood by the investment community. Shareholders can choose to hold and to own one or both equities, depending

on their preferences. Shareholders may have the opportunity to own stock in two distinct entities that have pure-play valuations more reflective of their industry segments. A separation process may generate increased investment community coverage. Research analysts may be able to better understand each entity's business model, financial statements and long-term plan. As a result, shareholders may benefit as the public markets come to better understand and ultimately more appropriately value their securities.

53. The following IPO/split-off transactions are representative of the form and execution of the proposed separation: E.I. du Pont de Nemours and Company/Conoco, Inc., The Limited, Inc./Abercrombie & Fitch Co., Lockheed Martin Corporation/Martin Marietta Materials, Cooper Industries, Inc./Cooper Cameron Corporation and Eli Lilly & Company/Guidant Corporation.

54. The following IPO/spin-off transactions are representative of the form and execution of the proposed separation: General Motors Corporation/Delphi Automotive Systems Corporation, Ford Motor Company/Associates First Capital Corporation, Monsanto Company/Solutia Inc., PepsiCo. Inc./Tricon Global Restaurants, Inc., AT&T Corp./Lucent Technologies Inc./NCR Corporation, Sears, Roebuck & Co./The Allstate Corporation and the announced and pending Hewlett-Packard Company/Agilent Technologies, Inc. spin-off.

55. Historically, a number of spin-off or split-off transactions have created significant value to the shareholders. For example, both the AT&T Corp. spin-off of Lucent Technologies, Inc. and NCR Corporation and the Eli Lilly & Company split-off of Guidant Corporation have produced significant positive annualized returns. It is important to remember that companies undertake these spin-offs and split-offs in order to increase shareholder value independent of any government requirement. Even court ordered separations such as the Standard Oil and the 1984 AT&T break-ups are perceived as having produced sizable positive returns to shareholders, assuming they held on to their original shareholdings.

56. As we noted above, prior to effecting the separation, a company must go through the process of structurally realigning its business in order to provide for the eventual separation. Again, while such realignments require significant internal efforts, a number of comparable realignments have been successfully executed in recent years. We have no reason to believe that Microsoft could not achieve a similar degree of success with appropriate planning and execution.

57. Microsoft would have to focus on separating its business units so as to preserve corporate governance and independence, sound and autonomous business execution, employee morale and qualified business reporting. One area of particular importance would be adequately handling the separation of human and intellectual capital, such as research and development assets, employees, patents, copyrights and other forms of intellectual property. As is the case with most companies, these assets are likely shared and/or distributed throughout a number of business units. Microsoft will, of

course, need to properly separate and distribute these assets to both entities in a way that preserves viability and promotes innovation. Other companies, notably AT&T Corp. in its separation of Lucent Technologies, Inc. and NCR Corporation, have been able to successfully manage such a process. Based on our experience and research, we believe that Microsoft, with proper planning and care, could successfully separate its human and intellectual capital.

58. The structural realignment process is time intensive, and could be moderately disruptive to Microsoft's operations; however other corporations have initiated voluntarily similar reorganizations. Many companies, throughout their corporate history, implement structural reorganizations in order to streamline operations and improve efficiencies, with the goal of enhancing shareholder value. Reorganization can involve dividing or otherwise separating, consolidating or creating completely new business units or altering the reporting relationships of existing business units.

59. Indeed, Microsoft has executed a number of reorganizations throughout its history. For example, on March 29, 1999, Microsoft announced a fundamental reorganization into five business divisions: the Business and Enterprise Group, the Consumer Windows Group, the Business Productivity Group, the Developer Group and the Consumer and Commerce Group. As part of this reorganization, the Company also created the Home and Retail Products division to operate outside of the five core business divisions.

60. On December 3, 1999, Microsoft further reorganized its operations by combining the Business and Enterprise Group and the Consumer Windows Group within the Windows Platforms segment to form the Windows Division, creating a new Small Business Division within its Business Productivity Group and realigning the Consumer and Commerce Group as the Consumer Group, creating seven separate divisions.

61. On March 30, 2000, Microsoft announced another reorganization of its operations, stating its intent to combine the Windows Division with its Developer Group.

62. In addition, Microsoft has performed an IPO of a business unit. On November 10, 1999, Microsoft sold 14% of its Expedia division, which provides online travel services, to the public. Microsoft has not publicly announced what it plans to do with its remaining 86% ownership.

63. It is our view, based on its history of reorganizations, among other factors, that Microsoft is sufficiently experienced and capable of successfully implementing a proposed separation.

Financial Impact of Proposed Separation on the Company and its Shareholders

64. The intermediate to longer-term market reaction to the proposed separation of the Company will be driven by investors' and research analysts' views on

the outcome. Based on prior assessments of comparable transactions by stock analysts, we believe the primary analysis that most investors and analysts will use to value the Company will be a "break-up" or "sum-of-the-parts" analysis, using comparable company multiples, similar to those that have been performed by major securities firms in the past few months. This analysis is an effort to model the new business in financial terms. In many cases, investors and analysts will use this type of analysis when a company has separate definable businesses, and provides financial disclosure concerning them. Such analytical methods are used even if there is no clear sign that a company ever plans on separating the businesses.

Financial Modeling

65. In order to understand the financial profile and prospects of OS Co. and Apps Co. and to assess the financial impact of the proposed separation on the share price, research analysts at securities firms, buy-side investment analysts and investors, other securities firms and financial advisors (the "Investment Community") will create financial models for the two companies. While there may be differences between the models each will use, they will generally be structured along similar lines as described below. We refer to a model consisting of the basic elements as "the Model". In creating the Models, the Investment Community will analyze all of the financial statements of the Company including the balance sheet and cash flow, but will generally focus on the income statement.

66. The first step will be to replicate in the Model the proposed separation in terms of revenues, operating income and net income. The Investment Community will rely on (i) available securities research on the Company, its comparables and the industry; (ii) Company disclosures; and (iii) other industry knowledge and research as may be obtained from industry participants, consultants and research firms (collectively, the "Information Sources"):

- A survey of publicly available research on Microsoft will produce research reports from a number of the securities firms and research institutions with varying levels of detail. For example, Goldman, Sachs & Co. publishes periodic research and notes on Microsoft (recent reports are dated February 4, 2000, April 13, 2000, and April 24, 2000), which provide revenue detail for its various divisions. Another way to survey the general available research is to subscribe to services that aggregate and provide summaries of industry research such as IBES or FirstCall. However, these services generally provide only the EPS estimates and anticipated growth rates for earnings. In addition, securities firms and research institutions periodically publish industry and other public company research.

- The annual report and 10-K provide descriptions of the Company's businesses and its divisions, management discussion and analysis, and historical financial information such as divisional revenue, divisional operating income margins and tax rates. The most recent 10-K for the

Company's 1999 fiscal year ("1999 10-K") as well as the most recently published 10-Q and earnings release will provide the most recent historical data and financial disclosure.

- For other industry research, a number of research consultants, including the Yankee Group, IDC and Gartner Group, provide general industry statistics such as growth rates and other data.

67. Most in the Investment Community will focus on current year and future period projections to base their analysis. However, in some cases, information for future periods is less detailed and often not available. In these cases, the Investment Community will generally focus on current year estimates along with long-term projected EPS growth rates, which are also often provided by research analysts at securities firms.

68. Starting with top line revenue and working its way to net income, the Investment Community will attempt to model the projected separation by dividing the current calendar year 2000 ("CY2000E") estimated revenues into OS Co. and Apps Co. A number of members of the Investment Community will likely choose to model the separation into three divisions: (i) OS Co., (ii) the Business Productivity Applications and Developer segment, and (iii) the Consumer Group segment, and then combine the Business Productivity Applications and Developer segment and the Consumer Group segment to create Apps Co. They will take the added step of modeling the Business Productivity Applications and Developer segment and the Consumer Group segment separately because these businesses have different operational and financial characteristics. The Information Sources provide enough information to perform the above analysis and estimate the income statement by division for CY2000E. For example, a number of securities firms' research reports project CY2000E revenue by division. Although publicly available research that provides future period estimates of divisional operating income margins is difficult to find, the Company's 1999 10-K provides historical divisional margins, which can be used as benchmarks. In addition, the 1999 10-K provides historical tax rates which can be used to estimate net income by division. As some of the research reports provide an estimated consolidated operating income, some adjustments may need to be made to reconcile the Models to those estimates.

69. In addition to the separation of the estimated revenues and incomes into the divisions, the Investment Community will likely make a number of adjustments to reflect OS Co. and Apps Co. as independent and separately traded public entities.

70. For example, each entity will have to have separate general and administrative staff and support including, but not limited to, executive management, accountants, lawyers, human resource staff, headquarters costs and other corporate expenses. These additional expenses will be estimated by the Investment Community relative to existing general and administrative expenses at the Company and the ratio of similar costs at other comparable companies.

71. Another additional expense that will be modeled will be the estimate for an increase in sales and marketing expenses, as the two corporations will have separate sales forces as well as separate names, logos, packaging and general branding.

72. On the revenue side, the Investment Community will estimate the potential effect of the separation on the total revenue for each entity. These factors will include, but are not limited to (i) the possibility of delayed spending decisions by consumers; (ii) marginal market share impact; (iii) potential pricing impacts, if any; and (iv) the effects of unbundling the different products. The Investment Community will analyze the net effect of these factors and estimate the impact on the CY 2000E Revenues as discussed above.

73. A number of members of the Investment Community may make positive adjustments to the revenue and/or cost structure projections at each company. These potential positive adjustments may be the result of those members' conclusions that the separation creates operational benefits that accrue to both companies, as described above.

74. Some members of the Investment Community will likely make the above adjustments to the estimated CY 2000E numbers on a "pro forma" basis, as if the separation occurred on January 1, 2000. This will be an attempt to view the adjustments on an annualized, recurring basis.

75. The result of this process of research and analysis will produce a Model with estimated revenue, operating income and net income for OS Co. and Apps Co., which will reflect the Investment Community's understanding of the Proposed Final Judgment.

Comparable Company Valuation

76. In order to estimate the equity market capitalization, which is the total value of the Company's equity, the Investment Community is likely to use an analysis generally called "Comparable Company Valuation." For each of the separate divisions, the Investment Community will form a view as to the publicly traded companies they most closely resemble, taking into consideration industry sector, size, profitability and prospect for growth, among other factors. Selecting comparable companies or a group of comparable companies is an imperfect science and by nature subjective. In some cases, competitors in the relative segment of the industry are often good candidates; however, in this case, the lack of companies that can be truly called competitors for OS Co. and the Business Productivity Applications and Developer segment of Apps Co. makes this process more difficult. There are rational choices available and the Investment Community will make reasonable selections upon which to base their comparison.

77. For example, although there are no companies currently in the operating system software industry that are comparable to OS Co. in terms of franchise, size, profitability and growth prospects, the current Microsoft may serve as an adequate comparable. Other options may include large capitalization technology companies with leading franchises and market positions in key segments of the information technology

industry which are well positioned to capitalize on the continued high rates of growth in the computer and technology industry, and which have prospective financial, marketing and operational characteristics comparable to OS Co.

78. Potential comparables that the Investment Community may select for the Business Productivity Applications and Developer segment of Apps Co. could include leading consumer-oriented and server-based software application providers, some of which currently compete against the current Microsoft in these market segments. While none of the companies provide a suite of product offerings as comprehensive and pervasive as Microsoft, some are among the leaders in their respective markets and are reasonable proxies for this segment of Apps Co.

79. While there are no pure-play companies comparable to Microsoft's Consumer Group segment, there are a number of companies that the Investment Community would view as having reasonably similar businesses. These companies include those with leading positions in the connectivity, Internet portal/online content and e-commerce industry segments.

80. The Investment Community will analyze the financial characteristics of their sets of comparable companies including the range, mean and median of each grouping for a number of different metrics including Price to Earnings or PE ratio, the PE to expected Long Term EPS Growth Rate or PEG ratio, and the Aggregate Value to Revenue Multiple. Largely based on these comparable company financial statistics and the revenue and net income estimates produced by the Model, the Investment Community will choose to apply a reasonable range of multiples to calculate the estimated market capitalizations of OS Co. and Apps Co. There are at least three different methodologies that the Investment Community may use.

Price/Earnings Ratio and the PEG Ratio

81. The PE ratio is commonly used in the Investment Community as one way of valuing a company based on its comparables. In order to estimate the total equity value, a range of PE ratios based on its comparables is multiplied by the company's net income. The appropriate range of PEs will be determined by the Investment Community's analysis of comparable companies as discussed above. However, recognizing growth as one of the factors influencing valuations in these industries, many investors rely on a growth-adjusted price-to-earnings multiple (the ratio between the PE and the expected Long Term EPS Growth Rate), also called the PEG ratio.

82. The Investment Community will likely focus on these methodologies to perform their valuations of OS Co. and the Business Productivity Applications and Developer segment within Apps Co.

The Revenue Multiple

83. In certain industries, the PE ratio is not meaningful. One reason may be because most of the companies in the industry are early in their growth stages consuming

capital and experiencing heavy expenses aimed at establishing leading market positions or new technologies and have no profits. A number of Internet-related companies are in this category. In these cases, the metric that the Investment Community is likely to focus on is the Revenue Multiple, which is the aggregate value (equal to total equity value in the absence of debt or excess cash) of a company divided by the total revenue. Although growth rates are also an influence here, there is limited published information regarding long term expected revenue growth. As much of the Consumer Group segment within Apps Co. consist of businesses associated with the Internet, the valuation methodology that the Investment Community may choose is the Revenue Multiple. Multiplying the Consumer Group segment's revenues and a reasonable range of Revenue Multiples based on comparables will produce a range of equity values. The Revenue Multiple could also be used to value the Apps. Co. as a whole or OS Co.

Cash and Investments

84. In addition to the operating businesses, the Company has a portfolio of strategic investments as well as a significant amount of cash. Based on the most recent information and the Information Sources, the Investment Community will add the estimated value of the cash and investments. To the extent that there is existing debt or other liabilities, those would be subtracted from the total value.

Contingent Liabilities

85. Much of the potential civil litigation liability is built into the existing Microsoft stock price, and will be reflected in its PE and PEG ratios and Revenue Multiples. It is one of the reasons why Microsoft may trade at a discount to its comparables. One way the Investment Community may factor in the potential civil litigation liability is to discount to some extent the ratios and multiples in the separate companies. Alternatively, the Investment Community could attempt to attribute an estimate of that liability.

Summary

86. For the reasons set forth above, we believe that separating the Company into two independent businesses, OS Co. and Apps Co., is feasible from a corporate, financial and capital markets perspective.

87. Although an appeals process may take years before the outcome is known, members of the Investment Community will build independent Models in order to estimate what the impact of the Proposed Final Judgment looks like from a financial perspective. The Investment Community will eventually determine a range of estimated market values for OS Co. and Apps Co. based on their perceived reasonable and rational assumptions.

88. We, based on our experience and expertise, have performed a sum-of-the-parts analysis assuming a range of assumptions and believe our estimates and adjustments

to be based on reasonable and rational business judgments based on the currently available public information. Based upon these ranges of values, it is our view that the impact due to the proposed separation of the Company (as opposed to macroeconomic, general market or industry effects) will not result in a material decrease in market value over the intermediate to longer-term. Indeed, depending on management's execution of the separation, the performance of the two independent companies, market conditions and a number of other factors, the impact of the proposed separation on the market value of the current Microsoft shareowners' holdings could be positive.

Respectfully submitted,

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Date:

Jeffrey P. Williams

Date: