


A person in a white long-sleeved shirt and white pants is jumping with their arms raised in a 'V' shape, facing away from the camera. They are positioned in the lower right quadrant of the frame. The background is a vast, open landscape with a flat horizon line. The sky is filled with soft, colorful clouds in shades of yellow, orange, and pink, suggesting a sunset or sunrise. The overall mood is one of freedom, achievement, and optimism.

Microsoft

WE SEE POTENTIAL



Each of us has a dream. A notion of what we might achieve and who we might become. In businesses large and small. Among teachers and students. At home and at work. From the commonplace to the remarkable. We at Microsoft are passionate about helping people realize their full potential.

INSPIRING NEW EXPERIENCES—FROM WINDOWS TO XBOX

Microsoft® Windows® XP enables people to use digital technology with more ease and reliability—from playing music to communicating with

friends and family to creating home videos. That's one reason it enjoyed a faster adoption than any operating system in PC history.

And we're continuing to invest for the long term to unlock the possibilities of digital technology. For example, this fall will see the debut of Windows Powered Smart Displays, cordless monitors that extend the Windows XP experience to any room in the house. Several Microsoft partners will be introducing next generation PCs that use Microsoft Windows XP Media Center Edition to integrate a variety of digital entertainment experiences with the convenience of remote control. And the next version of Windows Media™ will store and transmit

high-quality video and audio with 20 percent less file space and bandwidth.

We help people realize their potential for pure fun, too. With Xbox™, the most powerful console game system ever built. In the near future, we plan to launch Xbox Live, a groundbreaking online gaming service that will let broadband users play multiplayer Xbox games on the Internet.

HELPING PEOPLE ENJOY ALL THE INTERNET HAS TO OFFER

As more people turn to the Web for information, entertainment, and communication, we continue to improve MSN® to make

the Web even more useful. These ongoing improvements have helped MSN become the most popular service on the Internet, with more than 270 million unique users worldwide each month. MSN also has a growing subscription business: more than eight million subscribers use MSN for Internet access and other services.

The next version of MSN, coming this fall, will offer better online safety features, valuable communication services, and advanced browsing and productivity software that will help people accomplish even more on the Internet.

It doesn't matter who you are. It doesn't matter where you live or what you do. When your potential is pointed in the right direction, it can lead you anywhere. At Microsoft, we see no limits to the potential we all might reach because we see no limits to human imagination. That is what inspires us. And that is why we create software that helps people and businesses reach their potential. It's not just our purpose. It's our passion.

AND IT'S ALL YOURS.

A photograph of three business professionals—two men and one woman—walking and smiling in front of a modern building under construction. The woman on the left is wearing a light blue blazer and carrying a blue bag. The man in the middle is wearing a blue suit and glasses. The man on the right is wearing a blue suit and a striped tie. In the background, a yellow construction crane is visible against a clear blue sky, and the building's steel framework is partially visible.

FOR YOUR BUSINESS.

In today's global and increasingly digital economy, the businesses that are best positioned for success are those that can respond with agility to a dynamic marketplace. We're helping them with software that delivers high business value while driving down the total cost of ownership.

BUILDING A FOUNDATION FOR BUSINESSES OF ALL SIZES

Available early next year, the Windows .NET Server

2003 family will provide a solid foundation for increasing business connectivity and efficiency. The Windows .NET Server 2003 operating system provides a robust infrastructure platform for powering connected applications, networks, and Web Services from the workgroup to the data center. This new line of servers securely connects businesses with their customers and partners and integrates a powerful new application environment for

developing XML Web Services and solutions to dramatically improve business processes.

The Windows .NET Server 2003 family joins a comprehensive range of Microsoft server products, including Microsoft SQL Server™ 2000, the world's fastest database, which has received acclaim for its reliable performance, scalability, and positive impact on cost of ownership.

BOOSTING PRODUCTIVITY THROUGH INNOVATIVE TECHNOLOGIES

In 2003, we will launch several new products aimed at increasing information worker productivity and helping businesses grow.

The next generation of Microsoft Office will take full advantage of XML, allowing for more fully integrated business processes. It will also include a greatly enhanced version of Microsoft Outlook®, which will improve the management of

personal information and enable better communication and collaboration.

And a new generation of mobile devices—from Tablet PCs to Pocket PCs to Smartphones—will allow for greater productivity and connectivity from virtually anywhere.

PROVIDING BUSINESSES WITH SOLUTIONS, NOT JUST SOFTWARE

In July we introduced Microsoft Business Solutions, which provides businesses with proven technology

and experienced professional resources.

For example, Microsoft Business Solutions offers business applications that automate financial and operational processes and allow small- and mid-market companies to extend information to employees, customers, suppliers, and partners.

Our recent acquisition of Navision a/s further enhances our ability to serve these companies globally and underscores our commitment to our customers.

We're excited to be part of a technology industry that is fundamental to the way people live, work, and play. And we're dedicated to supporting it and creating opportunity for the partners and developers that comprise it.

CREATING THE FUTURE THROUGH INNOVATION

Our commitment to constant innovation is reflected in our ongoing investment in research and development. In fact, we have invested more than \$23 billion over the last ten years to develop innovative solutions to the technology problems of today and tomorrow.

Through the Microsoft Research group, we are exploring new worlds of software technology, user-interface design, language understanding, and digital media.

DEVELOPING A BETTER WAY TO CONNECT

In an online world filled with constellations of PCs, servers, smart devices, and Internet-based services, Microsoft .NET makes it possible to connect all of them seamlessly. .NET is Microsoft software for connecting information, people, systems, and devices. Built on XML Web service standards, .NET enables both new and existing applications to connect with software and services across platforms, applications, and programming languages.

In February 2002, we launched Visual Studio® .NET, the first development environment built from the ground up that enables software developers to create and integrate XML Web Services and connected Windows-based applications.

WORKING TOGETHER TO BUILD THE FUTURE

Our industry, perhaps more than any other, depends on the cooperation of its members to enable people to reach their potential. That's why we have joined a broad group of technology companies to form the Web Services Interoperability (WS-I) Organization. This alliance is designed

to accelerate the development and deployment of interoperable Web services across a variety of platforms, applications, and programming languages.

We've also embarked on a long-term initiative we call Trustworthy Computing, which aims to bring an unparalleled level of security, privacy, reliability, and business integrity to computer systems. It's the highest priority for every one of our product teams, and a core mission for the entire company.

FOR THE INDUSTRY.



A young girl with blonde hair and a boy with dark skin and curly hair are looking up and smiling. They are in a museum or gallery, with a large, colorful, abstract sculpture in the background. The girl is wearing a light green sweater, and the boy is wearing a light yellow shirt. The background is warm and out of focus, showing other people and museum displays.

FOR OUR COMMUNITIES.

Motivated by the belief that amazing things happen when people are provided with the resources they need, we have been using technology to unlock the potential in individuals and communities since 1983. Last year alone, Microsoft and its employees contributed more than \$246 million to 5,000 nonprofit organizations around the world to help underrepresented communities.

INVESTING IN YOUTH THROUGHOUT THE WORLD

In Soweto, South Africa, students in two local high schools have been trained in computer literacy and subjects ranging from accounting to economics through the Microsoft and International Youth Foundation Initiative.

Designed to equip young people with technology skills through education and training, the program

has targeted projects in South Africa, Poland, and the Philippines. Additional resources from Microsoft expanded the program into Russia, additional Asian countries, and Latin America.

GIVING KIDS THE TECHNOLOGY TOOLS THEY NEED

Club Tech is a five-year, \$100 million collaboration between Microsoft and Boys & Girls Clubs of America to “technology enable” every club by providing software and technology training.

More than 700 clubs across the country are now part of Club Tech. Kids from Boston to Orlando to Phoenix are spending time using technology to connect with each other and learn more about their world.

EMPOWERING NONPROFIT ORGANIZATIONS

The Microsoft & NPower National Partnership created an affiliation of nonprofit-focused

technology assistance organizations that provide low-cost and no-cost technology assistance to other nonprofit organizations, improving their ability to respond to issues in their communities.

The \$25 million Microsoft & NPower National Partnership established affiliates in seven major cities across the United States this year, with a goal of creating five more NPower affiliates in 2003.

CLOSING THE DIGITAL DIVIDE

By providing much-needed funding and software to nonprofit organizations, libraries, and communities, we hope to help bridge the “digital divide” that limits opportunities for success and prosperity. It’s our conviction that the true measure of our success is not in the power of our software, but in the power it unleashes in us all.



Microsoft

TO OUR SHAREHOLDERS, CUSTOMERS, PARTNERS, AND EMPLOYEES:

Fiscal 2002 was a year of solid revenue growth, significant product releases, and a continued focus on developing new technologies that position Microsoft for the future. Despite a challenging economic climate, revenues for the year increased by \$3.07 billion to \$28.37 billion, and operating income grew by \$190 million to \$11.91 billion.

Strong demand for Windows XP and other desktop software contributed to our positive performance. Revenue from enterprise software outpaced the highly competitive server market by a wide margin. And our consumer businesses saw a dramatic rise in sales, with the launch of the Xbox video game system and strong growth in MSN subscription income.

During the coming year, Microsoft will launch several important new products, including Windows XP Tablet PC Edition and Windows .NET Servers, and we plan to increase spending on research and development by 20 percent,

to \$5.2 billion. To reflect our role as an industry leader and to focus our efforts on the opportunities ahead, we have embraced a new corporate mission: *to enable people and businesses throughout the world to realize their full potential*. Delivering on this mission requires a clearly defined set of values and tenets, which are described on the next two pages. We are working to integrate these principles into everything we do.

INNOVATIVE PLATFORM LEADERSHIP

A highlight of the past year was the overwhelming

market acceptance that greeted the launch of Windows XP, which brings enhanced reliability, security, and performance to PC users at home and work. The year also saw sustained momentum for Office XP, with more than 60 million licenses sold in the 12 months after its launch in May 2001. A new version of Office, scheduled for release in 2003, will enable users to communicate and collaborate in new ways with even greater ease.

Delivering on our vision of software that empowers people any time, any place, and on any device, we

launched new versions of Windows for small and mobile devices, including Pocket PCs and set-top boxes for digital cable TV. Fall 2002 brings the launch of the first Tablet PCs, designed to boost productivity by combining the power and speed of a full-featured desktop computer with the flexibility and portability of a notepad.

One of our key goals is to expand our role as a provider of software solutions for small- and mid-sized businesses. In July 2002, we acquired Navision,

a leading global provider of integrated software for financial management and other business processes. Combining Navision with Microsoft Great Plains to form Microsoft Business Solutions, we now offer a wide range of applications and services that enable companies to reduce costs, streamline operations, and improve service. We are planning many new products for this market, including a solution for customer relationship management that will launch this fiscal year.

THE PROMISE OF .NET AND XML WEB SERVICES

A significant portion of the company’s revenue growth over the next five years will come from Microsoft’s .NET architecture, which holds enormous potential to connect information, people, systems, and devices in fundamentally new and important ways. Using common industry standards based on XML, a universal language for describing and exchanging data, our

goal is to enable seamless sharing of information across many platforms and programming languages, and over the Internet, with XML Web Services.

The potential of Web services is gaining wide support among software developers and leading technology providers. For example, the Web Services Interoperability Organization, formed by Microsoft and other industry leaders in early 2002 to provide guidance and best practices for developing XML Web services, now has more than 120 companies as members.

To provide software developers with the tools and infrastructure for building and deploying XML Web services and other .NET-connected solutions, we launched Visual Studio .NET and the .NET Framework in February 2002. In fiscal 2003 we plan to launch Windows .NET Servers, which will provide the most compelling platform for developing and hosting Web services and business solutions.

Companies that are helping to test the promising beta version of Windows .NET Servers foresee many benefits. JetBlue Airways, for example, plans to use it as the platform for a new reservations system and to secure access to its computers and facilities with fingerprint biometrics embedded in smart cards. The young airline has achieved a “paperless cockpit” by providing pilots with electronic versions of flight manuals that are automatically updated with an application that JetBlue developers wrote using Microsoft Visual Studio .NET. JetBlue credits Microsoft technology with helping it to limit spending on information technology to about 1.5 percent of revenues, in an industry where the average is about 5 percent.

DELIGHTING CONSUMERS

Our strategic investments in new consumer businesses brought gratifying results this past year, with more to come in 2003. In the eight months after our Xbox video

game system launched in November 2001, 3.9 million consoles and 20 million Xbox games were sold. MSN, already the most popular portal destination on the Web, is now also the leading provider of broadband Internet access.

Microsoft and more than a dozen leading electronics manufacturers have developed a new line of flat-panel, cordless displays that enable consumers to extend their Windows XP experience to anywhere in the house. These Smart Displays will start appearing in stores in time for the 2002 holiday shopping season, as will PCs running our new Windows XP Media Center Edition, providing remote-control access to digital music, movies, and a built-in personal video recorder.

INVESTING IN THE FUTURE

We are focused on long-term success for Microsoft as a business, for our 50,000 employees, our shareholders, our industry, our customers, and the communities where

we do business. Looking to the future, a few developments are noteworthy.

Antitrust Lawsuit

In November 2001, Microsoft and the Department of Justice announced a settlement of the three-year-old antitrust dispute. Nine state attorneys general joined in the settlement, while nine others decided to continue with the case. The settlement requires significant changes in how we do business, and Microsoft is fully committed to carrying out these responsibilities. The consent decree is a tough but reasonable compromise that is good for the industry, good for consumers, and good for the economy.

Trustworthy Computing

In January 2002, we outlined for employees what we believe is the highest priority for the company and for our industry over the next decade: building a computing environment for customers that is as reliable as the electricity that lights our homes. As a first step in achieving higher levels of

reliability, security, privacy, and business integrity, Microsoft made many changes in our operational and business practices. Thousands of our engineers received special training in writing secure software. And we conducted intensive security analyses of every line of source code for Windows and other products.

These efforts are starting to show results. Security updates of Microsoft Outlook, for instance, were followed by a dramatic drop in the number of e-mail virus incidents. But given the complexity of computing and the fast pace of technological change, achieving truly Trustworthy Computing will take many years.

An Agile Business System

To streamline internal decision making, enhance entrepreneurship within Microsoft’s key businesses, and increase collaboration across groups, we instituted a number of changes to internal business systems. One of the most significant changes was giving the

leaders of our key businesses the tools, resources, and responsibility for making the important decisions around product development, sales, marketing, and financial performance.

Business Integrity

During the past year, a number of major corporations were rocked by financial scandals that damaged shareholder wealth and confidence. At Microsoft, we take our responsibilities to shareholders, customers, partners, and employees very seriously. We aim to be open and candid about the condition of our business and the risks we face. We seek to properly assess assets so they are never overvalued, and we look hard for any costs or liabilities that should be reflected in our financial results. Consistent with the values of honesty and integrity that we strive to live by, we have long disclosed complete details of the diluting effect of employee stock options on Microsoft’s earnings.

Stock options are an important way that Microsoft attracts and encourages great employees. For the two of us, the vast majority of our individual net worth is invested in stock ownership of the business. Since Microsoft went public in 1986, we have never taken stock options, and we never will. We hope this provides further assurance that our personal interests are directly aligned with the long-term interests of all shareholders.

Finally, on a personal level, we feel incredibly privileged to play a role in bringing to life the technologies that will enable people and businesses to realize their full potential. Thank you for your support.

Bill Gates
Chairman and
Chief Software Architect

Steven A. Ballmer
Chief Executive Officer

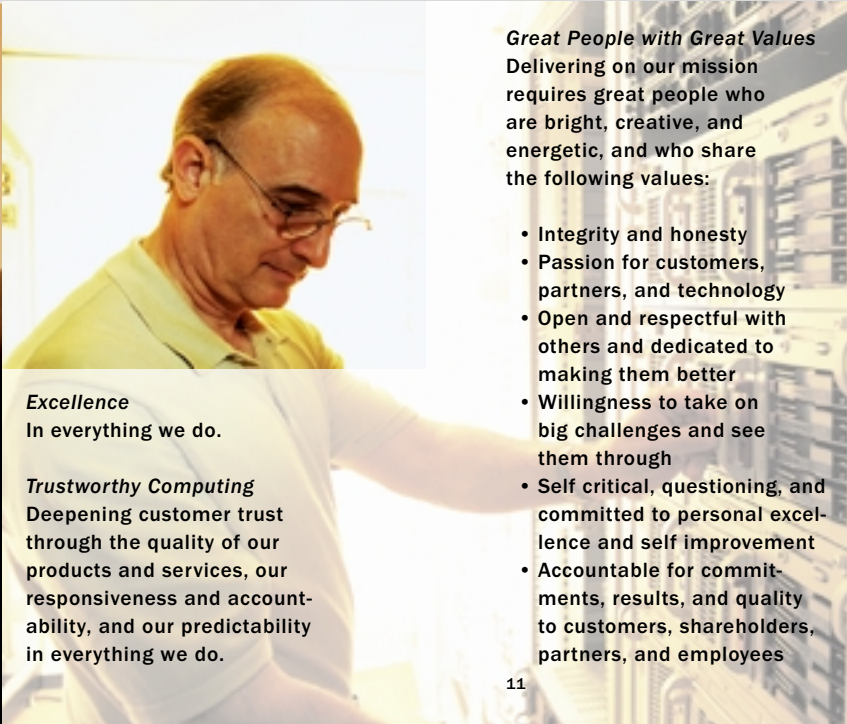
MICROSOFT’S MISSION
To enable people and businesses throughout the world to realize their full potential

MICROSOFT’S VISION
Empowering people through great software—any time, any place, and on any device

DELIVERING ON OUR MISSION
The tenets central to accomplishing our mission include:

Broad Customer Connection
Connecting with customers, understanding their needs and how they use technology, and providing value through information and support to help them realize their potential.

A Global, Inclusive Approach
Thinking and acting globally, enabling a multicultural workforce that generates innovative decision-making for a diverse universe of customers and partners, innovating to lower the costs of technology, and showing leadership in supporting the communities in which we work and live.



Great People with Great Values
Delivering on our mission requires great people who are bright, creative, and energetic, and who share the following values:

- Integrity and honesty
- Passion for customers, partners, and technology
- Open and respectful with others and dedicated to making them better
- Willingness to take on big challenges and see them through
- Self critical, questioning, and committed to personal excellence and self improvement
- Accountable for commitments, results, and quality to customers, shareholders, partners, and employees

Excellence
In everything we do.

Trustworthy Computing
Deepening customer trust through the quality of our products and services, our responsiveness and accountability, and our predictability in everything we do.



Innovative and Responsible Platform Leadership
Expanding platform innovation, benefits, and opportunities for customers and partners; openness in discussing our future directions; getting feedback; and working with others to ensure that their products and our platforms work well together.





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