

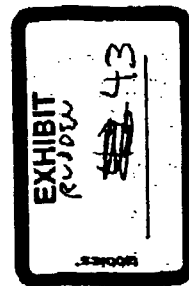
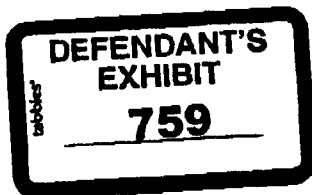
CONFIDENTIAL

Business Application Division

1997 Business Plan

Java Update!

Lotus



IBM 7510346236

Agenda

- ┌ 1996 Forecast v. Plan
- ┌ 96: The good, the bad and the ugly
- ┌ 1997 Growth Markets
- ┌ Market Segment Strategy
- ┌ Product Strategy
- ┌ Product Calendar
- ┌ Development Resources
- ┌ 1997 Revenue & Risks
- ┌ P&L Statement

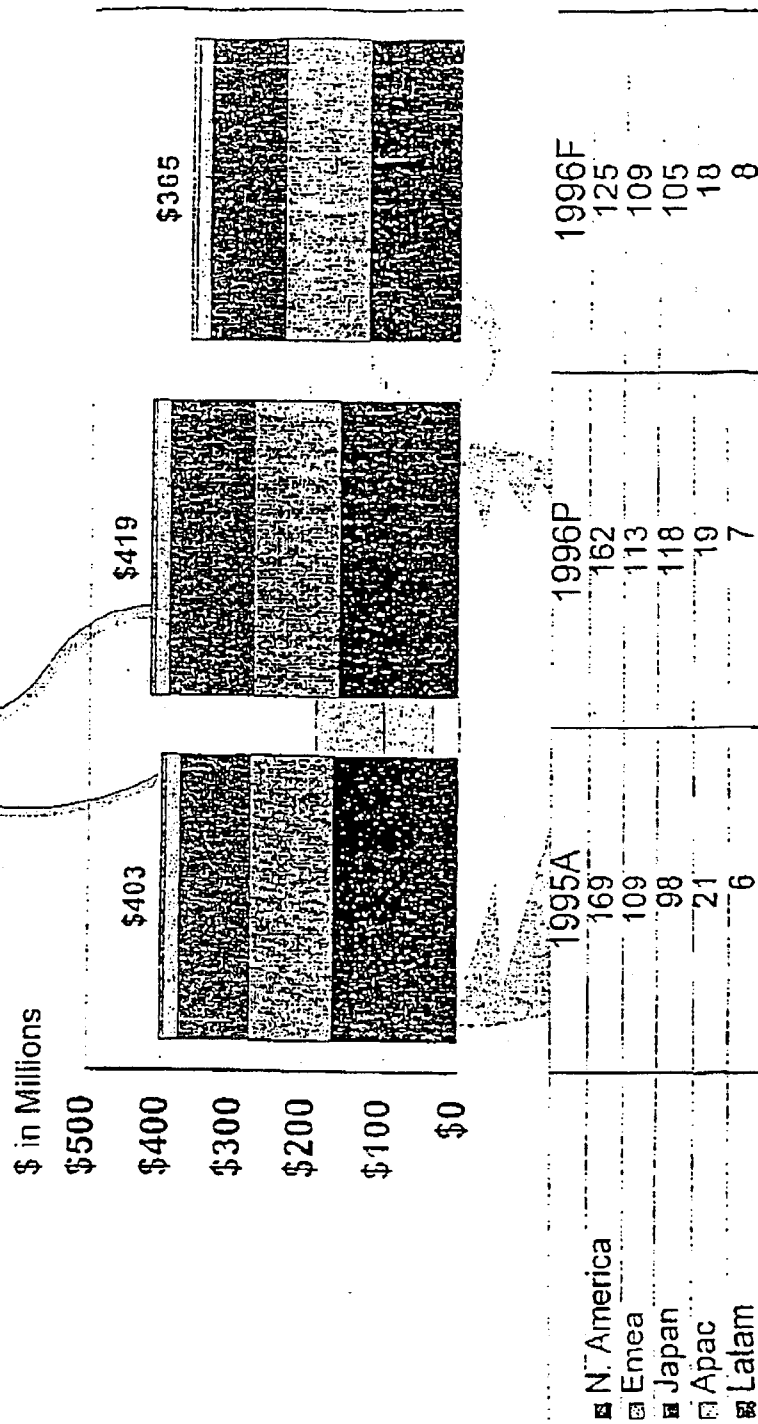
1996 Revenue Recap:

□ \$44M below Plan

(This would be the bad news ...)

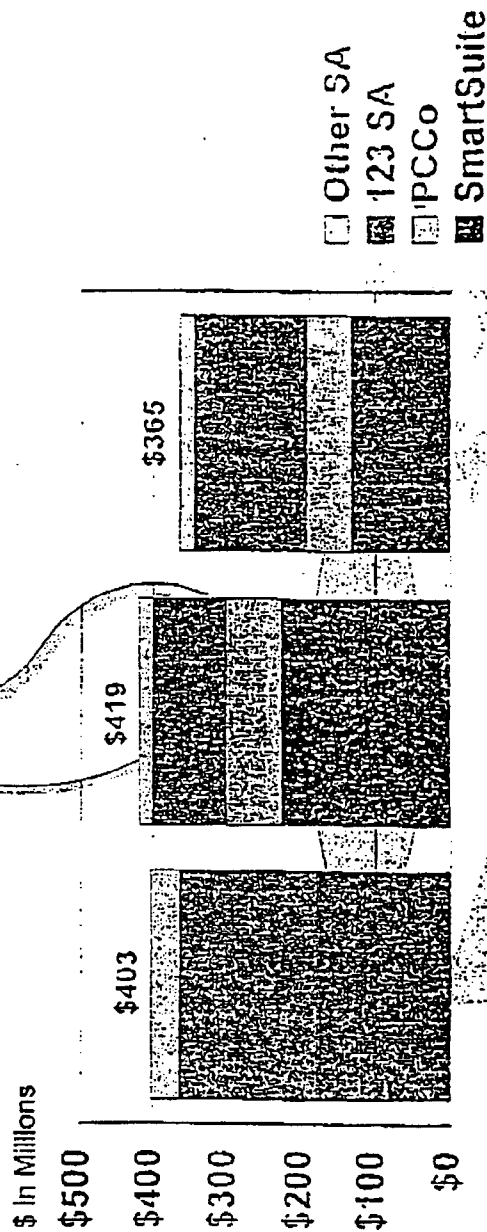


Regional Revenue shortfall concentrated in NA and Japan



Note: 1996 adjusted for PCCo price decrease

SmartSuite shortfall partially offset by strong 123 stand-alone

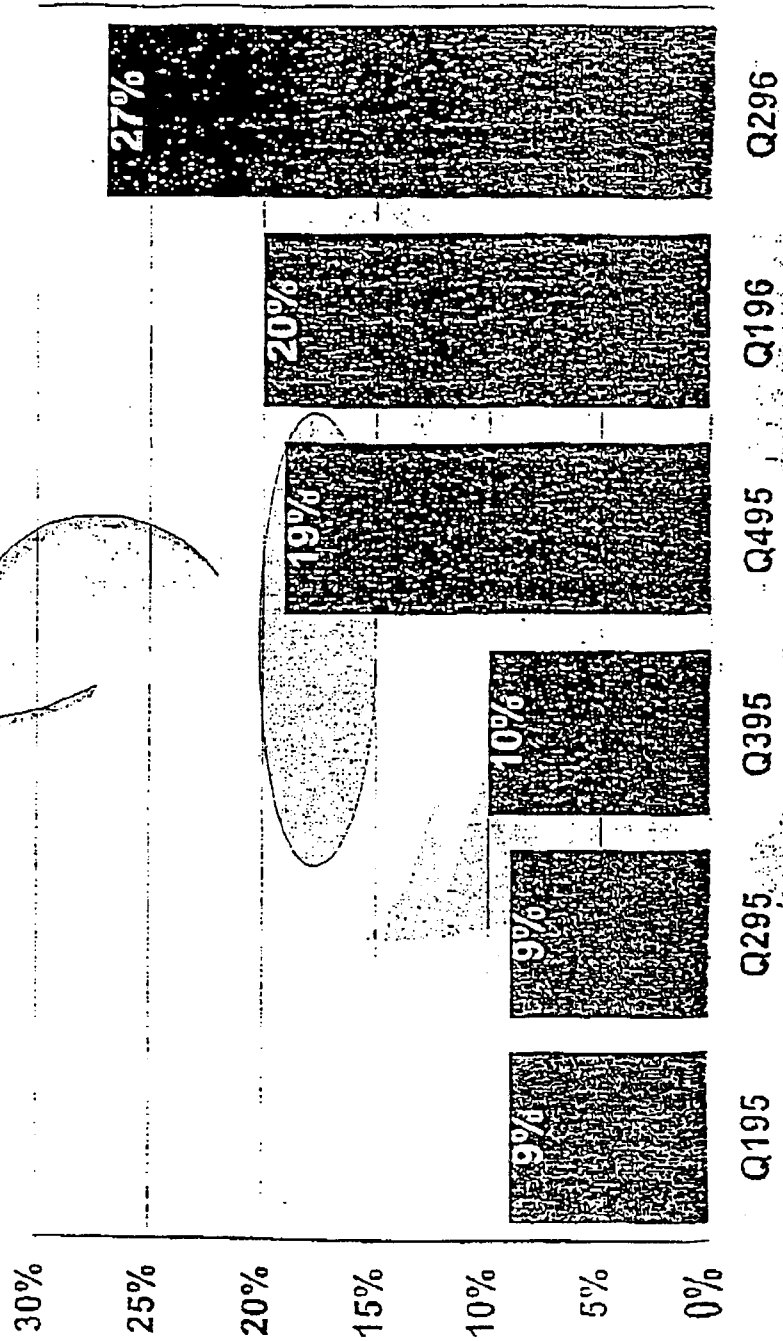


	1995A	1996P	1996F
SmartSuite	178	229	131
PCCo	3	73	64
123 SA	183	98	150
Other SA	39	19	20

Note: 1996 adjusted for PCCo price decrease

SmartSuite Continues to Achieve Market Share Objective

SmartSuite Unit Market Share



1996 Shortfalls

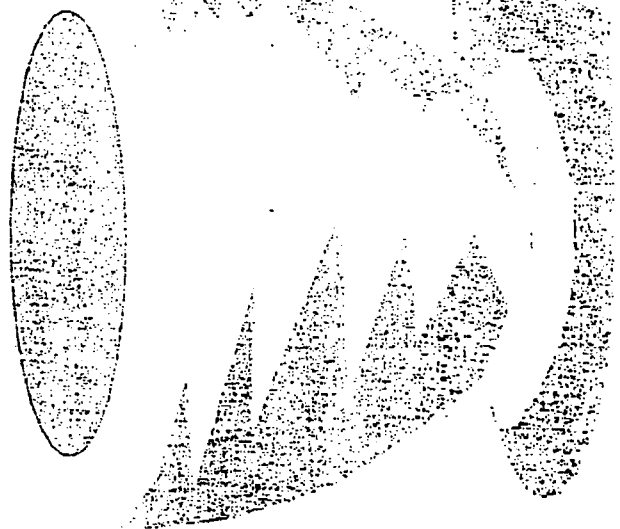
- └─ Competition is hotter than ever
 - ▶ Enterprise and mid-tier increasingly standardizing on Microsoft
 - ▶ Corel aggressive in retail and OEM
- └─ Product delay of SmartSuite & 1-2-3
- └─ Lack of execution/strategy for OEM
- └─ Performance problems of Word Pro

1996 Shortfalls

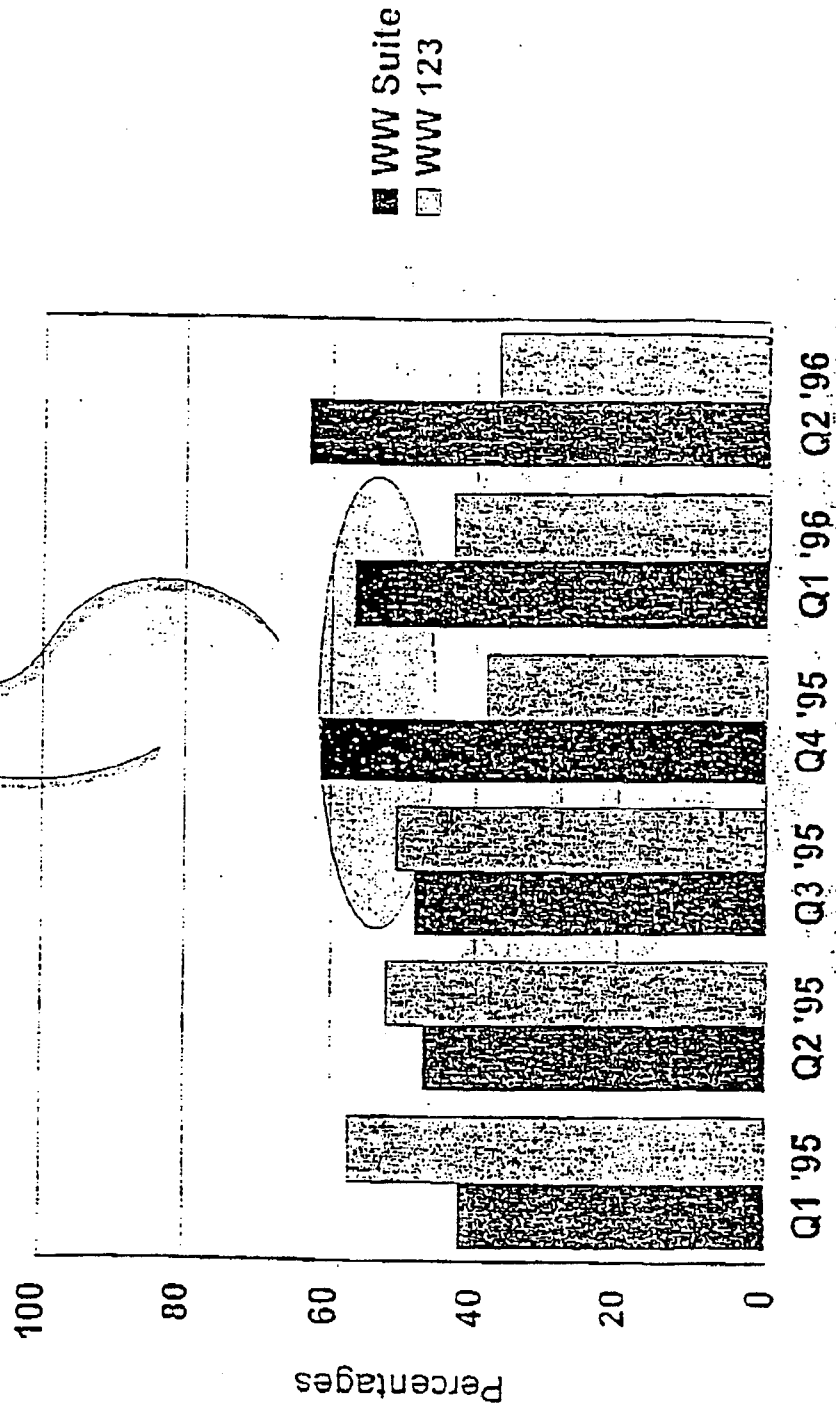
- Weak share in WP; most important app in Suite
- Lack of Desktop focus in Sales
- Cannibalization from PCCo bundle
- Corporate Strategy focused exclusively on Notes

Current Customer Base

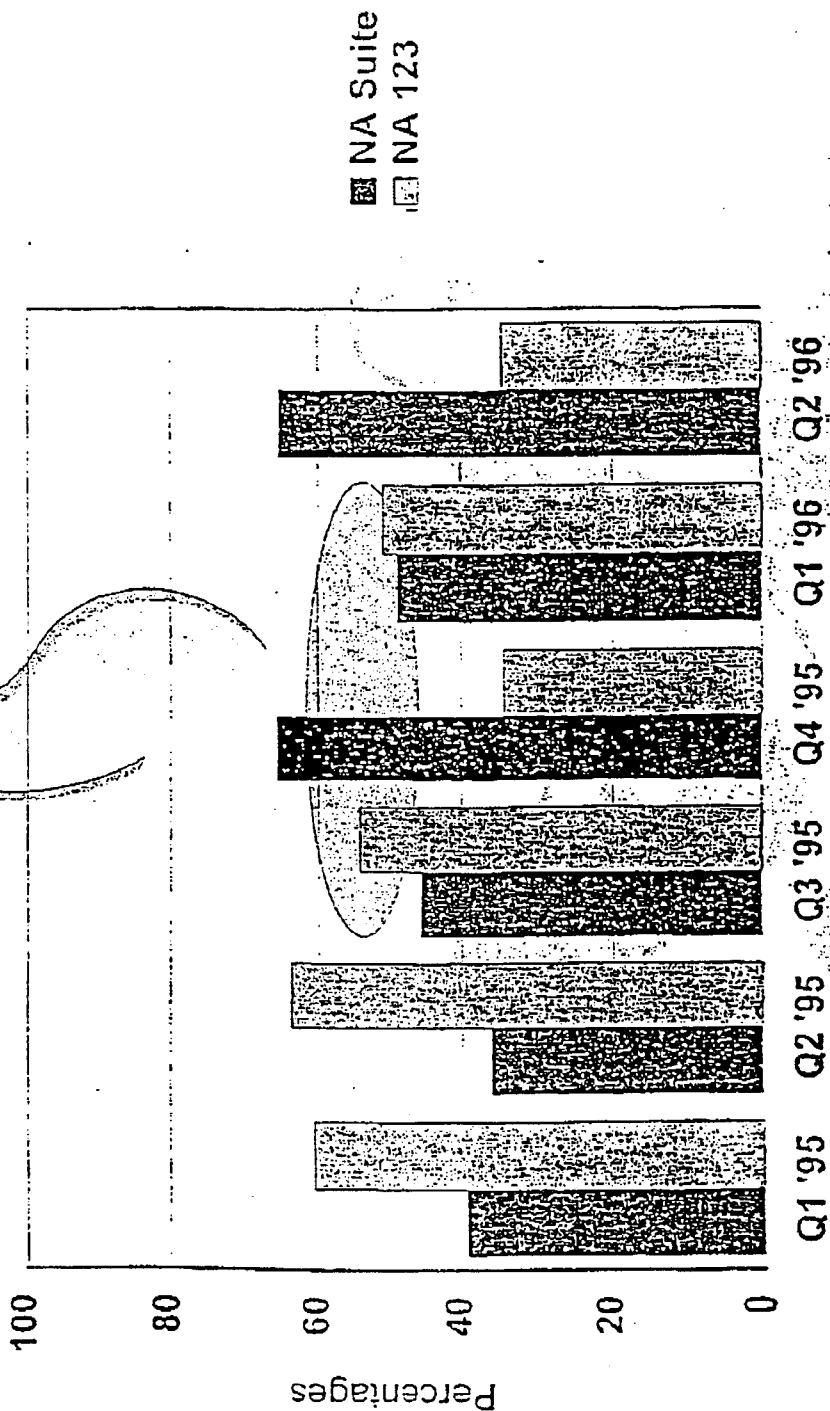
- The facts to know ...
 - ▲ 96 Product Purchase Information
 - ▲ Suite v. 1-2-3 Sales
 - ▲ Where is the customer base?



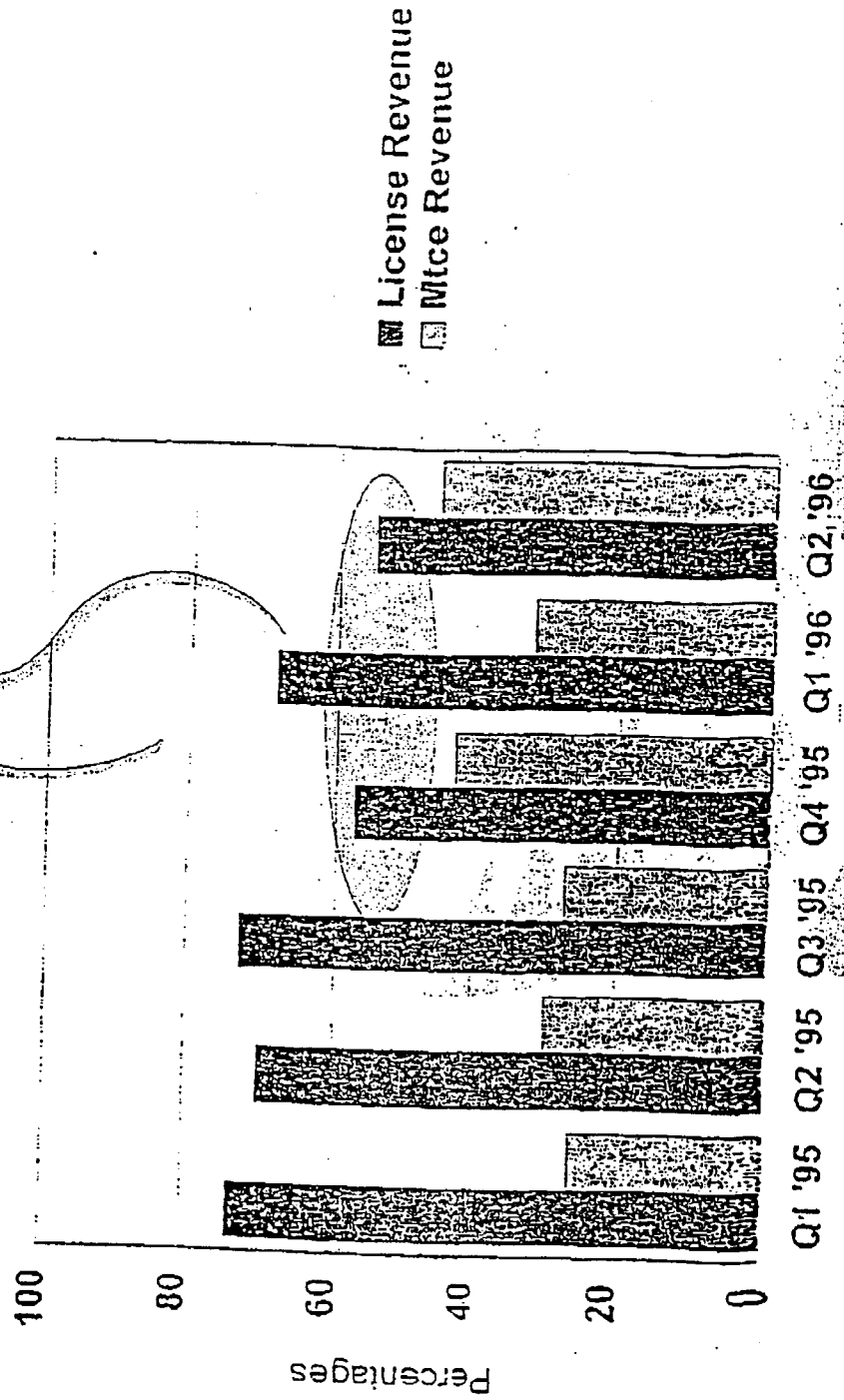
WW Suite vs. 123 Revenue



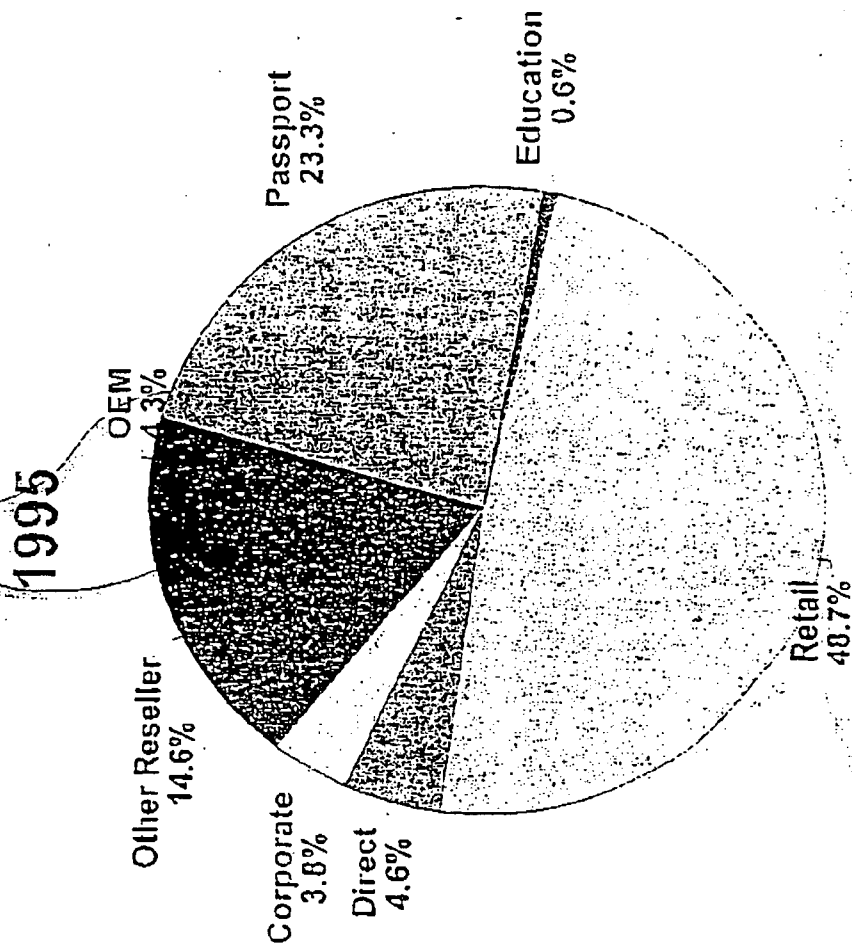
NA Suite vs. 123 Revenue



WWW Apps Passport Revenue

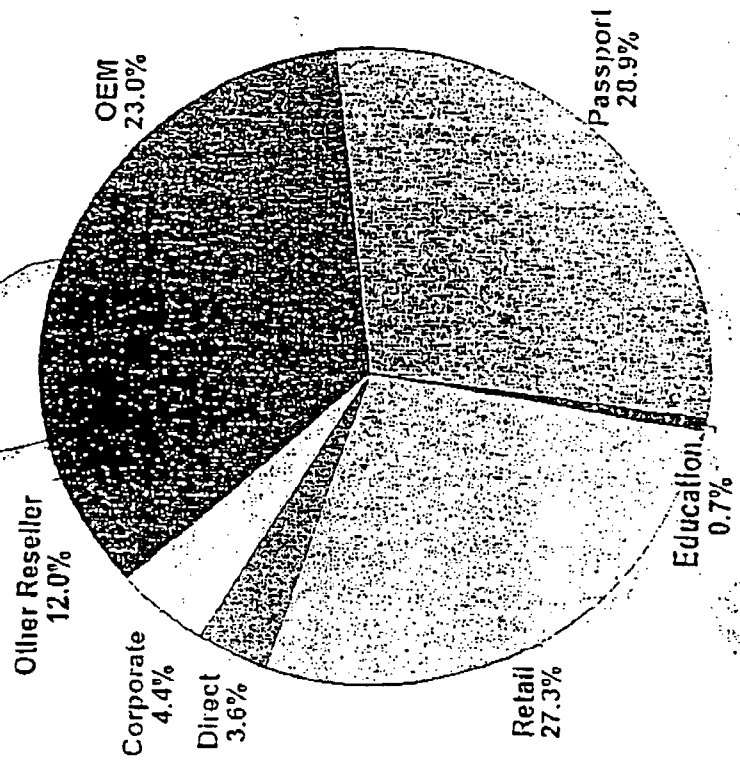


1995 NA Apps Revenue by Channel



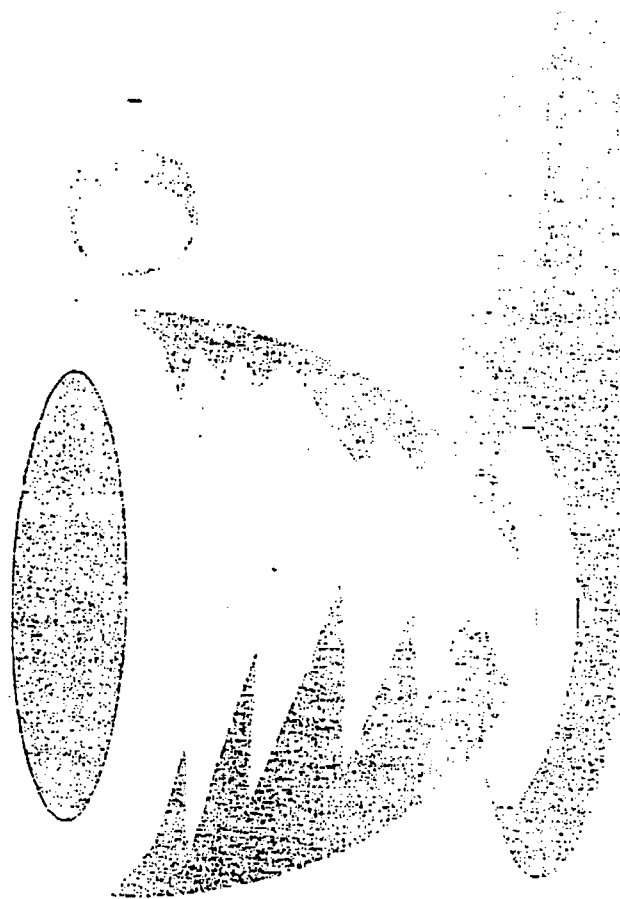
H1 '96 NA Apps Revenue by Channel

H1 '96



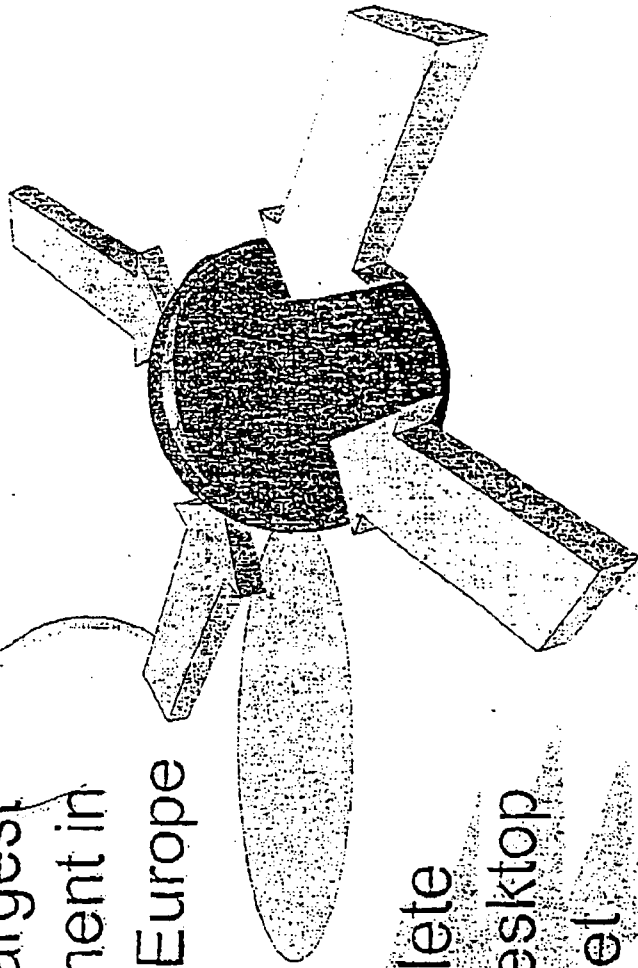
Suite Market Growth (Eric's graph)

- └ Graph of growth in Suite market worldwide
- └ legend with Regions of World



Industry Trends

- ┌ Lower Mid Tier/
Small Biz is largest
growing segment in
N America & Europe
- └ Product
requirements
include complete
solution for desktop
apps & Internet
access



1997 Goals

~~1] Maintain revenue~~

stream from

SmartSuite & 1-2-3

2] Generate revenue

from current LC 1.0
product

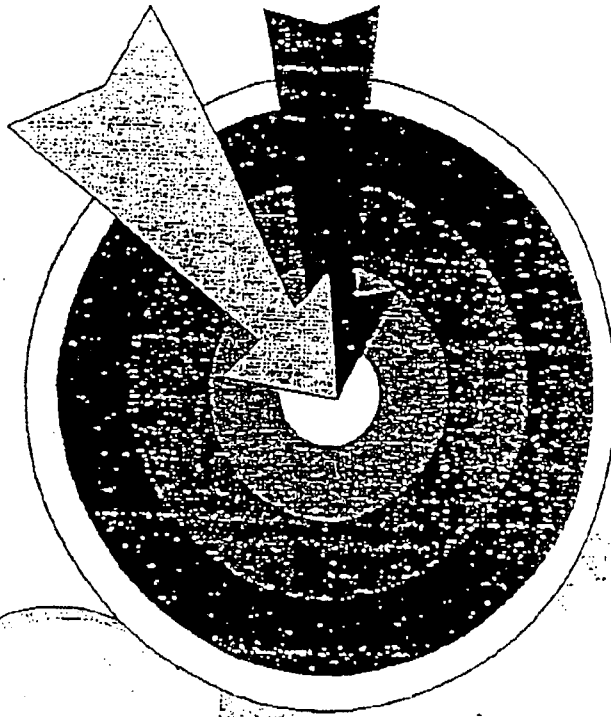
3] Continue to drive first mover

advantage in

Components and

Java Suite

technology



1997 Goals

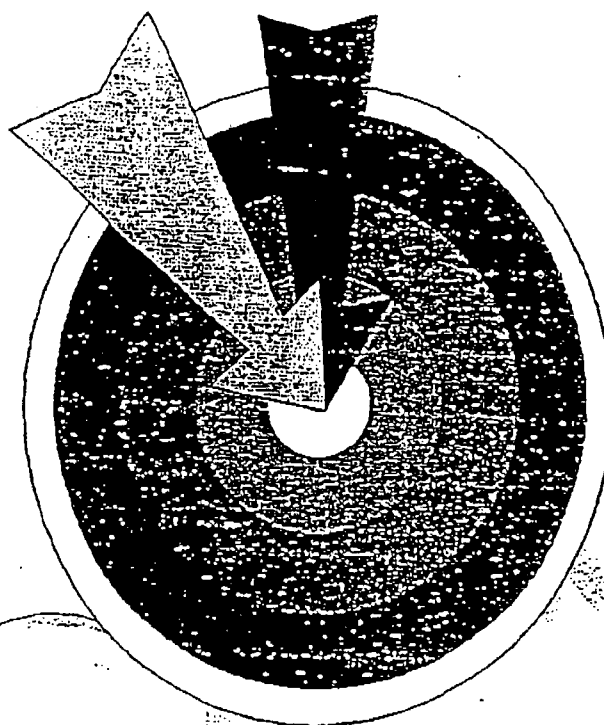
Develop a

supplemental
Business model with
Notes and Java
Components

Maintain Share of
30%

Sell Futures with
Components & Java
Suite

Transition to a
competitive Margin



Potential Strategic Alternatives

1. Expansion & share gain of SmartSuite into new Market Segments while simultaneously capturing a leadership position in Components (both Notes and Java)
2. Full migration to Components, with little to no SmartSuite investment making a paradigm shift to Component/Java Technology
3. Investigate other Web based alternatives in providing distribution of content rich Desktop solutions via the Web

Potential Strategic Alternatives

1. Expansion & share gain of SmartSuite into new Market Segments while simultaneously capturing a leadership position in Components (both Notes and Java)
2. Full migration to Components, with little to no SmartSuite investment making a paradigm shift to Component/Java Technology
3. Investigate other Web based alternatives in providing distribution of content rich Desktop solutions via the Web

Market Segment Strategy

Enterprise Segment:

- ▲ Maintain Current Suite customers (Harvest)
- ▲ Lead with Components to Office Customers

Products:

- SmartSuite 97/98
- Components (Notes & Java)

Market Segment Strategy

■ Lower Mid Tier/ Small Biz Segment:

- ▲ Growth in SmartSuite
- ▲ Customer Choice with Components

■ Reach through Retail and Business Partners

■ Products:

- Small Business SmartSuite 97
- Components (Notes & Java)

Marketing Execution

- ▣ Increase Awareness and branding of SmartSuite & Components
- ▣ Take leadership position with Components/Java Suite
- ▣ Expand Retail Presence
 - ▣ Maximize revenue through OEM units
 - ▣ Expand to Mid-Tier and Small Biz markets
 - ▣ Small biz SmartSuite (All Software a Business Needs)

Marketing Execution

- Mid Tier Programs
- Leverage IBM - Internet offerings and General Bus Segment
- Seeding Through Trials (a la America On Line)
- Drive Notes Components solution story thru BPs and VARs
- Educate the market on apps vs. component story thru advertising and PR

OEM Execution

- ┌ Maximize Revenue by marketing to users
- ┌ Incent registration of units through contests and promotions
- ┌ Active participation in closed loop sales process from IBM
- ┌ OEM Web Site with product information and giveaways
- ┌ Aggressive Maintenance offers
- ┌ Co-Marketing with OEMs

Potential Tactics:

- ❑ Marketing Bundle/Promotion with Corel - WordPerfect & 1-2-3
- ❑ Eliminate Stand Alone Apps
- ❑ Retail price reduction and SKU elimination to simplify the purchase for a customer - \$99
- ❑ Engage a Temp rep/ Telesales organization to support the Mid Tier Markets in certain regions

The "Take No Prisoners" attack on Corel

- Sole priority to eliminate them from the Market
- Aggressive PR to introduce the FUD factor
- Corel's financial position is questionable
- Have larger than life retail presence
- Aggressive Marketing/ advertising focused on Corel

1997 Marketing Spending Overview

	1996 Forecast	1997 Target	1997 Subm.	Expense Growth 97 Tgt 97 Subm.
\$ in Millions				
N. America				
SmartSuite	76.3	n/a	60.2	n/a
Components	2.0	n/a	12.7	n/a
Global Brand	10.0	n/a	6.7	n/a
Total N. America	78.3	51.9	79.6	43%
Emea	23.6	22.2	20.5	6%
Japan	19.5	19.1	20.7	2%
Apac	3.8	4.4	2.6	14%
Latam	4.1	6.6	1.6	16%
Total Spending	126.6	102.2	145.4	24%



Product Plans



Product Strategy

└─ Deliver SmartSuite 98

- ▲ Capitalize on OEM strategy with Q4 upgrade suite focused on quality, performance, Internet features

- ▲ Be prepared to deliver Gemini slipstream

└─ Expand Component technology

- ▲ Jump-start Java development effort
- ▲ Develop interactive web-based ActiveX components

- ▲ Deliver int'l release of LC 1.0 product

└─ Complete discovery & evaluation of content based web suite.

Component Development Plan:

- ┌ GOAL: Jump-start Java component development immediately
- ┌ Investigating how to merge v1.1 & v2.0 development schedules in the interest of jumpstarting Java
 - ▶ 1.1 is international release of Notes 1.0 product
 - ▶ 2.0 is Web-enable ActiveX components and merge w/Domino story to publish components
- ┌ 1.1 currently slated for Dec gold
- ┌ 2.0 currently slated for July gold

Components Plan

Plans for Public Showings:

- ▶ Announce at Strategy event @ Comdex - Comdex demo under NDA ?
- ▶ Lotusphere strategy presentation and demo
- ▶ Target Q2 gold delivery

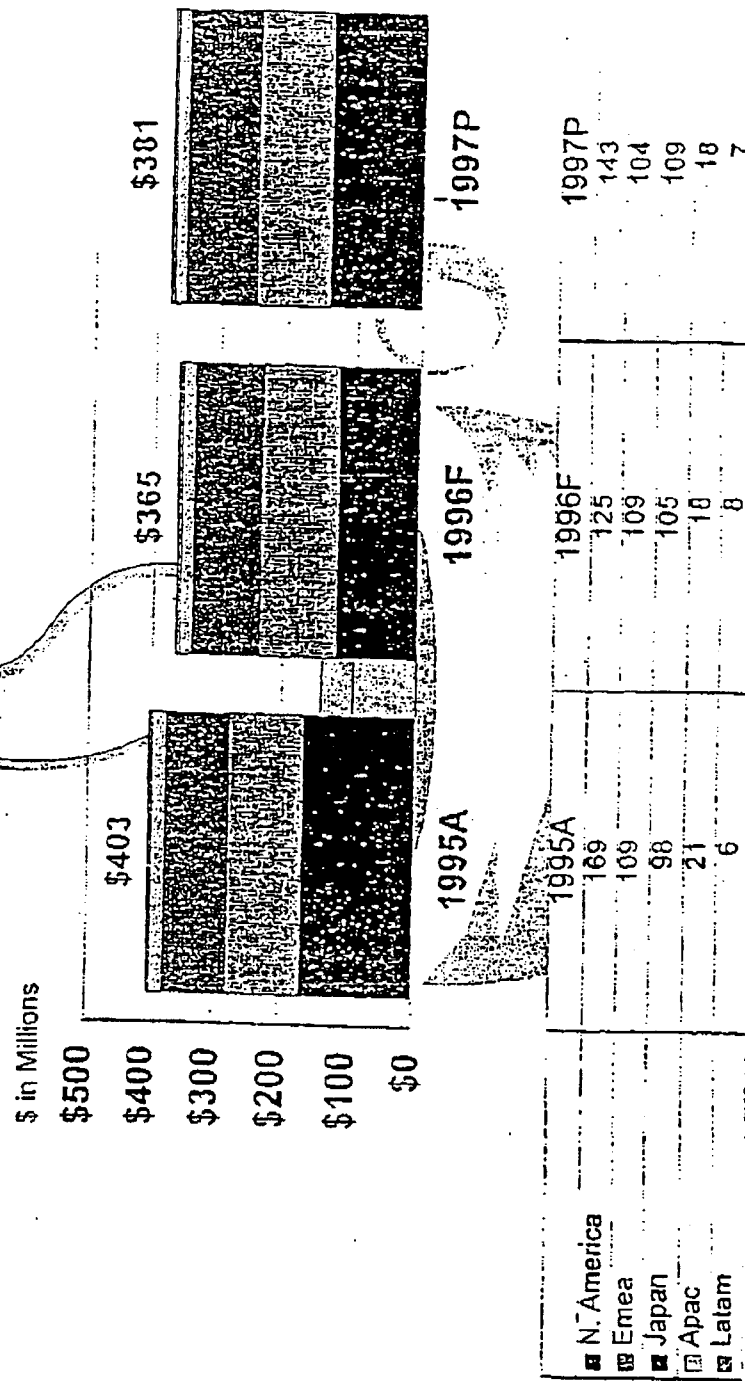
Product Calendar

OS/2 Suite 96	November 96	December 96
Lotus Components V1.1	December 96	January 97
Suite 97 Win95	December 96	January 97
Approach 97 for OS/2	Q1 97	Q1 97
WordPro 97 for 16b Suite	January 97	February 97
Suite 97 Slipstream	March 97	April 97
Lotus Components V2.0	July 97	August 97
OS/2 Suite 97	July 97	August 97
Suite 98 for Win 95 & NT	August 97	October 97

Development Headcount Profile

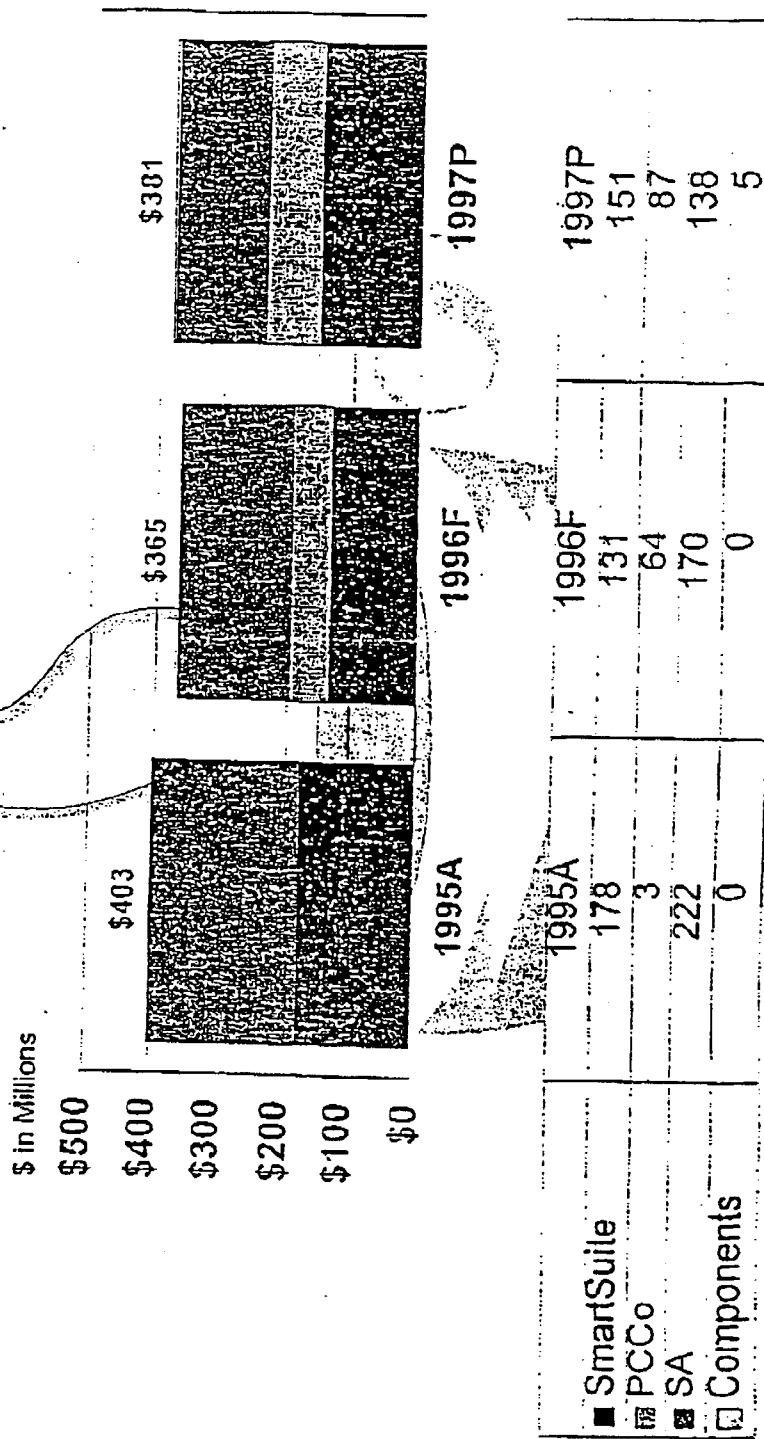
	1996 Heads	1997 Heads	1996 Exp. \$	1997 Exp. \$	96/97 Growth
Suite	517	450	54	52	-3%
OS/2	85	85	14	11	-20%
Components	45	12	5	18	174%
Admin	2	2	2	2	0%
IPD	N/A	N/A	24	24	0%
Total	649	649	98	102	4%

1997 Regional Revenue Plan



Note: 1996 adjusted for PCCo price decrease

1997 Revenue by Product



Note: 1996 adjusted for PCCo price decrease

97 Plan Risks & Issues

- Retaining & Hiring within division
- Corel Threat
- PCCo Strategy & Execution
- Pricing pressures
- Funding of Sales
- Lack of global Marketing accountability
- JAVA technical & staffing issues unknown

Desktop P&L Overview

	1996 Forecast	1997 Target	1997 Subm.	95/96 Growth	96/97 Tgt Growth	96/97 Subm Growth
Revenue						
Suite	10	n/a	92	26%	n/a	1%
PCC	64	n/a	82	200%	n/a	26%
S/A	170	n/a	57	26%	n/a	8%
Components						
Total Rev	865	430	66	n/a	n/a	n/a
Gross Mgn %	84%	83%	76%	9%	18%	4%
Mktg Exp \$	127	102	25	17%	19%	1%
Mktg Exp E/R	35%	24%	33%	17%	21%	1%
Dev Exp \$	79	74	86	7%	6%	8%
Dev Exp E/R	22%	17%	29%	7%	6%	8%

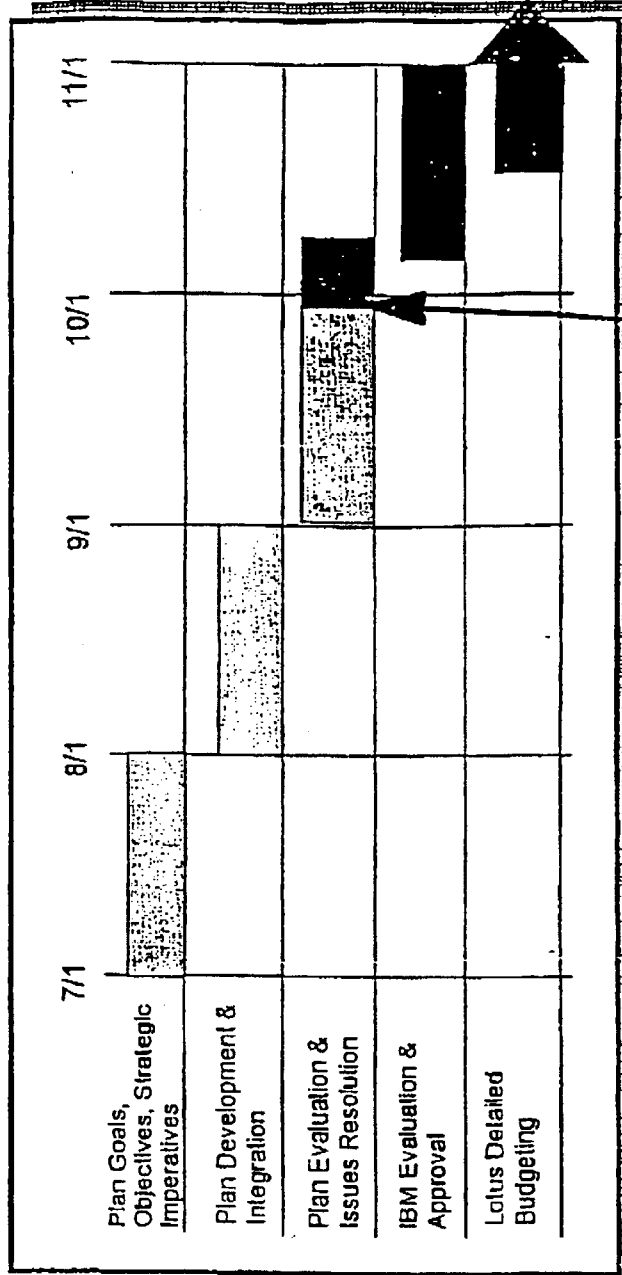
Note: Development expense excludes Q5/2 development spending

Operating Committee 1997 Plan Review

September 30, 1996

Lotus. Finance

Lotus 1997 Planning Process



We are here



Next Steps

Coming Events	Date
WW Sales & Services Plan Reviews	9/27
Operations Committee Plan Review	9/30
Plan Review with Bryant	10/1
Plan Submitted to IBM	10/3
Plan White Paper due to SWG	10/10
SWG Plan Review with Gerstner	11/1

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Aggressive Share Plan

Date

Milestone

Project Team Kickoff Meeting	10/3
Status Report to Steering Committee	10/9
Preliminary Report to Jeff	10/10
Draft White Paper / Financials to Jeff for Review	10/11
Final White Paper / Financials to SWG	10/15

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Target to Plan Bridge

	Target	Plan	Δ	Comments
Revenue	1,275	1,200	(75)	Revenue risk assessment
Prod COS	119	124	6	Concerns over '97 OEM mix
Serv/Supp	244	262	17	Support unable to make business model
Cost of Sales	363	386	23	
Gr Margln.	912	814	(98)	
Sales	240	225	(15)	Reductions in NA & reclass to Mktg/F&O
Marketing	285	291	6	Regional priority outside US
Development	250	248	(2)	Reductions due to new revenue proj.
F&O	107	108	1	Regional priority outside US
CADJ	30	17	(13)	Elimination of development fund
Expenses	912	889	(23)	
Profit Cont.	0	(75)	(75)	



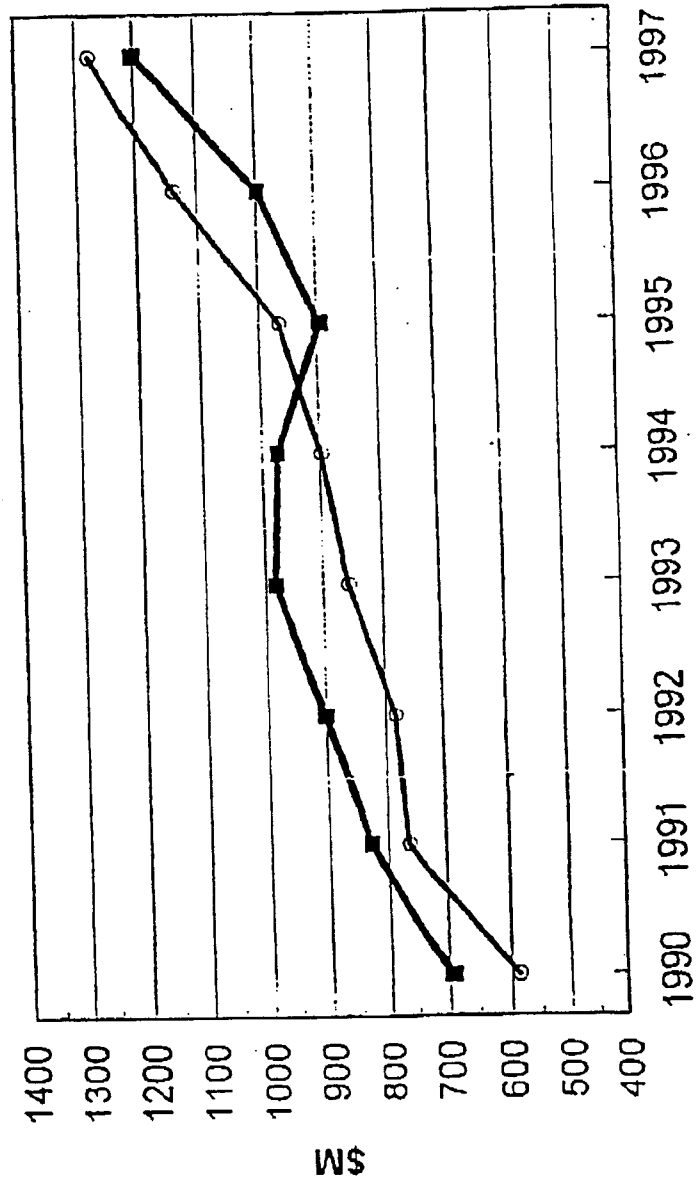
Some Issues/Concerns...

- Some specifics on "getting back" to target are not yet identified, i.e.
 - IPD reductions for Comms
 - EPG Q4 runrate concerns
 - Desktop marketing details
 - I/S Charge back process
- Headcount growth needs further review
- Notes Business Model/Pricing Strategy decision needed immediately
- PC Co Bundle discussions in process
- PLUS:
 - Growing Expense & HC with a \$75M loss

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Margin "Loss"

Revenue vs Cost/Expense



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Current Plan vs Original Targets

	Comms.			Desktop			EPG		
	Plan	Target	Δ	Plan	Target	Δ	Plan	Target	Δ
Revenue	621	621	0	342	430	(88)	32	40	(8)
Product Cost	55	55	0	62	61	1	2	4	(2)
Warranty	17	20	(3)	22	13	9	0	0	0
Service/Support	22	18	4	0	0	0	0	0	0
COS	94	93	1	84	74	10	2	4	(2)
Gross Margin	527	528	(1)	258	356	(98)	30	36	(6)
BU Sales	1	3	(2)	0	0	0	2	2	0
Marketing	178	172	6	102	102	0	11	11	0
Development	138	140	(2)	90	90	0	20	20	0
F&O	0	0	0	0	0	0	0	0	0
Expenses	317	315	2	192	192	0	33	33	0
Cont Margin	210	213	(3)	66	164	(98)	(3)	3	(6)

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Current Plan vs Original Targets

	LSG*			WW Sales**		
	Plan	Target	Δ	Plan	Target	Δ
Revenue	230	234	(4)	1,225	1,325	(100)
Product Cost	6	6	0	124	119	6
Service/Support	200	188	12	262	244	17
COS	206	194	12	306	363	23
Gross Margin	24	40	(16)	839	962	(123)
Sales			0	218	235	(17)
Marketing			0	123	116	7
Development			0			0
F&O			0	42	41	1
Expenses	0	0	0	383	392	(9)
Cont Margin	24	40	(16)	456	570	(114)

* Does not include Warranty Expense or Softswitch

** Revenue Includes contingencies, COS Includes total company
Sales excludes EPG and Softswitch

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P&L Trends

	1995	1996	1997	96/95	97/96
Revenue	895	998	1,200	12%	20%
Prod COS	113	106	124	-6%	17%
Serv/Supp	146	201	262	38%	30%
Cost of Sales	259	307	386	18%	26%
Gr Margin	636	691	814	9%	18%
S&M	413	490	516	19%	5%
R&D	211	235	248	11%	6%
F&O	92	97	108	6%	11%
CADJ	(10)	11	17		57%
Expenses	705	832	889	18%	7%
Profit Cont.	(70)	(141)	(75)		
E:R Ratios					
Prod COS	13%	11%	10%		
Total COS	29%	31%	32%		
S&M	46%	49%	43%		
R&D	24%	24%	21%		
F&O	10%	10%	9%		

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Expense Trends

	1995	1996	1997	96/95	97/96
Development					
Desktop	69	74	70	7%	-6%
Comms	83	100	111	21%	11%
EPG	17	17	18	-1%	9%
Localization	41	44	49	6%	13%
Total	210	235	248	12%	6%
WW Sales	197	200	225	2%	13%
Marketing					
Domestic	134	181	168	35%	-7%
International	83	109	123	33%	12%
Total	217	290	291	34%	0%
F&O	92	97	108	6%	11%
Corp Adjust	(10)	11	17		57%
Total Expenses	705	832	889	18%	7%

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Revenue Trends

	1994	1995	1996	1997*	95/94	96/95	97/96
Comms							
Notes	177	216	316	471	22%	46%	49%
Other Comms	132	161	150	150	22%	-7%	-0%
	309	377	466	621	22%	24%	33%
Desktop							
SSulte	218	178	148	135	-18%	-17%	-9%
Standalone	369	222	148	121	-40%	-33%	-10%
PC CO		3	63	86	1753%		37%
	587	403	359	342	-31%	-11%	-5%
EPG	3	10	15	32	240%	50%	109%
LSG							
Consulting	20	31	71	110	55%	129%	55%
Education	11	24	38	56	118%	56%	49%
Support	37	49	49	64	33%	-1%	31%
	68	104	157	230	53%	51%	46%
Total Revenue	967	895	998	1,225	-7%	12%	23%

* Not Including \$25M Contingency

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Volume Trends

	1994	1995	1996	1997	95/94	96/95	97/96
Seats							
Notes	760	1,556	2,881	4,426	105%	85%	54%
OEM		1,541	1,000	3,040		-35%	204%
Total	760	3,097	3,881	7,466	308%	25%	92%
cc:Mail	2,080	2,622	2,378	1,675	26%	-9%	-30%
Comms	2,840	5,719	6,259	9,141	101%	9%	46%
Units							
Smartsuite	1,098	1,678	1,916	2,437	53%	14%	27%
PC Co		184	4,826	6,771		2523%	40%
Total	1,098	1,862	6,742	9,208	70%	262%	37%

Action Items

- Revenue Risk Assessment
 - Is \$1200M a "50/50" Plan?
- PC Co Resolution
- Further Expense Reductions Required: \$25-\$30M
 - Identify what to "stop doing" in development
 - Headcount Growth Assessment
 - Re-examine Sales & Marketing affordability
- Share Plan Completion
 - May require further expense reductions

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An essential element of our strategy is to develop the market in new areas by delivering carefully selected, broadly appealing "infrastructure" applications that will drive demand for our clients and servers and generate substantial additional revenue. These applications are created by our Emerging Products Group, a development "skunkworks" that has entered the markets for document management (*Domino.Doc*), rentable applications (*Domino.SPA*), Internet commerce (*Domino.Merchant*), and distance learning (*LearningSpace*). While each of these market segments are attractive in their own right, they also showcase important Notes/Domino capabilities that can expand our core market dramatically. A key initiative in 1998 is to develop these businesses aggressively.

2.0 Desktop and Internet Applications Business

We are continuing our efforts to develop a new market for Java-based, network-centric business applications, where we believe we have a technological lead in a market that Microsoft is reluctant to exploit. At the same time, our traditional desktop business is being managed to maximize margin and protect our installed base. We are continuing scaled-back SmartSuite development to protect our existing revenue stream until the emerging market takes flight.

2.1 Market / Competitive Environment

Business applications is a \$5 billion software category, with annual revenue growth of 20% according to IDC estimates. Microsoft is totally dominant, with a 60% unit share and a commanding 91% of revenues, capturing virtually all of the category growth and likely improving its position in 1997. Lotus is the number two player, followed closely by Corel (Kanata, Ontario), which markets WordPerfect Office. We feel there is a high probability that Corel will fail entirely and not be a significant factor in the business applications market in 1998. (Corel currently has less than 30 days working capital).

The market appears ripe to divide into two components: traditional Windows integrated suites, and Java-based applets and tools. Market research reveals that corporate users are dissatisfied with the cost and complexity of the current Wintel desktop computing model. The total cost of maintaining a current generation PC ranges from \$8,000 to \$12,000 annually, based on various research studies. An important component of the cost is in end-user support of today's integrated desktop applications. There is a real need for easier to use applications as we deliver computing to a much wider class of users, extending beyond today's power users.

IBM, Oracle and Sun are responding to the market's desire for economy and simplicity by leading the development of network computers (NCs) that are less expensive to acquire and maintain, and which will run nimble, Java-based applets downloaded from a powerful server. While market size forecasts vary, the opportunity is significant. IDC forecasts NC clients to grow from estimated 1997 worldwide shipments of 565,000 units to 6.8M units by 2001. Gartner Group estimates that 70% of NCs deployed through 1999 will replace dumb terminals, replace older PCs primarily

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and Designers Only*

performing terminal emulation, and provide computing capability to users who have had no device on their desk. The installed base of dumb terminals worldwide totaled approximately 24M at YE96, with slightly more than one-third of these being 3270 and 5250 terminals; an additional 15M PCs are currently functioning primarily as mainframe terminal emulators.

Lotus will capitalize on these trends by leading in the development of productivity software for these new platforms. Of course, Microsoft is the likely major competitor in this business, too, and we believe that they are building applets similar to ours. However, because Microsoft derives the majority of its total gross margin from its Office business, we believe that they will be reluctant to lead a change from the existing model. Instead, we expect them to compete by leading improvements *in the existing model*. Indeed, Microsoft's focus for Office 99 and NT 5.0 is squarely on improvements in total cost of ownership (TCO), and they are proactively attempting to set standards for a range of devices from PCs to NetPCs to Windows Terminals. Microsoft will attempt to subvert attempts at making TCO cause for a "state change" by extending Windows' reach to these new devices.

We also expect "new" competitors to converge on this business opportunity. Vendors such as Oracle, Netscape, Sun, and Apple may very well bring competing applications to market to support NCs, and there is activity from smaller players such as Corel, StarDivision, and Applix. Our competitive advantage against these entrants hinges on time-to-market and our extensive experience in desktop productivity in enterprise accounts.

2.2 Strategy

To capitalize on these trends, our strategy is to be the first to market with products that will lead the state change from traditional integrated suites to Java-based applets, while continuing SmartSuite enhancements to defend our existing revenue stream and avoid the perception that we are abandoning our installed base. Our success depends on the market's acceptance of NCs as a superior platform for significant numbers of end-users. The key is for IBM, Sun and Oracle to ignite the NC market, exerting their considerable market influence to drive NCs into suitable applications quickly.

We will lead this change in the market with two new products: Kona WorkPlace, which is an end-user collection of integrated components, and Kona DevPack, which is a collection of tools for developers of interactive web applications. We will also break from the traditional upgrade model (delivering separately priced static levels of code with optional maintenance), to implement a new annual subscription model, in which we deliver more frequent enhancements to our customers on a renewable basis. This business model is designed to aggressively capture market share and set the stage for annuity revenue growth derived from ongoing product enhancements, service and support.

Step one in our strategy is to leverage OEM relationships with as many NC vendors as possible to establish an entry level "base version" of Kona WorkPlace as the standard desktop of choice. To

avoid NC market fragmentation, which would favor any Microsoft entry, we must gain exclusive distribution rights on IBM's NC platforms and quickly use this beachhead to drive agreements with other NC suppliers.

Step two in our strategy is to drive acceptance of our Kona DevPack programmable building blocks among application developers as the number one choice for creating interactive web applications, starting with our business partners. ISVs and corporate developers are increasingly interested in using pre-built Java components to speed the delivery of mission critical applications to diverse clients.

Step three is to translate success in steps one and two to "pull" Kona Workplace onto PCs for applications where cross-platform consistency is important. We believe this "backdoor" approach to PCs is likely to be more effective than competing head to head with Microsoft Office. The goal of our two-tiered strategy of Kona-based applications and ad hoc applets is to surround Office from all sides — the NC, web-based solutions, and pockets of PC use, thereby building momentum for new applications and even broader use.

Our Kona strategy reinforces our server-side Domino strategy, as business partner solutions incorporating our Java-applets create demand for Domino servers and other back-end services from Lotus and IBM. Additionally, the Java component model on PCs or NetPCs accentuates mobility as one of Notes/Domino's major strategic advantages, allowing the user to work with his/her desktop and applets while disconnected from any network.

In the traditional desktop suite segment of the market, we must succeed in two key areas. First, we must maintain a solid desktop revenue stream, while we continue to reduce investment in R&D, development, and marketing. Accompanying further reductions in expenditures, we project revenues declining from an estimated \$244M in 1997 to \$197M in 1998 (excluding Kona).

In the first half of 1998 Lotus will ship the last major feature release of SmartSuite with a native Windows UI, at which point the product will enter "maintenance mode" with a small team of developers assigned to fixing bugs and conducting certification testing for new Microsoft operating systems. Active maintenance will continue for approximately 24 months. We will also stop the production of all stand-alone applications except Lotus 1-2-3.

Second, we must articulate and effectively execute a well-defined plan for migrating our active SmartSuite customers to our component applications. Lotus plans to be very "up front" and direct with both our customers and the analyst community about this transition plan. In fact, we have architected the next version of SmartSuite to work well with our components. In 1998 Lotus will not only be able to articulate a transition plan, but also be able to demonstrate how it will work with real production software. We will focus on migrating customers quickly and smoothly to validate our strategy and serve as references.

Our most critical success factors in 1998 are: (1) timely launch of our Kona family, (2) establishing CEM arrangements with the leading NC vendors, (3) creating an effective channel for reaching

web application developers with DevPack, and (4) preparing for the migration of our SmartSuite installed base to Java-applets.

2.3 Go To Market Considerations

The enterprise market segment is the primary target for both our new network-centric applications and our traditional desktop. Large customers have the most to gain from Kona's TCO value proposition, and they account for the bulk of our desktop revenue.

The primary channels for Kona will be our sales force and OEM relationships. ISV's, such as Oracle and PeopleSoft, will be the focus for our DevPack developer tools. Kona's secondary target is the SMB segment, where we will partner with ISPs and Telcos to extend our reach down-market from our traditional channels. Electronic Software Distributors (ESD) and Lotus Direct, our direct marketing operation, will be developed as alternatives to the traditional retail channel, and no physical "shrink-wrap" offerings are planned. While ESDs have not developed as a viable channel for traditional software, they could emerge as a major channel for network-centric applications.

For our desktop products, while the enterprise segment is our largest source of revenue, it is also our fastest declining segment, due to the overwhelming momentum of Microsoft Office. We will continue to leverage our traditional channels, including our sales force, corporate resellers, and direct marketers. In the SMB segment, we will emphasize the retail channel and OEM programs, which also have important spill-over benefits for enterprise customers who want to be reassured by seeing the brand in retail stores, catalogs and OEM programs. We are also pursuing more cost effective channels, such as electronic distribution and various "soft" OEM opportunities such as bundling with electronic banking software. We are challenged to grow share in this segment given continued shrinkage in our development and marketing investment.

3.0 Services Business

Our fast growing services business has three components: Customer Support, Education, and Consulting. In 1997 we expect these businesses to contribute 24% of our total revenue, growing to 26% in 1998. In addition to their revenue and margin contribution, each of these businesses makes a crucial contribution to the achievement of our market share goals.

3.1 Lotus Consulting

Lotus Consulting has the mission of accelerating the rate at which our customers achieve lasting business value from their investments in Lotus technology, while meeting specific P&L targets. The group provides value to our customers by designing and implementing global Notes/Domino infrastructures and mission-critical business solutions. In 1998 we project revenue growth of 30% to \$181M, and a seven point increase in operating margins to 18%.

Our consulting resources are applied to drive Lotus' success in key markets, industries, and accounts. Our strategy is to focus on developing relationships with selected clients that are leaders in their industry and that have the capacity to commit to multi-year, multi-million dollar engagements in prominent application areas such as value-chain integration, knowledge management, and enterprise messaging. The goal is to reproduce market successes such as Procter & Gamble, in which diligence in high-level relationship building and vision creation helped secure 80,000 Notes seats in addition to substantial consulting revenues.

Key initiatives during the year will include a marketing campaign to position our consulting capabilities as more Internet-centric, helping us to compete more consistently and effectively for building corporate intranets and web-enabled business solutions. To support our work in this area, we will introduce an internal set of work practices and tools, called the "I-Net Framework" (templates, engines, implementation procedures, etc.).

Other important initiatives include (1) a greater emphasis on demand generation, including the delivery of high-level executive events that support the Lotus brand, (2) continuing the incorporation of business partners into engagements as subcontractors, (3) leveraging the virtual Notes practice with IBM IGS, (4) upgrading our Accelerated Value Method methodology to incorporate architected solutions (complex, integrated solutions), I-Net infrastructure planning and deployment, and project management, and (5) implementing a program for routine customer satisfaction measurement.

3.2 Customer Support

Customer Support will contribute 23% of our services revenue in 1998, with revenues increasing 39% to \$83.7M from \$60.2M. Gross margin improves to break-even, from a loss of \$10M in 1997.

Our goals are to (1) reposition Customer Support to become one of the company's key differentiators leading to customer satisfaction and loyalty, and (2) significantly increase customer participation in our support programs to grow revenues and profit.

To accomplish these goals, we are implementing a number of measures to make step-function improvements in the "time to resolution" of customer problems. For example, we have implemented a "Customer First" program to improve our basic operating practices, and strengthened essential cross-organizational processes, particularly linking Support with Development. We are making better use of our global Support resources and skills through the implementation of a "virtual worldwide support center," which focuses on solving problems wherever they exist and helps ensure high quality levels as we absorb new people. We have also opened a Center of Competency for advanced skills development and the recreation of customer problems in a lab environment.

While we lead with a direct support model in the enterprise market segment, we will bolster our support capacity by employing a Business Partner led model in the SMB segment. We will also significantly enhance our support synergy with IBM, and extend our multi vendor/cross platform support capabilities through arrangements with Alliance Partners.

Key initiatives during the year will include (1) the relentless execution of our "Customer First" program, (2) the continuation of aggressive skills development and enrichment, (3) the overhaul of our support offerings, pricing, and go-to-market model, and (4) the creation of web-based self-help tools for all constituencies.

3.3 Lotus Education

The mission of our Education business unit is to (1) continue to expand the pool of certified technical resources that our customers need to successfully implement business critical solutions based on Lotus technology and tools, and (2) drive increased services revenue. In 1998 we project revenue growth of 33% to \$75.6M.

To accomplish these goals, our primary strategy is to continue to strengthen the Lotus Authorized Education Center (LAEC) brand, extending it into the SMB segment as well as new and emerging regions. We will also drive more aggressively into the direct delivery of custom training in major regions, particularly North America and EMEA.

Key initiatives to support these strategies include (1) reducing curricula time to market, (2) implementing programs and tools, such as web accessed materials, seminars, and tutorials, that will accelerate the acceptance of new products, (3) broadening distribution through alternate delivery models and partnerships, to make Lotus the end-user curriculum brand in a number of formats and tools, (4) expanding channel competencies to better support Lotus and IBM requirements, and (5) expanding the Education product set, including assessment tests, testing tools, and tools for our internal use in custom engagements. Constantly adding value and creating new business opportunities for our LAEC's is essential to retain their mindshare and help them resist Microsoft's overtures.

The following section shifts our focus from product segments to sales strategy.

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4.0 Go To Market Strategy

To achieve our market share objectives, Lotus must be excellent at developing partnerships with organizations that can extend our reach and effectiveness with distinct market segments. To improve our capabilities, Lotus and IBM have formed a "virtual channel company" that maximizes the efficient allocation of our mutual resources and coordinates the way in which we engage our joint customers. This initiative enables us both to cover more accounts and deploy resources for technical enablement and new channel development.

4.1 The Enterprise Segment

The enterprise market segment is Lotus' primary target and revenue driver. We estimate that this segment accounts for 75% of our total revenue and comprises 25% of our existing customers.

In our messaging and groupware businesses, our primary strategy is to accelerate the shift of responsibility for account relationship management and vision creation to IBM client teams, thereby increasing both the extent and effectiveness of our coverage, due to IBM's greater numbers and often higher level executive relationships. The number one critical success factor is that IBM sales teams and technical resources are fully incented and trained to convincingly represent Lotus products to their accounts. We are working with IBM to step-up our enablement activities.

Lotus sales teams are opportunity focused, and bring to bear the product skills needed to close the business that is identified. Wherever practical, we organize our sales teams around industries, and our sales model stresses infrastructure and solutions. In re-engineering customer visions, we stress the convergence of messaging and application infrastructure in order to elevate the discussion to enterprise integration and collaborative work, where we have a distinct advantage. We focus on solutions in order to create the combination of business value and user support that is needed to offset Microsoft's control of the operating system and desktop infrastructures.

Our channels strategy emphasizes strategic alliances with partners who have influential positions with large accounts, such as the Big Five accounting firms, national systems integrators, and major computer vendors. OEM relationships are again key to drive trial and achieve our market share goals. ISVs, including the major ERP vendors, are essential to support our emphasis on solutions. Our traditional corporate reseller channel is also important. Our marketing messages stress business solutions instead of technology, along with the dependability, scalability and manageability required for mission critical applications.

In 1998 we will develop a new communications channel to reach internal software developers, in order to promote our integrated development environment and tools, such as BeanMachine and

Kona DevPack. Our Business Partner community, especially the custom solution developers, will be key in reaching this audience. Partner efforts will be augmented by direct marketing and education programs, such as Lotusphere and the Domino Web Developers Conference.

Other important initiatives in the enterprise segment include (1) stepping-up our enablement activities for IBM sales and technical resources, particularly the SAMs and ISU solution development resources, (2) strengthening relationships with other strategic partners, such as the Big Five accounting firms and global systems integrators, (3) deploying mail migration specialists to convert ccMail and PROFS accounts to Domino, where they can be protected from competitive displacement, (4) continuing our branding efforts for broad awareness, (5) intensifying our focus on industry solutions, coupled with a campaign to help our partners market their solutions more effectively, and (6) establishing our leadership in the emerging areas of knowledge management and distance learning.

The enterprise is also the primary target for our Internet and desktop applications. For our Internet applications, critical success factors are the Kona launch and our OEM recruitment activities. Our primary strategy is to use OEM agreements to carry Kona NC WorkPlace into corporations, and then leverage this beachhead to draw in Kona PC WorkPlace, too. We'll support this strategy with a campaign to convince web developers to incorporate our Java components in their interactive applications. For our desktop applications, OEM agreements and corporate resellers will be used to take SmartSuite 98 to market and drive unit volumes to achieve our share goals.

4.2 The Small and Medium Business (SMB) Segment

The SMB segment is a high priority target for Lotus, both to fuel future growth and to protect our share at the high-end of the market. We estimate that this segment accounts for 25% of our total revenue and comprises 75% of our existing customers.

In our messaging and groupware businesses, the sales model is partner led and solution oriented. Our primary strategy is to use business partner solutions to pull our clients and servers into accounts, and our marketing messages support this by emphasizing Domino-based industry solutions and the value being achieved by the industry leaders who are using them. We will continue aggressive recruitment of partners with "packaged" solutions, and help our partners bring their solutions to market on a broader scale. We are expanding support for our partners in the marketplace by redeploying some of our current enterprise resources. These resources will focus on field based marketing for demand generation, Inside Sales, and direct customer contact to close the largest opportunities.

Our channels strategy emphasizes Internet Service Providers (ISPs) and telephone companies as the vehicles for bringing partner solutions to the broadest possible audience. These new partners will provide a dependable, on-demand infrastructure to host customer solutions, as well as rentable applications, and are essential to help overcome the infrastructure and support constraints that may exist for many SMB customers. We are also recruiting regional systems integrators who

provide services to middle market firms that may not be comfortable installing and configuring complex products on their own. Skilled integration partners are essential to address the impression that our offerings are complex and difficult to install and manage.

Key initiatives in this segment include (1) the expansion of our Inside Sales capabilities, (2) the recruitment of ISPs and telcos, and with Lotus' support, the broad based demonstration of the economic viability of the outsourced infrastructure and rentable solutions models, (3) the enablement of IBM's SMB resources, with an emphasis on much closer cooperation in the field and at headquarters, and (4) an aggressive program to generate demand through field-based marketing programs, connected to an effective lead tracking mechanism for our partners.

For our desktop products, our go to market strategy is a highly leveraged sales model utilizing OEM relationships and business partners. Smaller firms may find the simplicity and life-cycle economics of NCs appealing, and they may not yet have selected a standard desktop, giving us an opportunity to leverage a unique position on NCs to win the desktop. While we do not expect the traditional retail channel to be appropriate, we will test the suitability of the electronic software distributor channel as an alternative. In this segment, our marketing messages will emphasize ease of use and hence lower support costs, as well as thorough integration with the Internet, and the comfort of dealing with IBM, "just like the big players."

Key initiatives include OEM sales and efforts to promote web solutions that incorporate our Kona applets.

5.0 Financial Strategy and Outlook

Our business goals for 1998 are:

- to grow our revenue faster than the industry in strategic product segments where we hold a leadership position, and to fund this growth through managing remaining product segments to optimize margin; and
- to achieve step-function improvement towards competitive financial returns in all key financial metrics.

The first of these goals represents a continuation of the "portfolio management" approach to extending market leadership adopted in our 1997 Plan. The latter recognizes the need to begin to capitalize on our past investments in development and sales/marketing to achieve competitive financial returns.

At the end of this document are four exhibits which present the details of our 1998 financial plan. It should be noted that the 1997 numbers shown in these exhibits represent our current outlook for the year, while the accompanying compulsory charts contain our official August forecast for 1997.

5.1 Financial Strategy

5.1.1 High Growth Segments

Our 1998 financial plan reflects continued strong revenue growth in our strategic core— Notes/Domino and consulting/education. 1998 revenues in these segments grow 42%, following 68% growth in 1996 and 54% growth in 1997. Notes Seats (Notes Clients + Domino Servers) will grow 35% to 11.8 million in total. This follows seat growth of 52% in 1996 and 85% in 1997. It should be noted that these growth rates are off of a base which has grown geometrically over the past few years, and therefore reductions in percentage growth rates are to be expected. In 1998 we will begin to add revenues from our Kona (Java) products, which we expect to grow rapidly in 1999 and 2000.

5.1.2 Declining Segments

1998 will represent the fourth consecutive year of double-digit revenue declines in our traditional desktop suites/applications business. Revenue from this segment will fall below \$200M in 1998, from a level of \$244M in 1997. In addition, revenues from our cc:Mail product will decline 27% to \$53.2M, and SoftSwitch revenues will decline 11% to \$32.6M. Development and Marketing spending on SoftSwitch and cc:Mail will decline 66% to \$7.1M in 1998. We will continue, as in 1997, to reduce our investment in development and marketing spending for suites, and reallocate a portion of these resources to Notes/Domino/Internet offerings and to Java components development and marketing. However, given the relatively small traditional desktop revenue base at this point, and the need to continue aggressive Java development, albeit with very little revenue expected in 1998, the development E/R for the Internet Applications Division will improve only modestly in 1998, from 34% to 33%.

5.2 Financial Outlook

5.2.1 Communications Business

Total revenues from our Communications Business Segment (including the Emerging Products Group) will grow 34% to \$854M in 1998. Software revenue from sales of Notes/Domino will grow 46% to \$773M, while revenues from other Communications products fall 25% to \$81M.

Development expenses in the Communications/EPG segment will grow 14% to \$138M, as we shift resources to this segment from declining business segments such as traditional desktop

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suites/applications. Software development E/R will improve 3 points to 17%, a level which meets the competitive model objective. (This measure of E/R uses only software revenue in the denominator.)

Marketing expenses for the Communications group will increase 24% to \$255M, while the marketing E/R improves 2 points to 30%. Much of this increase is "sourced" from reductions in Suite/cc:Mail/Organizer, and redirected to Notes/Domino marketing.

Overall, the Communications/EPG Business Segment will generate a contribution margin of \$541M in 1998, up 44% over 1997.

5.2.2 Desktop and Internet Applications Business

Revenues from our Desktop and Internet Applications segment will decline 14% to \$211M in 1998. As mentioned above, this decline is attributable to our traditional suite/applications business, where unit volumes are expected to increase only 9% in 1998 after growing 30% in 1997. In 1998, we will begin generating the first significant revenues from our emerging Java components business (Kona). This product segment has high potential, but also high uncertainty in terms of the rate and pace of market penetration. We have structured what we believe to be a conservative 1998 revenue plan-- at \$14M for revenue from Kona products.

Development expenses for the Internet Applications segment will decline another 20% to \$55M in 1998 after declining 8% in 1997. Within this total, we are funding a significant buildup in resources devoted to Java components development. The development E/R for this segment (Suite and Kona) will remain at a fairly high 33% level, as we reach a base maintenance level necessary to support our existing suite/applications clients and continue to build our Java components development capacity.

Marketing expenditures in this segment will also continue to decline, falling 29% to \$59M. Marketing expenditures for SmartSuite will be reduced by more than half in order to fund new programs for Kona. The overall marketing E/R improves a healthy 6 points to 28% in 1998.

The contribution margin from this segment improves slightly in 1998, from \$74M to \$84M.

5.2.3 Services Business

Our Services business (including Support) will generate revenues of \$364M in 1998, an increase of \$88M or 32%.

Margins in the Services Segment continue to improve, despite the significant investment we are making in the Customer Support segment to deal with customer satisfaction challenges. Gross

Profit Margin improves from 17% to 23%, and PTI margin improves from (1)% in 1997 to 8% in 1998.

5.2.4 Operating Expenses

Total Development expenses grow 3% in 1998, following 2% growth in 1997. Within this total of \$241M, we will continue to grow our investments in Notes/Domino and fund that growth from reductions in mature segments (e.g. Suites, cc:Mail).

Worldwide SG&A expenses will increase 8% in 1998 to \$727M, after a 1997 increase of 9%. Sales expenses grow 10%, reflecting investments in SMB and channels, as well as high growth markets like Asia and Latin America. Marketing expenses grow 9% to \$314M in total. We continue to invest in Operations/Administration support in our growth markets and Services Business Segment. Overall, our SG&A E/R improves 6 points to 53% in 1998.

5.2.5 Headcount

Controlling headcount growth has become an increasing focus during our planning efforts for 1998. Total headcount will grow by just over 500 (6%) in 1998, after growth of 15% in 1997. Over 80% of this growth is in our rapidly growing Services segment and in our worldwide sales force. Headcount throughout the balance of the company will grow by less than 100 (2%).

Our 1998 financial plan includes one-time restructuring charges of \$17.5M in our EMEA region and \$7.5M in North America to bring headcount in selected functions to targeted levels more rapidly than normal attrition will accommodate.

5.3 Growth Opportunities -- Not Yet Funded

We are still working to close on the funding for two important growth opportunities that are high on our list of priorities: the markets of China and Malaysia, and the emerging areas of knowledge management and learning and adaptation systems. We will continue to work the internal issues, and as we do so, to explore synergies with the plans of the IBM Software Group, Corporate Marketing, Education and Training, IGS, and other areas.

5.4 Risk Summary

The achievement of our plan depends on the realization of important economic, market and execution conditions, as identified in the following table:

<u>Category</u>	<u>Risk</u>
Economic	<ul style="list-style-type: none">• Strong economic conditions in the United States continue, and the economy of Japan recovers
Market	<ul style="list-style-type: none">• There is strong and rapid market acceptance of the value of NCs and network-centric Java applets• Customers continue to recognize the value of integrated clients over the increasingly competitive browser and mail offerings of competitors• Java becomes a unified standard• Microsoft's position in the consumer and home markets doesn't become any more influential on business decisions
Execution	<ul style="list-style-type: none">• IBM Client Teams and Software Account Managers are fully enabled for enterprise coverage — starting January 1, 1998

We will be challenged to achieve our goals if these conditions do not materialize. While the economic risk is beyond our control, we can exert varying degrees of influence over the market and execution risks. We will do this as the year progresses, and make whatever midcourse corrections are necessary.

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6.0 Financial Exhibits

6.1 Profit & Loss Statement

(3000)		1996	1997	1998	5/95	5/97
Product Revenue		829	870	1,011	5%	15%
Services Revenue		189	278	384	45%	32%
		1,018	1,148	1,395	13%	20%
Product Cost		127	122	138	(4%)	13%
Services Cost		149	230	279	54%	22%
		276	351	417	27%	19%
Gross Margin		742	795	959	7%	21%
		73%	69%	70%		
SG&A		819	875	727	9%	8%
Development		231	235	241	2%	3%
OI/OC		(25)	(11)	(10)	(57%)	(7%)
		225	223	259	9%	7%
PTI before Restructuring		(83)	(105)	(0)		
Restructuring Charges		0	0	25		
PTI after Restructuring		(83)	(105)	(25)		
		-8%	-9%	-2%		
E/R Ratios					S/WI	S/WI
Product Cost		15%	14%	14%	1 pt	0 pt
Services Cost		79%	83%	77%	(4) pts	6 pts
SG&A		81%	89%	53%	2 pts	0 pts
Development		28%	27%	24%	1 pt	3 pts

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6.2 Revenue and Volumes

Revenue (\$000)	1996	1997	1998	97/96	98/97
Notes/Domino	352	529	773	50%	46%
Consulting/Education	119	195	257	64%	32%
KONA	0	1	14		900%
Subtotal	471	725	1,044	51%	41%
Desktop Apps/Suites	350	244	197	(30%)	(19%)
All Other	197	177	164	(10%)	(7%)
Subtotal	547	421	361	(23%)	(14%)
Contingency			(30)		
Total Revenue	1,018	1,146	1,375	13%	20%

Key Product Volumes (K Units)	1996	1997	1998	97/96	98/97
Notes Clients	4,534	8,317	11,122	53%	34%
Domino Servers	183	401	645	119%	61%
Notes "Seats"	4,717	8,716	11,767	55%	35%
cc:Mail Seats	2,869	3,005	1,977	5%	(34%)
SmartSuite Units	7,238	9,416	10,282	30%	9%

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6.3 Expenses

(0000)	1996	1997	1998	97/96	98/97
Development					
Communications/EPG	115	121	138	5%	14%
Internet Applications Division	75	63	55	(8%)	(12%)
Localization	41	46	48	12%	4%
	231	235	241	2%	3%
Sales	204	233	255	14%	10%
Marketing					
Communications/EPG	171	206	255	20%	24%
Internet Applications Division	111	83	59	(25%)	(29%)
	282	289	314	3%	9%
Operations & Administration	122	138	155	13%	12%
Corp Adjustments/Other Charges	11	14	2	27%	(64%)
Total SG&A	619	674	727	9%	8%
Total Operating Expenses	850	909	958	7%	5%

6.4 Headcount

	1996	1997	1998	97/96	98/97
Development	1,796	1,839	1,934	43	15
Sales	1,246	1,346	1,358	100	22
Services & Support	1,705	2,273	2,668	563	395
Marketing	571	684	718	113	34
Operations/Administration	917	1,100	1,160	183	60
Manufacturing	479	479	486	0	7
Total Lotus	6,714	7,721	8,234	1,007	513

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