To our shareholders, customers, partners, and employees:

We’ve always believed that technology creates opportunities for people and organizations to achieve their dreams. This belief continues to drive us towards new inventions and new markets so we can impact the lives of billions of people around the world. The products and services this belief has inspired fueled our success in fiscal year 2011 and gives us confidence in what’s ahead.

In fiscal year 2011, we delivered record financial performance by growing revenue 12 percent to $69.9 billion. Thanks to our continued discipline and focus on managing costs and expenses, operating income grew at an even higher rate – 13 percent, to $27.2 billion. In addition, we returned $16.9 billion to shareholders through stock buybacks and dividends, a 10 percent increase over the previous year.

The best way to understand our results and the opportunities that lie ahead is to look at three areas:

* product innovation and momentum
* strategic partnerships and acquisitions
* big bets for the future

**Product Innovation and Momentum**

Microsoft continues to be the company that businesses look to for the software they need to boost productivity and operate with efficiency, effectiveness, and intelligence. Throughout fiscal 2011, we saw business spending increase and strong demand for Windows 7, Office 2010, SharePoint, Exchange, Lync, Microsoft Dynamics, Windows Server, System Center, and SQL Server. Windows 7 and Office 2010 continue to sell at record rates. At the end of fiscal year 2011, more than 400 million Windows 7 licenses and 100 million Office 2010 licenses had been purchased by businesses and consumers.

The rate of businesses moving to the cloud continues to accelerate. For many businesses, moving to the cloud is a journey, not a sudden transformation. They are moving to the cloud on their terms and often use hybrid solutions that include the cloud and their existing datacenter investments. The Windows Azure Platform allows businesses to connect existing investments and develop new applications reducing the time from concept to deployment with little upfront cost. Customers find our approach unique because we ultimately enable them to choose what’s right for them.

In June, we launched Office 365 - a new service where Office meets the cloud. Office 365 offers collaboration for businesses of all sizes - from the smallest neighborhood store to the largest global enterprise. It represents a culmination of the work we’ve been doing in the enterprise cloud space for more than 5 years. Because it is a subscription based cloud offering, with a variety of different service plans, businesses can choose the right plan for their needs, and get access to the best collaboration and productivity tools anywhere including Office, SharePoint, Exchange and Lync – a new technology that unites video and voice calls, instant messaging, and Web conferencing. Of the small businesses using Office 365, 80% have never purchased Exchange, SharePoint or Lync before and customers using Office 365 are reporting up to a 50% overall IT cost savings realized through increased efficiency. With hundreds of millions of businesses around the world striving to prosper and grow, we believe Office 365 can be an engine of growth for these businesses and us.

Beyond the cloud, we also made significant strides with our consumer offerings against very tough competition.

In November, we launched Kinect for Xbox 360 - called “the fastest-selling consumer electronics device” in history by Guinness World Records. Kinect creates a new form of entertainment by changing the way people interact with games, movies, and music simply by speaking and moving. Then in May, we announced how we’ll continue the evolution of Xbox from a gaming console into an entertainment hub by increasing our content partnerships 10 fold and bringing live television to Xbox in the United States this holiday season. With millions of content choices, a new entertainment challenge arises– discovery. So, we also announced that we’ll bring voice search to Xbox, using Bing and Kinect – simply say a movie, TV show, song or game and Xbox will find it.

Bing made strong strides this year. It’s redefining the way people find information and make decisions – Bing Internet search share grew over 30% in the United States during fiscal 2011, to 14.4 percent. It has also played a key role in making other products better like Windows, Windows Phone and soon Xbox.

We also introduced the new Windows Phone. Based on a fundamentally new, modern design, this phone gives people an easier, quicker and more delightful experience. We are proud of the new Windows Phone and are thrilled with the feedback from our customers – nine out of ten say they would recommend it to a friend. We continued to innovate quickly on Windows Phone, and just eight months after the first version we delivered a major update that will be available this fall.

**Partnerships and Acquisitions**

Strategic partnerships and acquisitions have always played an important role in Microsoft’s strategy for growth and technology leadership. Fiscal year 2011 saw a number of critical moves that will play a key role in our future growth.

During the fall of 2010, we completed the integration of Yahoo! search with Bing, and by the close of fiscal year 2011, Bing and Yahoo! together powered more than one-quarter of all U.S. searches. In May, we announced a new partnership with Facebook that enables us to deliver personalized search results that are based on friends’ opinions. This data helps people make decisions more quickly and easily based on recommendations that are personal, more relevant, and reflect the wisdom and experience of known and trusted friends.

In February, we announced an important partnership with Nokia aimed at building a new mobile ecosystem that will pave the way for choice and opportunity for consumers, mobile network operators, and developers. Through this partnership, Nokia will primarily develop and sell Windows Phones as the two companies work together on mobile technology design, development, and marketing initiatives that in the next year will bring Windows Phones to a much wider range of market segments and geographies across a much broader range of price points.

We announced in May our intention to acquire Skype, the world’s leading provider of real-time Internet video and voice communications services and technology. Skype is a perfect fit with Microsoft’s core vision to unleash our customers’ productivity and creativity by making it easier for them to communicate and work together. With the acquisition of Skype and requisite regulatory approval, we’ll connect hundreds of millions of people and provide them exciting new ways to communicate and create on PCs, phones, the Xbox, and through applications like Office and Lync.

**Big Bets for the Future**

At Microsoft, we believe the most engaging digital experiences will grow out of the combination of four things: smart devices, cloud-based services, natural forms of interaction between people and technology, and finally, people’s imaginations.

We will continue to create and sell great software that people use every day at work, at home and everywhere in between. Increasingly, the full value and benefit of software will be optimized and expressed in the services and devices that people use at work and in their personal lives. So increasingly, we will view ourselves as a devices and services company.

We believe the number of devices on which software will run will increase dramatically. We’ll continue to build some devices like the Xbox and work in close partnership with PC, tablet, phone, and other manufacturers around the world to design powerful and compelling devices that consumers love and businesses need.

We are looking ahead to Windows 8 with confidence and excitement. We are creating a reimagined version of Windows that builds on the advancements in cloud computing, on touch interfaces and other natural ways to interact with technology. Without compromise, we will deliver the security, reliability and manageability businesses require, along with personalized and seamless connections to information, people, services, and applications across the variety of devices people use.

For services, we’ll continue betting on the cloud for both businesses and consumers. For businesses, we’re focused on enabling all of our products for the cloud including continuing our work with Windows Azure, Office 365, and Microsoft Dynamics services. For consumers, we’re focused on Skype, Bing, Windows Live and Xbox Live.

We’re also investing in natural ways for people to interact with technology. For example, we’ll bring the advances of Kinect beyond entertainment to business, science, education and medicine by connecting it to the Windows PC and the Windows Phone. Bing will have a broad impact beyond search as we apply its understanding of the world's people and knowledge to scenarios that help individuals accomplish a task. Imagine that instead of trying to print a boarding pass by finding a website and typing in a confirmation code you could simply say “print my boarding pass.” There are so many opportunities to fundamentally improve how we interact with the range of devices and services by pushing the capabilities of natural user interfaces.

We’ll continue to inspire and be inspired by the imaginations of more than 7 million Microsoft developers, our 600,000 and growing partner community and billions of customers who all think about how to personalize, extend and leverage Microsoft technology to achieve their dreams.

As I said at the beginning, we have always believed that technology creates opportunities for people and organizations to achieve their dreams. We’re excited about what we will be able to accomplish next year and beyond.

Thank you for your continued support.

Steven A. Ballmer

Chief Executive Officer September 2, 2011