Thank you. Good evening. It's a pleasure to be here tonight. I noticed there are a lot of financial management topics on the agenda. You guys are getting lots and lots of advice - maybe before it's all over, you'll feel like Bud Grant at the last Viking game; a heckler kept screaming his advice to Bud on how to run the game. Finally Bud walked over to the guy and asked him his name and business address. Flattered, the heckler said, "I'm Bjarne Olson, my office is at the IDS Tower." "Why do you want to know?" "Because," Grant replied "I'm going to be at your office tomorrow morning early to tell you how to run your business."

Speaking of running our business, Control Data has had a phenomenal growth since its inception. Through 1974, we have achieved over $5.5 billion in total revenues. What is even more amazing, we will probably surpass this revenue in the next four years. In the early years of Control Data's life, increased volume meant increased profitability. The volume game worked so well in early years, we may have fallen trap to it later. In 1965, it was my opinion, that somehow, we at Control Data, made money in spite of ourselves. As you know, the last ten years have been a different story. In four of the last ten years we have lost money. In 1974, we lost $75 million in S&S Company. During much of the last ten years, I'm not sure we had a good understanding of where we wanted to go or the road we wanted to follow. We talked and managed in terms of "Gear up now, increased volume is just around the corner". "Reduce prices and sweep the market, an order with some gross profit is better than no order at all." "Besides, we've got to pay the people!" "Sell the lease base!" "Mortgage the future!" "Volume will take care of it in the long run." "The impact of inflation has had a linear effect on our expenses; more volume, more gross profit will solve this problem." "We can't afford not to do it!" I'm sure you've heard these terms before. The days of automatically increasing profitability by increased volume, if that was ever true, are gone forever.

In order to survive in today's social and economic environment, major emphasis must be placed on profitability, all aspects of profitability. I said profitability, not profit and loss statement. Let's not get the two confused. My definition of a profit and loss statement is the quantification of past performance, historical performance! A history book! The result of your previous actions. On the other hand, profitability is much more encompassing: It includes linked strategies, linked plans, linked goals in the form of budgets, and most of all, it includes dedicated execution by the entire team. This is what profitability is all about. Marketing field performance must translate into product family financial performance. Product family financial performance must translate into market field performance. One without the other will not result in long term profitability. To accomplish this, we must have a sound understanding of the business. We must understand the essentials of orders, revenue, costs and expenses, their relationship to one another, their relationship to the balance sheet, at least their relationship to the operating assets: namely, accounts receivable, inventory and plant capacity. This may sound very complicated, very complex. The computer industry is a highly competitive and complex business. I'm sure you've heard this statement used over and over. There is a difference in accepting that as a fact, as opposed to using it as an excuse for poor performance. If we use it as an excuse and crutch, the business will remain an unsolved mystery. Instead of
managing our destiny and understanding where we are going, we will simply report which shoal we drifted out to last. Over the last three years in systems and services, we have made a lot of progress in gaining understanding and visibility, of the fundamentals of our business. We can manage our destiny, if we will just do it, and that's where you come in. We are not demanding that field management become instant financial experts. Certainly we don't want you to become bookkeepers either! Rather we would like to establish a dialogue with you, a dialogue with regard to the basics of the business.

In this regard, I'd like to discuss the basic business transactions with you. It applies to all business! It's necessary for all of us to understand it. It's basic, it's understandable, it can be applied to our business. To illustrate this conceptually, let's walk through the basic business transaction. The first requirement to get started in any business is cash. Cash is the near one element of the business transaction. There are many ways to raise cash. Control Data started with Founders Cash, Equity Cash and Bank Borrowings. Once you have cash, you can invest in resource, you can hire people, you can buy plant, property and equipment; you can establish your resources. Again CDC did this, and used the resources to transform our founders ideas into salable products and services. Through your marketing efforts we sold them to customers. We were in business. Those are the first three elements of the business transaction; cash resource and products and services.

Let's stop here and talk about some relationships. When you borrow money, you must pay interest. Interest costs about 10¢ for every $1 borrowed. Systems and Services Co.'s current debt is $550 million. Our annual interest bill is $55 million. Looking at it in a slightly different way, in 1975, 7¢ of every revenue $1 went to pay interest. That doesn't sound like much, but on the other hand, less than a penny of that revenue $1, ended up as profit. We paid more in interest than we spent on R&D. We paid 55¢ in interest for every $1 we spent on marketing. So the question is: How can you influence it?

Let's look at U.S. Cybernet as an example. In 1975 revenue increased from $3 million a month, early in the year, to $3.6 million a month, going out of the year. At the same time, we actually reduced our resources. Obviously we had excess capacity during 1975. We borrowed cash to establish this excess capacity. We paid interest on that money. It cost us profit dollars! How did we get into this position? We didn't have linked plans! Or at least we didn't understand them. We didn't perform to plan either. Suppose the plan calls for revenue to increase, from $1 million a month, to $2 million, over the course of the year, to occur in even quarterly increases of $250K a month. It's not the same thing to achieve the increase, by doing nothing for 9 months, and make the plan all in the last quarter. The resulting profitability will be dramatically less. Once again, revenue achievement isn't the name of the game. Profits are the name of the game! In "minor leagues," revenue achievement is perhaps an adequate measure for marketing. But in the major leagues, revenue and profit contribution must both be achieved. We want you to be major leaguers. Your profit influence, is directly proportionate to the soundness of your revenue plan, and the execution of it.
As long as we are talking about cybernet, let's discuss another large opportunity to improve profitability. Let's discuss marketing expense. In 1974 marketing cost 25¢ for every $1 of revenue. In 1975 it also cost 25¢ for every $1 of revenue. This is true, even though cybernet revenues were $10 million more in 1975 than in 1974. Should marketing expense remain at the same percent, when revenue increases? What is a good relationship of marketing expense to revenue? The real question, of course, is, what is the relationship of marketing expense to profits. Your influence can be profound, provided we adopt a view that says, what is my profit contribution! Rather than, how do I justify my expense base. Then and only then, will there follow, territory, salesman, marketing method analysis, that looks for improvement, rather than justification. Then and only then, will we look seriously at what we are returning to the business, for the cash, resources and products put into the business.

But I'm getting ahead of myself. Back to the basic transaction. The 4th element of the business transaction occurs when you make a sale. We refer to it as an order, but it's really a contract. It's a legal obligation between buyer and seller. An order, particularly in the system business, has a lot of detail -- price, configuration, delivery dates, payment terms, etc. But beyond all that, and crucial to managing the business, an order is a measurement. A kind of mini forecast. This is a crucial point. Let me put it yet another way. There are many things explicit in an order. They tell us what we must do. There are many things implicit in an order as well, and they tell what is going to happen financially, as a result of what we actually do. The implicit things in an order are: asset and cash requirements, an expected revenue volume, which explicitly may not be stated in the order at all, as in the case with systems lease profit and cash contribution. Marketing people say "Everything starts with an order." A better way to say that might be, "Everything we are going to get back as a result of cash, resources, products and services we've gathered together, starts with an order." In any event, an order is a financial forecast, the place where financial return begins, and, it's by means of an order value, that we attempt to put a measurement to all these implicit things. We make a financial plan. We determine the NR, the value, or orders; which must be booked to make that plan. For some products this is almost trivial. For others, it's quite complex, and none is more so than valuation of computer systems orders. I'll come back to orders later, first let's go to the next element of the business transaction.

Once you have an order, the next step is to deliver the product. If done properly, the customer is satisfied. It does for him what you told him it would. Our production schedule was right, we had the right equipment to ship at the right time. The customers site was ready. We even sent the right cables. We all paid attention to detail. We worked as a team, and we successfully delivered the system.

The next step in the business transaction is to invoice the customer. The minute we have successfully delivered the system, we should prepare and submit the invoice. The invoice also establishes our receivable, so we know which customers owe us, how much, and for how long. The final element of the business transaction is the collection of the cash. I know you understand collection, your record in 1975 was outstanding. The question is, can we do better! Of course, we can. For example, creative thinking in aero; resulted
in a significant improvement to receivables. The U.S. government has been invoiced historically on a monthly basis. In fact, the vouchers used, are referred to as monthly vouchers. In 1975 aerospace met with the government, and succeeded in renegotiating payment terms. They could now voucher or invoice twice a month. The government paid in their normal manner. The net effect was collection improvement of 15 days. We received the cash 15 days sooner than before. We reduced our assets and turned our receivables quicker. Are there any of your volume customers who can be invoiced sooner? Do all cybernet customers have to be billed as of the last day of the month. Can the normal billing process be shortened. These are some of the questions you should be asking yourselves. Somewhere there's an opportunity for you. Only when the cash is in the bank, have we accomplished anything. We started with cash, we ended with cash, and the final measurement of our performance is the efficiency with which we return cash for the investment we made.

Let me go back now to that subject of orders, their measurement and its use. If the value of orders equals revenue, and the amount of the revenue is the invoiced amount, and the invoiced amount equals cash collected, then life gets pretty simple. If costs and expense are well understood, we have a very direct measurement and forecast, from orders to cash and profits. But this isn't the case for us. The relationship between orders and revenues is complicated by 4 things -- sales accruals, long term leases, the lease base, and the fact that our total revenues are a mixture of outright sales revenue and lease revenues. Sales accruals are really not that difficult. Sales accruals apply to orders for outright purchases in excess of $1 million. The accrual is usually made in 2 increments: The 1st accrual is made when the mainframe goes to systems test. The 2nd accrual is made when the equipment is shipped. The remainder of the revenue is taken when the invoice is prepared. To track orders to revenue, when using sales accruals, you must understand backlog. Backlog is the amount of order value that will revenue over future periods. We calculate backlog monthly. We age it by quarter for the current year. It's also a simple calculation. Beginning balance plus new orders minus revenue equals backlog. For you in the field to understand revenue, time-framed revenue, it's necessary to have a monthly backlog calculation. This is something you can look forward to in the near future. The lease base has also been a problem in understanding orders to revenue. You're familiar with COV - 30X and lease extensions. We've been trying to isolate the lease base revenue. The lease base in this case is the beginning of the month revenue on rent. It's not the net lease revenue for the month or the year. It's not field billings. What we want to do is to calculate the net incremental revenue increase. We refer to it as (NIRI). To do this we take the beginning base, plus new adds, less terms, minus price erosion for renewals, less purchase conversions, arriving at the ending lease base. It doesn't take into consideration partial billings, but is in monthly terms. We want to know if we are increasing the base. These same ingredients are used in planning and budgeting the lease base. So, the objective here is to track the lease base revenues, and to understand what is happening compared to plan. The use of NIRI is timely concerning revenue, but is not timely in measuring incoming orders. Net selling revenue increase or (NSRI) is a way to measure current selling success. NSRI is derived by netting all new orders, minus decrements from the lease base. Again it employs a netting concept. The objective is to track future revenue production, through order achievement. The NIRI and NSRI techniques will be discussed in your
session tomorrow. I'm sure they too will be used in the future. Finally, we have the mix of 0/R sales revenue and lease revenues. Each of these implies quite different asset and cash requirements, as well as different time frames for revenue and profit return. If we plan for a 50/50 mix, for example, and achieve an 80/20 mix, not only will the resulting profits differ greatly, but financing requirements will also be different. In fact, it might not be possible to provide financing at all, other than through very expensive short term borrowings. Orders then are certainly where the action is, but planning, measuring, controlling orders - that's where the profit is!

In summary, the basic business transaction is straight forward - it includes cash, resources, products and services, orders, delivery, invoices, revenue, cash and profit. As Marketing Field Managers, you're directly involved in many of the elements. You influence them all. So it all comes down to people. You people working together as a team.

John Ruskin once said, "The highest reward for man's work is not what he gets for it, but what he becomes by it." Our goal is the combination of material success with professional pride. I truly believe that we have the opportunity here to enjoy both. Thank you.