Control Data Board of Directors

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Introduction

The operations report will be in a slightly different order than what you have on the agenda. After my overview, Gary Polaczyk will give the financial report. Also, Walt Bruning will report on the Business Center operations, not Consulting and Education. His report will be last.

1980 is rapidly drawing to a close -- International Operations' fiscal year closes two weeks from now -- U.S. Operations in six weeks. As you will see in the financial report, results year-to-date are very good. Computer business net earnings are up 21 percent and CCC 7.6 percent. And, overall, the outlook for the year remains good -- there has been little change in that regard since we met in September. And while the gain in earnings for the year will not be as dramatic as in some prior years, the important thing is we will once again show improvement as well as exceed budget.
Orders

One healthy indicator for the future is the order outlook for this year. In the services area, orders and revenues are synonymous and, as noted in previous reports, revenues continue to grow in our services business. Overall, the growth rate of 16 percent is about the same as last year although there have been pluses and minuses. Hank White will comment further on Data Services which is the largest segment of services.

In the hardware businesses, the order outlook is basically strong -- but with variations -- OEM Peripherals will be up 44 percent for the year. But the IBM end user orders are down. Government Systems orders are up nearly 60 percent over a year ago. Computer Systems orders are also forecasted to be over plan. The CYBER product line has excellent strength for a line in its sixth marketing year. At the same time, I want to remind you that overall, our computer product line is going to be decreasingly competitive over the next couple of years until faster hardware is phased in across the line. This is not news -- in fact, we've had a year's grace that five years ago I didn't think we would have. But it is no less true that marketing will face a bigger challenge next year than it has in the recent past -- at least as far as Computer Systems orders are concerned.
1981 Budgets

We are still deeply engaged in putting together 1981 budgets. Although our original schedule called for budgets to be completed by now, that hasn't happened. When we presented the strategic plan in September, I noted among other factors the significant increase in technical effort required for 1981. I also remarked that such an increase would be very difficult to accept and would be worked on during budgeting. The requested level of effort was simply out of balance with our ability to sustain all the follow-on increases. Also there is the need for continued pressure to reduce technical effort for non-standard items and for product support. Those costs are always level-of-effort in nature. Not only do they tend to perpetrate themselves year-to-year without productivity improvements, they also siphon off valuable dollars from new product development. As all of you are aware, we have an enormous number of opportunities in Control Data and it is no small task to provide appropriate wherewithal for each of them.

At the same time, we have the need to steadily increase the profitability of the computer business. Our financial performance is still lowest in the industry. I discussed the circumstances involved in that with you in September, so I'm not trying to raise anybody's level of concern. Our basic
long-term strategy approach is sound. Our slow but steady approach is sound. And, by way of example of what happens where short-term numbers dominate corporate thinking, just look at Burroughs: (read excerpt -- pass out copies of article).

But with all that, it is important for us to improve a little bit every year in profitability. Given where we are, that's just a simple basic need -- a need of the organization to have confidence in itself as much as anything. So that's the process we're about. We should be through in another month.

At the January board meeting, I will spend some more time with you on the technical effort question, the various major projects and potential projects which require funding, and how that funding is allocated for 1981.

Economy

A few words about the economic environment. As we have noted before, there are both pluses and minuses for us in the current economy. Overall, it is surely no help. Inflation is impacting the expense base and is truly a tough thing to deal with, and it is worldwide. The first look at West Europe budget submissions, for example, showed expenses up 19 percent with revenue growing 14 percent. All that can and will be worked, but underneath there is a hard core expense inflation that can't be wished away.
In order to control and limit our exposure to inflation and adverse economic conditions, an intensive effort to reduce expenses has begun and was discussed with you last March. Since July, expenses as a percent of revenue have declined and are now below both last year and budget. Similarly, employee population has decreased by 116 people since this time a year ago, and has been almost flat for the past few months. There have been increases in people in Data Services, Education and Retail Marketing, while CCC and Peripheral Products headcount are down. So there's been some progress, but expense control efforts are being intensified in the fourth quarter and for 1981. At the same time, we have been aggressively pursuing a policy of no lay-offs and, in fact, have the rudiments of an employment maintenance policy in place. A little later in the agenda we will give you an example of how that works in practice.

Another way of ensuring that we will have greater insulation from the adverse effects of economic conditions is strengthening the balance sheet. The equity offering in September certainly improved our ability to weather economic storms. Other balance-sheet related items involve inventory and trade receivables programs. With regard to receivables, our collection ratio has improved steadily from the beginning of the year. That's no mean feat in the economy we've had this
year. In the past few months, net inventory levels are down 8.1 million dollars. One other area available to us that is not so usual is that of customer advances. Computer Systems and Peripherals both work at this particular cash flow technique extensively. Cash advances at the end of October amounted to some 120 million dollars.

**International Operations**

I mentioned earlier that the International fiscal year will close November 30, so perhaps a word or two more on that area of the operation is in order. 1980 has been, for the most part, a continuation of past trends. Revenue in total will be up 21 percent year-to-year. At $834 million, International represents 31 percent of total computer business revenue. Development of services continues to lag in the U.S. Only 29 percent of total International revenue is from services compared to 42 percent in the U.S. Lately, however, we have seen some promising signs in International -- for example CALL revenue has grown to $1.5 million per month.

With more dedication to the services area, and some of that precious resource -- technical effort -- set aside specifically for our International people to manage, 1981 can really lay the foundation for better things in 1982 and beyond. While
mini-computer delivery of some applications is important to Data Services here in the U.S., this is a far more important factor elsewhere. We are finally about that task -- especially in West Europe. And while there is still a lot more studying and analyzing than action, I feel much more encouraged about future prospects for Data Services in Europe.

This year has been a good one for education in International -- four PLATO systems ordered. We are particularly pleased with the progress being made in South Africa. The University of Western Cape started this past May with sixteen PLATO terminals. This program generated so much excitement and total acceptance by September that the University told us they wanted to purchase a dedicated 64-terminal PLATO system.

In 1980, CD Australia completed a test market program which indicated a significant acceptance of PLATO-based training. As a result, a PLATO system will be installed in our Data Center in Melbourne in January 1981, and we expect to have over fifty subscribers to it in our first month of operation.

A significant PLATO subscription order was received by CD France from the makers of the Airbus 300 airplane to train pilots and engineers on PLATO. This order was certainly influenced by the success that both United and American Airlines have had using PLATO in the U.S.
Finally, in the International services area, this year we have seen beginning activity with regard to BTC's, formation of some small courseware companies, and some seeds planted in the human services area.

So there is progress. Finally, I want to note for the record two noteworthy performances in International Operations. Manny Otis has been in charge of West Europe for six years and has done an excellent job in growing that operation from 250 to 603 million dollars in revenues. More important has been his development of the management teams within the countries. That has been the real key to the changed fortunes of West Europe operations. When Manny started, most European subs were still creating tax-loss carry-forwards. Now those loss carry-forwards are all used up! And that says more about the job he has done than any recitation of financial ratios I could make. Manny, by the way, has just taken over from Bob Duncan in charge of EDP Systems.

The other person is Herb Hughes. Herb has run Pan Am Pacific Operations for five years. That's a tough territory comprising Japan, Korea, Taiwan, Southeast Asia, Australia, New Zealand, Canada, Mexico, Venezuela, Brazil, and South Africa. The business problems truly run the gammut of conceivable difficulties. This year this mixture of far flung countries
will turn a pre-tax profit of close to $10 million. It was budgeted to lose $1--1/2 million. Herb's list of accomplishments over the last five years is so long I wouldn't attempt to mention them all but here are a few:

- turning Mexico profitable after fourteen years of unprofitability,
- the leadership he has given in making Data Services profitable in his operations in Australia, Brazil, and Canada, and
- like Manny Otis, the fact that most of the previously accumulated tax-loss carry-forwards in Pan/Am operations are now gone speaks for itself about the job that has been done over the last five years.

Herb has been promoted to head marketing operations in the new International organization.

As an added note, I also want to say that International has also had a banner year in CCC -- contributing $8.7 million in net earnings. That's far cry -- even when you take out the $1.5 million French bonding claim -- from a few years back and I know Paul Miller gives great credit to George Shaw for the contribution International is making.
So once again -- we are blessed by having some excellent management people who work very hard to make all our strategies come true.

Miscellaneous Highlights

Last week, we met with the so-called "splinter group" of the New York Society of Security Analysts -- the group dealing with computers and electronics. This was an annual November meeting with this group, so over the years we have gotten to know many of them quite well. Some 75 people were in attendance. Bob Duncan covered Services, Walt Bruning the new Business Center operations, while I covered the remainder of the computer business and Joe Minutilli and Bill Radomsky reviewed CCC. Marv Rogers covered financial highlights -- it's pretty much an all-day session so quite a bit of territory gets covered.

All in all, Control Data is favorably viewed by the group. In recent years the questions have become much less challenging and much more in the vein of seeking perspective from us on the industry. The questions this year revolved mainly around: retail stores, mini-computers, and CYBER 205 versus Cray, and the perennial discussion about when we are going to get to be as profitable as everyone else.
Summary

With that then we'll move on to the financial report. I'll only add that this is the last report for 1980 -- when we get together again in January, 1980 will have been closed -- and I'm sure it will be closed satisfactorily. As I noted earlier, 1981 is going to be a lot tougher than this year -- so I'm already kinda anxious to get started at it.