I. INTRODUCTION

THE STRATEGIC PLAN REVIEW TONIGHT WILL BEGIN, AS IN PAST YEARS, WITH A STATUS REPORT ON THE BUSINESS AS IT LOOKS IN 1981. I'LL SPEND SOMewhat MORE TIME THAN IN THE PAST ON THE EXTERNAL ENVIRONMENT BOTH FROM A TECHNICAL AND ECONOMIC VIEWPOINT. AND, AS IN THE PAST, I'LL BRIEFLY REVIEW THE ALLOCATION OF MAJOR RESOURCES: TECHNICAL EFFORT, MARKETING AND CAPITAL ASSETS.

AS FAR AS THE BUSINESS UNIT PLANS ARE CONCERNED, WE WILL RESTRICT THE PRESENTATIONS TO KEY AREAS. (INTRODUCE SIX SPEAKERS.) THROUGH THE BUSINESS BOARDS AND OTHER SESSIONS, YOU'LL HAVE THE OPPORTUNITY TO LOOK AT THE COMPLETE STRATEGIC PLANS OF THE VARIOUS OPERATING UNITS.

FINALLY, MARV ROGERS WILL PROVIDE A SUMMARY OF WHAT THE PLAN ADDS UP TO IN TERMS OF FINANCING AND FINANCIAL POSITION.

LET ME SAY AT THE OUTSET THAT OUR CONSENSUS VIEW IS THAT 1982 WILL BE THE MOST DIFFICULT YEAR FOR US SINCE 1975. THIS IS DUE TO EXTERNAL TECHNOLOGICAL DEVELOPMENTS, THE ECONOMIC CLIMATE
IMPACT ON SEVERAL KEY MARKET SEGMENTS, THE COMPETITIVE CLIMATE AND SOME INTERNAL FACTORS. YOU MIGHT ASK "WHAT ELSE IS THERE?" AND I WOULD RESPOND: "WELL, BELIEVE IT OR NOT, WE ALSO HAVE A LOT GOING FOR US." WE'LL COME TO ALL THAT IN DUE COURSE AS WELL AS TO HOW IT ALL TURNS OUT AT THE BOTTOM LINE.

OUR MAJOR BUSINESS STRATEGY REMAINS UNCHANGED -- INDEED WITH EACH PASSING YEAR IT SEEMS MORE POWERFUL. THAT IS NOT TO SAY THAT THERE ARE NO PROBLEMS AHEAD IN IMPLEMENTING THE STRATEGY. BUT, IF THERE ARE DIFFICULTIES, I WOULDN'T TRADE OURS FOR THOSE OF ANY OTHER COMPANY.

LIKEWISE, OUR OBJECTIVES REMAIN THE SAME -- TO PURSUE STEADY IMPROVEMENT IN FINANCIAL PERFORMANCE WHILE MAINTAINING AN AGGRESSIVE LONG-TERM INVESTMENT PROGRAM.

II. STATUS
OVERALL "PORTFOLIO"
LET'S BEGIN, THEN, WITH THE PORTFOLIO CHART WE HAVE LOOKED AT IN PREVIOUS YEARS (CHART 1A). THIS CHART REPRESENTS THE STATUS AT THE END OF 1981 (EXPLAIN CHART: HORIZONTAL AXIS, VERTICAL AXIS, SIZE OF CIRCLE, COLOR OF CIRCLE, OROA). RELATIVE TO PREVIOUS YEARS, THE BUBBLES ON THIS CHART ARE LOWER. REVENUE GROWTH IN OTHER WORDS IS DOWN.
FOR 1982, THE FIRST YEAR OF THE NEW PLAN, THE CHART HAS BECOME THIS (CHART 1b): NOTE THAT FOR 1982, WE HAVE ADDED A MARK TO INDICATE COMMERCIAL CREDIT'S POSITION. (GO OVER HIGHLIGHTS: CONTINUED HIGH GROWTH IN OEM, EDUCATION AND DATA SERVICES. IMPROVEMENT IN PERIPHERAL SYSTEMS. LOW GROWTH IN INTERNATIONAL DATA SERVICES.) THE BUSINESS UNITS OF COMMERCIAL CREDIT ARE SHOWN ON THIS NEXT CHART (CHART 1c) (GO OVER HIGHLIGHTS: CLUSTERING IN LOWER RIGHT COLUMN). WITHOUT OVERLAYS IT IS A BIT DIFFICULT TO FOLLOW THE YEAR-TO-YEAR CHANGES, BUT I HAVE SUMMARIZED THEM FOR THE COMPUTER BUSINESS ON THIS NEXT CHART (CHART 2). OVERALL, CASH FLOW REMAINS NEGATIVE ALTHOUGH THERE IS MOVEMENT BOTH UP AND DOWN BY VARIOUS BUSINESS UNITS. HIGH GROWTH RATES IN BOTH OLD AND NEW BUSINESSES ARE THE BASIC FACTOR INVOLVED IN THE CASH FLOW PICTURE. BECAUSE OF THE RATE OF CHANGE IN CURRENCY RATES, GROWTH RATES HAVE, AS NOTED A MOMENT AGO, MODERATED IN 1981, BUT OVERALL AND FOR THE FUTURE THEY REMAIN HIGH. ALMOST EVERY MAJOR BUSINESS UNIT OF THE COMPUTER BUSINESS IS IMPROVING ITS PRE-INTEREST, PRE-TAX RETURN ON ASSETS. THE CHART DOES NOT SHOW THE CHANGE IN COMMERCIAL CREDIT'S POSITION FROM 81 TO 82 BUT CASH EMPLOYED IS PLANNED TO INCREASE TO $4.8 B (82) FROM $4.3 B (81), ROI WILL DECLINE SLIGHTLY TO 1.1 PERCENT (82) FROM 1.2 PERCENT (81).

LET ME TAKE A MOMENT AND FURTHER HIGHLIGHT THE TRENDS OVER 80-81-82:
FOR THE COMPUTER BUSINESS REVENUE GROWTH IS:
79-80 -- 23.0
80-81 -- 12.3
81-82 -- 21.2

(COMMENT ON REVENUE GROWTH RATES RE TRANSLATION EXPENSE AND OEM VOLUMES IN 82.)

OROA IS:
1980 -- 14.4
1981 -- 14.7
1982 -- 17.2

CASH FLOW IS:
1980 -- 30.6M (POSITIVE)
1981 -- 159.4M (NEGATIVE)
1982 -- 164.5M (NEGATIVE)

FOR COMMERCIAL CREDIT:
YEAR-END CASH EMPLOYED IS:
80 - 81 -- $4.3B
82 -- $4.8B
ROI IS:
1980 -- 1.4 PERCENT
1981 -- 1.2 PERCENT
1982 -- 1.1 PERCENT

EXPLANATION OF TREND CHARTS
THE "BUBBLE CHARTS", AS WE CALL THEM, GIVE A GOOD, QUICK, AND
COMPREHENSIVE VIEW OF AN INDIVIDUAL BUSINESS SEGMENT WHEN THEY
ARE SUPERIMPOSED OVER TIME AND THEY WILL BE SHOWN FOR EACH OF
THE INDIVIDUAL BUSINESS SEGMENTS AS THEY ARE REVIEWED. BUT LET
ME ILLUSTRATE BY USING THEM FOR SOME BUSINESSES WHICH WILL NOT
BE REVIEWED TODAY. FIRST IS ENGINEERING SERVICES (CHART 3a).
THE DOMINATE CHARACTERISTICS OF ENGINEERING SERVICES IS
STABILITY. TRENDS EVOLVE OVER LONG PERIODS OF TIME BECAUSE OF
THE FLYWHEEL EFFECT OF A LARGE INSTALLED BASE. THIS IS EASILY
SEEN IN THE CHART -- NOT MUCH CHANGE, GOOD PROFITABILITY,
MODEST CASH GENERATOR.

THE NEXT CHART IS FOR OUR GOVERNMENT SYSTEMS BUSINESS (CHART
3b).

THE HISTORY OF GOVERNMENT SYSTEMS IN CONTROL DATA IS ONE OF UPS
AND DOWNS. AS YOU CAN SEE IN 1980 GOVERNMENT SYSTEMS WAS
HAVING A GROWTH SPURT AS SHIPMENTS BEGAN ON THE ANAYK-14
PROGRAM. THE TREND, AS INDICATED, IS FOR SLOWER GROWTH IN THE
YEARS AHEAD BUT CONTINUED PROFITABILITY IN THE 23 - 25 PERCENT ORAO RANGE. GOVERNMENT SYSTEMS HAS Seldom Achieved a Positive CASH FLOW AND (OVERLAY) AS YOU CAN SEE THE LOOK AHEAD IS FOR MORE OF THE SAME. THE STRATEGIC ISSUE FOR GOVERNMENT SYSTEMS IS WILL IT SINK BACK AS IT HAS DONE BEFORE, OR WILL IT REMAIN A RELATIVELY HIGH-GROWTH, GOOD PROFIT, ALBEIT MODEST, PART OF CONTROL DATA'S BUSINESS. AND, AT THE SAME TIME, BECOME A CASH CONTRIBUTOR. THAT IS PART OF HANK WHITE'S NEW CHALLENGE -- TO MAKE IT HAPPEN.

FINALLY, HERE IS COMPUTER SYSTEMS (CHART 3C). IN SPITE OF THE SOMEWHAT DRAMATIC ASPECT PRESENTED BY THE CHART (SINKING SUN), IT ACTUALLY REFLECTS -- AND ACCURATELY SO -- A FAIRLY POSITIVE SITUATION FOR COMPUTER SYSTEM. ALTHOUGH IT IS DIFFICULT TO DISCERN ON THIS SCALE, THE BASIC MOVEMENT IS FROM RIGHT TO LEFT AS WELL AS TOP TO BOTTOM. THAT MEANS THAT EVEN IN A DECLINING GROWTH RATE SITUATION, WE ARE INCREASING MARKET SHARE RELATIVE TO OUR MAJOR COMPETITORS. THE DECLINING GROWTH RATE OF REVENUES IS A DIRECT REFLECTION OF THE CURRENCY EXCHANGE SITUATION. ALSO 1982-1983 ARE YEARS IN WHICH WE INTRODUCE NEW MODELS OF GREATER PRICE PERFORMANCE AND MORE UNITS ARE REQUIRED TO GENERATE EQUIVALENT REVENUES. INDEED, ONLY THE STEADY INVESTMENT IN THE LEASE BASE (AND THUS THE LARGE ASSET BASE AND NEGATIVE CASH FLOW) OVER PAST YEARS WILL ALLOW US TO ROLL THROUGH THE CHANGE WHILE MAINTAINING SOME GROWTH IN PROFITS IF NOT OVERALL PROFITABILITY.
WELL, AS I SAID, YOU'LL SEE MORE OF THESE IN THE INDIVIDUAL PRESENTATIONS WHICH FOLLOW. (CHART 3 -- OFF)

DEVELOPING BUSINESSES AND NEW PRODUCTS

THE FINAL PERSPECTIVE ON CURRENT STATUS IS TO LOOK AT THE EXPENDITURES FOR NEW SERVICES BUSINESS AND FOR NEW PRODUCTS. THESE ARE SHOWN ON THIS NEXT SERIES OF CHARTS. (NOTE: EXPAND ON HARDWARE/SERVICES R&D CONCEPT.) IT'S NOT MY INTENT TO REVIEW EACH OF THESE WITH YOU BUT RATHER JUST TO REMIND EVERYONE OF THE SIZE OF THE TASK. (CHARTS 4A, 4B, 4C, 4D). ONE OBSERVATION IS PERTINENT, HOWEVER, AND THAT IS THAT THESE PROGRAMS RANGE FROM RELATIVELY NEW (E.G. BUSINESS CENTERS) TO SOME SEVERAL YEARS OLD (EFT, ETS, ETC.). (CHART 4E)

SUMMARY STATUS -- A LOOK BACK AND FORWARD

LET ME TRY TO SUMMARIZE, THEN, THE CURRENT STATUS (CHART 5 -- SITUATION SUMMARY):

(1) WE HAVE HAD STEADY IMPROVEMENT NOW FOR SIX YEARS
(2) AS THE SCIENTIFIC AND ENGINEERING MARKET BOOSTED COMPUTER SYSTEMS
(3) AND PERIPHERALS HAS BEEN THE FASTEST GROWING PART OF THE BUSINESS
(4) WITH DATA SERVICES COMING INTO ITS OWN.
(5) COMMERCIAL CREDIT'S COST OF BORROWED FUNDS WAS 6.51 IN 1976, TODAY IT IS 13.08...MORE THAN DOUBLE IN FIVE YEARS TIME.

LOOKING AHEAD, LET’S NOTE FIRST OF ALL THAT:

(6) WE ARE A BIG COMPANY AND STILL GROWING VERY FAST,
(7) WHICH MEANS AMONG OTHER THINGS THAT WE ARE NOT SELF-FINANCING.
(8) AND WHILE THE TRADITIONAL COMPUTER MAINFRAME COMPANIES OUTSIDE IBM ARE UNDER INCREASING FINANCIAL PRESSURE AND STRUGGLING
(9) WE FACE MORE INTENSIVE COMPETITION FROM OTHER COMPANIES IN PERIPHERALS, DATA SERVICES AND IN LARGE SCIENTIFIC COMPUTERS
(9) JAPAN WILL BE A MAJOR FACTOR IN THE NEXT FIVE YEARS. THIS IS IN CONTRAST TO THE PAST FIVE YEARS.
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(10) EDUCATION BUSINESS IS NOT YET OF CRITICAL MASS.
(10) ALL OF THIS MEANS ADDITIONAL INVESTMENTS.

III. WITH THAT LOOK AT WHERE THINGS STAND, LET'S TURN TO THE
EXTERNAL ENVIRONMENT.
GENERAL ECONOMIC FACTORS
FIRST OF ALL, THE OBLIGATORY LOOK AT BASIC ECONOMIC
INDICATORS. THIS CHART (CHART 6) SHOWS, IN TERMS OF RATE OF
CHANGE, TWO SETS OF PROJECTIONS MADE BY COMCRESS. AT THE TOP
OF THE CHART IS THE ASSUMPTION ABOUT WAGES AND THE CONSUMER
PRICE INDEX. THE FORECAST SHOWN IS FOR THE CPI TO DROP IN THE
LATTER HALF OF 1981 AND INTO 1982, BUT NOT FALLING MUCH BELOW
THE TEN PERCENT MARK FOR THE ENTIRE FIVE-YEAR PERIOD. AT THE
BOTTOM OF THE CHART IS THE PROJECTION FOR THE REAL GROSS
NATIONAL PRODUCT. COMCRESS ANTICIPATES THAT THE RECOVERY FROM
THE 1980 RECESSION WILL CONTINUE AT A SLOW RATE THROUGH 1981
AND INTO 1982. AS A RESULT, 1981 IS PREDICTED TO HAVE NO REAL
ECONOMIC GROWTH WITH 1982 BEING A WEAK COMEBACK YEAR. THEN, IN
LATER YEARS OF THE PROJECTION, REAL ECONOMIC GROWTH IS FORECAST
IN THE 2 - 3 PERCENT RANGE, WHICH IS STILL BELOW THE LEVELS
EXPERIENCED BY THE U.S. ECONOMY IN THE 1970'S.

I UNDERSTAND THESE PROJECTIONS WERE MADE BEFORE THE E.R.A. OF
1981 WAS ENACTED. THE EFFECTS OF THAT LEGISLATION VERSUS
COMCRESS PROJECTIONS ARE EXPECTED TO BE SLIGHTLY POSITIVE.
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Moving from the macro effects of the tax bill to its effects on control data specifically, there are some pluses and some not-so-pluses. We still have some analysis to do and detailed regulations have not been issued, but in broad terms the R&D tax credit will be a plus and to a lesser degree the investment tax credit will also be a plus. That is, both will serve to reduce the tax rate and improve cash flow. On the other hand, contrary to what you might have expected from all the press accounts, the new depreciation rules do virtually nothing for companies like Control Data. By definition, they do not reduce the tax rate and allowable depreciation charges are in some cases actually reduced from those previously allowed. In fact, our analysis is that allowable depreciation will be reduced for Control Data in 1982. Tomorrow you will have a more detailed presentation on this subject. But it nets out to this: while the new tax bill will help somewhat it is certainly not any big tail wind.

Moving from taxes to money costs, interest rates are having a pronounced negative impact both on commercial credit’s earnings and on computer business earnings. In the latter case, this is both direct and indirect to the extent high interest rates help strengthen the dollar. Pre-tax earnings in the computer business in 1981 will be some 38 million dollars less than they would have been at the exchange rates of a year ago. For 1982,
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That number would be in excess of 50 million dollars. Theoretically, of course, the exchange rate problem can be overcome by local currency price increases. In reality, this is difficult both because many of our international contracts are long-term leases and, of course, there is the competitive factor as well.

All-in-all, as we have said before, the only realistic outlook for the 80's is one of economic doldrums. Specific factors change from year to year but, overall, there is no great boost in store for us from the business cycle. Fortunately, neither are we in one of the traditional Businesses so tightly tied to it. (Chart 6 -- off)

On the contrary, it is social and economic change, it is disruption of historical patterns, that gives rise to our greatest opportunities. In June, Business Week carried a special section entitled "American Restructured Economy." Its basic thesis was that our economy comprises five distinct sectors which "instead of moving together...are being pulled apart with widening differences in growth of output, employment, investment and profits." It went on to point out that no one government policy "will solve the economic ills of all of these (widely diverse) sectors." But whatever the differences may be, in every sector there are fundamental
FORCES WHICH ARE SIMULTANEOUSLY MAKING BUSINESS MORE CAPITAL INTENSIVE AND SQUEEZING AVAILABLE FINANCING. A SECOND COMMON THREAD WHICH ALL FIVE SECTORS SHARE IS THE PRESENCE OF INFLATION GENERATING FACTORS. NOW, WITHIN THIS BROAD FRAMEWORK OF ECONOMIC DISLOCATION, CAPITAL SCARCITY, AND INFLATION THERE ARE MANY SUBCURRENTS OF CHANGE.

SPECIFIC TRENDS AFFECTING CONTROL DATA

SO WITH THAT IN MIND, LET’S NEXT LOOK AT SOME OF THE SPECIFIC TRENDS AND CHANGES THAT ARE IN PROGRESS AND THE STRATEGIC OPPORTUNITY (OR THREAT) WHICH THEY PRESENT TO US (CHART 8A).

THE TREND TOWARD SERVICES AND THE PARTICULAR NEED FOR KNOWLEDGE ENHANCING SERVICES HAS BEEN THE FOUNDATION OF OUR STRATEGIC THINKING SINCE BEFORE THAT TREND SURFACED GENERALLY. BUT AS THE BUSINESS WEEK ARTICLE NOTES “THE SERVICE SECTOR WILL SHINE DURING THE 1980’S” AND “THE KEY TO SERVICE PRODUCTIVITY GAINS...IS THE COMPUTER.” IN THE PRESENTATIONS ON EDUCATION, DATA SERVICES, INTERNATIONAL, AND COMMERCIAL CREDIT THIS EVENING WE WILL TRANSLATE THAT BROAD BRUSH STATEMENT TO SPECIFICS.

THE SECOND TREND OF IMPORTANCE TO US IS THE GENERAL ECONOMIC RESTRUCTURING WHICH IS GOING ON -- THE MISMATCH OF AVAILABLE JOBS AND AVAILABLE SKILLS -- AND THE OPPORTUNITY THAT CREATES
FOR EDUCATION AND RE-EDUCATION. THE DEGREE OF EMPLOYMENT
DISLOCATION IN THE ECONOMY CAN BE APPRECIATED WHEN YOU CONTRAST
THE $2,500 BONUS SOME COMPUTER FIRMS IN HOUSTON ARE PAYING TO
EMPLOYEES WHO AGREE TO STAY ON THE JOB AT LEAST SIX MONTHS WITH
16 PERCENT UNEMPLOYMENT IN DETROIT. HIGH RATES OF MINORITY
UNEMPLOYMENT, ESPECIALLY IN THE 18-24 AGE GROUP, IS SOMETHING
OF WHICH WE ARE ALL WELL AWARE. LOOKED AT MORE GENERALLY, IT
HAS BEEN ESTIMATED THAT TO BRING ALL PEOPLE IN THE U.S. BETWEEN
THE AGES OF 20 - 29 TO HIGH SCHOOL EQUIVALENCY WOULD COST $96 B
BY TRADITIONAL EDUCATION METHODS.

PERHAPS I’M BELABORING THE POINT TOO MUCH BUT THE CONNECTION
BETWEEN WIDESPREAD SOCIAL AND ECONOMIC DISLOCATION IN THE LABOR
FORCE AND THE OPPORTUNITY FOR PLATO COMPUTER-BASED EDUCATION IS
SO POWERFUL THAT IT IS HARD TO DO OTHERWISE.

BUT LET’S MOVE ON. THIS NEXT TREND IS RECEIVING PLENTY OF
PUBLICITY WITHOUT ELABORATION ON MY PART. WHETHER MANY PEOPLE
IN THE PRIVATE SECTOR APPRECIATE ITS IMPLICATION OR NOT IS
ANOTHER QUESTION. BUT FOR OUR PART, CONTROL DATA IS WELL
POSITIONED TO PROVIDE VIA PLATO THE ESSENTIAL INGREDIENT TO THE
JOB CREATION, URBAN REVITALIZATION, HEALTH CARE AND EDUCATION
SERVICES THAT MUST BE ASSUMED BY PRIVATE SECTOR INITIATIVES.
THE PACE OF TECHNOLOGICAL CHANGE CONTINUES UNABATED IN OUR INDUSTRY. THE "BIG BANG" THEORY OF THE CREATION OF THE UNIVERSE IS RUNNING INTO SOME OBSERVATIONAL PROBLEMS THESE DAYS. BUT IN OUR LITTLE WORLD OF ELECTRONICS IT SURE SEEMS APPROPRIATE. THINGS ARE MOVING FASTER AND FASTER AT THE FRINGES. THE RESULT IS INTERESTING IN THAT IT IS THE VERY LARGEST AS WELL AS THE VERY SMALLEST APPLICATIONS OF MICRO-ELECTRONICS -- THAT IS MICRO-COMPUTERS AND SUPER-COMPUTERS -- WHICH ARE ENJOYING THE MOST RAPID GROWTH. BOTH OF THESE PLAY IMPORTANT ROLES IN OUR TOTAL STRATEGY.

MICRO-COMPUTERS ARE KEY DELIVERY VEHICLES FOR EDUCATION AND DATA PROCESSING SERVICES AS WELL AS A MEANS OF MAKING SUPER-COMPUTERS EVEN MORE EFFECTIVE. OUR STRATEGY WITH REGARD TO MICRO-COMPUTERS CONCENTRATES ON SOFTWARE AND COURSEWARE. FOR MICRO-HARDWARE, WE WILL DEPEND PRIMARILY ON OUTSIDE VENDORS -- EITHER UNDER OEM ARRANGEMENTS OR JUST AS A DISTRIBUTOR OF THE HARDWARE PRODUCT. THE CONTROL DATA 110, TO BE ANNOUNCED MONDAY, IS BASED ON A ZILOG COMPUTER. OUR BUSINESS CENTERS ARE DISTRIBUTORS FOR OHIO SCIENTIFIC COMPUTERS. THE CYBER 120 IS BASED ON DATA GENERAL COMPUTERS AND WE ARE HAVING DISCUSSIONS WITH ATARI, ICL, AND TEXAS INSTRUMENTS AND OTHERS WITH REGARD TO POTENTIAL ARRANGEMENTS.
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Another implication of rapid technological change is the need for technological cooperation. Not long ago, a top research executive of Motorola made a presentation to us in which he said one of his greatest concerns viz-a-viz his obligation to the company is the threat of a new technology arising that they simply aren’t covering, and certainly as the frontiers of our electronic universe expand the probability of overlooking some remote "galaxy" of technology is increasing. This alone is a major reason to foster cooperation in our industry.

(Chart 8b) Another reason for cooperation is increasing capital intensity. This is compounded by the outlook for high cost of capital for the indefinite future. Gordon Moore of Intel has estimated a capital requirement in the semiconductor industry of $65 billion dollars in the 80’s -- only half of which will be financed out of earnings. This contrasts with the $5 billion invested in the 70’s. That’s a 13-fold increase. Moreover, each investment dollar will yield only $1.25 of production. That compares with a yield of about $2.00 in the 1970’s.

And increasing capital intensity is not just a feature of the semiconductor industry. All sectors of the economy are experiencing the same thing. And herein lies a major opportunity for us as well. Much of the new capital is for
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Automation and computer-aided design equipment. CAD is a major strategic thrust for both our systems and services. It remains our single largest applications software development expense.

The continuing demand for capital represents an opportunity as well as a problem for commercial credit. If our cost of money is high, so will be the rewards for innovation with regard to financing alternatives -- particularly for small business.

The "Japanese factor" in our competitive environment is one we have discussed before. Perhaps one quote from the current issue of World Business Weekly will suffice to dramatize the threat: "So great is the Japanese lead in electronics that its challenge will...preclude industries that might have been. Protectionist lobbies will disappear -- there will be no industries to protect." Hopefully, all the alarm will suffice to bring about the micro-electronics cooperation we need in the U.S. semiconductor and computer industries. As far as direct impact on control data of Japanese products is concerned, we are better positioned than most because of our services strategy. The area of control data potentially most threatened is peripherals. The continued cooperation to yield economies of scale in the R&D and production of peripherals will help to offset this Japanese competition. The competitive threat also intensifies the need for investment in automation in peripherals. You'll hear more on this from Tom Kamp.
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As micro-electronics broadens the potential markets for application of computers and inflation raises the cost of traditional marketing methods, we are exploring new channels of distribution and marketing. Business centers, distributors, selling services, direct mail, telemarketing, focused industry sales teams -- all of these and others like them are a response to a basic marketing productivity threat. Although we are trying a lot of things -- and approaches like the business centers are a given -- the numbers in the strategic plan reflect the fact that in total we are not quite sure which approaches or combinations and variations thereof will work best -- marketing expense as a percent of revenue remain essentially constant at 13 percent in 1981 through 1984 and then drops somewhat to 11 percent in 1986.

Deregulation of the financial industry is another continuing trend. The presentation later of small business services and homeowner services will cover the two principal strategic thrusts of commercial credit in response to this trend.

(Chart 8c) The last four major trends are contained on this chart. The first two again have to do with the subject of governmental regulation and deregulation. Deregulation of the communications industry is both an opportunity and a threat. The door is opened to many new combinations of computing and
COMMUNICATIONS SERVICES. ON THE OTHER HAND, CURRENT LEGISLATION WITH REGARD TO THE REGULATED AND UNREGULATED SUBSIDIARIES OF THE COMMON CARRIER COMPANIES -- AND AT&T IN PARTICULAR -- POSE A SUBSTANTIAL THREAT. OF MOST CONCERN IS THAT COMMUNICATIONS SERVICES AVAILABLE TO AT&T'S UNREGULATED SUBSIDIARY WOULD BE AVAILABLE TO OTHER USERS ONLY AT MUCH HIGHER COST OR EVEN WILL NOT BE AVAILABLE AT ALL.

DEALING WITH THE THREAT IS A MATTER OF TRYING TO IMPROVE THE CURRENTLY PROPOSED LEGISLATION, BUT ULTIMATELY BY HAVING ALTERNATIVES TO THE TELEPHONE COMPANY. WHILE THERE IS MUCH IN THE WAY OF POTENTIAL -- CABLE, CELESTIAL RADIO, SATELLITE AND SO ON, THERE IS NO GENERAL SOLUTION FOR THE NEXT FIVE YEARS OR MORE. WE CURRENTLY HAVE A TASK FORCE ADDRESSING THIS SUBJECT.

TRANSBORDER DATA FLOW RESTRICTIONS ARE SIMPLY ONE MORE FORM OF ECONOMIC NATIONALISM IN PRIVACY AND SECURITY CLOTHING. THIS ALONG WITH A MONOPOLY APPROACH TO DATA COMMUNICATIONS BY FOREIGN GOVERNMENTS GENERALLY IS RAISING COSTS AND HAMPERING THE DEVELOPMENT OF DATA SERVICES IN INTERNATIONAL MARKETS.

NEXT, THERE IS THE MATTER OF THE WORLD FOOD SUPPLY. ACCORDING TO BUSINESS WEEK, REAL FARM PRICES WILL RISE ONE PERCENT TO THREE PERCENT EACH YEAR FOR THE NEXT DECADE. THAT COMPARES TO AN AVERAGE TWO PERCENT PER YEAR DECLINE FOR MOST OF THE PAST
THIRTY YEARS. SO AGRICULTURE WILL REPLACE ENERGY AS "THE INFLATION VILLIAN." $15 A BUSHEL SOYBEANS, $7 A BUSHEL CORN MAY BE HARD TO ENVISAGE -- BUT THAT'S THE PROJECTION FOR 1990. CLEARLY THERE IS OPPORTUNITY TO MAKE SMALL FARMS MORE VIABLE THROUGH COMPUTER-BASED KNOWLEDGE SERVICES VIA COMPUTERS. INTERESTINGLY, THE EDITORS OF BUSINESS WEEK MISSED THE POINT AND POINTED TO THE NEED FOR LARGER MORE CAPITAL INTENSIVE FARMS. THAT MISTAKE IS A CLEAR REFLECTION THAT THIS TREND HAS NOT SURFACED IN BUSINESS THINKING GENERALLY. BUT IT WILL. AND IN THE YEARS JUST BEYOND THOSE OF THE CURRENT STRATEGIC PLAN SERVING THE NEEDS OF SMALL FARMERS WILL PROVIDE A MAJOR OPPORTUNITY FOR US.

FINALLY, THERE IS INFLATION AND THE SPOTLIGHT IT PUTS ON THE NEED FOR IMPROVED PRODUCTIVITY. EXTERNALLY, THIS INCREASES THE NEED FOR EDUCATION, COMPUTERS-AIDED DESIGN, AND OTHER KNOWLEDGE ENHANCING SERVICES ALREADY MENTIONED.

BUT THERE IS INFLATION’S IMPACT ON INTERNAL OPERATIONS AS WELL. HERE, TOO, IS OPPORTUNITY. SO MOST OF THE PRODUCTS AND SERVICES WE DEVELOP CAN BE USED BOTH ON THE INTERNAL PROBLEM AND THE EXTERNAL OPPORTUNITY. THIS IS TRUE NOT ONLY OF THE OBVIOUS THINGS LIKE CBE, CAD AND SO SO, BUT OF HUMAN RESOURCE DEVELOPMENT PROGRAMS LIKE EAR, EEAO, STAYWELL, AND WISERWAYS. IN FACT, EVEN THE POLICIES AND PRACTICES DEVELOPED UNDER THE
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UMBRELLA OF THE FAIR EXCHANGE CONCEPT ARE MARKETABLE IN THE
FORM OF CONSULTING SERVICES AVAILABLE THROUGH CDBAI. (CHART 8c
-- OFF)

ONE FINAL NOTE WITH REGARD TO INFLATION. BECAUSE OF BUILT-IN
PROBLEMS, IT IS NOT VERY SUSCEPTIBLE TO SIMPLISTIC GOVERNMENT
POLICY. WHAT RELIEVES ONE PROBLEM MAY WELL AGGRAVATE ANOTHER.
CONSIDER SOME BASIC REASONS FOR INFLATION. FIRST, THERE IS THE
UNDERLYING INFLATIONAL PRESSURE OF INCREASING CAPITAL
REQUIREMENTS IN EVERY SECTOR OF THE ECONOMY: ENERGY,
AGRICULTURE, INDUSTRY, HIGH TECHNOLOGY, EVEN SERVICES. SECOND,
AS I NOTED A MOMENT AGO, THE BASIC SUPPLY/DEMAND SITUATION IN
WORLD AGRICULTURE IS INFLATIONARY. AND THEN THERE IS A THIRD
AND EVEN MORE FUNDAMENTAL REASON. NOT LONG AGO, I NOTED IN
WORLD BUSINESS WEEKLY THAT UNEMPLOYMENT IN THE OECD NATIONS
WILL REACH SOME 26 MILLION PEOPLE BY THE END OF 1982. 26
MILLION PEOPLE WHO SIMPLY DON'T WORK. CONTRARY TO CONVENTIONAL
WISDOM, UNEMPLOYMENT IS NON-INFLATIONARY ONLY IF THOSE
UNEMPLOYED ARE ALLOWED TO STARVE -- OR SOMETHING CLOSE TO IT.
IN OUR CULTURE THAT'S NOT POSSIBLE. SPREADING THE SAME AMOUNT
OF WORK OVER MORE PEOPLE IS AT VERY BEST NO LESS INFLATIONARY
THAN UNEMPLOYMENT. SO UNTIL AND UNLESS THE BASIC TASK OF
INNOVATION AND JOB CREATION IS MORE EFFECTIVELY ADDRESSED,
THERE IS NO BASIS FOR EXPECTING INFLATION TO RETURN TO THE
LEVELS OF THE GOOD OLD DAYS.
II. RESOURCE ALLOCATIONS

We have now had a look at the overall status of the business here in September, 1981, and at the major trends and changes which affect our strategic thinking and present us with business opportunity. Next I'll turn to the question “Well, how are we going to handle all that?” In other words, I’ll turn to the question of resource allocation. As in the past, we will look the three key resources: technical effort, marketing and assets. Technical effort, as I have said so many times before, is the wellspring of everything we do. As the demands from data services and education have grown for applications technical effort, our resource allocation job in this regard has grown more difficult.

This next chart (Chart 9A) shows the allocation of technical effort expense for the past three years and for the next three years. (Explain definition of incremental technical effort)

You will note that we have an apples and oranges situation here in that for the past three years we have no technical effort data for commercial credit -- for the simple reason that it wasn’t tracked. Beginning in 1982 it will be, and although the number shown for commercial credit is preliminary, we are on a path of strategizing technical effort expenditure across the total business. As you can see, an increasing proportion --
OVER ONE THIRD -- WILL BE SPENT BY PERIPHERAL PRODUCTS. SERVICES WILL DECLINE AS A PERCENT OF THE TOTAL. PART OF THIS IS DUE TO THE FACT THAT SOME OF THE SERVICES TECHNICAL EFFORT RESOURCE HAS BEEN GIVEN TO CCC FOR ITS SMALL BUSINESS AND REAL ESTATE STRATEGIES. SYSTEMS EXPENDITURES THOUGH LOWER IN PROPORTION TO THE TOTAL WILL ACTUALLY BE SOME 55 PERCENT HIGHER IN THE NEXT THREE YEARS THAN THE PAST THREE. IN TOTAL, STRATEGIC EXPENDITURES FOR TECHNICAL EFFORT WILL BE 64 PERCENT HIGHER. AS NOTED, HOWEVER, THE COMPARISON IS SOMewhat DISTOURED BY NOT HAVING DATA FOR CCC IN THE BASE PERIOD. IS THE TECHNICAL EFFORT EXPENDITURE BALANCED CORRECTLY? ARE WE INVESTING ENOUGH IN THE HIGH POTENTIAL AREAS? ARE WE DAMAGING THE FUTURE OF ONE AREA BY INVESTING TOO MUCH IN ANOTHER? THE ANSWERS ARE YES, YES, AND NOT AS FAR AS WE CAN TELL. CERTAINLY SERVICES IS RECEIVING ADEQUATE RESOURCES. I WORRY TO SOME DEGREE ABOUT PERIPHERALS ABILITY TO EFFECTIVELY SPEND SUCH LARGE INCREMENTAL INCREASES -- BUT THAT'S AN OPERATIONAL ISSUE NOT A STRATEGIC ONE. SYSTEMS IS VERY TIGHT BUT THE INCREASES ARE SIGNIFICANT AND SHOULD BE ADEQUATE. THEN, TOO, THERE IS AN EFFECTIVITY QUESTION.

TURNING NOW TO MARKETING (CHART 9B)

WE HAVE A SIMILAR SITUATION HERE WITH REGARD TO CCC BETWEEN THE TWO PERIODS, I.E. IT IS NOT IN 79-81 BUT IS IN 82-84. THE
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PICTURE IS OBVIOUSLY DOMINATED BY INCREMENTAL MARKETING EXPENDITURES FOR SERVICES. IN FACT, IF YOU ADD COMPUTER SERVICES AND FINANCIAL SERVICES, THEN YOU FIND THAT OVER THREE-FOURTHS OF INCREMENTAL MARKETING EXPENDITURES WILL BE FOR SERVICES. AS WITH TECHNICAL EFFORT, THE QUESTION HERE IS NOT THE ADEQUACY OF THE INCREASES OR PERCENTAGES PER SE BUT RATHER THE DEGREE TO WHICH WE CAN BECOME MORE EFFECTIVE IN USING MARKETING DOLLARS.

ASSETS ARE SO SIGNIFICANTLY DIFFERENT IN MEANING BETWEEN THE FINANCIAL AND COMPUTER BUSINESS THAT A RESOURCE ALLOCATION CHART COMBINING THE TWO WOULD BE MEANINGLESS. THIS NEXT CHART (CHART 9c) IS FOR THE COMPUTER BUSINESS ALONE. ONCE AGAIN, WHAT WE ARE LOOKING AT IS INCREMENTAL EXPENDITURE.

PERIPHERALS REQUIRES 629 MILLION DOLLARS OF ADDITIONAL ASSETS IN THE COMING THREE YEARS. THIS AMOUNT IS SLIGHTLY MORE THAN HALF -- 51.8 PERCENT -- OF THE TOTAL $1.2 BILLION INCREMENT FOR THE COMPUTER BUSINESS. FOR PERIPHERALS NOT ONLY DOES THE CONTINUED HIGH GROWTH RATE REQUIRE LARGE INCREASES IN WORKING CAPITAL, THERE IS THE NECESSARY EMPHASIS ON AUTOMATION EQUIPMENT WHICH I REFERENCED EARLIER.

THE PROPORTIONATE USE AMONG THE VARIOUS BUSINESSES OF INCREMENTAL ASSET EXPENDITURE IS ABOUT THE SAME AS WE HAVE SEEN
IN RECENT PLANS, SO FAR WE HAVE NOT PLACED A LIMITATION ON GROWTH BECAUSE OF ASSET RESTRICTIONS. I SAY THAT KNOWING FULL WELL THAT THERE IS INCREMENTAL MARKET AVAILABLE TO PERIPHERAL PRODUCTS IF WE HAD GREATER CURRENT MANUFACTURING CAPACITY, BUT STRETCHING TO GRASP THAT INCREMENTAL SHARE WOULD BE IMPRUDENT IN MANY REGARDS BESIDES THE INCREMENTAL FINANCING REQUIRED. NOT THE LEAST OF THESE IS THE PROBLEM OF PEAK AND TROUGH EMPLOYMENT IT WOULD GENERATE.

FOR COMMERCIAL CREDIT THERE IS A SEPARATE LOOK AT TOTAL ASSETS BY EACH OF ITS MAJOR BUSINESS SEGMENTS (CHART 9D)

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LET ME GO BACK TO TECHNICAL SPENDING FOR JUST A FEW FINAL COMMENTS ON THAT IMPORTANT SUBJECT (CHART 10).


ONE LAST NOTE ON THIS VITAL RESOURCE: AS HAS BEEN THE CASE IN RECENT YEARS, A GREATER PROPORTION OF TECHNICAL SPENDING WILL GO TOWARD APPLICATIONS SOFTWARE. IN 1982, APPLICATIONS TECHNICAL EFFORT WILL INCREASE 31 PERCENT COMPARED TO THE OVERALL TECHNICAL EFFORT INCREASE OF 18 PERCENT. THIS TREND WILL CONTINUE IN 1983 AND ALTHOUGH THE TECHNICAL DOLLARS ARE NOT THAT SPECIFICALLY ALLOCATED BEYOND 1983 WE CAN EXPECT IT TO CONTINUE THROUGHOUT THE PLAN.
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V. FINANCIAL SUMMARY AND CONCLUSION

Well now we've covered where we are -- the good and the not-so-good of the current situation. We've seen what the environment -- economic and otherwise -- is like around us. We've had a look at resource allocation -- that is how we are going to spend our money to move ahead. What will be the results? That's next.

This chart (chart 11) is for the computer business and shows our basic financial ratios. There is continued high growth in revenues -- 20 percent or more. The dip in 1981 is primarily attributable to exchange rates. We don't expect changes over the next twelve months like those we've had over the past twelve so growth will resume. Earnings exhibit slow but steady improvement as a percent of revenue, and both ROIC and ROE improve. The debt-to-equity ratio remains in the moderately high, .7 to .8 range we desire except for 1982 and 1983. By the time budgets for those years are completed, I expect we'll be within the desired range.

The next chart (chart 12) shows revenue and earning growth for the total corporation including commercial credit. The ratios represent earnings as a percent of 1980 which is taken as the base year. As you can see, by 1986 earnings will have quadrupled while revenue triples. But the main point is that
IN 1982, FOR THE FIRST TIME IN SEVEN YEARS, TOTAL EARNINGS WILL
NOT GROW FASTER THAN REVENUES. THAT HAS PRESENTED A CLEAR CUT
ISSUE. ON THE ONE HAND, SINCE WE HAVE NOT YET REACHED THE
LEVEL OF PROFITABILITY WE DESIRE, WE NEED TO GROW EARNINGS
FASTER THAN REVENUE. ON THE OTHER HAND, THE NEED TO INVEST FOR
THE FUTURE IN COMMERCIAL CREDIT IS EVEN GREATER. TO BE SURE WE
COULD RESTRICT THE GROWTH AND INVESTMENT IN THE COMPUTER
BUSINESS -- TO COMPENSATE FOR THE INCREASED INVESTMENT IN
COMMERCIAL CREDIT. BUT THAT COURSE HAS RISKS OF ITS OWN. IN
ANY EVENT, THE PLANS ARE THAT BY 1983 EARNINGS WILL ONCE AGAIN
BE GROWING FASTER THAN REVENUES. SO, ON BALANCE, THE CHOSEN
COURSE SEEMS BEST. (CHART OFF)

LET ME CLOSE, THEN, AS I BEGAN. THE SIZE OF THE MANAGEMENT
TASK AHEAD OF US IN THE NEXT 24 MONTHS IS VERY GREAT. WE HAVE
OPPORTUNITIES APLENTY, BUT WE ALSO HAVE SOME UNFINISHED TASKS
IN PAST OPPORTUNITIES. AS THE CHARTS I SHOWED YOU INDICATED,
WE HAVE SIGNIFICANT SEGMENTS OF THE BUSINESS IN DATA SERVICES,
IN EDUCATION, IN COMMERCIAL CREDIT, IN PERIPHERALS, AND
COMPUTERS WHICH NEED TO REALIZE THEIR POTENTIAL. AT THE SAME
TIME, IMPROVING PRODUCTIVITY IS A MAJOR TASK AND IT IS A
CHALLENGE JUST TO KEEP ABREAST OF BASIC TECHNOLOGY. THERE IS
NO QUESTION THAT THE 80’S WILL BE TOUGH FOR MANY COMPANIES.
AND, BY THE WAY, RECENT EARNINGS ANNOUNCEMENTS BY SPERRY-RAND,
BURROUGHS AND NCR REFLECT THAT FOR THEM THE ROCKY ROAD IS NOT
SOMewhere IN THE FUTURE.
OUR STRATEGY AND PLANS ARE SET TO MEET ALL THESE CHALLENGES AND STILL CONTINUE US ON OUR PATH OF FINANCIAL IMPROVEMENT. I FEEL GOOD ABOUT THAT. WE’RE POSITIONED WELL, WE’VE PLANNED WELL, IT ONLY REMAINS TO DO WELL.