I. INTRODUCTION

Thank you and good evening. It's a special pleasure to be here with this group again after three years. It's hard to believe it's been that long! More important, I feel grateful that you scheduled me before Lou Holtz -- nobody should have to follow an act like that. But that Lou Holtz is something -- you know I was out of town last weekend and when I got back Sunday evening my phone immediately started ringing. The person calling said they were taking up a special collection to express appreciation for Lou. When I asked why, the person said -- "Haven't you heard? We only lost to Nebraska 38-7 this year.

But I'm reminded of this guy who was in the hospital -- on his death bed as a matter of fact. His wife was at his side holding his hand. He looked up and said, "You know [high school -- busted football knee, drafted into army, discharged with shattered arm, later business went bankrupt, bypass surgery, now death bed]. You know what Agnes -- you're bad news!"
Anyway, I would like to talk for a minute about good news or at least a very good activity, and that is the United Way Campaign which is underway right now. [United Way -- people helping people, thousands of volunteers who devote hours and is some cases months of their time, it is the right approach -- fits our thinking -- EAR -- as F. Vince says, not just faceless people but our friends and colleagues, kudos to Frank -- so it's important for each of you to personally give and more important to support by actively making sure that each of your organizations has 100% participation.

I spent last evening with a great group of Control Data people who were with me making this year's "Ask Bob Price" Telenews which will be released in about ten days. The format is really a lot of fun but with over 400 of us here tonight, it's a little tough to handle that format. Also, there are some topics of sufficient common interest that it's easy for me to cover those and then we can still try some questions and answers.

First of all, though, I want to recognize some people celebrating 25 years with Control Data.

[NAME ANNIVERSARY PEOPLE - Del Bruss, Marlys Grantwit, Jack Karnowski, Dean Nelson, Dick Gunderson]

Stand up. Let's have a round of applause for all of them.
Now let me turn to the organization change that was announced last month.

II. NEW ORGANIZATION - RATIONALE

There are two factors which led to the changes and which are sufficiently urgent that we felt we should make them now rather than next year or the year after or some such future time.

By far the most significant factor is one having to do with market opportunity. There are two market areas -- both relatively wide open and unexploited -- where Control Data has great opportunity. Those are elementary and secondary education and healthcare services. We already, of course, have a group of divisions addressing the healthcare services market with a variety of products and services. But in the education area, what we really had was a "PLATO" group -- that is, a product focused group rather than a market focused group. Actually, we had begun to move toward a more market-focused direction last year with the establishment of BI & G under Chuck Marino, Academic under Bob Powell, and EDS under Bill Steinberger. But academic, in particular, was too broadly chartered. For example, there's almost no relationship between the marketing problems in universities and those in local school districts.

[COVER BRIEFLY THE INTENSE LOCAL NATURE OF SCHOOL DISTRICTS. MARK WHITE COMMENT.]
Moreover, in the past year we've learned a lot about how to operate in this environment through our experiences in Forest City, Iowa, Altanta, Bloomington, St. Paul, Toledo, and others. That is, we've learned to adapt programs to the particular factors at work in a local community. Although it is by no means a sure thing -- there's probably been more failures than successes selling anything to local school districts -- we did feel that with a dedicated effort we have a good shot. And, Walt Bruning has shown more ability to deal with that market than anybody -- inside or outside Control Data. So, in short, the formation of USSA, Inc. is the principal driving force of the change and quite simply Walt has to devote himself full time to that endeavor if we are to have any chance to succeed.

The second factor is more a financial technicality. That's the fact the cost of funds to a financial services company, simply stated, ought to reflect the performance of only the financial segments to that business. By separating out non-financial services such as ERA, GBS, Applications Services, which do not use funding from the finance company, the legal entity -- which issues public debt offerings -- will better reflect performance of those "pure" finance products. The result should be lower cost of funds. In effect, then, without changing the strategy or the products and services of the financial services group, we changed the legal/administrative structure to accommodate that funding issue.
Anyway, those two things said make some changes and do it now. At the same time, this provided the opportunity -- while attempting to minimize the amount of change (no, I'm not joking - computer products, international, urban and rural ventures, management committee, etc.) to, in general, increase the marketing focus of the company. That market focus thread has run through most of the corporate strategic issue teams discussion for the past two years.

[REVIEW ISSUE TEAM PROCESS - AND THIS YEAR'S ISSUES]

1. CCC Consumer Services Market Segment Strategy
2. CCC Business Services Market Segment Strategy
3. Data Services Market Segment Strategy
4. Management of the Hybrid Control Data Organization
5. Advertising Effectiveness
6. High Volume/Low Unit Revenue Business Processes
7. Peripheral Systems Long Term Viability
8. CDC Printer and Centronics Strategies
9. Managing to High Expectations
10. Internal Technology Leveraging
11. Control Data Japan - Business Strategy

With regard to the data services market, in particular, the issue team recommended strentthening CIM and increasing the market as opposed to product focus of the data services
business. So we had the opportunity to get a better market focus for Cybernet and with the changes we have grouped products and services more along market lines -- commercial, scientific and engineering, health and leisure, and so on -- and less along product lines -- data services, education, etc. More important, perhaps, we, in a real sense, have finally enfranchised marketing in the oldest of Control Data's computer businesses. That is, we have truly positioned it to help shape the future destiny of those businesses and to make them more marketing oriented. Let me go back to Cybernet and the subject of market focus for a moment.

[CYBERNET, SCIENTIFIC AND ENGINEERING, ECAD.
PART OF OUR PROBLEM HAS BEEN WE FORGOT WHO THE CUSTOMER IS AND WHAT THEY DO --
THUS THE "TIME-SHARING EROSION" EVERYONE HIDES BEHIND.
FUNDAMENTALS OF SCIENTIFIC AND ENGINEERING DATA SERVICES.]

Now it's up to all of us to make the most of that opportunity.

I know that this will involve discontinuity and is not without a host of problems, but I also know together we have the creativity and the flexibility to deal with the problems.

Let me move on now to business status and some remarks about the computer and financial services industry in general.
III. OVERALL STATUS AND OUTLOOK

As perhaps some of you may be aware, the key characteristic of the plan for 1984 was a budget unusually skewed toward the second half. Through the first six months we were, with the exception of U.S. and International Services, performing to plan. Those deviations, while important, still left us in a position to meet the plan for the year, depending, as I say, on how the second half unfolded. Over the course of July and August it has become clear that the planned second half improvement in the systems and systems-related part of our hardware business and in Commercial Credit will develop but it will not do so in Peripheral Products. In fact, the past two months have seen the outlook for two parts of the peripherals business deteriorate significantly. In addition, the degree of second half improvement U.S. and International Services will be somewhat less than what we expected. As a result, it is now clear that 1984 will not meet our original expectations.

By far the largest impact is in the peripherals area so let me cover that first.

The single, largest loss in the computer business in the 1984 budget was the IBM plug compatible peripherals business. We have always viewed the plug business as incremental
strategically to the basic OEM business. As such, it brought additional manufacturing volume at modest incremental expense. It also provided a base and an entree' into a profitable, third party maintenance business. Without going into a lot of technical detail, with the 33800, it wasn't really possible to maintain an incremental approach. For example, the technical expense alone of the current 33800 program is $45 million. The market risk is also high with IBM having been out with their product so far ahead of others.

Events of the past two months have not helped the situation. In July and August we began to experience problems with our installed units that resulted in head crashes at an increasing rate. The severity of this problem has led us to sharply curtail production and customer deliveries for a short time while we sort out the problems. Even so, this will serve to reduce the total shipments and PSG's revenue for the year, and will also generate negative manufacturing variances within MPI. The result will be a loss in PSG even larger than budget.

The Peripheral Products plan for 1984 depended, in addition to a second half turnaround in the plug business, on the microcomputer market for floppy disk drives. We went into 1984 with an order in-house for 400,000 units from IBM at a price of $148. In February, IBM began discussions about an additional
300,000 units for delivery this year. But actually at about that point the market for floppies began to change dramatically with new products and market entries announced by 26 Japanese competitors -- all attempting to gain market share at the expense of the three principal U.S. suppliers -- Tandon, Shugart, and Control Data.

The majority of these Japanese products were technically sound, and thus, price became the only differential. For example, IBM has qualified a number of additional suppliers who are proposing to sell the same full-height floppy for $78 in reasonable volume purchases. Obviously, such a price is well below our actual current manufacturing cost.

To counter this price erosion, we began an aggressive program to subcontract manufacturing to off-shore suppliers in Taiwan and Hong Kong. This approach will enable us to retain some portion of our customer base at break-even to nominal profit levels -- but the adverse impact of these events on our 1984 results cannot be avoided.

On a more positive note (and there are some), orders and revenues for mature disk products continue at well above budgeted levels -- and production levels for new OEM disk products that were introduced in 1983 are increasing at a rapid rate. This is particularly true for the XMD, FSD, and 5 1/4" Wren disk drives.
Thus, in spite of the problems, the OEM product line, ranging from an OEM version of the 33800 drive down to the 5 1/4" Wren, appears to be well positioned for strong market performance and profitable business growth. The same can be said for the OEM tape drive business. We currently expect to double production levels in 1984 and expect a major turnaround for Valley Forge (where our tape drives are designed and produced). From a loss in 1983, to a profit this year.

In summary, these OEM disk and tape products and the newly announced optical disk products from the Phillips partnership, provide a broad range of storage products to meet the demands of the OEM market.

IV. MARKET RESTRUCTURING

All of this is but one more instance of the enormous market restructuring that is going on in every aspect of the computer industry. The peripherals business is now truly a pure commodity market at the low end of the line and this will spread over a relatively short period of time up through the higher end -- that is higher technology products. The Japanese factor is truly at work here as is the increasing dominance that IBM is gaining in mainframe computers and with it their ability to control the plug compatible peripheral makers. For
example, look what one of them -- STC -- is going through. In essence, they have run out of strategic options. Their 3380 program has experienced the same too little, too late problem ours has. A couple years ago they started a foray into the plug compatible computer mainframe market which ended in failure (and limited partner lawsuits) earlier this year. A recent article which was intended to give an optimistic look at STC inadvertently actually highlighted its strategic dilemma by pointing out that its future growth, because of the mainframe failure and the 3380 problems, rested on one more attempt at a new technology -- the optical disk product. (That's an interesting arena all right -- but as a volume replacement for the basic disk business, it has a long way to go.) Trilogy is an even sadder story. The only plug compatible mainframe manufacturers today are the Japanese (counting Amdahl as a U.S. based Japanese manufacturer). That fact, likewise, reduces the available plug compatible peripherals market. The fact is that with peripherals a technology factor alone can no longer assure survival in the face of Japanese and IBM economies of scale.

Fortunately, we have achieved a volume of peripherals business which allows us to compete in this market if we learn commodity level manufacturing techniques rapidly enough. Needless to say, this is a matter of top priority for management of Peripheral Products Company and the products group.
But there is as a consequence of such restructuring as is going on in the peripherals market -- an enormous short-term pressure on profits. In that regard, I want to make sure I don't miscommunicate. Even with all the problems, the peripherals business will be profitable this year and is reacting aggressively and well to its challenges.

Having mentioned the subject of market restructuring and the peripherals business, let me elaborate on the general situation in our industry for a moment. I already mentioned IBM compatible mainframe computers and peripherals. Take micros. Here's an excerpt from the Wall Street Journal last week with regard to Hewlett-Packard: "Spectrum is the code name for a project to develop, according to the company, a 'breakthrough' computer technology. The project was announced at a securities analysts meeting last January, but the company hasn't disclosed when it might unveil the new technology....the problem with a 1986 rollout of Spectrum products, according to both Mr. Kurlak and Ms. Muratore, is that the delay, if it is one, will increase pressure on the company's margins....like Digital Equipment, Ms. Muratore notes, Hewlett-Packard needs a high-margin product line such as Spectrum to improve its profitability. The HP 3000, the company's existing line, is a mature product that the company is under increasing pressure to discount in order to maintain sales, she and some other analysts assert. 'You have a company that's struggling at the end of a product cycle.'"
And even IBM is adapting to a changing world -- here's a quote from a recent Business Week: "The party followed a venerable Texas formula: beer, barbecue, and country-and-western music. Big Blue used magicians and comedians to help sell its new Personal Computer AT. 'Thomas Watson would have rolled over in his grave to see alcohol served at an IBM function,' marveled a former IBMer."

Apple? Again, here's what Business Week said recently. "Apple Computer, one of Wall Street's hottest performers in recent years, has been frozen out of August's blistering market....Analysts expect the stock, which reached its record high of 63 1/4 in June, 1983, to stay in the summer's trading range of 24 to 30. Only sheer faith is holding up the stock to where it is now....McKay notes that Apple is 'extremely well managed and has excellent manufacturing and marketing capabilities and great products.' But the industry's proliferation of new products, he warns, is certain to bring increased pressure. The business, notes Newman, is 'at the maximum stress point in terms of an industry consolidation.'"

What about the traditional mainframe part of the industry? The restructuring there, of course, has been going on for much longer. The fact is that the only U.S. mainframe manufacturers in existence today -- other than Control Data -- required an older established business to sustain them in the computer business: NCR, Sperry, Burroughs, and Honeywell.
What all this represents is an industry which is moving at an incredibly rapid pace from one in which technology is everything -- to one in which while technology is both necessary and increasingly expensive and simultaneously more widely available, it is not at all sufficient. "Value added" and "market focus" are the key words as our industry goes into the second half of the 80's.

What it nets down to is this: As technology becomes more widely available and technological advantage more elusive, the frantic scramble for strategic options becomes more and more desperate. Ultimately, all except IBM and the Japanese are led to either demise -- we counted up the other day in the Management Committee meeting and at least six micro manufacturers have gone under this year -- or a strategy based on the premise of market focused value added. In that sense, Control Data is as well positioned as possible for we started such an approach 20 years ago. I think the bad news may be that because we were so far ahead of others in our services strategy that we became too complacent and this has led to the sluggishness of our response, for example in Cybernet and BIS, to the demands -- and for that matter the opportunity -- presented by distributed computing.

Finally, I hardly need elaborate on the restructuring in the financial services market -- you can hardly pick up a paper or a business publication without a headline jumping out at you in that regard. [SHOW BUSINESS WEEK COVER]
THE PERIL IN FINANCIAL SERVICES

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