Good morning. Thank you, Marv. As you said, we are pleased to be here today. Over the years, I've had the opportunity to speak to you under a variety of circumstances. The financial results thus far in 1984 certainly do not make this the happiest of those circumstances, but we do want you to know where we are and what is occurring in the business.

So, this morning I'll cover a number of items: I'll start by giving you a status report. I'll talk about some of the specific problems in peripherals. I'll spend a few minutes describing the environment -- the market restructuring taking place in our industry which is important with regard to each major segment of the business. And then I'd like to say a few words about the survey of security analysts we conducted early this summer. I'll close by describing future plans in each major business segment, and then we can take your questions.
Control Data's objectives for 1984, excluding the possibility of discontinuing the plug business, called for record earnings. As you are well aware, we will not achieve that goal. Nevertheless, it is worthwhile to comment on the plan. In the first place, it was a plan in which results were unusually skewed toward the second half due to the continuing adjustments we were making to market changes in several sectors. And, through the first six months, with the exception of some of the U.S. and International Services businesses, we were performing to plan. Those deviations, while not unimportant, still left us in a position to meet or exceed last year's results if the second half unfolded as we hoped.

Over the course of July and August it became clear that wouldn't happen. While we believed the planned second half improvement would indeed develop in the systems part of our hardware business and in Commercial Credit, we had to face the fact that it would not occur in peripherals or in some parts of the services businesses.

I'll cover each of those with you. First of all, I want to point out that even with the problems I'll discuss, the peripherals business is experiencing very strong performance in
OEM. And our people are reacting aggressively and well to the challenges. The problems fall into two areas: The plug compatible disk drive business -- and the price erosion in the floppy disk drive market.

**PERIPHERALS SYSTEMS:** Within our '84 plan the single, largest loss in the computer business was that budgeted for the plug business. There's no point in flogging this whole subject to death, but it's important to repeat that, for us, from a strategic viewpoint, this business has always been incremental to the basic OEM business. As such, it brought additional manufacturing volume at modest incremental expense -- mostly marketing and lease base financing as opposed to additional technical spending. It also provided a base and an entree into a profitable, third party maintenance business.

Without going into a lot of technical detail -- most of you are fully aware of the technological complexities of newer disk sub-systems anyway -- suffice to say the past incremental approach to the plug business -- i.e. incremental to the basic OEM business -- is simply no longer possible. The technical expense of the 33800 program was very high -- roughly seven times that of the predecessor 33500 product -- and the market risk significant. Moreover, the third party maintenance business is no longer dependent on the plug compatible business as it was in the past. So, really, the question had become not so much whether we got out of the business but when and how.
The outcome, of course, was our announcement this September that we were going to phase out of the plug compatible market.

In addition to a second half turnaround in the plug business, however, the peripheral products plan for 1984 depended in part on the OEM market for floppy disk drives -- and that market changed dramatically in a period of less than six months. We went into 1984 with not only sizeable backlogs at attractive prices -- as late as the end of the first quarter we were still having discussions with customers about sizeable increases to some existing orders at those same prices. But at about that point, the market for floppies began to change significantly, 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 CDC.

Very quickly price became the only differential. For example, IBM by summer had qualified a number of additional suppliers proposing to sell the same full-height floppy at approximately one-half the price which had prevailed four months earlier.

As we indicated (at the Minneapolis analysts meeting) in June, we had begun a program to sub-contract manufacturing to off-shore suppliers in Taiwan and Hong Kong. This program,
however, was targeted to become effective more for 1985 as opposed to mid-1984. This approach will enable us to retain some portion of the planned shipments at break-even to nominal profit levels -- but the adverse impact of these events on 1984 results is nevertheless significant.

On a more positive note, orders and revenues for mature disk products continue at well above budgeted levels -- and production levels for new OEM disk products introduced in 1983 are increasing. This is particularly true for the XMD, FSD, and 5 1/4" Wren disk drives. In addition, looking to the future, the OEM business just plain has more depth and power without the drain of valuable technical and marketing talent to serve the plug compatible market.

Thus, in spite of the problems I've described, the OEM product line appears to be well positioned for strong market performance and profitable growth.

**MARKET RESTRUCTURING**

Let me turn now to a somewhat broader look at the computer industry market environment within which we work. The price erosion in the floppy disks and the turmoil in plug compatible disks are just two instances of the enormous market
Restructuring going on in every aspect of the industry. At the low end of the line, the peripherals business is now truly a pure commodity market. The Japanese factor is certainly at work here, as is the increasing dominance IBM is gaining in mainframe computers -- and with it an ability to control the plug compatible peripheral makers.

I don't want to belabor that point, but it is instructive to consider the tragedy at STC. In essence, they ran out of strategic options. Their 3380 equivalent program experienced the "too little, too late" problem inherent in a "follower" situation where there's increased technological complexity. Sensing a need for new options, a couple years ago they started the foray into the plug compatible computer mainframe market which ended in failure earlier this year. An article which appeared only a couple months ago which tried to give an optimistic look at STC inadvertently highlighted its dilemma by pointing out that its future, because of the mainframe failure and the 3380 problems, rested on one more attempt at new technology -- the optical disk product. That's an important and interesting new technology with potential, of course, but as a vehicle to salvation, it leaves a lot to be desired.

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 peripheral market. Also, I am not in any way belittling wafer scale technology -- it just points out how incredibly expensive exploring technological alternatives has become. In any event, 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, Control Data has achieved a volume of OEM peripherals business which allows us to compete in this market. Clearly we must and we are exerting every effort to improve manufacturing and marketing so as to achieve the efficiencies necessary in such a market. But there always has been and still is a consequence of the kind of restructuring going on in the peripherals market -- that's an enormous short-term pressure on profits -- in this instance on those of all competitors of IBM, Fujitsu, Hitachi, and the rest of Japan, Inc.

Let me elaborate a bit further on the general situation in the industry. I've mentioned IBM compatible mainframe computers and peripherals. Take micros. You've hardly been able to pick up the paper this year without reading of another microcomputer company in trouble. And it is not just the start-ups. Within the past two months articles in The Wall Street Journal and
Business Week have appeared which mention companies with fundamental difficulties evidenced by premature, speculative technologies (Spectrum -- Hewlett Packard) as indications of "increased pressure on company margins" (H.P.), and with phrases such as "the company's existing line is a mature product that [they] are under increasing pressure to discount in order to maintain sales" (H.P., DEC), "you have a company that's struggling at the end of a product cycle" (H.P.), "only sheer faith is holding up [Apple's] stock to where it is now....[he] 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," and even IBM is having to change to deal with the very forces it has set in motion: "'Thomas Watson would have rolled over in his grave to see alcohol served at an IBM function,'" marveled a former IBMer [Business Week] -- a reference to the "AT" introduction in Dallas.

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, I might note -- required an older established business to sustain them in the computer business: NCR, Sperry, Burroughs -- and Honeywell, and to one degree or another each has been struggling for some time to achieve some form of strategic differentiation.
What all this represents is an industry moving at an incredibly rapid pace from one in which technology is everything -- to one in which even though technology is both necessary and increasingly expensive and simultaneously more widely available throughout the world, it is not at all sufficient.

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 companies are led to either demise (we counted up the other day and at least six micro manufacturers have gone under this year) or they are led to a strategy based on the premise of market focused value added. In that sense, CDC is well positioned because we started such an approach 20 years ago. I think the bad news was probably that because we were so far ahead of others, so sure of the necessity of this approach, that we became too complacent. This has led to the sluggishness of our response, for example in Cybernet and BIS (Business Information Services, formerly part of SBC), to the demands -- and for that matter the opportunity -- presented by distributed computing. I'll come back to that in a moment.
OVERALL STRATEGY

As most of you know, Control Data conducted a survey of security analysts during May and June of this year. Cambridge Reports did face-to-face interviews with a broad spectrum of analysts and portfolio managers. Many of you in this room were involved.

The results, as you might guess, are not exactly positive. Of all the constituencies we surveyed -- and we talked to customers, government policy-makers, the business media, educators and others -- the analysts were the most aggressive (i.e. negative) in their responses. Many of the people interviewed are in this room today, and although I can't say it was fun reading your inputs I nevertheless appreciate them and the time you took and the fact that you care enough to give us your opinions.

One aspect of the findings especially concerned us: Nearly two-thirds of the analysts and portfolio managers surveyed did not believe Control Data had formulated a clearly defined set of long-term goals and strategies.

I'd like to address that perception because it is wrong. I'm not saying that isn't what you think -- just that it is wrong. We may not have made our goals and strategies clear -- that's
our problem. You may not understand them -- that's both our problem and yours. But we've been moving concertedly in one direction for a number of years now and intend to do so in the future.

So let me reiterate that direction and strategy.

Control Data is in the business of applying microelectronics and computer technology in two areas: computing-related hardware and computing-enhanced services, which include computation, information, education and finance. These products and services are for the most part market focused -- for example the scientific and engineering market for computers, small business for many of the services, and so on.

Ten years ago we formulated a long-range plan within this strategy that would yield steadily improving profitability while allowing us to make the expenditures and investments necessary for long-term stability. That pattern was interrupted in 1982 and again this year, as I have already outlined. But the objectives and the determination to achieve them have not changed and we fully expect to achieve them as we go forward.

Let me go back to the strategic statement again: Applying microelectronics and computer technology to develop hardware
that is computing-related -- and services to which microelectronics and computer technology can add significant value. Quite simply, our business turns on delivering solutions, through technology, to specific problems: applications.

As for market focus, that has evolved continually since the late sixties as the services business developed and various markets were explored. And it has accelerated in recent years. As our market knowledge has grown we are able to drive product and service strategies to meet customer needs. The organizational changes we announced in August are an example of the increasing market focus of major organization units.

Let me use PLATO computer based training and education as an example. The basic organization unit handling PLATO for many years was simply a product division. The division was involved in defining, developing, and selling the product. The market was approached on an opportunistic basis. As success and experience grew, we were able two years ago to set up three units within the division -- one unit dealt with business, industrial, and governmental applications for CBE, one with the academic market, and one with delivery of vocational training. As the business has grown, we've been able to further focus these efforts and now by setting up entirely separate profit
centers in these markets to further refine them -- in the academic area, for example, by separating the post secondary or college and university market from the elementary/secondary market which has clearly distinct needs and market characteristics.

STATUS AND OUTLOOK

Let me take just a few more minutes to summarize the current situation by major business segment -- and to underscore some of the steps we are taking to respond to the challenges.

PERIPHERALS

I've already indicated the strength we see in the OEM product line. The new optical disk products are also performing well and will ramp up rapidly in production from the first quarter onward. OEM profits will essentially hold in 1984 in spite of the floppy disk drive situation and will improve significantly in 1985.

COMPUTER SYSTEMS: In the computer systems area, orders in terms of numbers of systems are ahead of last year by more than a third. Shipments are also ahead year-to-date by a similar amount over 1983 are expected to be so for the full year as well. Two new products -- the Cyber 810 and 830 -- began
shipping last month. New accounts are ahead of plan and eight 205's will be shipped for the year. Government Systems continues a strong profit performance.

U.S. SERVICES: The Data Services business, of course, comprises many diverse elements. Data Services for specific applications -- credit unions, legal support services, ticketing, automated wagering, market research, audience measurement, and so on -- are experiencing good growth and profitability. In general, that will continue next year. Remote computing services such as Cybernet in the scientific area and BIS in commercial services are experiencing declining revenues -- for different reasons. For the past two years Cybernet has had more and more of its customers move to dedicated large mainframes and its Cyber 205 revenue has not built up fast enough to offset that, although it is growing rapidly. As a result, Cybernet has excess capacity and it will be second quarter next year before we have plant capacity in line with demand. From that point, we expect steady growth in the business as 205 applications increase and workstations feed the network. I should emphasize that Cybernet's business has traditionally been and continues to be remote batch, as opposed to time-sharing. BIS, on the other hand, has been predominately time-sharing. Ironically perhaps, although BIS revenues have also declined this year, the profit impact has
not been as severe as Cybernet's. One reason is that with a single large central facility in Cleveland, capacity adjustments have been easier and quicker. BIS, too, is moving strongly to distributed computing applications and here, too, we expect steady improvement over the next several quarters.

PROFESSIONAL SERVICES CONSULTING: Professional Services Consulting is an area of good progress. What we refer to as "consulting products" are being introduced, and revenues generated from these products represent a rapidly growing part of that business. This is a strategic shift in professional services business from time and material to packaged products, and is accompanied by an improvement in profit margins.

MAINTENANCE SERVICES: Another area of rapid growth is so-called third party maintenance services that cover mainframes, minis and, beginning this year, micro-computer service facilities. All of this business was originally able to leverage off the service network which was necessary for Control Data computers and now is a significant business in its own right.

INTERNATIONAL SERVICES: The situation with regard to Control Data's services business in international markets is quite different from that in the U.S. in that they are largely newly developing. For the most part, hardware -- both computers and
OEM peripherals — have been the mainstays of our international business. Cybernet services have been offered, of course, for many years. We also have operated Control Data Institutes outside the U.S. But it has only been in the last three years that we have begun to move aggressively in applications services, consulting products, PLATO education and training services, and so on. In order to gain as quickly as possible expertise and local market orientation, a large part of this move has been through acquisitions and joint ventures. In the past 18 months, we have added 24 such ventures, 15 in 1984 alone. Given the underlying strategic considerations, some of these acquisitions were made knowing they were having troubles or needed investments to grow them. In short, whether de novo or by acquisition, shaping and building an international services business, country by country, has been both time consuming and has required considerable expenditure and investment. In total, International Services will operate at a loss this year and at best reach break-even in 1985.

**SMALL BUSINESS SERVICES:** No topic has been more widely misreported than that of Control Data's Business Centers. So let me spend a minute or two on that. We have historically offered both financial services and computation services to small business. In total, we have more than 50,000 small business customers. Several years ago, we began, through
actions in different parts of the company, to expand the range of services offered to small business to include consulting, training, and microcomputer-based applications. Then, in 1982, we brought these various groups together in one organization to serve the small business market. In doing so, we also brought together a variety of physical locations -- by that I mean Commercial Credit business loan offices (21), so-called satellite business loan offices (51), learning centers (49), Service Bureau offices (44), and the retail locations (36), which had been established to sell the microcomputer-based systems. In total, these locations numbered some 200. Over time, they would become homogeneous -- and in any event we called them all "Business Centers." We have moved, closed, consolidated and otherwise changed these locations as we have gained experience in bringing these products to the market.

One important aspect of this has been the change that has resulted as we have moved from selling microcomputer-based applications at what we refer to as "level 1," which is just the hardware and basic applications such as spread sheet or word processor to levels 3 and 4 which are integrated application sets -- or turn key solutions if you will -- for specific applications in vertical market segments. The marketing approach has thereby moved from a store-front retail marketing approach in which customers are attracted to a
location and sold in a normal retail setting to a systems selling approach. In that regard, the number of retail locations -- which has never been more than 36 regardless of what you may have read -- has been reduced to eight and are truly oriented toward being "Business Centers" as opposed to simple retail stores. (Maybe "business clinics" would have been a more descriptive term.)

In total, in Small Business Services over the past three years, including this year, we have incurred significant losses. But as opposed to the impression generated, the minority of those losses have resulted from microcomputer marketing efforts. Indeed, in 1983, fully half the loss came from financial services -- loans to small businesses. That, I'm happy to add, will not be true in 1984. Anyway, in total, Small Business Services is targeted for profitability in 1986 with a modest loss still occurring in 1985.

FINANCIAL SERVICES: Let me turn now to Financial Services. Actions to reduce the operating costs, to take better advantage of the expertise and distribution networks which are in place, and assess product offerings, have improved Financial Services steadily over the course of this year. Although the results of these programs are beginning to pay off -- as witnessed by our third quarter earnings report -- obviously the full impact won't be felt in 1984.
Commercial real estate lending provides an example of the types of problems which have been addressed. Because of short-term variable rate fundings, relatively low leverage and lack of specific expertise in commercial real estate, we decided to discontinue pursuing this market with a stand-alone product offering. We concluded that the risk of taking additional fixed rate contracts, funded with variable rate debt, in an industry where we do not have the expertise to pick and manage specific projects, did not offer the types of returns required.

In other areas, increased profit is resulting from providing more information, management services, and similar value added services. We are seeking major growth in Financial Services where straight lending services can be supplemented with such value-added services. Here are a few examples:

- Financing income associated with fleet automobile leasing is, as you are aware, a growing business for us. But the fees from automated fleet management systems are equally important and actually growing more rapidly.

- We also offer corporate clients relocation services for their employees. In addition to earning a fee for financing homes, we earn a fee for managing the disposition of the real estate.
In the receivable factoring operation, we generate finance income, but in addition are earning fee income for credit management and collection activity.

Most of these value-added services are not brand new products, but they are being given increased emphasis in the marketplace because they can be a competitive edge and, more importantly, they increase the profitability over a pure finance product.

In general, Commercial Credit is becoming a leaner and more productive organization. We have initiated a program to push certain pricing and credit authority lower into the organization. As a result, we've become more responsive to the market; the yields on personal loans are increasing; and there has been a reduction in the number of staff people at the region and group levels.

The current population of Commercial Credit is just under 8,500 people. This is down more than 1,000 people from 12 months ago. At the same time, the volume and quality of the business is up.

**SUMMARY AND CONCLUSION**

I should add that the drive for efficiency and productivity is corporate wide and does not represent some new found
enlightenment. Earlier this year, Control Data was cited as having the greatest growth in productivity over the past decade of any company in the information processing industry -- a growth of some 170 percent. Since June 1982, including the figures I cited for Commercial Credit, employment has been reduced some 5,700 people and productivity has improved 27 percent.

There is no question that we have faced some difficult transition times in almost every major segment of the business and for the past three years in three of them simultaneously. It is no pleasure to live with or report the results this year. But there is no absence of resolve or aggressiveness in solving problems, and fundamentally our strategic position is sound and firmly in place thanks to more than two decades of building it.

Now we'll turn to your questions.