I. INTRODUCTION

Coming here today I realized that we are almost dead center between Thanksgiving and Christmas. It hasn't exactly been the kind of year that you can be thankful for -- for any of us. And we sure have learned the hard way that there ain't no Santa Claus. But still, if we're honest about it, this year has done a lot for us -- to make us face things more realistically. That's true in all parts of Control Data including PPCo. Ironically, we were a lot closer to a record harvest than the tally we will actually post might make you think. I know that sounds like an improbable statement but it's not, and I'll come back to that in a few minutes.
II. OVERALL STRATEGY

But first -- so much has happened, is happening, there is so much media attention and rumor-mill attention to our problems that I want to talk a bit about current events and how they actually relate to what we're doing. To start with, let's go back and state some basics. Control Data always has been and always will be in the business of applying micro-electronics and computer technology. We apply those technologies to produce computer mainframes and to produce computer peripherals. Likewise, we apply those technologies to produce computing-related services. We have tackled some tough applications in pursuit of that business -- the biggest, fastest computers, leading edge magnetic recording products, optical disks, truly different computing-related services -- for education, for better self-health management, for people in prisons, and so on. More important, we're good at it. For example, using the concept of technological cooperation, which was at the time totally foreign to conventional wisdom, we've parlayed a basic requirement to have high performance peripherals for super computers into a billion dollar OEM business -- in less than 25 years. We've understood how to manage, leverage, and deal with the key strategic resource of the computer business -- technology -- better than anybody. And we're only here today because we did that.
Well, yeah, you might say, but how do some of these other businesses which get so much press fit with that -- job creation networks, small businesses, and other so-called "critical societal needs," and what about Commercial Credit -- what's computer-related technology about that? Well, with regard to any business Control Data pursues, let me give you a simple rule: Ultimately, it will involve the use of computers or computer-related technology or we don't do it. I'm not going to spend a lot of time explaining each business, but if you can't figure it out in some specific case, just drop me a note and I'll be happy to elaborate for you.

III. COMMERCIAL CREDIT

Now with regard to Commercial Credit, as some of you may recall, back in the '60s, Control Data was continually faced with a large financing problem. The preponderance of leases as opposed to purchases in our industry was an enormous financial burden for a would-be computer company unless there was some older part of the business to provide that needed cash. The financial burden was so great, in fact, that no mainframe company other than Control Data has survived without it. Think about that. Well, in 1968 Commercial Credit was the target of a hostile takeover -- the purpose of which was ultimately liquidation of Commercial Credit's businesses. Control Data came to the rescue. As a result, CCC was able to survive intact and Control Data obtained a stable source of lease financing. It was a great arrangement for both.
However, it was also necessary that a strictly arms-length arrangement be maintained to satisfy CCC's lenders. Still, in the long run, we knew that unless we could bring value-added through application of computer technology, then we could not be successful with Commercial Credit in the long run. By the late 70s this was compounded by the enormous restructuring taking place in the financial services industry. A finance company has high cost of raw material relative to banks, savings and loans, and similarly regulated financial institutions.

So, as banks and other financial institutions expanded beyond their traditional lending markets, it became imperative to bring value-added to CCC's finance services. In the case of finance services for business, it was more readily clear that the objective could be achieved. Let me give you a few examples. Factoring [explain], fleet leasing [explain], small business lending [explain]. In the case of consumer services, it was more difficult. Now, I'm not referring to the use of computers to make operations more effective -- that's relatively straightforward, though the investment is very large. What I mean is, as with the business services I mentioned, to have knowledge and information services integrated with an underlying money service for which value-added fees can be charged. Now, it's also possible of course with consumer services, but the cost and time required is enormous.
What it has come down to is this: Given resource limitations, Commercial Credit either had to be greatly cut down in terms of both product lines and geographical coverage or we could seek a buyer for that business. The latter choice will provide the most long-term opportunity and job security for the people in Commercial Credit and that's the course we have chosen to take.

I've gone into all this in some detail because it's necessary for you to understand it in order to deal with the innumerable rumors which you hear every day. With what I've said, you can see that the decisions with regard to CCC are not a reaction to the earnings results Control Data has had this year. It is not a simple-minded defensive strategy. We are not looking to sell chunks of the company. Indeed, if no suitable buyer of CCC is found, we will pursue the other strategic options for it. The whole strategy with regard to CCC is to better assure that we have the ability to make the on-going, increasing, necessary investments in peripherals, computers, and so on. So we are certainly not looking to sell our peripherals business to AT & T or X, Y, or Z -- just the opposite. And all of you know damn well by now that Control Data would fight an attempt to take over this company with every means at our disposal.
IV. **PERIPHERALS**

With that backdrop, let's move on now closer to home and talk about the peripherals business itself. It has not exactly been a glorious year for the executive team here in this room and you've got to face up to things if we're going to fix that -- not patch it up -- not just recover with a year or two of big revenue growth -- but fix the fundamentals. There is, I hardly need remind you, an enormous restructuring going on in the peripherals part of the computer industry. "Restructuring" is a beautifully impersonal and analytical word. But if you worked on the floppy line at Oklahoma City or on a design team in PSG, restructuring hits home -- the word gets to be very personal and emotional in a hurry.

Take peripheral systems. For Control Data, the IBM mainframe plug compatible disk business has been incremental to our basic OEM business. As such, it brought additional manufacturing volume at modest incremental expense -- mostly marketing and lease base financing as opposed to requiring additional technical resources. It also provided a base and an entry into a profitable third-party maintenance business.

But the advent of the 3380 architecture has rendered that incremental approach impossible. The technical expense of the 33800 program was roughly seven times that of the predecessor
33500 product, and the market risk was also 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 the announcement in September.

In addition to that, however, peripheral products results 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 IBM about sizeable increases in their planned volume. 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.

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.
We had a plan to sub-contract manufacturing to off-shore suppliers in Taiwan and Hong Kong, but this program was targeted to become effective more for 1985 as opposed to mid-1984, and the adverse impact of all this on 1984 results is some $20 million pre-tax.

On a more positive note, orders and revenues for mature disk products have done well, and production levels for new OEM disk products introduced in 1983 are beginning to increase.

So, in spite of the problems, the OEM product line is well positioned for strong market performance and profitable growth. It's simply a matter of how determined we are to improve the operation.

Let me turn for a moment to a somewhat broader look at the computer industry market environment. The price erosion in the floppy disks and the turmoil in plug compatible disks are just two instances of the enormous 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, as we know, but a vehicle to salvation it could not be.

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 exert every effort to improve purchasing, 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 -- and 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.

What does it all mean? Well, first of all, it means investment -- money. That's not exactly news, but I want to talk about it because due to some lousy reporting over the past two years, some poor-mouthing by one or two ex-employees from peripherals, and something of an admittedly puzzling "red-headed stepchild" culture that has roots that go way back in this organization, there continues to be some misconception in that regard.

Peripheral Products does require substantial and consistent capital and technical investments to maintain its competitive leadership in the industry. Those investments have been made -- at least in terms of dollars spent. What needs work is to improve the quality, the effectivity, of how we use them.
Over the last five years, capital expenditures in the peripherals business have totaled $355 million. That's not only a large chunk of money, but it also represents 56 percent of Control Data's total capital spending over that five-year period.

Moreover, in the next three years, about 60 percent of the corporation's capital expenditures will go to Peripheral Products. Since 1977, on average, 37 percent of Control Data's assets have been invested in the peripherals business.

We've also substantially increased the amount of money provided for research and development on future technology and products. If you take the period starting in 1977, when growth of the minicomputer industry spurred Peripheral Products' revenues, we've more than doubled our annual technical expenditure.

What's more, because the proportion of technical spending that goes to support costs was cut from 53 percent to 36 percent, a greater percent of each technical dollar is available to fund R&D instead of fixing mistakes. That's an example of what I mean by the quality, the effectivity, of the money we spend. It's only one small step, but it is a step.
By 1987, we expect spending on technical effort in PPCo. to be about 78 percent more than it was this year. That kind of information should squelch any descriptions of Peripheral Products Company as a so-called "cash cow." It wasn't. It isn't. And, anyway, anybody with half a brain knows there is no such thing in this business.

The issue is how well are we going to spend the more than half-billion dollars of technical expense and a similar amount of capital expense planned over the next three years. Even more crucially, the issue is -- are we going to attack product cost hard enough to give us a reasonable return on those technical and capital expenditures?

V. THE FUTURE

So let's talk about that. As I noted a moment ago, we have entered the time in the whole computer industry and certainly in peripherals when mere technological creativity is not sufficient to succeed. It's still absolutely necessary -- just not sufficient. Fortunately, you have the necessary part -- and you've proved it over and over again for a quarter of a century. There is a great heritage in this organization. You have demonstrated creativity, agility, responsiveness, and an ability to do hard things. There is no reason why you can't
learn the lessons necessary to future success. If you had demonstrated incompetence or inability, it would be easy. We would just wipe you out. No, you have what it takes -- I know that -- you know that -- the only question is that of determination. As a team, are you determined enough to do it?

Back in the 1600's, in the time of Charles I of England, there was a knight called Sir Jeffrey Hudson. He had been taken into the royal court at age nine in the service of the Duke of Buckingham. At eleven, he was accepted into the British diplomatic service. On his first mission to the continent, he was interrupted by pirates off the coast of Dunkirk, whom he fought with great gallantry. Still in his teens, he aided the Dutch in their fight against the Spaniards and after many exploits came home a hero at 19 to be knighted.

The ladies of the royal court fought for his attention -- and for years he experienced an incredible succession of romantic exploits. He was as successful in fending off outraged husbands as he was Flemish priates. At the age of 60, he emerged from retirement to join the king's secret service. A book was written about his duels to the death, unjust imprisonment and escape, world travel, and even slavery among the Turks.
But there was one adventure from which he barely escaped with his life -- he nearly drowned. Yes, his closest brush with death, was a near drowning. And that near drowning happened one day when Sir Jeffrey went to wash his hands and face....and nearly drowned in the washbasin!

The reason? The gallant Sir Jeffrey Hudson, the knight whose days were laced with heroism and romantic intrigue, the remarkable cavalier, the valiant warrior, the notorious lover, Sir Jeffrey Hudson, in his stocking feet....was only eighteen inches tall! Determination to succeed in spite of handicaps is an incredible force.

Let me go back to my comments at the beginning about being close to record results this year. Well, exclusive of PSG, the difference in what we will probably report and a record result is about $68 million in net earnings. That sounds like a lot -- it is. But the difference is actually the sum of little things that add up to a lack of determination and attention to detail. I feel a little bit like the coach of a team which is on the goal line with a chance to win the game, only to have the quarterback sacked because some blocks were a little weak or off the mark. That's what lack of concentration and determination does.
Often it takes only one more effort to make the difference. Some of you may recall the 1958 NFL title game. People remember that game because Johnny Unitas took the Baltimore Colts the length of the field for a game-tying field goal in the final seconds, and the Colts won it in overtime. But how many people remember that Unitas would never have had the chance to tie the game if Frank Gifford had been able to make just two more feet on a third down play late in the fourth quarter? If Gifford had made the first down, the Giants would not have punted -- and Unitas would never have gotten the ball back for his last-second heroics.

Questions of inches count even more for us. Let me rough out the difference for you -- that $68 million in earnings -- between where we could have been and where we are. It's not strategy, it's not game plan, it's not the fickle hand of fate. Where did that shortfall come from? First of all, your colleagues in some of the U.S. and international services share about half the difference -- but I'll talk to them another day about their part. Let's talk about your part.

OEM will be about $30 million dollars below budget this year in pre-tax profit and BPG more than $15 million. Now, in spite of the floppies, the market problems in BPG and all the rest of it, OEM alone in the fourth quarter will produce over
$30 million in pre-tax profit! One quarter could have made their difference! And think of the differences even one quarter, much less two, would have made in our ability to react to the floppy problem. And quarters are made of months, months of days, and days of hours! A few lost hours, a few slipped days -- that's the difference. And what you do this afternoon, tomorrow, and the next day, and the next, will make all the difference for the future.

Right now, I bet there are hundreds of "yeah, but...." in the heads in this room. But what was missing, where did the lost quarter go? Products? We've got products. Orders? We've had orders. In fact, we're having an outstanding year in the market. Assets? Peripherals in total has increased assets some $200 million since December 31 last year. People? By mid-year, the full-time and supplemental population together rose 1,546 people. (Then we had to let them go!)

In short, the ingredients were all there -- customers, money, and human resource. What was missing was determination -- your determination to make it happen.

There was a Chinese pianist named Liu Shih-Kun, who finished second in the 1958 international competition to Van Cliburn. He returned to China and by the middle of the 1960's was an established concert artist.
Then came the Cultural Revolution -- and because he refused to renounce his music, Liu Shih-Kun was imprisoned. Beaten mercilessly -- and a bone in his right forearm cracked, for six years he languished in a tiny prison cell -- no books, no paper on which to write -- and, of course, no piano.

Then, when relations between China and the U.S. began to thaw, the Philadelphia Orchestra visited Peking -- and Mao Tse-Tung's widow ordered Liu Shih-Kun to perform with the Orchestra in concert -- after not seeing a piano for six years. He did -- to resounding applause -- and then he was tossed back into jail. For another 18 months he stayed there before he was released to perform again and finally regained his rightful political and cultural position.

How did Liu Shih-Kun preserve his ability during those long years in prison? He did it by using the one possession the jailers couldn't steal from him. He had no piano, and he had no paper on which to compose music. But for seven and a half years, in a tiny prison cell. Every day Liu Shih-Kun practiced his beloved music in his vivid, disciplined imagination -- on a piano no one else could see!

We can fix the problems and do it quickly if everybody in this room makes up their minds to do so and has the determination to exercise their imagination. Step one is to point your finger
not at your colleagues, the competition, or "them" -- but to point it at yourself. Make up your mind you will do whatever is necessary to reach the potential I know you have. As I say, you've proved that to me in a hundred little ways.

But it takes an unrelenting determination to be hard on yourself. If you do it, you will achieve greater satisfaction than you have ever known. If you can't or don't want to -- well, there are a lot of easier ways to make a living.