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Lenders Meeting
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1) INTRODUCTION

From the presentations my colleagues have given you this morning you have had a thorough look at Control Data's business. In the next few minutes I will summarize as succinctly as I can long range strategic considerations, challenges and responses, as well as short range problems and actions. After that we will answer your questions.

Before anything else, however, let me address Control Data's earnings objectives for the year -- a subject much in the media attention in recent weeks.

As most of you recall I shared with you last December some figures on financial objectives for 1985 which included an earnings goal of $4.00 per share. At the end of the first quarter we publicly stated that we no longer regard that figure as an attainable goal. The reason for that is straightforward. In the first quarter the problems affecting the business outlook for our largest OEM customers caused a rapid change in their assessments of 1985 volumes. That in turn caused them to stretch out and/or cancel orders for our peripherals. It also has heavily skewed demand toward newer products where there are start-up problems. Larry Perlman has discussed this with you. The resultant drop in the outlook for peripherals earnings for the year is much too large to be made up in other areas of the business. On top of that is the charge to earnings as a result of the Ohio S & L guarantee fund event.

The point that needs to be made here is that while these events have made our 1985 task much more onerous than anticipated they have not in any way changed the basic strategic actions we have been taking in the business. Basically what we laid out for you in December is still the game plan. Moreover four months of 1985 have produced the progress we anticipated when we talked to you in December. Naturally we have also taken additional action to help offset the new developments since January 1.

Each segment of Control Data's business faces its own particular strategic threats. In each case we have formulated responses to the threats that are aggressive and which we believe are equal to the challenge. It is first of all important to remind ourselves that Control Data has faced such problems before and we have proved that aggressive response will be effective.

2) SYSTEMS

Take for example the computer systems business. Today it is a very healthy part of Control Data. Yet a dozen years ago conventional wisdom had it that Control Data would shortly be forced out of the computer mainframe business. By 1972 the reality of escalating technological effort costs, customer migration costs and market penetration costs made it clear that, whatever else, an across the board approach to computer systems would quickly see us out of the business. So adjustment to that reality was made. It took time and effort, several years in fact, but it was done.

So dealing with such strategic threats to survival is something that as a fledgling company in a sea of giants Control Data dealt with from its beginning. In recent years however, the number and intensity of those threats have been the greatest in our history. We are justifiably confident of anticipating, understanding, and devising answers to any of the problems. However, having the resources -- money, people and time to deal with them all simultaneously, is a far greater challenge. It is in this context, by the way, that the decision with regard to financial services is properly viewed.

3) COMPUTER SERVICES

As Dave White, George Troy and Bob Duncan have told you the basic strategic challenge in the computer services business is to make the transition to distributed computing brough on by the existence of more powerful individual workstations. We are on track in that regard and the first quarter of the year has been further confirmation of what we told you in December. The problems Bob Duncan mentioned in International are being dealt with by stopping the aggressive expansion we have pursued over the last 2-3 years and cutting out some marginal investments that look too long term in view of the lowered earnings forecast this year for the company in total.

4) PERIPHERALS

I have already summarized the short term situation. Beyond that as we stated in December and as Larry Perlman has restated for you this morning, we have been in the process of putting the Peripherals business on a true commodity basis -- that is one which emphasizes quality and cost. Technology as we have said before is absolutely necessary but it is not sufficient -- as once was the case. This means concentrating money and people where there is the greatest potential pay-off -- OEM rather than plug compatibles for example.

Meanwhile what we have had is more competition, lower volume and a product mix of lower margin products. On top of that, the organization facing this challenge was a billion dollar plus division almost the entire history of which was one of responding to an environment of exploding demand. This challenge was not unforeseen. Actions were taken with regard to new products, cost reduction, and orders of magnitude improvement in quality. We began making management and organization changes three yeas ago, but the mental set resulting from those years of responding to demand has simply been a more difficult challenge than we ever anticipated.

Nevertheless the basic responses we have made to the long term situation will work. And while reducing employment we are, to the degree possible, protecting valuable people resources which are vital to the business. Furthermore, as Larry said, the peripherals business is determined to get on a path of profitable aggressive growth.

5) <u>SITUATION SUMMARY</u>

These pressures on Control Data -- both strategic and short term -- mean among other things reduced general employment levels, some asset redeployment, reduction in levels and numbers of management, and pay cuts for executives. We have eliminated most external hiring and are concentrating on further improving productivity. All this means workforce adjustments. To the extent possible we are doing this with retraining and reassignment and encouraged use of our time off without pay program. We will reduce employment level but the reduction will not be carried out on a straight across-the-board basis. All these are necessary in the short-term to give longer term actions time to work. But as you have seen, in spite of these actions, we also will have profits below our objectives for the year. Believe me, it is no pleasure to stand here this morning and report that. Nevertheless we know that our strategy is sound, where we are headed, what we have to do to get there, and we know there are better times ahead.

6) <u>ASSET REDEPLOYMENT</u>

I mentioned asset redeployment; others today have mentioned asset programs; and there has been a fair amount of media space devoted to mostly misinformation in that regard. So let me expand on the subject for a moment.

First let's talk about divestitures. I mentioned that we would be making some selected divestments in my letter to employees of March 29. Media comments on that topic have ranged from confusing to down-right wrong. We have no massive sale of a business unit or units planned. Mostly we have some relatively small affiliates or acquisitions which it appears it will take longer to develop than we can afford. There are others which simply haven't worked out. About half of these are in the International market. None of the planned shut downs or divestitures involve more than $10M/year in revenue. More specifically we will not divest either Ticketron or Arbitron as suggested by Electronic News. Nor do we have any planned sale of our interest in Centronics. Since Centronics is not a strategic investment but represented part of the dissolution of CPI we <u>would</u> like ultimately to reduce our ownership. To do so on a reasonable basis will be better done when that business is in better shape.

Having spoken of divestitures I should also say a few words about management of acquisitions, joint ventures, affiliates and cooperative projects.

All such activity in the company is dictated by the strategic needs of one of the business:services, peripherals or systems. The most common strategic need is <u>technology</u>. Other strategic purposes for undertaking acquisition or affiliation include market access and marketing distribution needs.The need for technology -- and the cost of it -- cannot be overemphasized.

Technology comes from: in-house development, licensing, product development joint ventures (such as MPI or CPI in peripherals), university research grants and cooperative programs such as MCC. Except for things like MCC which are corporate-wide in scope, all these efforts are initiated and managed by the appropriate operating executive. As such they are included in his or her financial results and are subjected to the performance norms expected from that part of the business. This is a dynamic and on-going job. Over the past two years we have made 62 investments in affiliates or acquisitions (the # does not include research grants or licenses) and some 20 divestitures or shut downs.

7) QUALITY

In the comments of both Larry Perlman and myself with regard to the peripherals business you heard the emphasis on quality. That emphasis, however, is a major aspect of the total business. Because this is such an important part of our management job I want to elaborate on the subject for a moment.

We have always had a belief in quality, and our approach to quality was like much of the rest of U.S. industry until the early 1980's. This approach was that quality was the responsibility of the quality assurance/quality control groups. From 1980-1983 we concentrated our quality efforts on the basic quality tools, such as process flow analysis (PFA), involvement teams (I.T.), statistical quality control (SQC), productivity opportunity analysis (POA), just in time (JIT), parts per million (PPM) vendor improvement programs.

Late in 1983 we decided that this just wasn't good enough and that the strategy for quality had to be based on line management ownership with emphasis on prevention and a continuous improvement in processes. We had an excellent base from which to start this approach. Our previous investment in tools and training people in the use of these tools formed the necessary base with which we could move forward with a running start.

In 1984 we concentrated this total quality management process in the computer products group and are moving it to the rest of Control Data in 1985.

By the end of the first quarter 1985 all management personnel in computer products group had attended an eight hour briefing on the total quality management process with all employees in computer products group to be briefed by June.

In addition to the prevention attitude and a continuous improvement process, we stress a defect-free attitude. The briefing also includes the specific quality improvement plan that each division creates to implement the concepts of total quality management process.

8) CONCLUSION

We, as well as all of U.S. industry, face increasingly difficult challenges if we are to remain internationally competitive. Those challenges require new approaches. More specifically for Control Data, we adopted a strategy some fifteen years ago that was designed to provide long term growth for the company. In times past and today we have suffered set backs in implementing that strategy. From these times as well as earlier difficulties we have learned hard lessons. We have a dedication to cost-competitive quality products and services for our customers which yield an appropriate return to the company.

This year while, as we told you in December, we are continuing the significant transitions necessary in both peripherals and services we now have the extra burden of less revenue than we had planned and some large one-time charges such as the Ohio problem. But I want to emphasize that the actions we planned for the year are working. Expenses for the first quarter were planned to increase by only 9% -- for the full year even less. Actual expense for the lst quarter were up only 3%, and that was entirely interest related plus a small increase in the effects of balance sheet currency translation. With the additional actions undertaken since March we will see even more improvement.

As Marv Rogers pointed out to achieve any reasonable earnings result at all will require substantial improvement in the second half. We believe that will happen. We have the conviction that we are "doing the right things" and that the effect of those actions will indeed become increasingly apparent in the second half.

All this, then gives us the strength and confidence to overcome whatever obstacles may appear from time to time as we implement our basic plan for the future.