1) Introduction

Now that you have had presentations from the operating executives and a financial update from Marv Rogers, I want to take a few minutes and give you a summary of the most recent actions we have taken to adjust to structural change in the computer industry -- to 1985 in particular -- and to discuss the changes and outlook down the road into 1986 and 1987.

The overall strategic and financial framework for these actions was presented in my remarks to stockholders last month. Copies of the stockholders meeting speeches are available on the literature table, so I will not repeat those remarks.

2) Restructuring

First of all to meet the requirement for a tighter management focus as the pace of change increases in the industry, we have been divesting and will continue to divest segments of the business and we will augment those that have the best prospects for superior financial performance. The two events of note were the exit from the plug-compatible disk business and the
proposed divestiture of Commercial Credit. The latter as announced could not be achieved on reasonable terms in an acceptable timeframe and so we have embarked on an alternative plan which will (1) significantly restructure CCC (2) separate CCC with a different relationship to the computer business, and (3) improve CCC to competitive levels of profitability by 1987.

We have further narrowed the focus of the peripherals business with selective/market segment withdrawals such as the floppy business. As Larry Perlman has told you we are also announcing a major organizational restructuring of the peripherals business as well.

In Services we are concentrating on five markets: (a) The Scientific and Engineering market which as George Troy explained is spearheaded by engineering design and analysis applications; (2) Commercial Services -- Dave White gave you a variety of examples of the kinds of applications offered the financial industry such credit union services and marketing decision support services such as Marksman and Arbitron ratings; (3) Healthcare Services; (4) K-12 and Vocational Education to which USSA is offering a full spectrum of consulting, administrative systems, computer managed learning processes as well as micro-computer based PLATO CBE; and
(5) Economic Development Services which center on computer based services for job creation networks and assistance to the disadvantaged.

These same markets, for the most part, are also being developed outside the United States. However, as I noted in my annual meeting remarks the severity of the downturn in the other parts of Control Data's business this year have not allowed us to pursue international expansion on as broad a scale as we had planned. The net effect of the actions Bob Duncan referred to in his remarks would have been -- had they been in effect for the full year -- to reduce this approximately $200M a year business by some 10% and cut the loss by more than 50%. Since, however, it will take the better part of 1985 to full effect the people reductions, shut downs, and divestitures, there will not be much in the way of visible 1985 P&L improvement from the changes.

In short in services as well as hardware -- in both the U.S. and International we are restructuring to gain tighter market and product focus. I won't take the time to recite the further details of these actions -- some of them are in confidential discussions anyway. Rather let me go on to say what they mean.
3) **Effects of changes**

a) **People.** We have reduced fulltime employment by some 3,800 people since June, 1984. We have reduced fulltime employment by more than 2,300 people since January of this year. That number will increase through the rest of the year. In addition to that, the number of supplemental employees is 1,500 less than those employed at the beginning of the year.

b) **Assets** are down $119M since 12/31/84 which reflects a decrease in receivables of $218M and an increase in inventory -- primarily finished goods in peripherals and systems of $97M. By year end assets will decrease an additional $120M.

c) **Restructuring Effects.** The actual effects of the restructuring we have done are not yet evident in operating results because of terminations, close down, and related costs. But the effect on an annualized basis would be to reduce revenue by some $400M, improve profitability by about $170M and reduce invested capital by $150M.
d) **Cost and Expenses.** Through 2 quarters people related costs and expenses in effect will have been reduced by an annualized $100M from the first two quarters of 1984. The full effect of this reduction does not immediately flow to the operating statement. I should also add that interest on the other hand is up some $14M.

We expect that during 2nd half costs and expenses will be reduced another $80M on an annualized basis.

4) **1985 results to date compared to 1984 and outlook for the future**

Cost reduction, then, has been aggressively pursued both through basic restructuring and straight cost cutting. But price erosion and reduced volume in peripherals is such that the effects of these cost reductions, divestitures and other actions has not yet produced an improved bottom line. Revenue from Peripherals alone will be down over $100M year-to-year through two quarters.

The second half will show improvement over the 1st half. Primarily this is because we will realize the impact of costs reductions rather than have increased revenue. Nevertheless we do expect 2nd half revenues to improve by approximately 4-5%.
5) **Summary**

I'll conclude my remarks by making some general observations regarding Control Data and the industry. First, Control Data.

As noted by George Troy and Dave White, Control Data's U.S. Computer Services businesses are on plan and some of those businesses are showing encouraging signs of strengthening. Computer systems is operating close to plan with unit shipments expected to be up sharply again this year.

The two major business groups experiencing significant earnings pressure are Peripheral Products and International Services. Both are expected to record improved operating results late in the year but it is unlikely that the combined improvements will be sufficient to overcome the 1st half. At Commercial Credit, the outlook continues, on an operating basis, for a meaningful improvement in profits and profitability.

For the Corporation in total, it is very difficult at this time due to current losses in Peripheral Products and International Services, to determine if earnings for the year will match 1984's level of $32M. At this point there are very few, if any, signs indicating that the bottom has been realized in sales to other computer companies. While this outlook is not what we'd like to be describing to you, it nevertheless is reflective of future near-term business conditions.
For the U.S. computer industry overall the reports have been growing steadily more pessimistic over the past two months. The industry is described in terms ranging from "maturing" to "stumbling" to being "in a state of disarray."

There is no question that the industry is going through fundamental change. We have said for five years now that that would be the case throughout a good part of the 80's. Three years ago at this meeting I recall it was thought I was a pessimist when pointing out the difficulty that changes in the computer industry and the economy in general would cause.

I said in response that I am not a pessimist, but rather an optimist because in spite of the great hurdles we faced there is an ever-increasing long term need for information and computing. I still feel that way. At the same time it is obvious that Control Data has not been as quick as we should have been in responding to the changes. In Peripherals particularly there is just no question that we misjudged the size of the task we faced in 1981 and we are paying the price now.

For the industry in total I do not see any sudden rebound either later this year or next. So the answer will be to reduce costs to a sustainable level and continue to work at the
basic businesses and markets where we have established strengths. You hear a lot more talk these days about "differentiation", "value-added", "restructuring" and so on -- such as John Young's comments last week about H-P's needs for "value-added", "integrated-solutions" to gain differentiation from other vendors. I recall discussing those sentiments with regard to Control Data and the mainframe business fifteen years ago. We were right of course, and our computer systems business reflects that fact. Still I would say having been through the experience that saying it is one hell of a lot easier than doing it. So there's a lot of folks in for some tough times.

In spite of the current industry circumstances as well as our own we have the strength and experience to make our strategic and structural adjustments and get back on a path of improving profitability -- and for sure we aren't just beginning to learn the skills necessary to do so. We've done all this before and we'll do it again.

Now let's turn to your questions.