Introduction

Thank you for that kind introduction Joe (Minutilli). I'm delighted to be here tonight to address the Baltimore/Washington Management Club. I want to thank Hank Franklin and the other members of the Executive Council and the Tiger Team for inviting me.

I understand there are more than 5,000 Control Data employees representing 36 different organizations in the Baltimore/Washington area, and it looks like many of them are here, including more than 50 managers from Arbitron alone. But I want to say to you Joe and to the other people of Commercial Credit that this is the first time in my life that I've felt good about not making a sale. It was a great week for both Control Data and Commercial Credit. We got to keep Commercial Credit in our corporate family and you got Earl Weaver back in Baltimore.
Seriously, all of us at Control Data are excited about the prospect of helping write a new chapter in our long and productive relationship with Commercial Credit. Through all the uncertain and trying time of recent months, you who are the managers of Commercial Credit and all of your people have shown enormous dedication, loyalty and discipline. There were a lot of good reasons to come to Columbia tonight to address this gathering of lots of wonderful Control Data people. But one was sufficient for me -- and that was to say thank you to all of you from Commercial Credit.

Tonight I want to emphasize four overriding objectives which everybody in Control Data needs to understand and make a personal commitment to achieve. The first is profitability, the essential ingredient of survival and success in our business or any business. The second is to understand fundamentally that Control Data's greatest strength lies in providing solutions to market needs through technology -- computer technology. Third is the need for even more concentrated effort on specific markets -- "market focus" as it is generally referred to. And the fourth -- and perhaps most important -- is quality. For quality is the key to the other three -- without quality there can be no steady and sustained growth in profit; poor quality performance will kill any business -- and especially a business involving computer
technology; and market focus is but a fuzzy illusion without quality. Think of it in personal terms. The best way to succeed as an individual is to use your best skills and focus them on those tasks where they best fit. And whatever you do, do it absolutely the best you can. And so it is for us as a business as well.

I'm sure if I said -- "everybody stand up who believes in those objectives" -- the whole room full of you would rise. So if we all believe that, how come Control Data isn't achieving the basic objective of profitability? It is because in one form or another we are not achieving the others.

It is not a matter of either strategy or being a victim of the fates. Control Data has understood for years what others in the computer industry are only now realizing. The other day I was fascinated to read that John Young, CEO of Hewlett-Packard, said that "the answer for [HP] is to stress complete -- systems including software and ...... networks ...... solving customer needs will help isolate the vendor from completion." Those words are little more than a paraphrase of the ones we used to describe Control Data's basic strategy as it was put in place in the early 70's.
In my remarks to stockholders last month I covered Control Data's challenges and responses both in terms of basic strategy and current operational problems. So there is no need to repeat all that here tonight. What I want to do is bring you up up-to-date on developments affecting Control Data. I'll make my remarks brief because I know that many of you have questions. And I'll save the time for that.

Profitability

Let's start with profitability. The actions we have taken with regard to reducing costs and expenses are beginning to take effect. At the end of the 1st quarter expenses were about 3% above the 1st quarter of 1984. Through two quarters, however, we will be below the 1984 first half. Through two quarters people related costs and expenses in effect will have been reduced by an annualized $100M from the first two quarters of 1984. Of course full effect of this reduction does not immediately flow to the current operating statement.

This reduction has obviously involved reducing the number of people in the company. Through it all, however, we have not lost sight of the caring regard for people that has always characterized Control Data. Within the constraints imposed upon us by circumstances we will always strive to provide the greatest possible degree of stability and opportunity for people in Control Data.
Peripherals.

The principal problem area with regard to profitability continues to be the peripheral products segment of the company. The revenue outlook in peripherals has continued to deteriorate over the last two months. For the year peripherals will probably be some 17% under the revenue planned for this year. In spite of actions to reduce costs this will mean a year of little if any profits in this business.

The negative results in both revenues and profits have been primarily caused by two reinforcing factors.

First there is the impact of direct competition -- from numerous small start-ups and, much more important, competition from Japan. The second factor is that our largest OEM customers, the microcomputer manufacturers and systems houses, have themselves had to react to greatly increased competition. So, they have had to move much more rapidly from older to newer products just starting into production. This kind of rapid change means reduced purchases of older, more profitable products and a switch to products where competition is stronger and for which we are lower on the learning curve in terms of costs and reliability.
That nets down to more competition, lower volume, and a product mix of lower margin products. On top of that, PPCo was a billion dollar division which during most of its history responded to an environment of exploding demand. I want to emphasize that this coming 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 years ago, but changing the mental set resulting from all those years of responding to demand has simply been more difficult than we ever anticipated. But I truly believe that that problem is behind us. One small reflection of this is the announcement which was made last week with regard to restructuring the Peripherals organization. The purpose it was noted of the restructuring was "to help peripherals become a leaner (fewer levels of management), more responsive, ..... organization." And further "to make the structure of the organization."

The demand fall-off in peripherals has not only been faster and greater than anyone in the industry predicted, it is still occurring. At Comdex, the huge trade show for personal computer manufacturers held in Atlanta last month, a lot of evidence surfaced that the home computer market is fizzling. Among the dismal statistics noted was this one: personal computer sales rose only 11 percent in 1984, compared to a 107 percent gain in 1983. Another reflection of this has been the rash of press releases from many companies since the first of the year regarding lay offs, lowered earnings and losses.
In spite of all the pain however, Peripherals has been making good progress in narrowing its focus -- e.g., the decision last year to exit the plug compatible disk drive market, concentration on the so-called hard disk drives as opposed to floppy disk drives, and other basic product strategy decisions. Progress has also been made in refocusing development and manufacturing operations to improve quality and reduce working capital requirements for stores and work-in-process. The main focus here is yield improvement, which will result in less rework and higher quality. We know that the more you "handle" or rework a product or an assembly, the more likely it is that it will fail in the field. We recently, in a disk media plant, had a shut down for 17 days to address a quality related problem. A team from design and manufacturing was put together to re-examine the process and fix the specific items causing the problems. This resulted in a yield improvement from 41% to 52%, or an 11 point (27%) improvement. Each point of yield is worth $102,000/month to us in terms of rework or scrap costs.

Another example is in the Systems side of the house. Through-put time for Memory BDS has been reduced from 10 days to 5 days, which the workmanship defect rate has improved by a factor of 14 with a resulting product cost reduction of $110 per board to $28 per board. The cost reduction is simply less
rework and scrap. Incidentally by year-end throughput time should go from five days to two days and the defect rate will go from 4,000 PPM to 500 PPM or another factor of 8. Improvements in quality and costs are coming about in hundreds of examples like this -- all over our company.

Basic changes such as these which (1) more tightly focus our product strategies, (2) commit the greatest intensity possible with regard to quality, and aggressive attention to reducing current costs and assets will soon get the peripherals business back on a path of profitable growth. Meanwhile we simply have to tough it out.

Services

Over the past fifteen years Control Data has been a leader in developing new and innovative services based on computer technology. It is a distinguishing characteristic of the company. Although the services business from its start was dominated by the remote computing network services of Cybernet and Call 370, within the total business important market and application specific services were also started. Remote computing for the past two to three years has been undergoing a fundamental transition to distributed computing. As I said at the stockholders meeting last month, we were slow to respond to
that change and we have paid a heavy bottom line price for it. 1985 is the transition year. In the first half these basic network services will be little more than breakeven. But in the second half profitability will return. In Services things are unfolding this year pretty much as planned and there are encouraging signs of strengthening.

Meanwhile the market/application specific services have grown and served as a catalyst to help focus Services on the right markets and strategies. In Services we are concentrating on five markets: First is the Scientific and Engineering market which centers around engineering design and analysis applications; Second is Commercial Services -- where there are a variety of applications offered the financial institutions such as credit unions, banks, and finance companies. The other principal focus in Commercial Services is a marketing decision support services such as Marksman and the products of Arbitron Ratings; Third is Healthcare Services; Fourth, 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 finally, 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 we have taken would have been -- had they been in effect for the full year -- to reduce this approximately $200M a year business by some 15% and cut the loss by more than 50%. Since, however, it will take the better part of 1985 to fully 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.

**Systems**

In the Systems business, as I pointed out in Direction '85, the key is the same as it always has been: technical effort.

The price of competing in mainframes has always been high. For Control Data, nearly 25 percent of Systems revenue has to be reinvested in R&D in order to maintain competitive hardware and software. Clearly, to generate sufficient margins, we need maximum creativity and efficiency in how we produce, market, and deliver systems.
Peter Drucker, in his book *Management*, makes the following observation: "During the first fifteen years of the computer, that is, until the mid-sixties, only two companies out of fifty or so who had entered the field worldwide managed to make any profit on computers and obtain any kind of market position: IBM and the much smaller Control Data Corporation. Both owed their success largely to facing up to the concentration decision. IBM, in the very infancy of computers, decided to concentrate on the business market and to offer the computer essentially as an accounting machine. Control Data, at almost the same time, made the radically opposite decision to concentrate on large-scale scientific applications. Both companies did very well. The other computer companies all tried to 'cover the market'; none succeeded."

So Control Data's success in computer systems over the years has resulted from a disciplined market focus. It is also a great tribute to many people. Continued success, however, will require continued efforts in reducing expenses, improving processes, and quality management.

Having mentioned quality with regard to the computer systems business which has been leading the way in that respect, let me expand on it for a moment. Quality in some parts of the company has become more than a word -- it is a way of life. Let me illustrate that with some things that Bob Romfo has told me.
A connector problem at Arden Hills caused a shut down for 12 days, including missed shipments. A team was pulled together, they applied statistical analysis to the process, changed several steps in the process, and cut the defect rate by 80 percent. Result? The connector part dropped in price from $146 to $28. Not only were part failures, rework and scrap minimized, the actual cost (and price) of the part dropped.

To salespeople, quality means that product costs decrease, and that there is less manufacturing overhead. That translates into better prices and more reliable products for customers.

The key to quality management is in scrutinizing the process. When statistical analysis is applied (via the tools such as Process Flow Analysis, and Statistical Quality Control), problems are identified in a way that allows measurement and improvement to occur more efficiently and effectively. In some cases, as a result of new knowledge, retraining is necessary for some of the people involved.

One final example: at Roseville, a Quality Improvement Team is currently boosting yield of the Viking X Terminal. Right now, six months into their effort, yield has jumped 100 percent, that is twice as many are coming off the line without requiring rework. The actual to-date savings is $85,000. And the projection for the year is $110K.
By far the most prosperous part of Control Data in 1985 is Commercial Credit. When you think about the change that has occurred since the first quarter of 1984 Commercial Credit has had remarkably improved performance over the past fifteen months.

In 1983 and 1984 we had corporate level strategic issue teams look at the then stumbling financial services. One question was the degree to which we could achieve synergism between the computer technology based businesses and financial services. While it was clear that computers are essential to financial services, as they are to all businesses today, it was not so clear that a true blending of information and financial services was possible except at great cost over a long period of time. While the dream of Walter Wriston at Citibank was to do that, it was simply judged to be simply beyond our resources. The need for us, then, was to more tightly focus Commercial Credit as to markets and services -- or -- alternatively we could seek to divest CCC to a financial services institution with sufficient resources to offer more strategic options for that business.
We chose the latter course and it has been pursued with great care, sensitivity and diligence. It simply turned out not to be possible on a reasonable basis. By that I mean under a set of terms that would have a good chance of achieving the strategic objective of the divestiture. That's why we said in the release "after carefully investigating all the alternatives and evaluating the risks of not being able to conclude a sale on acceptable terms in a timely manner, we have decided that the benefits of retaining Commercial Credit outweigh the advantages of continuing the sale process."

So we have embarked on the alternative path of shaping Commercial Credit into a tightly focused, somewhat smaller and highly profitable financial services company.

Incidentally, in responding to a question at a security analyst meeting on Tuesday, I said that we fully expect increased profitability in Commercial Credit in both 1986 and 1987 and that our goal is a return on equity of 10% or more in 1987. I'm counting on you Commercial Credit managers to make a prophet out of me -- and that's not a pun.
Close

All of us in Control Data are faced with a big rebuilding job, with driving the company to achieve acceptable norms of profitability. That means careful strategic focus. Put another way it means doing few things much more intensely and with much more quality than we ever have in the past.

Let me close with a final point about quality. Techniques like process flow analysis and statistical quality control can focus attention on what needs to be improved, but, as necessary as they are, they really don't get the job done. The real source of quality work is people who care about what they're doing, who have an infectious spirit that is reflected in the quality of their output.

Without that spirit, improved quality just won't happen.

Without that spirit, the best product strategy, R&D, or financial plan won't make much difference.

In Control Data, that spirit has also included the entrepreneur's gamble, the innovator's drive to make something different, difficult and decisive, the engineer's commitment to do whatever is needed to make it work, and everyone's enjoyment in being on an underdog team that wins.
We lost some of that spirit along the way, but we're regaining it, and all of you can play a leading role in spreading the enthusiasm -- and the caring -- which drive it.

With that spirit, we will have profitable -- market-focused -- quality solutions to meet our customer's needs. We will also have a hell of a lot of fun.

Thank you. Now I understand that Bob Trimyer wants me to answer some of your questions.