I. Introduction

Chuck Roskam's report has given you the picture with regard to Y-T-D results. Although it is clear there are problems in several parts of the business, it is also obvious that our major problem is the large loss in peripherals. It not only is difficult enough by itself, it amplifies the effect of other operating problems. Moreover, in spite of a lot of actions taken, as yet we have seen no turn in the deteriorating position of the peripherals business. Last night you saw the dimensions of the problems facing the peripherals organization. Let me only emphasize here that there is both an internal as well as an external dimension to the peripherals problem. Neither the required internal change nor market stabilization will be quick or easy.

As we have discussed at each of the Board meetings this year, the industry position, strategic considerations and operational problems are distinctly different in each of our three businesses. Systems, including supercomputers, is a very tightly market focused business concentrating on scientific and engineering computing -- that has been and remains the core
driving force of the business. Peripherals represents an opportunistic and fortuitous diversification of the business (rationale). Services represents the major strategic diversification.

In the last two Board meetings we have dealt with the six basic market focus segments of this $1.5B part of our business. As you have seen the situation varies with those six segments. Also I want to repeat that while computer services is widely equated with "time sharing" or more generally "remote computing." "Time sharing" represents less than 7% of the total of Control Data's services and even all "remote computing" in total is less than 20%. Time sharing is, as has been pointed out, a dying business. Remote scientific computing is likewise changing to a distributed mode, which means among other things, much more emphasis on workstations and turnkey systems and a narrower market for the central computer element. The whole computer services market, however, encompasses a host of other kinds of processing services, turnkey systems as well as software and consulting services. We have major opportunities ranging from engineering design services to education, from financial information services to healthcare information services. And so on.
Right now Control Data is certainly in the midst of a particularly turbulent time. Change is nothing new to our industry or Control Data. [50 companies to 2]. To repeat we have been particularly hard hit in peripherals. Let me however frame for you our position with regard to the total picture.

II. **Response**

First of all, response to the industry slump.

(1) First, as far as peripherals is concerned, yesterday you saw the reduction in people (chart) which has occurred in response to both business decline and technology change. Incidentally, though the chart doesn't go back that far, in 1981 the total population in PPCo was over 21,000 people. Similarly the change in facilities (chart). Also for nearly four years now we have been reducing the product scope in peripherals so as to be able to better focus our resources. This in itself in some instances incurs added cost. Here are examples of that (chart).

(2) Services - we also have been reducing the scope of effort within the six basic markets of interest. This has meant both divestiture and withdrawal. Coupled with some actions in the hardware area this has meant some 13
divestitures or shut downs in the past 15 months. There are 8 others in process. That's a lot of very difficult kind of work.

(3) Restructuring of CCC. Cf J. Minutilli's remarks. Note leverage goes from 6.5:1 to 4:1; ROE doubles to 8.4%. We expect double digits by 1987.

(4) General employee reduction (chart). Reductions since the beginning of 1984 include over 100 executives. Increased productivity/employee '84 (91.4), '85 (100.2) '86 (107.3).

In spite of these actions -- in fact as I say, in part due to the reserves and close out expenses accompanying these actions, computer business profits and equity have declined over the past 12 months. While what we have done will strengthen both our short and long term position, it is necessary to achieve some strategic flexibility that we consider additional actions and I will cover some aspects of that shortly.

III. News vs. reality

But now let me turn to the second major aspect of the situation. While what make news are problems, what count are strengths -- and high yielding assets.
o Svcs. - more established Svcs. - TSS, SES, ARB, TICKET, GBS, $1.0B in Rev. ROIC - 16%

o Systems - new product line 60x range over 6 models.
  Gov't. Sys. $300M growing 12-14%, ROIC over 20%
  ETA - supercomputers, Cyberplus

o Peripherals - new products - 90% of '86 models introduced since '84. TFHA capability, Media, customer service.

o Growth/divestiture/flat revenue

IV. **Financial Status**

Finally, let me take a few minutes to put our financial and financing situation in perspective.

To begin with, contrary to what the press might want to have people believe we are not in a dire financial situation. One simple statistic will suffice: as of June 30 Control Data had equity of $1.7B including its investment in CCC and debt of $750M. While we have not had and do not have any crisis in liquidity, clearly, when operating losses are at the level we have seen this year financing and financial structure are serious concerns.
What we do have and have had for over a year now is the need to restructure our capitalization from less dependence on short term bank debt (principally in the form of the revolving credit agreement) to longer term debt and/or equity. This has become more critical over the last two years for two reasons. First there are the opportunities open to us in the Service business -- the ground work laid over the past 15 years has provided those opportunities, but the investment needed to actually realize the opportunity is significant. This is equally true in engineering design, commercial services or education and healthcare services. The "investment" is not so much investment in capital equipment, but rather it is operating expenditure and/or acquisition. In either case cash is involved and there are operating statement considerations as well. The second reason financial structure became more critical is the financial volatility of peripherals -- a high volume, low value-added, low margin business which demands a more conservative debt-equity structure than we have had to have in the past.

This chart is a summary of parent co. capitalization (chart). I have taken some liberty with the conventional long-term/short-term format to better portray the sources of debt and the particular nature of our equity. [go over chart format]. [also point out 1.4B/750M 12/31 #'s]
Even with relatively poor operating results in '83 debt/equity, the relationship was in good shape. In fact it had improved over the year. In 1984 this changed quickly as inventories built up in peripherals and systems and equity decreased with the plug compatible change and FASB 52 effect.

During 1984 not only was short term debt increasing by over $200M, but also equity was decreasing by over $80M -- a result of the write-off associated with discontinuing the plug business and (foreign exchange losses). Peripheral Products were not the only factor in that but that business was by far the single largest contributor. Debt to equity went from .5 to 1 to about .8 to 1. We were not happy about that. But while liquidity was tight, we had, and still have for that matter, unused funds under our Revolving Credits - at the moment some $100 million. In that regard, I should mention that the "technical defaults" resulting from the restatements were a "non-event" so far as the banks were concerned. The SEC/Accounting profession disagreement is not an operational event. To the extent our credibility with the banks has suffered -- and it has -- it has resulted from our failure to meet profit projections - not from accounting restatements.
In any event, by year-end 1984 computer business debt had risen to about $750 million. But the essential point is that by that time the need for refinancing, as you know, was going to be solved with the sale of Commercial Credit. With that sale the pro forma based on 12/31/84 would have looked like this (overlay). [review pro forma, "conversion" of investment in CCC to parent equity, potential investments, etc.] And that was the plan (Plan "A", if you will) for the better part of nine months as the negotiations dragged on and on.

With the decision to terminate negotiations for the sale of Commercial Credit, an immediate consequence was that we had to have a new financing plan. That plan is principally the public offering of which you are well aware. With this plan the structure that we know have is (overlay - 6/30/85 actual & pro forma 6/30/85) [go over overlay].

Certainly the current industry slump, together with Control Data's own problems, have made the execution of this alternative financing plan more costly - as has the rash of adverse publicity. And clearly the financing problems would have been much easier to address through the original refinancing plan, i.e. the sale of Commercial Credit. But that is irrelevant at the moment. We have executed the alternative plan. This achieves a desired goal -- that is less dependence
on bank debt and a better debt to equity structure. That is not to say that provides a comfortable margin for error against continued large losses in peripherals. The pro forma I showed is based on application of the proceeds of the financing as of June 30. Since that time, debt has increased about $45 million and equity has declined by $41 million. Losses in the computer business are the reason, of course, but that problem is compounded by the fact that most likely we will not be able to tax effect losses in the third quarter. So we have not tax effected July and August losses in the parent company in calculating equity.

Moreover the new financing does not really give us the strategic financial wherewithal to go after the opportunities available to us. Of course realizing those opportunities requires much more than just the cash to pursue them. But it surely is a necessary first condition.

Also while current projections call for achieving a positive cash flow over the remainder of the year, truly accurate projections in a severely declining situation such as we have are seldom achieved. So we must look at additional alternatives to provide more financing flexibility and hedge against unforeseen problems. In this regard it is my recommendation that we undertake the divestiture of ________, and we had initial discussion of this in the Finance Committee on Wednesday.
V. Conclusion

We have been through a trying and difficult time for the past 2 1/2 years as the waves of change in our industry washed over the business. In peripherals particularly the depth and the extent of the change required were greater and the time available shorter than any rational expectation -- even in this fast moving industry. At the moment we have no choice but to make sacrifices in other areas of the business to help compensate for the losses which are accompanying that change.

We have also weathered a particularly virulent storm of media criticism for the past four months. That it was for the most part at least grossly misplaced if not actually unjustified is beside the point -- that generally goes with the territory when you have lousy results.

The criticism is also not finished. We understand that. There are serious problems remaining in peripherals and in services, especially in International Services, that will cost money to fix. There are investment needs in Services, Systems, ETA, and so on. And of course there are other problems. But we also have lost neither the vision of our business, the strength of our culture, nor the resolve to fix the problems -- whatever it takes.