INTRODUCTION

Since January we have looked at each of Control Data's kind of businesses: Systems, including supercomputers, Services and Peripherals. We've presented the strategic considerations and problems of each of them and how we are responding to those circumstances and problems. All the presentations including the one today, are included in notebooks that will be mailed to you.

Over the course of the year our operating results have deteriorated terribly. The planned divestiture of Commercial Credit did not happen and we have had a multitude of lesser woes of which we are all painfully aware. I know you, as well as many others in the company, have strong feelings of concern, confusion, frustration and even anger. The Company has suffered badly from the events of the last three years and especially this year. And no one is saying we have not made mistakes or that all the corrective moves we've made have worked out as planned. But we have taken aggressive actions
dating back two years which are stabilizing the situation. Moreover, in the midst of all this turmoil we need to keep in mind a few fundamentals.

(1) We are not going broke, we are not insolvent, and while we sure as hell have had a liquidity problem for the past few months, we have managed the problem, and the cash flow situation is not only not desperate, it is actually improving, as I will show you shortly.

(2) Strategically the situation in Computer Systems, in Services and in Peripherals is no different today than it was at the start of the year. Larry has just explained the long-term strategic questions for Peripherals. They must be answered, however, within the context of Control Data’s current short-term financial situation. For Control Data and the peripherals business there is another question, and that is the long-term difficulty of nurturing the “commodity” culture and management system which is necessary to the success in a high volume, low margin business like peripherals, and its ability to co-exist with the “value-added” nature of systems and services. I’ll return to that question shortly as well.
(3) We actually are well-positioned strategically, but if we are going to succeed strategic position is not enough — Control Data must change — we must have fewer businesses if we are to do any of them well. First of all we can't afford the investment. But it's even deeper than that. We have been a project oriented, challenge accepting organization. Nothing, we believe, is too hard or too different for us. We believe, given time, we can do anything. And it's true. We've been blessed over the years with some extraordinary people who could, and can, do extraordinary things. You don't do what Control Data has done unless, for example, you believe you can bend the laws of physics — and then do it. But having grown to a five billion dollar company we are beyond the point of just looking for hills to climb. We have not concentrated hard enough on excellence in the things already started.

We must change from this project orientation — to profit orientation. Culture change is neither easy nor quick, but we've begun and it will be done.

CURRENT STATUS

From a balance sheet point of view, in spite of all the actions we have taken and due to the sale of Commercial Credit not being accomplished, the financial structure of the company has grown worse over the last two years. Again, I would remind us
all that that's not because we have been passive. And had we not taken strong action we would not be here today talking about the problem. Only because of what we've done already do we have options, only because of anticipation of the problems and initiatives undertaken do we have the opportunity to not just deal with the problems, we have the opportunity to go forward to renewed growth and profits.

You'll recall from this depiction of the right-hand side of the balance sheet, Chart (1), that during 1984 we became dependent on short-term bank debt to finance the peripherals business.

1983- total debt/equity, CCC investment, D/E ex-CCC, short-term bank debt. In 1983 we were cognizant of investment needs in Services over the coming years. One other crucial financial characteristic surfaced in....

1984- 1984 change: D(+20D) E(-80)
Asset change in Peripherals (+200) total (+214),
Debt year end (750), CCC decision.

Actual September.
We are as we talk tonight in a tough situation with no new loan money available to us, and ironically, we are in a relatively poor negotiating position with the banks. Marv Rogers will cover that tomorrow, but in a nutshell: The fact that we have healthy, valuable businesses gives us available collateral far in excess of the debt to be refinanced. Ironically, as I say, that actually detracts from our bargaining leverage because the banks know they will come out whole -- even in the worst case. You might think that that assurance would cause them to recognize what we have put in place and to be more lenient with terms and conditions which would help the business, but the initial indications are that it is having somewhat the opposite effect.

As I said we are not going broke. Here is the projected cash flow for the last two months of this year and the first three months of next year, plus the quarterly projected cash flows for the remainder of next year, chart (2a). (Comment: we have been weak in cash flow forecasting and management. Strengthening the financial information and management system must be a priority). This is a more detailed breakdown of the next 8 weeks, charts (2b,c,d). I must first comment that I've heard there is talk that the company will run out of money by mid-December. It should be clear that such "beware the ides of December" talk is terribly disconcerting to uninformed
management and employees. Although I understand the reasons why it arises, it makes it all the more incumbent on top management and directors to seek facts and solutions rather than contribute to the general alarm.

Also the tax escrow matter which has been raised, while of legitimate concern, can be more than handled operationally. And in addition if we so desire the proceeds from the BPG sale announced earlier this week could be used to allow us to go forward on a purely escrowed basis.

Not included in this cash flow are the following potential upsides, chart (3). The total of that amounts to some $272M. And that does not include any proceeds from BPG -- assuming as I said they are set aside to cover the tax escrow. There are also of course exposures -- reduced revenue from plan being the principal potential exposure. A good estimate of downside exposure in 1986 is $60M -- this assumes that ERA may not close and that proceeds of the BPG sales will not be available to cover the tax escrow. Nevertheless we have the ability to manage within the cash we generate from operations. The real question to be answered is not do we pay off the bank debt, but how do we put in place the financial structure to succeed.
There are three time periods to look at with regard to financing and financial strategy: short term until the sale of Ticketron (0-4 months), medium term (reminder of '86), and longer term. In that regard, Marv Rogers, Norb Berg, Dan Pennie I and others of the corporate staff have met every M, W, F morning to discuss alternative strategies. As I said Marv will cover that tomorrow in more detail, but I'll touch on some aspects of it today.

We have also taken steps which not only have helped us deal with the horrendous losses in Peripherals as well as those in International Services, but will help to deal with the short and medium term financing needs as well as set us on our new course.

**ACTIONS TAKEN**

This chart (4a,b,c) shows the divestitures and/or shutdowns we have undertaken beginning last year, including those currently underway. (chart -- divestitures/effects).

This chart (5) which I showed you in September, shows the population decline since 1982. It has been updated to show the projected 3/31/86 level (42,000 net of BPG, Ticketron). I want to emphasize again that this does not just represent layoffs in
response to lower revenue. Revenues after all grew in 1983 and 1984 and will decline only 2% this year. We've been raising productivity by changing processes. You've just heard some of the kinds of changes in engineering productivity we're developing in Peripherals. It is equally true elsewhere. With fewer businesses to work on processes and productivity will improve even more. This next chart (6) which I also showed you in September, shows productivity growth. That compares as I mentioned before to 1984 figures of Honeywell of 64K, Sperry of 73K and IBM of 116K. Early retirees [66 thru 12/85 -- $5.4 million base salary]. Executive population change (2/83 -- 716, 10/85 -- 599, 12/85 -- 550). The annualized effect of the actions taken this year would have improved profits by $240M and are summarized in this chart (7). In addition deferral of capital spending has saved $60M. We of course haven't realized that full year effect, but even so expenses are down not only from budget, but from last year as well. Chart (8) (10 months actual, budget '84).

STRATEGY BASICS

Let me now review briefly the business and product strategy essentials. The core of Control Data's business and the key to success is "value-added" -- which in this business means applications of computers. If we can augment that with a
commodity peripherals business or a finance business, O.K., but the core of our business is value-added computer systems and services. And we must not lose sight of that one fundamental fact.

As we have discussed the nature of a successful value-added service business is (1) long build up times to critical mass, (2) heavy front end loads of technical and marketing expense and (3) low capital investment requirements.

We have some strong businesses today built on applications. Go over chart (9a,b) showing EMSD and Arbitron. Those are only examples. In addition we, as presented in July and September, have established market positions in credit union processing, and payroll and general accounting systems. We have a start in CIM, K-12 education, and agri-business information processing and health care. We have an excellent opportunity in ECAD.

The peripherals business on the other hand requires overhaul as Larry has explained, and that requires both capital expenditure and operating expenditure resulting in further losses and poor profits.

The financial services business is fortunately well along in its restructuring and is a source of P&L support.
From these things we must fashion a compatible financial and business strategy — something we do not have. I know this can be done and indeed if we have a dilemma at all, it is that we have more than one alternative to do so.

FINANCIAL STRATEGY

This next chart is our projected starting point ([chart (10)]) in 1986.

The problems to be solved from this starting point are two: first, the bank debt repayment, and second, getting the financial structure we need to go forward. That structure is one which finances the business primarily through equity and some long-term debt.

The first, the repayment of short-term bank debt, requires we raise $343M by the end of 1986. The sale price of Ticketron is estimated at $200M. Applying this to the debt would leave a net repayment by 12/31/86 of $143M. This amount would then have to come from operations cash flow and/or other divestitures.
The second problem is illustrated in this next chart (11). This shows the financial highlights: revenue, earnings, debt, equity at year-end 1986, '87, '88 taking the balance sheet situation I showed a moment ago at year-end '85 as the starting point and assuming a business strategy which attempts to establish a solid market position in each of our current businesses. (Review assumptions briefly -- assumptions in hand-out, e.g., healthcare). (Point out both P&L and debt/equity problems. Earnings 3, 3%).

As you can see, then, we have a totally unacceptable debt/equity financial structure, and I want to emphasize equally unacceptable P&L progress.

How to address these problems? Since we earlier proposed the divestiture of Commercial Credit, that alternative, now that Plan "B" is nearing completion, could be reinitiated. This next chart shows financials for the same scenario I just showed except that it assumes the sale of CCC by the end of next year ..chart (12).

The debt/equity structural problem would clearly be fixed by that course of action. But it does not fix that problem long-term, nor more important does it fix the P&L problem (it makes it worse short-term) and it does little for the management problem. (Go over #'s on alternative charts debt/equity and net earnings.
SOLVING THE PROBLEM

These numbers merely make explicit the need that I emphasized already to narrow the focus of the business.

To begin this process there are certain actions which we have already undertaken to divest: These items are summarized on this chart (X) -- Mickelberg "Menu" part. (1) City Venture/Rural Venture, Worldtech, (2) The real estate portion of the BTC's (i.e. CDP), (3) Healthcare other than MEDLAB, and (4) Much of International Services including 51% of Cybernet Japan, Cybernet Brazil and the DEC-related business of Systime. In addition CBE sales will be shut down in 15 countries and restricted to those countries where we have CDI's. Fin. Info. Services is also being cut out in some countries -- about 1/3 of the business in terms of people. [explain]

In addition K-12 education (USSA) will be restricted for now to the PLATA/WICAT joint venture -- principally that means the proposed entry into private schools will be put on hold. Also the Disabled and Corrections Services will be discontinued as separate divisions, and the training component of them (which is the guts of those businesses anyway) will be included in the Voc. Ed. Services. As plans develop they will be discussed and decided upon by the Executive Committee.
The pro-forma result of these actions is included in the chart I just showed (refer to charts 11 and 12), so although they are important and will help us in our objectives of profit improvement and narrowed focus. They are not adequate. Among other things they do little to solve the P&L problem (the total benefit to the 1985 P&L would have been $51.4M, more than half of which is International).

We must then do more. This next chart shows the total business by SBU. The chart is arranged by SBU in descending order of 1985 projected profitability. Chart (13). (Chart 13 1985, forecast, 1986. NPBT & Rev. for each SBU).

A variety of alternatives can be chosen from these SBU to complete the task of getting a manageable business. In your hand-outs are financials that would result from the divestiture or joint venturing the following businesses: (1) Peripherals, (2) ETA, (3) Medlab (i.e., the remaining part of Healthcare), (4) K-12 Education (i.e. the PLATO/WICAT joint venture), and (5) Business Development (the remaining portion).

The plan of action I am proposing is the following:
(1) CCC -- (a) Finish Plan B, (b) Make every effort as soon as practicable to get the ratings up, (c) Sell CCC in major segments over time, and/or (d) Sell off a significant portion to public ownership. Failing (b) we should simply sell CCC outright by 12/31/86.

(2) Joint venture the peripherals business. This may be done in either one or two parts. Discussions have begun. Japanese not the only choice. In evaluating a JV -- resources, mfg. capability, design capability (2 parts), market accessibility. Not necessarily even one partner. Low end -- not much in the way of design. High-end more engineering.

(3) Joint venture USSA, the K-12 education beyond the WICAT joint venture. AT&T has been identified as a desirable prospect for JV partner.

(4) Divest Medlab.

(5) Joint venture ETA with 1 or 2 corporate strategic partners.
These and other alternatives will, as noted before, come to the Executive Committee for discussion and approval. Assuming those actions were in place, now the financial picture would be as shown on this chart (14). We may -- as is certainly the case in Peripherals -- want to pursue one or more variations of these alternatives simultaneously and see which looks best as we proceed. In any event with the strategic background we have given you over the course of 1985, we can proceed with Board discussion and action as we move into 1986.

Finally let me say that Control Data is in a bind. The resolution of the bank debt and even more so the resolution of our profit problems, according to our outside financial advisors, 1st Boston, make the threat of an attempted takeover over the next few months a near certainty. It will take time and all the skill we can muster to survive and to realize the great potential of the foundation which has been laid with painstaking care over the past quarter century. I, for one, am confident that we will succeed in solving our profit problems. Moreover in many people in the financial community, investment bankers, private investors and tens of thousands of loyal employees I see a shared confidence and vision. It won't be easy. 1986 will be no great year. PPCo., ETA and International account for more than $100M in pretax losses, and that is just too big an anchor for the rest of the business to
overcome. As you have seen we are committed to reviewing every part of the company, without exception, with a view to deferment of investment, sale of all or a part of business units, or closure of business units.

Particular attention will be given affiliate investments, developing businesses and peripherals. The situation in peripherals is the most difficult and may well result in further down-sizing if a suitable joint venture cannot be found.

We are a company with pride in our past and high expectations for our future. We know that the restructuring program will succeed and that Control Data will be a stronger, more focused and profitable company.