Introduction

It's been said that prosperity is a great teacher, and that adversity is an even greater teacher. I assure you, at least as far as Control Data is concerned, that is a true statement. Our task for the future is to profit from the adversity we have been going through.

Review of 1985 and First Quarter 1986

Control Data's financial results for 1985 are outlined in detail in the annual report. The company recorded a net loss of $567.5 million on revenues of $3.67 billion.

The reasons underlying this performance are also set out in the annual report, and I will not repeat them at any length this morning. In summary form, however, a number of our recent problems came about because we have never been afraid of great challenge and sometimes we took on too many new opportunities. This happened at a time when the marketplace -- through declining demand, rapidly changing technology, and increased competition, both foreign and domestic -- began to punish
diversity. At the same time, we were slow to make certain key product introductions. The result is the financial performance as reported.

It's my principal purpose this morning to bring you up-to-date on events subsequent to year-end 1985 and review the actions we are taking with regard to the remainder of 1986 and the future. These actions are aimed at both operational restructuring and financial restructuring.

The fundamental task is to return the company to profitability, and that has meant a considerable restructuring of operations which is taking place under the constraint of having to accomplish a financial restructuring as well, which in this instance means repayment of all U.S. bank debt by year-end and providing new financing for future needs. Until this financial restructuring is achieved, since no external funds are available to us, we are operating under very strict cash flow constraints.

While this is, to say the least, an arduous task, we have the wherewithal and the determination to accomplish it. Control Data's financial problems are serious, but by no means insurmountable. As far as refinancing is concerned, we have valuable assets and assets exceeded liabilities by over $1.2B
at March 31, 1986. Top management and the Board of Directors, ably assisted by First Boston, our investment bankers, have analyzed at length a variety of alternatives for addressing the financing need. The essence of the analysis has been an evaluation of the short and long-term implications of the alternatives versus their feasibility and cost. I'll come back to financial restructuring in a moment, but first let me cover the operational restructuring.

Operational Restructuring

I want to make clear at the outset that the Control Data I am describing today is already much different from the Control Data of one or two years ago, or for that matter, even six months ago. It has changed enormously and the changes have been for the better. Again, since the annual report sets forth some major aspects of that change there is no need for me to repeat them here.

The principal feature of what we have done is to reduce the diversity of the business through the divestiture of certain businesses and the shut-down of others. It also involves narrowing the product line focus of the remaining businesses. Examples of the former are the divestiture of the Business Products Group, BTSI in the Financial Info. Services Group, and
Ticketron. Examples with regard to product line discontinuance are floppy disk drives, and several International and U.S. services. In total, the reduction in scope of the business, including the pending Ticketron divestiture, amounts to 12% of 1985 revenues or some $430M.

In the meantime as we recently announced, the first quarter results for this year are a net loss of $21.2M on revenues of $796M. Although this is no small loss, it does represent an improvement over expectations at the start of the year. Moreover, results for the computer business have improved significantly over the preceding two quarters. In particular, the progress in Data Storage and International Services has been considerably more rapid than we anticipated.

The restructuring actions taken thus far will make it possible for us to return to profitable computer business operations. However, achievement of longer range profitability goals may well necessitate a further reduction in the scope of the business. In that regard we are currently engaged in an in-depth analysis of each strategic business unit as to its future investment requirements and profitability potential. This analysis will be complete within the next few months.
One of the most publicly evident aspects of the changes already made is the reduction in the number of employees. I want to expand for a moment on that subject since I believe there is generally a serious misunderstanding with respect to it.

At 1/1/85 there were 54,100 full-time employees in Control Data. At 3/31/86 there were 41,400. Of this difference of 12,700, some 3,400 left as a part of divestiture and other actions aimed at reduction in scope. So on a fully comparable basis, then, employment is less by some 9,300. Of these reductions, about half occurred through normal attrition and the other half, nearly 5,000, through involuntary termination or "lay off" as it is most commonly called.

The misunderstanding is that this reduction in employment is caused by reduced demand -- that sales were "bad." And the implicit assumption is that when sales are "good" once more, employment will go right back up. That's wrong. The change in the employment beyond reduction in the scope of the business results principally from the fact that the process by which today's products are designed and manufactured is entirely different from those of a year or two earlier.
I believe one example will suffice to show what I mean, and perhaps the best example is in Data Storage Products. For years, one of the staples of the Control Data product line was the SMD. It has 80 megabytes of storage, which translates in non-technical language to about 27,000 typewritten pages; it sells to the OEM customer for about $4,000; it occupies about three-and-a-half cubic feet of space; and it requires roughly 40 hours of labor to build.

The current 80-megabyte drive which internally is known as the WREN II (also external model #), sells for under $1,000, occupies 1/35th the space, and involves a total of 10 hours of labor. But of those 10 hours only 2 1/2 are supplied by Control Data employees. The other 7 1/2 are embodied in parts procured from outside vendors.

If these were Control Data's only Data Storage products, we would need to sell 16 times as many WREN drives compared to SMD to maintain the same labor force. This is a sudden, qualitative as well as quantitative change in the peripherals marketplace, and requires a fundamental change in the way we design and manufacture products.

This year, 90 percent of Control Data's data storage unit shipments will be products introduced in just the past two years.
Unit volumes are increasing. Five years ago, a high volume manufacturer in OEM data storage might have been producing 100,000 drives a year. This year, Control Data will ship half-a-million. Two years from now it could be a million-plus.

This kind of transition puts tremendous pressure on every part of the organization. Engineers have had to learn to design products with easier assembly and automation in mind, process yields have had to be improved, inventory management and manufacturing control systems have had to be replaced. Adding to this pressure, we have had to do it all under combat conditions, so to speak, and in a matter of months, not years.

This is the kind of operational restructuring that, to one degree or another, is underway in each of our businesses. We have spent a great deal of time making sure that everything Control Data is doing in some way makes the company more responsive to the marketplace as it is and will be -- not as it used to be.

As a footnote let me add that dramatic impact on employment from technological change is inevitable in today's industry. For several years we have had innovative human resource policies and practices which attempt to deal with such change. We described those in some detail at the 1983 stockholders
meeting. The existence of those policies moderated the wrenching pain we went through in 1985, but they could not fully cope with the fact that a drastic change was crammed into a few months time.

As far as the future is concerned, while we fully expect to see growth in both unit and dollar volume, it is equally certain that manufacturing will become increasingly less labor intensive. So it is crucial to have an intensive program of skill enhancement and personal development for all employees so that they can move on to new tasks. But the point I want to repeat, is that the change in employment is as much a result of the change in technology as it is business conditions per se.

Let me conclude these comments on operational restructuring by noting that Control Data's business is comprises 5 Strategic Groupings covering 11 Strategic Business Units: Scientific and Engineering Systems & Services contains 4 Strategic Business Units; Financial Information and Commercial Services contains two; Data Storage Products; Human Resource Information Services three and the last group is Commercial Credit. All of these businesses except K-12 Education and Healthcare Services have an international as well as a domestic component.
All of them will require significant expenditures in marketing and research and development in order to maintain or gain a favorable market position in the coming years. In addition, some, in particular Data Storage Products, will require significant capital investments as well.

It is the evaluation of these needs, their quantification and timing that are the guiding parameters in selecting an appropriate financial restructuring strategy. So there's a lot more to the financial restructuring we must undertake than simply repaying the bank debt which has been in default.

**Financial Restructuring**

Let me turn then to that matter of refinancing and debt repayment. In February we reached agreement in principle under which Control Data will repay its domestic lenders approximately $380M by the end of the year. I'm happy to report that the task of finalizing that agreement is proceeding well and nearing completion. This is the first and basic piece of the financial restructuring plan. As part of the arrangement, the stock of Commercial Credit and Arbitron Ratings have been pledged as collateral for the direct debt as well as contingent obligations.
There are three potential sources for obtaining the cash necessary to repay the debt and meet the company's other cash requirements for the year: cash flow from operations, asset sales, and new external financing. I'll discuss each of them in turn.

Cash flow from operations is expected to be modestly positive for the year, but in any event nowhere near sufficient to repay the bank debt. That means the additional funds needed must come from asset sales and/or new external financing. Asset sales presently planned are anticipated to yield between 230 to 300M dollars. The single largest part of that will come from the sale of Ticketron. The remainder will come from the sale of some smaller business units and surplus real estate and other assets. As you probably know, we signed a definitive agreement yesterday with Allen and Company for the sale of Ticketron, which will be operated as an independent company under its current management. This transaction will close when we have secured the required state and federal regulatory approvals. So another major piece of the financial restructuring plan is nearing completion.

To complete that restructuring -- and recall that we must anticipate at least the medium term financial needs for investment in the on-going businesses -- the alternatives are
new medium term debt, the sale of equity, or the sale of additional assets -- that is to divest some business or businesses in addition to those currently planned.

Each of these alternatives has advantages and disadvantages as well as differing short and long-term implications. Without belaboring you this morning with that somewhat involved discussion let me simply say that we will be reaching a decision on those issues shortly and when we have we will share it with you and explain fully the rationale behind it. I also want to assure you that as part of the financial restructuring we intend to operate with a more conservative debt/equity ratio than Control Data has historically maintained. Our goal in that regard is a debt/equity ratio in the computer business of less than .5. At March 31, 1986 that ratio stood at 1.05. Let me also reiterate that we have the wherewithal to achieve the restructuring we desire. It is not a question whether it can be achieved -- it is only a question of choosing among alternatives to best achieve it -- with appropriate balancing of short and long-term implications.
Commercial Credit Separation and Restructuring

I don't want to leave the topic of restructuring without a few comments on what we have achieved in the financial services business, Commercial Credit, where the priority is to regain an investment grade credit rating.

In 1984 we determined that either we should divest Commercial Credit entirely or significantly reduce the scope of that business. When Commercial Credit could not be divested on reasonable terms, due in large part to the diversity of that business, we immediately began the actions necessary to reduce its scope and improve its profitability.

Commercial Credit has now divested more than a third of its operations and its profitability is improving. Last July Commercial credit put in place a tough plan. They've done it, and done it well.

Unfortunately, however, the financial problems in the parent company last year caused Commercial Credit to lose its investment grade credit rating without which it cannot achieve competitive access to capital markets and therefore acceptable profits. So, as I say, regaining investment grade ratings has become a matter of top priority.
To assist in that regard, we recently announced a restructuring of our legal relationship with Commercial Credit. The purpose was to put it at arm's length from Control Data, with a separate board of directors and more restrictive limits on intercompany funding and dividends. Given this separation and with demonstrated consistency in profits, the prospects for regaining the desired ratings are quite good. Commercial Credit is today a solid business.

Current Trends

I'll turn now to the outlook for 1986. We expect improvement over the course of the year. The results of the first few months have increased our confidence in that expectation. Over the past four months, orders are up in most of Control Data's core businesses. The softest spot at the moment is in U.S. mainframe computer sales. Although orders and shipments of mainframes were up in the first quarter, the outlook for the full year is affected by the continuing general slump in the industry. In Data Storage Products, margins which were hammered disastrously in 1985 have improved and orders are considerably in excess of plan for the year thus far.
New Mission

In the past few months, we have gone to great lengths to define Control Data's basic mission consistent with our new direction. Control Data has one basic mission, which is to provide its customers with products and services based on computer technologies. We are not confused about this strategic direction or what business we are in.

In support of this mission, we have made four fundamental commitments:

To customers, for innovation and technological leadership yielding high-quality, cost-effective products and services.

To stockholders, to provide consistent and increasing profits, with an ultimate goal of a 15 percent R.O.E.

To employees, for an environment of fairness, concern for personal quality of work life, and opportunity to pursue their full potential.

And to society, where our technologies can be profitably and productively applied in addressing unmet needs.
Strategic Direction

We'll make this mission a reality as we continue a product-by-product, market-by-market evaluation. In those areas where we do not have significant market share, or are not confident we can create a competitive advantage in a reasonable timeframe, we will exit the business.

The overriding purpose and principal objective is that in every area, Control Data businesses will be managed first and foremost for profitability. Survival -- much less profitability -- means we must continue to make the substantial technology investments required to pursue market leadership.

The increasing requirement for both the technical and marketing expenditure necessary to compete in today's world will mean fewer businesses and/or less diverse product lines within a business.

To the extent possible, we will also maximize the use of available resources -- by continuing to engage in the kind of joint ventures and cooperative arrangements that net us greater leverage of technical expenditure, reduced inventories, lower capital investment, and greater productivity on a per-capita and per-asset basis.
Yesterday, for example, Control Data's Arbitron Ratings subsidiary signed an agreement with SAMI, a subsidiary of Time, Inc., to form a new joint venture to be called ScanAmerica. This new venture promises to offer the largest, most powerful marketing information databases in the country, and could revolutionize the effectivity of a consumer products company's advertising expenditure. The combined strengths of Time/SAMI and Control Data/Arbitron will significantly increase our competitiveness in this important business arena.

Finally, the dominant force in our daily lives will be quality. Not only in the traditional product sense of value-received, but quality in each process or procedure by which each employee accomplishes his/her daily task. In order to reinforce this all-important message, among many other things we have produced a videotape which employees will soon see and which you will see after I conclude my remarks.

At its root this culture of quality means that each employee truly feels that "what I think and do matters." To emphasize the contribution each employee must make and the stake each person has in Control Data's future, the Board of Directors has approved an award of ten shares of stock to each of the full-time employees in the U.S. The total number of shares to be awarded under this plan will amount to approximately 350K.
I should also point out that this award will exclude all executives who participate in other stock award programs.

In an operational sense, the Control Data of even a year ago is gone. We have taken steps to create a new organization, one which will do fewer things, but do them more effectively. As this new entity emerges, it will be smaller, more focused, more aggressive in its markets, and above all by making quality a way of life, it will be more profitable.

I would like to be able to set a date for Control Data's return to profitability. However, given the uncertainties of the industry, and business in general, I will simply say this: We have done what is necessary. We have reacted not only to the company's immediate problems, but also to the fundamental and permanent changes in the computer industry. So, as we return to profitability -- and I assure you we will -- it will be on the basis of permanent restructuring of the company, and not the result of a short-term cure.
Close

I want to conclude by returning to what should be clear from my remarks, which is that Control Data is becoming a different company. But throughout Control Data's history, and especially in the difficult and painful period we have just come through, we have always been able to rely on a loyal and dedicated work force whose qualities represent our greatest strength.

These qualities are an unshakeable spirit of determination and the willingness to do whatever it takes to get the company back to where we want it -- and where it rightfully belongs. It is this attitude that will assure a successful future for Control Data.