INTRO

Control Data has experienced a great deal of change these past 18 months including a fundamental restructuring, both operationally and financially. This change has one underlying objective -- transform Control Data into a strong, ongoing economic entity.

Time doesn't permit reviewing all the actions we have taken. I will, though, give you a snapshot overview of the Company and a brief financial summary.

OVERVIEW

Basically the strategy we have undertaken is to move away from a position of overdiversification to one of concentration on three core computer businesses and concentrate Control Data's energies on doing fewer things more profitably. Growth will come from thoroughly understanding markets and customer needs and concentrating on three core businesses.
They are:

1. Scientific/Engineering Systems & Services

2. Data Storage Products

3. Business Services

Scientific and Engineering Systems and Services serve six markets: Electric Utilities, Petroleum, Weather/Environment, Higher Education, Manufacturing and Government. We are a niche player in these markets -- offering value-added application specific systems. Orders for 1986 are running slightly ahead of 1985, but below plan. International activity has been very strong, but the U.S. market remains soft.

In the supercomputer arena, excellent progress is being made at ETA in developing the ETA-10 -- a 10 gigaflop system. ETA is the company that Control Data established 3 years ago as an entrepreneurial company to develop a new world-leading supercomputer. The 20K CMOS technology used in the ETA-10 is the most advanced in commercial use today. It offers a dramatic lower cost alternative to the ECL technology which has dominated the large mainframe and supercomputer business. But this technology goes far beyond making possible the ETA-10. It
also can be used in developing very high performance application systems and specialized processors. This has great potential for a specialized niche business such as Control Data operates.

I would like to note that ETA recently received a $21M order from the West German Weather Service for an ETA-10 supercomputer and other computing equipment. This is the first competitive award for ETA outside the U.S. and outside of the academic arena. The first shipment of an ETA-10 will go to Florida State University and is scheduled for first quarter of next year.

Also, in the systems and services group is Technical Support Services which supplies maintenance services as well as professional consulting and training. I should note that this business has a high return on invested capital and is a solid profit contributor.

And, finally, there is the Government Systems segment which concentrates on specialized military applications such as the AN/AYK-14 Navy standard airborne computer and the Army's M-1 tank fire control computer. Government Systems is another solid profit contributor.
The second core business, Data Storage Products, is a billion dollar business aimed at the high-performance, high-capacity magnetic and optical storage market. The disk drive business has had a dramatic turnaround from the large losses incurred in 1984 and 1985. Both second and third quarters reflected a modest profit and gross margins are now running slightly over 20% with programs in place for continued improvement. OEM orders (dollarwise) are running more than double that of a year ago.

Disk storage products are driven by head media technology. From '82 to '85, Control Data invested heavily in thin film head technology. Today, we are the only U.S. world class manufacturer of thin film heads other than IBM. The quality of heads we are able to produce is such that we have established a new division to supply the OEM components market. A recent meeting we held for customers and prospects was attended by virtually every disk drive manufacturer from around the world.

Advances in head/media technology will continue and the result will be a continuation of dramatic reduction in cost of magnetic data storage, which could reach $1-2 per megabyte by the end of the decade. Low cost, high quality manufacturing capability is the factor of overriding importance in the disk storage business. The experiences of the past two years have solidified our confidence in being able to be a leader in that all important aspect of this business.
Moving to the 3rd core business — Business Services, a leading supplier of data base and information services and application software products and services to selected segments of the commercial and financial community. These services include market research information services for radio and TV advertisers, general business data processing, payroll processing, legal administrative application systems and others.

Technology just as surely drives the services business as it does systems or data storage products. Everyone can cite the example of how technology changed the nature of processing services. Remote processing became desk top processing. That not only made obsolete old forms of services, it likewise opened up new vistas for other services. And now a new technology — optical recording — has the potential with regard to informations services to equal the change micro-computers brought about in processing services. We intend to capitalize on that opportunity.

Business Services has excellent profitability. By mid-1985 the transition from a time-sharing dominated business was essentially complete and since then profits have increased steadily. Business Services offers some of our most profitable opportunities and we will place increasing emphasis on expanding the business.
FINANCIAL SUMMARY

Now, I would like to review some financial data.

The financial restructuring program was aimed at raising cash, strengthening the capital structure of the company and improving operational cash flow. We raised some $160M from the sale of assets, as well as some $530M from the sale of our 80% share in CCC. We also received, at the end of the first quarter, a one-time $200 million dividend from CCC, and we replaced essentially all bank debt with the successful public offering of senior notes and convertible debentures which totalled $400 million.

The result of all this is a dramatically stronger CDC. This is true from a P/L point of view, as well as with regard to balance sheet and capitalization. Let's consider a few numbers which reflect the strengthening of CDC as an economic entity.

First of all, profitability. The computer business hit bottom in 3Q '85 as the restructuring program got into full swing, and the pre-tax results of operations before all extraordinary items was a loss of $69 million.
The loss in 4Q '85 was $53 million. The loss in 1Q '86 was $39 million. The loss in 2Q '86 was $14 million. Finally, the loss in 3Q '86 was $2 million. Still a loss, but I'm sure you will agree with me that the trend is in the right direction.

Of course, there are other ways to measure financial strength. A telling ratio is the ratio of debt to equity. In the computer business, as of December 31, 1985 our debt to equity ratio was approximately 2.0, with total debt of $744M and equity of $373M.

The successful completion of the CCC transaction means that the debt to equity ratio has dropped to approximately .5. At this point, debt totals about $550 million and equity about $1.2 billion. The dramatic equity change reflects, of course, the selling of the majority of CCC and liquifying our remaining 18% investment.

But, even after eliminating all intercompany debt with CCC, eliminating all A/R facilities, "catching-up" A/P with our vendors and taking into account some 4Q cash charges, at year-end we should have some $300M cash. Thus, considering this cash offset to the $550M debt we would effectively have a debt/equity ratio that is certainly within our goal of .4 to one.
The challenge going forward is a happy one - how do we effectively redeploy a large amount of available cash to improve capitalization and strengthen the strategic thrust of the three core computer businesses in such a way as to improve the returns to the shareholders.

Regarding the outlook for 4Q '86, we don't make forecasts, but I will say that we expect continued improvement at the operating line pre-tax, pre-restructuring and pre-special charges. However, some health one-time charges mainly associated with work force reduction and facility closings will be taken. As we've said, before the restructuring process which began in 1985 will continue through the fourth quarter of 1986. Each business or investment that has not demonstrated over the course of this year appropriate financial progress will be downsized or divested. Those actions will be completed by year-end and/or the necessary provisions will be taken now, so as to provide the basis for the return to profitability in 1987. With these actions and the re-establishment of Ticketron as a Control Data business, the operational restructuring program will end.
SUMMARY

So, in 1986, we have taken strong measures to strengthen the company structurally and financially. Our product positioning from both a market and technological standpoint is improving.

We will be leaders in giving scientists and engineers the best computing tools for their trade.

We will be number one in OEM -- we will be the low cost manufacturer.

We will ultimately be recognized as the leading computer services company.

As for 1987, we are hard at work at establishing the budget -- one that we can and will achieve. One that is profitable essentially across the board. It is important psychologically, as well as economically, that CDC meet its 1987 plan and budget. Our 1987 performance should demonstrate that we are continuing to make progress and will succeed in turning CDC into a strong, ongoing economic entity.