I. 1987 Results

It's been a long time since at the 1st Board meeting of a new year we could look at positive numbers -- both backward and forward.

We should take a few minutes to summarize everything that has been done over the past 2-3 years to make that happy circumstance possible: [chart]

1) We sold all or part of more than 20 businesses -- including CCC -- for nearly $1.3B.
2) We sold real estate -- 11 facilities -- worth $138M.
3) Raised $400M in public financing through the senior notes and convertibles.

Through these actions we simultaneously narrowed the focus of the business to make it more manageable and restructured the balance sheet to give us the opportunity to manage it.
The organization has been structured with fewer levels of management with up to five levels having been removed. The levels now range from four to eight across the operating groups. In so doing we have decentralized as well as downsized the corporate staff: from 2,300 to 1,100 (1988 projection in budget submission).

The executive population has been reduced from 716 to 385 and the employee manager ratio has risen from 6.6 (1982) to 9.0 (current) The number of VP's have been reduced 58%.

In spite of significant employee reduction (61K in 1/82 to 34,500 in 1/88), supplemental employees increased over that period from 16.3% to 20.4%.

Technical/professional areas have been reduced by 25%, while management, production and clerical were reduced by more than 50%. Another important perspective is that 45% of the reduction was achieved through voluntary attrition and retirement — both normal and early. Only 27% occurred through involuntary termination (the remainder was divestiture), and of particular note is the fact that it has been accomplished with no employee lawsuits having been brought against the Company.
There has been a concerted effort to bring in new management. 10 of 34 members of the Management Committee have been with the company two years or less.

These significant restructurings were the dominating tasks of management and the dominating characteristic of 1985 and 1986. 1987, on the other hand, has been characterized by a gathering of momentum especially new product momentum. More specifically:

1) Removal of major barriers to growth in profits. FSD II (cost 80), ETA 1st deliveries new orders (cut loss in half or $25M), education old businesses such as EPS ($15M), Govt. Systems ($10M).

3) Strategic conceptualization of the business and, perhaps even more important a greatly improved strategic process. By that I mean the process induces strategic, market-oriented thinking in operating managers.

These achievements give us a far better position as we proceed into 1988.

II. 1988 — Current Company Status & Outlook

As you have just seen in the 1988 budget information that John presented, the Company still cannot be considered robust from either an earnings or a cash flow point of view.

On the other hand while there are certainly risks in the plan for 1988, there are fewer unknowns. Although you may well ask how can you "know unknowns" -- which is maybe an ultimate oxymoron -- there are circumstances which can be analyzed for the probability of surprise from unknowns.
Perhaps the principal one of these is the increased management tenure in key areas. Last year Tom Roberts, Gil Williams and George Troy were all just starting their new roles. Moreover, the management team under Larry Perlman was new or weak and the key area head/disk technology was most poorly staffed of all.

Out of these weaknesses came the major surprises of 1987. Only Gil Williams and Computer Systems escaped some major upset.

With the experience of management and progress made in 1987 we have at least a better shot at quantifying the risks of 1988.

While obviously there is risk in any business unit's plan for the year, these are the major ones:

1) ETA - 25-30; ability to sell

<table>
<thead>
<tr>
<th>1988 Budget</th>
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<tbody>
<tr>
<td>Orders</td>
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<tr>
<td>Air Cooled</td>
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<td>Liquid Cooled</td>
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2) TEG - 10-15; PES

3) DSP - ?
Of these the greatest uncertainty/risk is in DSP. Perhaps I can give you some idea of this from this chart which relates to 1987 -- not 1988 -- but it is illustrative [Muehleck chart]

Another illustrative statistic with regard to the risk is the following: DSP NPBT for 1988 is budgeted at $32M. Inherent in that budget is the need to reduce costs and expenses by $175M over the annualized 4th qtr. average. Obviously we feel that can be done, but it nevertheless must be done.

Finally, market demand weakness is highly leveraged to reduce profits. You could see that from the chart I just showed. Lower volume reduces profits directly and forces margins higher, but in addition because of the number of competitors forces extreme price cutting which further reduces gross margins. Each 1% gross margin deterioration in the 5 1/4" product line in 1988 equals $5M at the bottom line.

So, this business is more susceptible to the general economic climate than any of the others. The forecasts in the data storage industry are bullish right now, but clearly the uncertainty factor is greatest for this business.
Nevertheless we look at the job to be done in 1988 not just in data storage but in the whole business, with considerably more confidence than we had at any time last year.

I should add that there is upside potential as well -- in Computer Systems, in ETA, in Business Services. Government Systems has a stronger backlog position than a year ago and the order picture at the moment in DSP is such that the year could be stronger than planned.

And as I said a moment ago, perhaps our greatest upside is that with another year of experience and a long list of tough actions behind us, the whole bunch of executives are more confident in their jobs.

III. Hostile Takeovers - Potential Threat

I covered this in some detail at the dinner last night. Apart from the rumored specific threat of Maxwell Communications, I want to emphasize that Control Data has never been in a more vulnerable position. This results from the confluence of three factors:
1) The lowered stock market prices put a market cap on the company of only $907.4M.

2) The weakened dollar in a very real sense "discounts" this value by an additional 20-25% (relative to one year ago - $700M. This discount is a very real enticement to foreign raiders.

3) The turnaround of the Company is not only real — we've done the hard part for someone — but most important is is understood and realized by the financial and business community at large. It's one thing to be in this "just coming out of trouble" stage when no one knows or cares about you. It's something else to be there at center stage in that situation.

As we have discussed and will review again later in the agenda, we are taking appropriate precautions to protect the long-term interests of our stockholders and employees to help assure they will realize appropriate value.

Handouts: WSJ, Del. letter, NY Times

In all of this it's necessary to some sense of balance. In that regard I thought you might be interested in this letter written in 1970 to Harold Hammer, then the CFO of Control Data [hand out].
IV. Data Storage Products -- Strategy & Status

1) The need for resources

The 1988 plan shows the following capital investment needs: Bus. Svcs. 40M; CS&S (incl. ETA) $108M; DSP 90M; Ticketron 45M; Govt. Systems 18M; and TEG 13M.

These large capital needs are partially offset as you have seen by P&L and depreciation cash inflow. But the net result is so large as to induce considerable risk in the 1988 plan.

This situation will of course improve as profitability increases in future years. But there will be a continuing need for large capital investments if we are to remain competitive and grow.

In short it seems clear that unless we want to pursue a strategy of underfeeding all the current portfolio of businesses we have got to make some choices.
For reasons we have discussed before -- the basic mission of Control Data as a value-added, competitively advantaged systems and service company, the competitive structure of a low cost producer industry such as Data Storage, the imminent restructuring of this industry and so on, it seems clear that we should find a way to exit the OEM data storage business -- at least as a principal thrust of Control Data's business.

This is no trivial decision: (a) it is 30% of our total business, (b) we have a strong market position, (c) we have spent 3 years and several hundred million dollars restructuring the business, (d) we have assembled as fine a management team as any company in the business, and (e) market conditions as well as our own circumstances tend to undervalue the business at the moment.

Waiting for the right moment to act however is an exercise in futility, and so we are moving.
2) Options we have discussed:
   a) Divest in it entirely. However, must in some way provide for our own computer systems needs.
   b) Divest pieces — several alternatives as to which. Retain other pieces.
   c) Enter into a JV in which we have a minority interest.

V. **Miscellaneous**

**New Directors** — NRB will discuss, but I would like to mention my discussions with Donald Rumsfeld (also thank Ben S. for his help).

Finally, Ticketron FLA contract. Earlier I mentioned Product momentum. Retrace: 1 year on the block — nothing but bad news and being bad mouthed. New system being developed through it all. Fla., the major competition of the year, and they won!

**Gallagher Report**