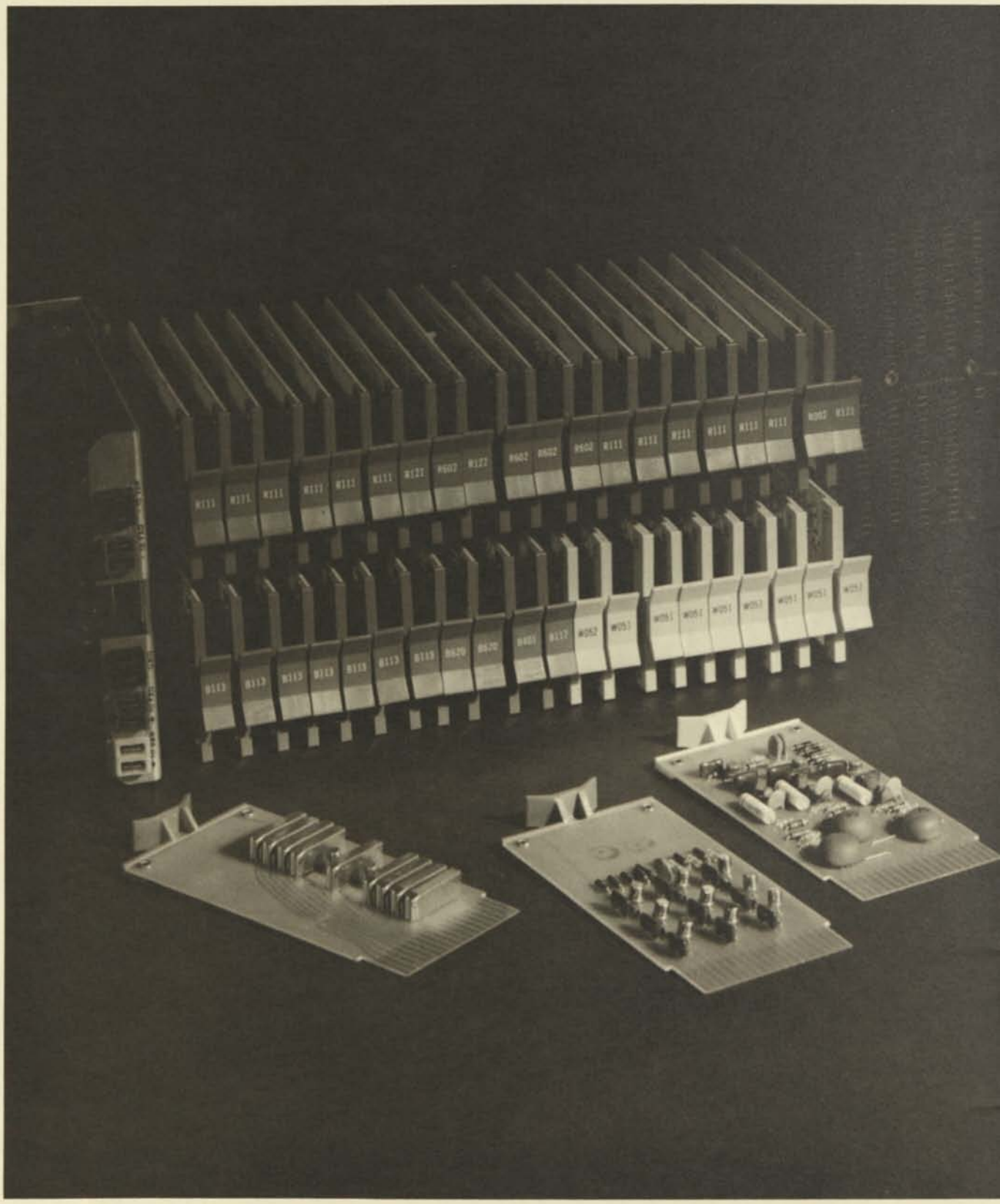
DIGITAL ANNUAL REPORT 1965

DIGITAL EQUIPMENT CORPORATION • MAYNARD, MASSACHUSETTS



PRESIDENT'S LETTER

During the past year, Digital has successfully brought into production a complete new line of products. The facilities to manufacture the new products have been significantly expanded, and the staff to sell and service them has been increased.

The investment in developing the products, expanding the facilities, and training the staff has been substantial and is reflected in a lower profit for this year, but we are pleased to announce that as a result of this effort we start the new year with a large backlog.

Digital's large, high-speed, time-sharing computer, the PDP-6, was first delivered in the Fall of 1964, and now eight have been installed and are in use. Three of these are overseas, one in Australia and two in Germany.

The PDP-7, a modernized and speeded-up version of the PDP-4, was also first delivered this year. It is now being shipped at the rate of seven or eight a month. The PDP-7, like the PDP-4, has been very successful in control and real-time applications, and we have a continuing program to improve and update it.

The PDP-8 was one of this year's most exciting products. It is an improved version of the PDP-5 incorporating our newest technology and manufacturing methods. The result is a computer which is four times faster than the PDP-5 and sells for only $18,000. The response to the PDP-8 is much greater than expected, and we are now expanding manufacturing facilities to satisfy the demand. We think this will be the first computer to have its components completely checked by a computer and then to be put together on an assembly line.

This year we also started to manufacture the LINC computer, which was designed at Massachusetts Institute of Technology for biomedical applications. The interest in this machine remains high not only in the medical profession but also in other research areas. A program to continue the development of the LINC and expand its capabilities is under way.

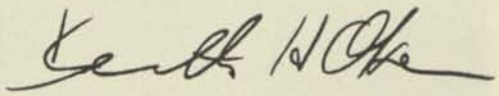
Memory testing equipment continues to be a profitable line. We have started a program for developing new techniques for testing which will make possible speed and thoroughness that have never been obtained before.

Digital's first product line when the company started was modules, and it continues to be one of our most important products. It takes a large investment in engineering, tooling, and inventory, but it is a very profitable business. The new FLIP CHIP line, designed for high production and simplicity of use, has been well received by all classes of customers. A high-volume assembly line that has much automatic equipment, including computer testing, is being completed, and we expect that in the next few weeks production capacity will meet the order rate.

We have significantly expanded our sales activities and now have offices in four foreign countries, Canada, the United Kingdom, Germany, and Australia, as well as several new branches in this country.

During the year we have organized the company by product lines so that responsibility and authority are more precisely defined. The four product lines are large computers, small computers, modules, and special products; the latter includes medical and digital testing equipment.

We are very pleased with the results of our investments during this last year in new product development, in manufacturing techniques, and in market development, and we plan to continue investing heavily in these activities in the coming year.



Kenneth H. Olsen
President

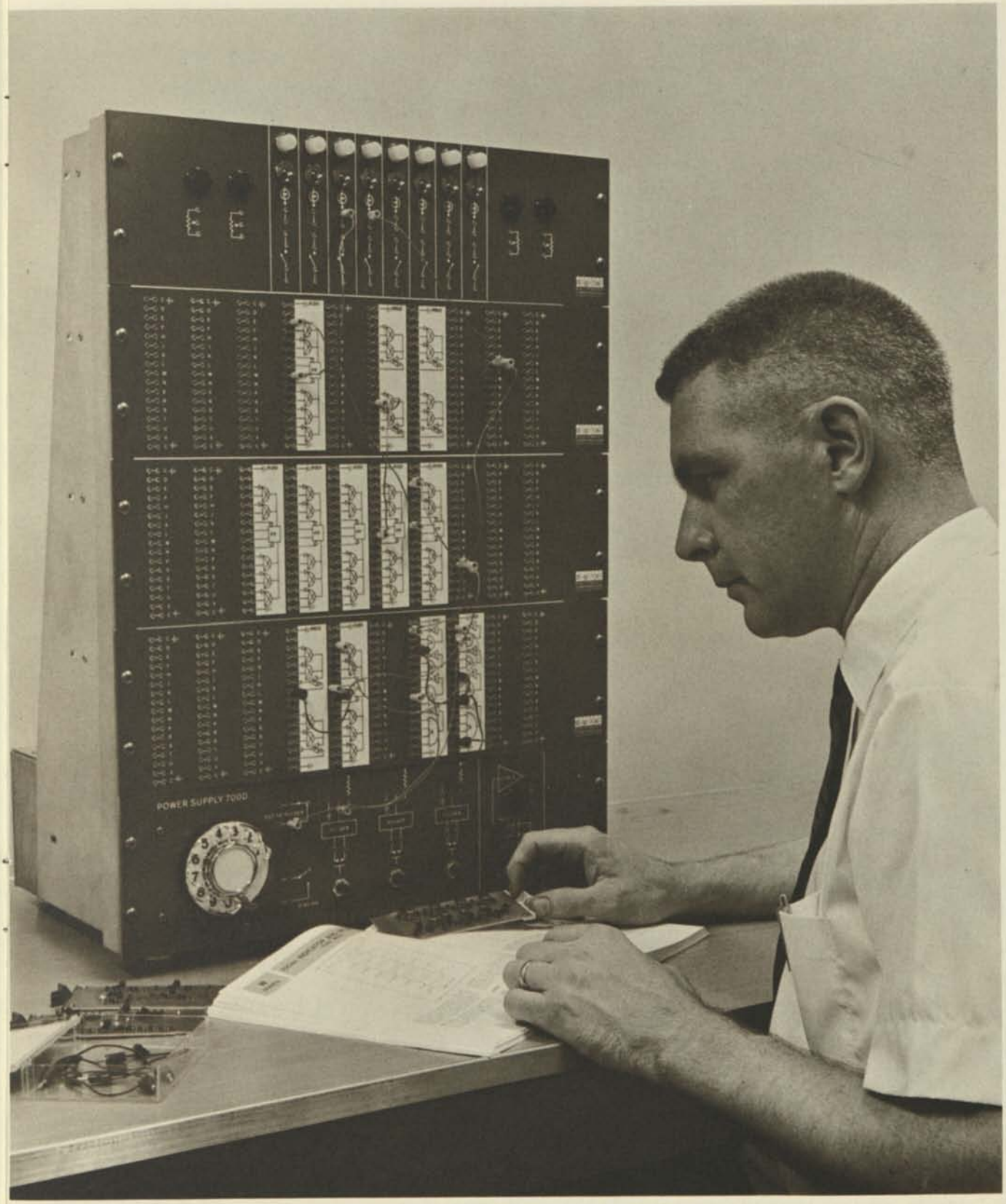
MODULES

Module activities have centered on the expansion of the FLIP CHIP™ line and the development of high-speed equipment and techniques to build the new circuits. Lower costs for total system production are made possible through the use of FLIP CHIPs and their accessories, and this saving is attracting the attention of system building firms. The resulting demand testifies to the soundness of the design of the new modules and to their acceptance by engineers. Production equipment is also being developed for the hybrid integrated circuits used in FLIP CHIPs.

One of the most significant of the new products reaching the field of technical education is the Logic Laboratory which we introduced this spring. It is designed to augment class instruction in numbering systems, machine logic, and computer operations. Its price is less than $1000.

Semiconductor mounting and several other operations are performed under clean room conditions in the manufacture of the hybrid integrated circuits for the FLIP CHIP Modules

Flip Chip is a trademark of Digital Equipment Corporation

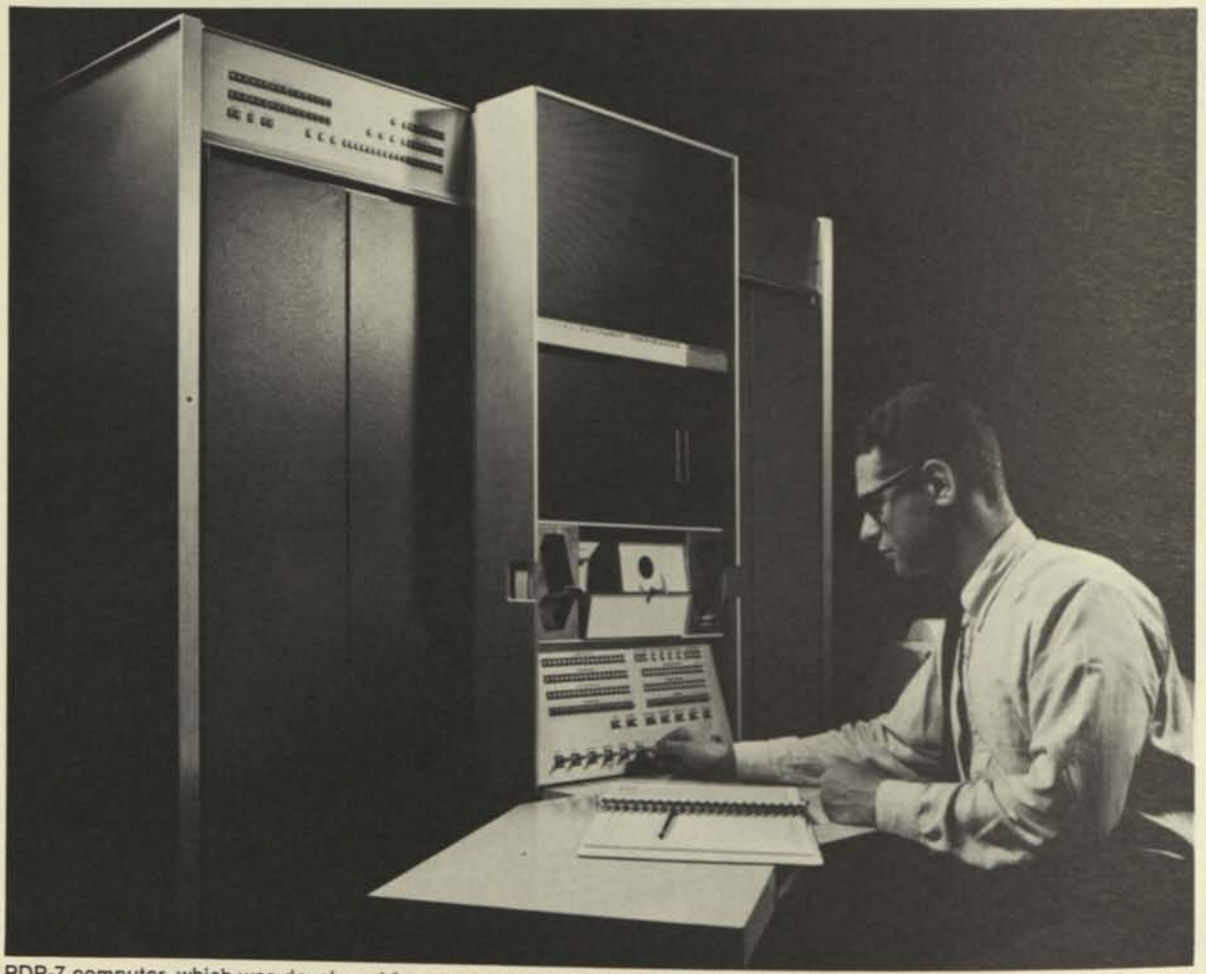


The Logic Laboratory is unique in its ability to demonstrate analog-to-digital conversion

SMALL COMPUTERS

More than 100 PDP-5s were sold in the eighteen months that it was actively marketed, so we were prepared for the enthusiastic reception that followed the announcement of plans to build the PDP-8, a smaller machine four times as fast as the PDP-5 and, at $18,000, one-third less expensive. In the eight months between our announcement and the end of June, more than 200 of the new computers were sold. Deliveries began at year end to such organizations as Stanford Research Institute, Harvard Medical School, Massachusetts Institute of Technology, and the University of Wisconsin. Principal application areas are in aerospace, biomedical instrumentation, and physics. In addition, the PDP-8 is being offered to the newspaper and book publishing fields for automatic typesetting where it has a definite advantage in price as well as availability.

More than 50 PDP-7 computers were sold in the same period. Installations include the Jet Propulsion Laboratory, where it processed photographs taken of Mars, at Bell Telephone Laboratories, at Stanford University, and at New York University. Overseas installations include the Technological Institute at Delft, Oxford University, and the Royal Institute of Technology.



PDP-7 computer, which was developed from our earlier PDP-4 has FLIP CHIP Modules that make it more than four times as fast and permit a price reduction of more than 20 per cent

The significance of the assembly line now being developed is that it centralizes all steps in building and checking a PDP-8, including the use of computers to test components before assembly

LARGE COMPUTERS

Development of the monitor program for the PDP-6 computer was a major achievement this year, since it enables us to supply the first complete, hardware-software integrated system for time-sharing use. The advantage of such a system is that it gives several users immediate, simultaneous access to a powerful computer through a keyboard or display screen. The system delivered to the Rand Corporation, for example, is designed to provide the 500-member professional staff a "personalized" computing service, bringing the individual into closer, more creative communication with the computer, eliminating time delays and avoiding the need to use a programmer as an intermediary.

Another major activity for the PDP-6 lies in large data processing assignments, such as the accelerator experiment recording and analysis being performed by a trailer-mounted PDP-6 computer at Brookhaven National Laboratory. The Physics Department at Rutgers University is also using the PDP-6 for elementary particle analysis, as are the Universities of Aachen and Bonn in Germany.

Other organizations with PDP-6 systems are the University of Western Australia, Lawrence Radiation Laboratory, and M.I.T.'s Project MAC.

PDP-6 being loaded aboard jet freighter for delivery to Australia

Typical large PDP-6 time-sharing system

SPECIAL PRODUCTS

DIGITAL TEST SYSTEMS

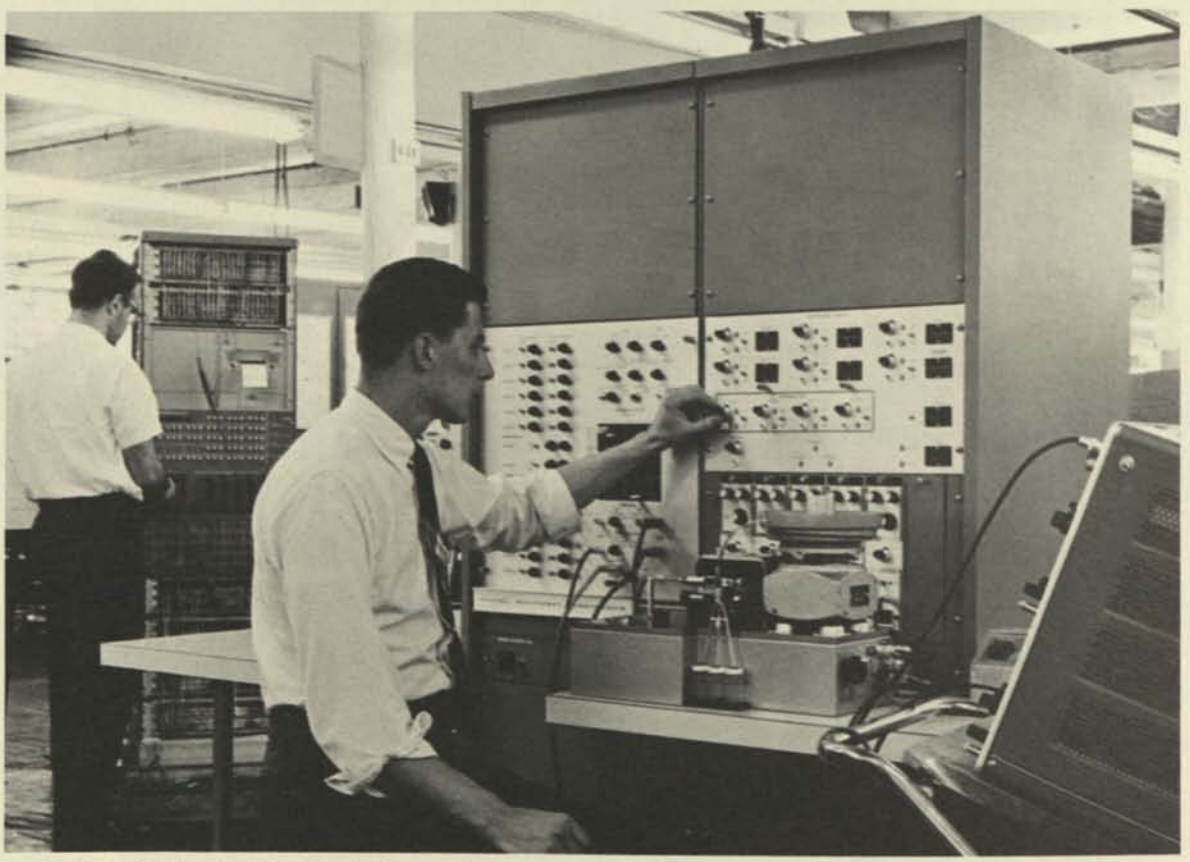
To capitalize on our experience in building equipment to test computer memories and their components, several new products were developed during the year, including faster, more powerful current drivers, a new memory tester incorporating improved switching and sensing systems, and a new core tester offering a plug-in-diode programming board and a pull-out-servicing feature.

Typical recent deliveries of memory test equipment have been to Bell Telephone Laboratories, Burroughs Corporation, Cofelec of Paris, Electronic Memories Incorporated, Hitachi Limited of Japan, and Indiana General Corporation.

LINC

Our growing interest in the data processing needs of biological, medical, and psychological research has been underscored by the decision to market the LINC computer. This move made LINC (for Laboratory INstrument Computer) available commercially for the first time as a complete system, tested, warranted, and supported by our field service organization. LINC incorporates all the features of the original machine developed at M.I.T., and it can use all the programs written for the earlier machine.

Of the 39 LINCs currently in use in various research laboratories, all were built using Digital's modules. Among the installations with LINCs supplied completely by Digital are Lederle Laboratories of American Cyanamid Company, the University of Pennsylvania, Worcester Foundation for Experimental Biology, Philadelphia General Hospital, Mayo Foundation, Stanford University, and the University of California at Los Angeles.



New ferrite tester developed for Radio Corporation of America

LINC's modular construction makes it suitable for even the most crowded laboratories

BALANCE SHEETS

As at July 3, 1965 and June 27, 1964

ASSETS	1965	1964
Current:		
Cash	$ 340,715	$ 105,160
Accounts receivable	4,482,738	2,013,203
Inventories, at lower of cost (principally first-in, first-out) or market	4,769,075	2,837,732
Prepaid expenses	67,790	43,616
Total current assets	9,660,318	4,999,711
Property, plant and equipment — at cost less $529,000 and $341,000 allowance for depreciation	926,858	615,542
Other assets	188,814	92,920
	$10,775,990	$5,708,173
LIABILITIES		
Current:		
Notes payable to banks	3,900,000	
Accounts payable	1,110,664	666,716
Accrued liabilities	465,423	428,790
Provision for U.S. and foreign income taxes	579,641	684,590
Current maturities of long-term debt (note A)	316,250	16,250
Total current liabilities	6,371,978	1,796,346
Long-term debt (note A)	38,125	354,375
STOCKHOLDERS' EQUITY		
Common stock, par value $1.00 per share authorized: 1965 — 3,499,800 shares; 1964 — 100,000 shares issued and outstanding: 1965 — 51,600 shares (note B); 1964 — 51,100 shares	51,600	51,100
Capital in excess of par value	183,928	87,328
Retained earnings	4,130,359	3,419,024
Total stockholders' equity	4,365,887	3,557,452
	$10,775,990	$5,708,173

STATEMENTS OF INCOME AND RETAINED EARNINGS

Fifty-Three Weeks and Fifty-Two Weeks Ended July 3, 1965 and June 27, 1964

	1965	1964
Net sales and other revenues	$14,982,920	$10,909,565
Cost of goods sold	7,163,595	4,472,744
Research and engineering expenses	2,270,303	1,811,477
Selling, general and administrative expenses	4,080,380	2,846,713
Interest and other charges (income)	81,617	(1,998)
Provision for U.S. and foreign income taxes (note C)	606,590	891,472
Net income for the year*	780,435	889,157
Retained earnings at beginning of fiscal year	3,419,024	2,529,867
Excess of cost of treasury stock retired over par value and amount charged to capital in excess of par value	(69,100)	
Retained earnings at end of fiscal year	$ 4,130,359	$ 3.419,024

*After deducting depreciation and amortization; 1965 — $288,000; 1964 — $290,000.

NOTES TO FINANCIAL STATEMENTS

A — Long-term debt comprises the following 6% notes issued to American Research and Development Corporation:

Date of Issue	
January 29, 1958	$ 7,500
January 19, 1959	9,375
November 30, 1959	37,500
June 25, 1963	300,000

The first three notes are each due in equal annual installments with the final installment due nine years from the date of the note. The note dated June 25, 1963 matures on June 25, 1966.

The terms of these notes provide among other things that dividend payments, without the prior written consent of the holder, will be limited to 50% of the net income for the preceding fiscal year.

The principal payments on these notes shall be subordinated to borrowings from banks maturing not more than one year from their respective dates.

B — At July 3, 1965 there were stock options outstanding for the purchase of 2,180 shares of the company's common stock.

C — In 1963 and 1964 the company reflected the investment tax credit as a reduction in basis of the property to which it applied and was reflecting the credit in income over the useful lives of those assets.

In 1965 the company changed its method of accounting to reflect the credit as a reduction in the current year provision for U.S. income taxes. As a result of this change, current year income has been increased by $60,700, of which $21,150 is the 1965 investment credit and $39,550 is applicable to 1963 and 1964.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Digital Equipment Corporation
Maynard, Massachusetts

We have examined the balance sheet of Digital Equipment Corporation and subsidiaries as at July 3, 1965 and the related statement of income and retained earnings for the fifty-three weeks then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the financial statements for the fifty-two weeks ended June 27, 1964.

In our opinion, the accompanying statements present fairly the financial position of Digital Equipment Corporation and subsidiaries at July 3, 1965 and June 27, 1964 and the results of their operations for the fifty-three and fifty-two weeks then ended, in conformity with generally accepted accounting principles applied on a consistent basis, except for the change, in which we concur, in the method of accounting for the investment tax credit as described in note C to the financial statements.

Boston, Massachusetts
August 6, 1965

Lybrand, Ross Bros. & Montgomery

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Dorothy E. Rowe, Secretary

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Stanley C. Olsen, Modules
Nick J. Mazzarese, Small Computers
Harlan E. Anderson, Large Computers
Winston R. Hindle Jr., Special Products

September 14, 1965

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PRINTED IN U.S.A.

The heart of Digital's powerful new MicroVAX systems is the revolutionary "VAX-on-a-Chip," with 125,000 transistors and the functional power of 3,200 conventional chip sets.

DIGITAL EQUIPMENT CORPORATION
ANNUAL REPORT 1985

Corporate Profile

Digital Equipment Corporation is one of the world's largest manufacturers of networked computer systems and associated peripheral equipment and the leader in systems integration with its networks, communications and software products. The Company's products are used worldwide in a variety of applications and programs, including scientific research, computation, communications, education, data analysis, industrial control, timesharing, commercial data processing, graphic arts, word processing, personal computing, health care, instrumentation, engineering and simulation.

Financial Highlights

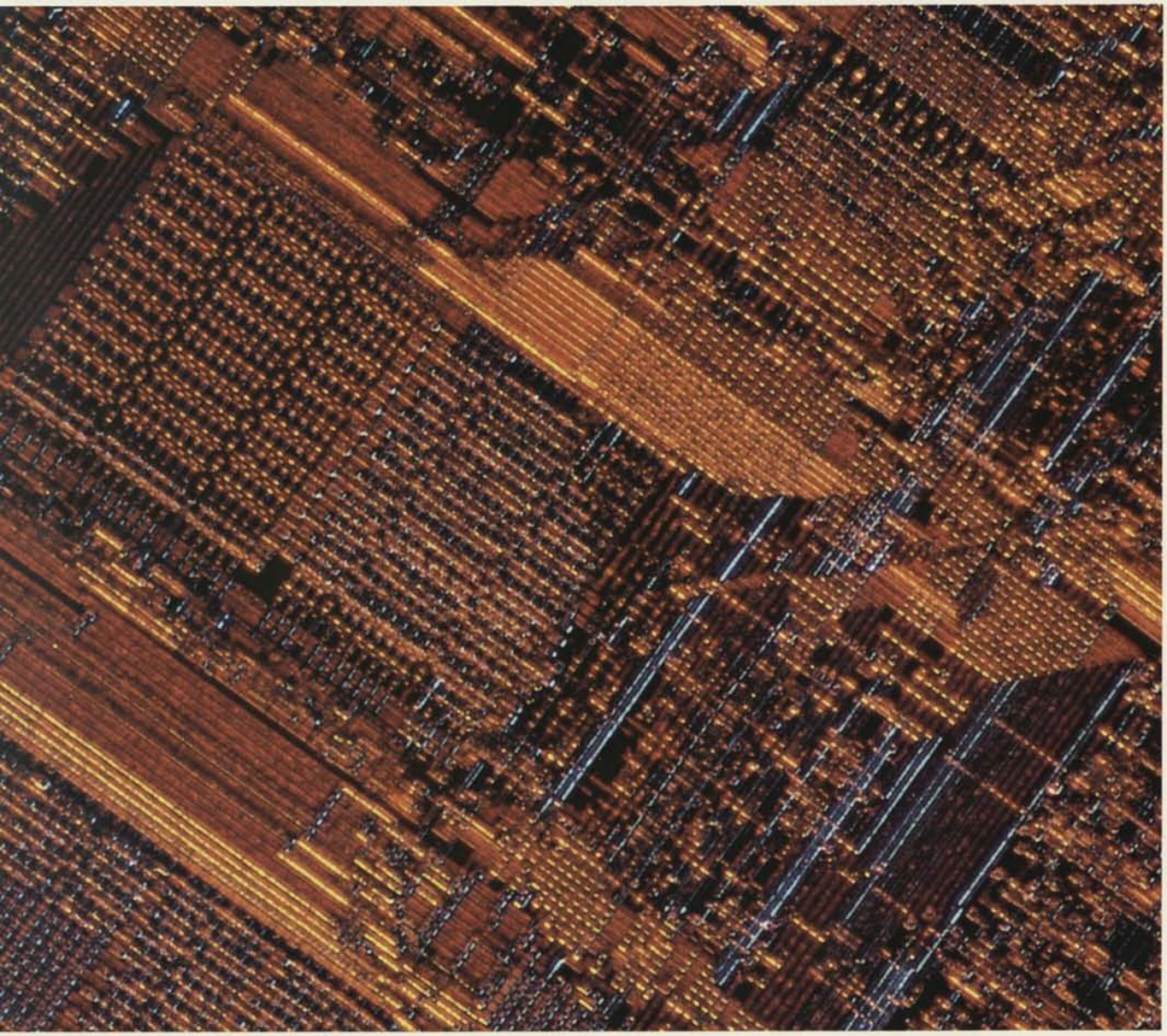
Fiscal Year	1985	1984	% Change
Total operating revenues	**$6,686,316,000**	$5,584,426,000	+ 20
Net income	**$ 446,682,000**	$ 328,779,000	+ 36
Net income per share	**$7.42**	$5.73	+ 29
Total stockholders' equity	**$4,554,599,000**	$3,979,216,000	+ 14
Stockholders' equity per share	**$76.87**	$68.83	+ 12

Annual Meeting of Stockholders

The Annual Meeting of Stockholders will be held at 11:00 A.M., Friday, November 8, 1985, at the Marriott Copley Place Hotel, 110 Huntington Avenue, Boston, Massachusetts. Stockholders of record on September 13, 1985 will be entitled to vote at this meeting.

Contents

Implementation of VAX architecture on a single chip, enlarged here 10,000 times, brings full VAX functionality and networking capabilities to desktop VAXstation II, whose advanced features include multitasking, multiwindowing (right), and high-resolution graphics.



To Our Shareholders, Empl es and Friends:

Fiscal 1985 marked the 28th r of operations for Digital Equipment Corp tion and we are pleased to report to you on o progress.

We finished the year with gai in both revenues and profits. Our business grew well outside the United States despite the streng th of the dollar. However, the U.S. economy ca sed some customers to postpone computer pur ases and slowed our growth in the last six mon s of the year. The revenue growth was due the success of new products and rapidly spr ling recognition of Digital's unique ability in b ding local and global networks. Digital is the ly full line computer manufacturer deliverin mplete networks today.

Digital has been making comp r networks for 25 years. Today we can make h speed networks that the rest of the industry can only promise. We can integrate desktop, departmental, and data center computers into a complete network that functions as a single system throughout an organization; and, we can integrate many other vendors, including IBM.

Digital also has all of the components and the experienced staff to wire virtually any department, building, campus of buildings, or an entire worldwide organization into a unified network. The company also provides assistance to customers in designing, installing and managing local and global networks. Only Digital has the products, the experience and the expertise to do the complete job of building local area and wide area networks.

Customers have installed almost 3,300 Ethernet networks, which include more than 30,000 computer-to-computer links. The total number of computers, workstations, and terminals connected by Ethernet exceeds 100,000, making Digital, by far, the world's largest supplier of computer networks.

The large VAX 8600 computer we introduced in October 1984 continues to ship well ahead of schedule and demand remains excellent. More than 700 of these large systems have been shipped to date, virtually all of them equipped for Ethernet and VAXclusters.

VAXclusters are Digital's multiprocessing technology that allows multiple computers to share a common database. We have installed 2,500 to date. This technology allows the addition of computers and disks to make very large computer systems using a common database. VAXclusters have become a key part of our strategy and will, we believe, have a significant influence on the market in the future because they provide the large-scale capabilities that users demand and because of the ease with which they permit the addition of more computing and data storage capacity.

Another highlight of the year was our successful implementation of the VAX architecture on a single chip, which we consider to be one of Digital's most significant technical achievements. It culminated an intensive effort which Digital engineers succeeded in compressing the normal development cycle of three years for such an advanced chip to twenty months.

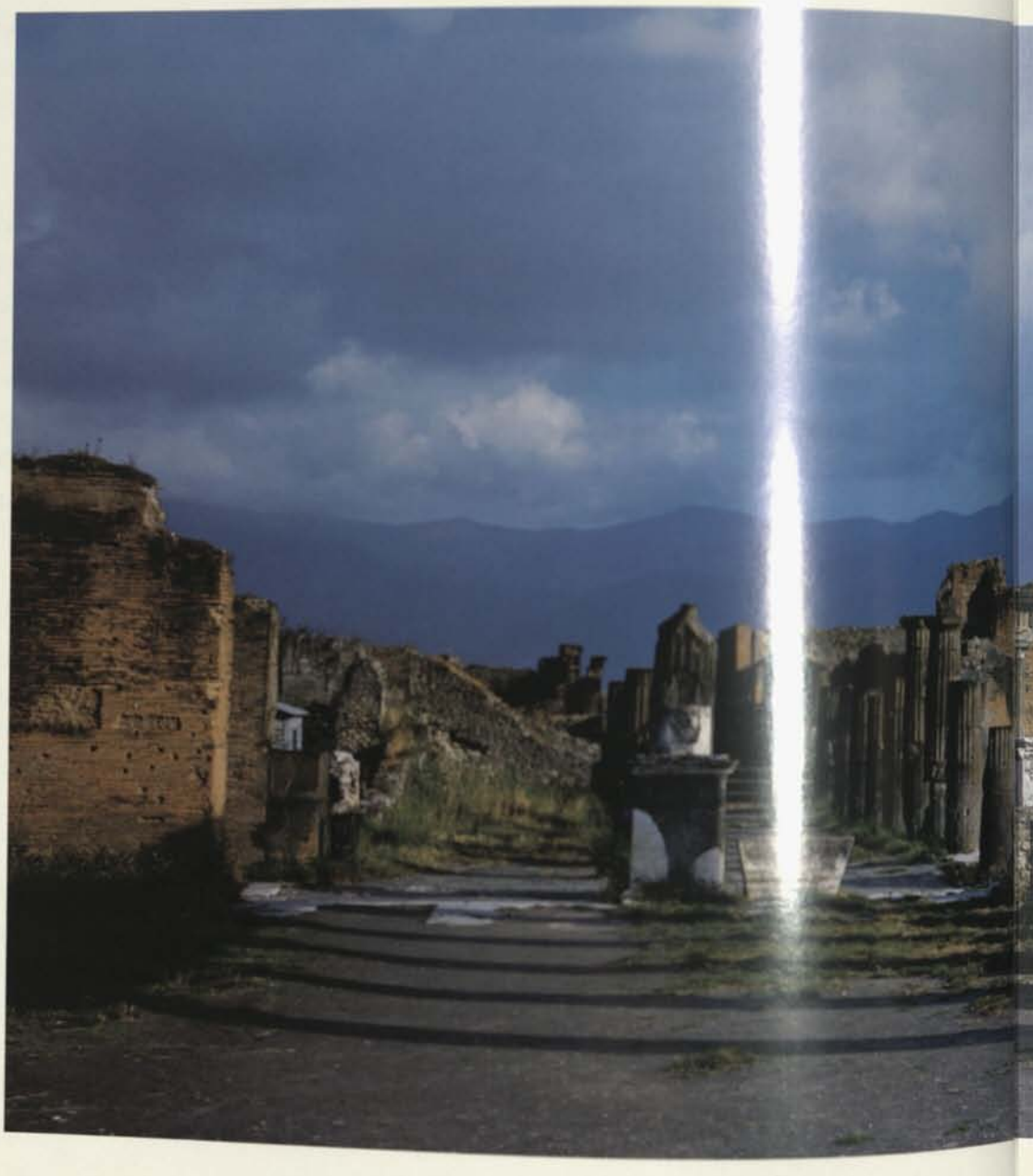
Digital's MicroVAX chip was the first newly developed integrated circuit to be granted protection by the U.S. Copyright Office under the Semiconductor Protection Act of 1984. The Act protects the "mask work"—the pattern of materials which make up the layers of the chip—from unauthorized copying.

More important than the chip itself, however, are the compact, powerful computer systems it enables us to build, all of which run the vast array of VMS software. The first of these are the MicroVAX II and the VAXstation II, which were introduced in May 1985, and each has been very successful. More than 2,000 of these systems have been shipped, and we see this initial strong demand as just the beginning.

We were particularly pleased with the improvements in our balance sheet during Fiscal 1985. At year end, our inventories were lower than a year ago, despite the 20 percent growth in revenues. We also had positive cash flow and closed the year with cash reserves in excess of $1 billion.

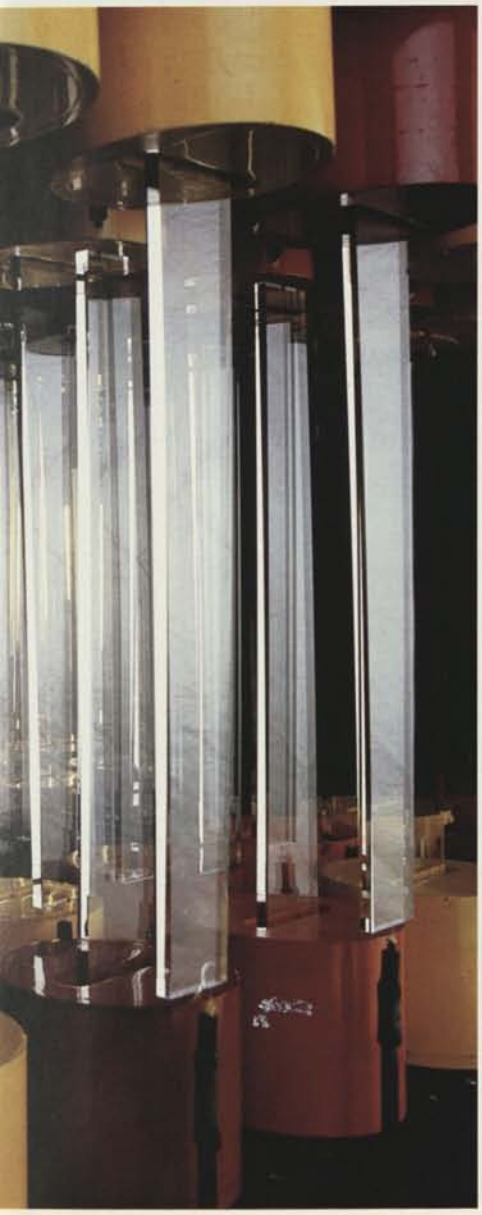
Digital will remain focused on the overriding goal of building quality into our products and services to ensure that we meet the ultimate criterion of our success: customer satisfaction. To that end, we will continue to invest heavily in new technologies that enhance Digital's leadership in networking and in powerful computers.

Kenneth H. Olsen, President
August 28, 1985



A monitoring station near Naples, Italy, is one of 46 sites in a nationwide network that feeds seismic data to the Istituto Nazionale Geofisica headquarters in Rome. Large VAX computers analyze the data as part of the institute's national program of geophysical research and earthquake forecasting.

Lawrence Berkeley Laboratory in California employs a wide range of sophisticated instruments to support research. Data is collected, transported, and analyzed by a network of Digital computers including a cluster of five VAX 8600s. This Ethernet network includes seven fiber-optics links, and supports over 100 computer systems.



When Digital started 28 years ago, its mission was to be a business success by making real and useful contributions to the ways in which people and organizations use computers. We provided fast, interactive computers that could be used for many applications in a large number of industries.

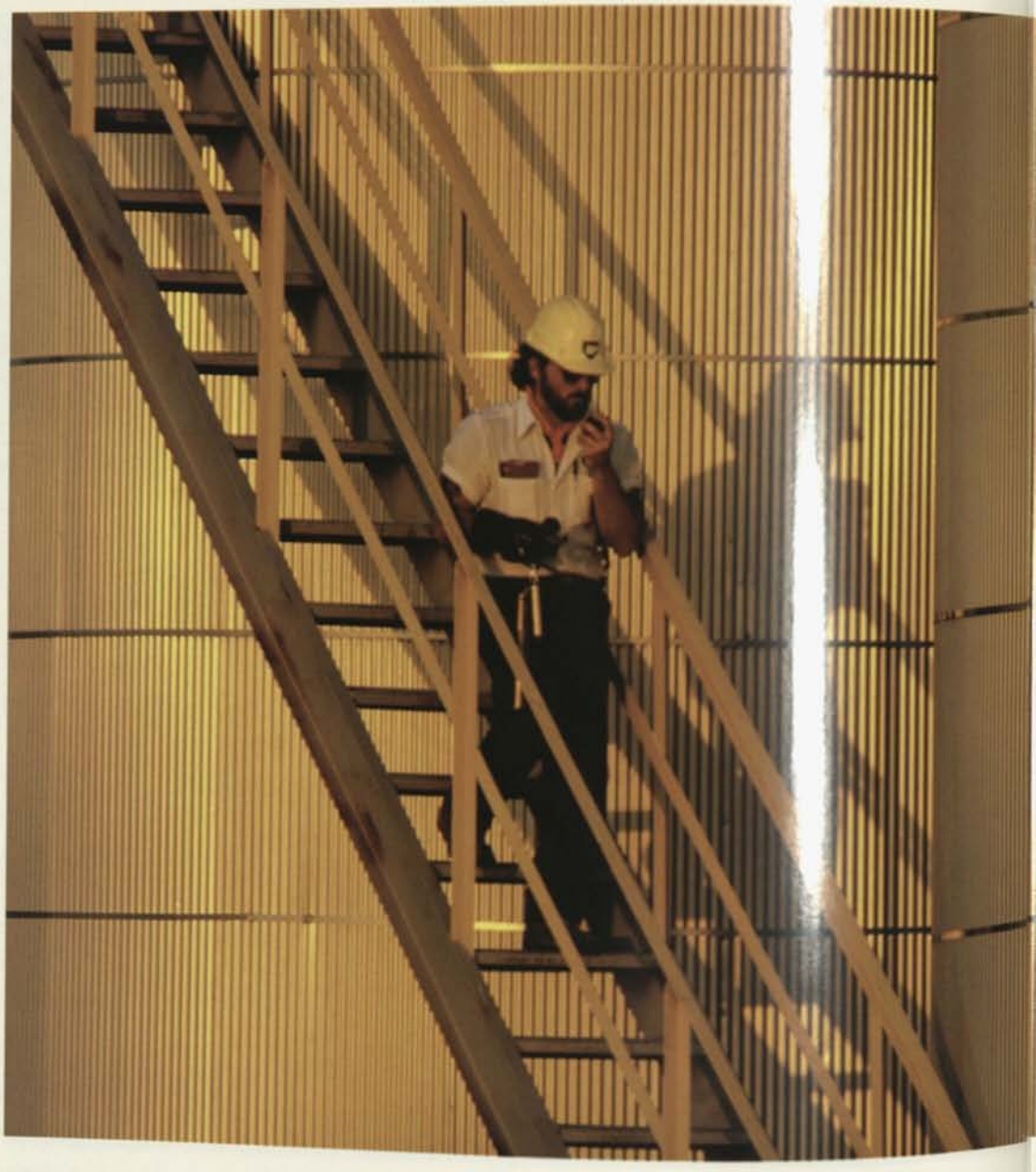
For 25 years we have built networks of our own computers and computers made by others. For the past 15 years, we have developed a systematic, disciplined strategy for high-speed, easy-to-use networking. Today, we offer all the components and skills necessary to build these networks.

We exploited the latest technology to develop high-performance machines that could be put virtually anywhere and used by anyone, free of the need for a large staff of expensive experts working in an isolated computer room.

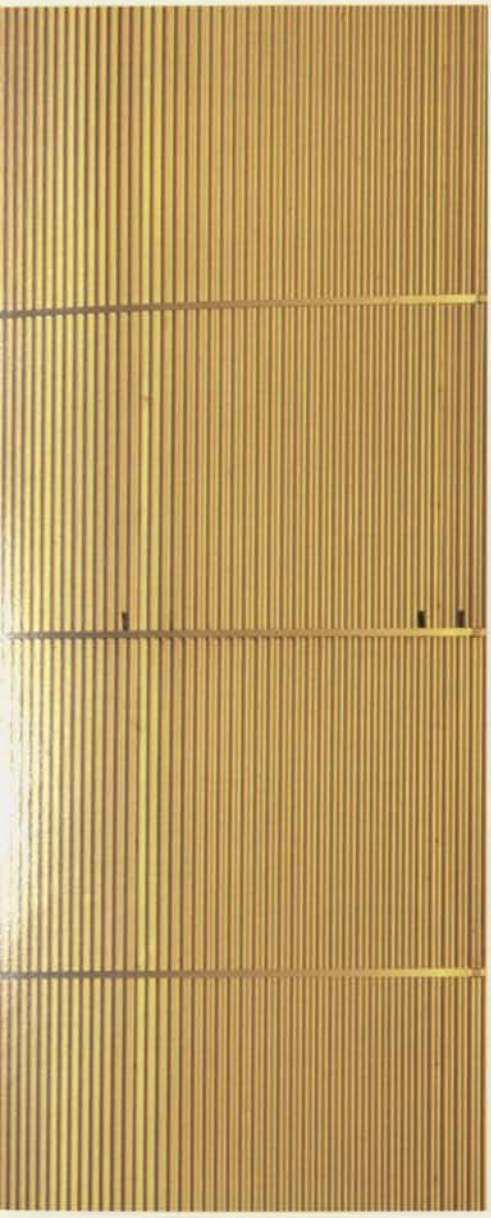
From the start, we chose to accomplish the harder, more technically challenging jobs, partly because of our engineering background but mainly because this was Digital's contribution to the computer industry.

Over time, we introduced computers into a wide range of markets: education, manufacturing, medicine, machine tools, process control, publishing, engineering, government, science and research, office and management information systems (MIS).

The Need For Networks □ It was clear to our customers from the start that they needed to share information and workload among computers and people and organizations. The minicomputer, as defined by Digital, became a communications device and introduced the idea of distributed computing.



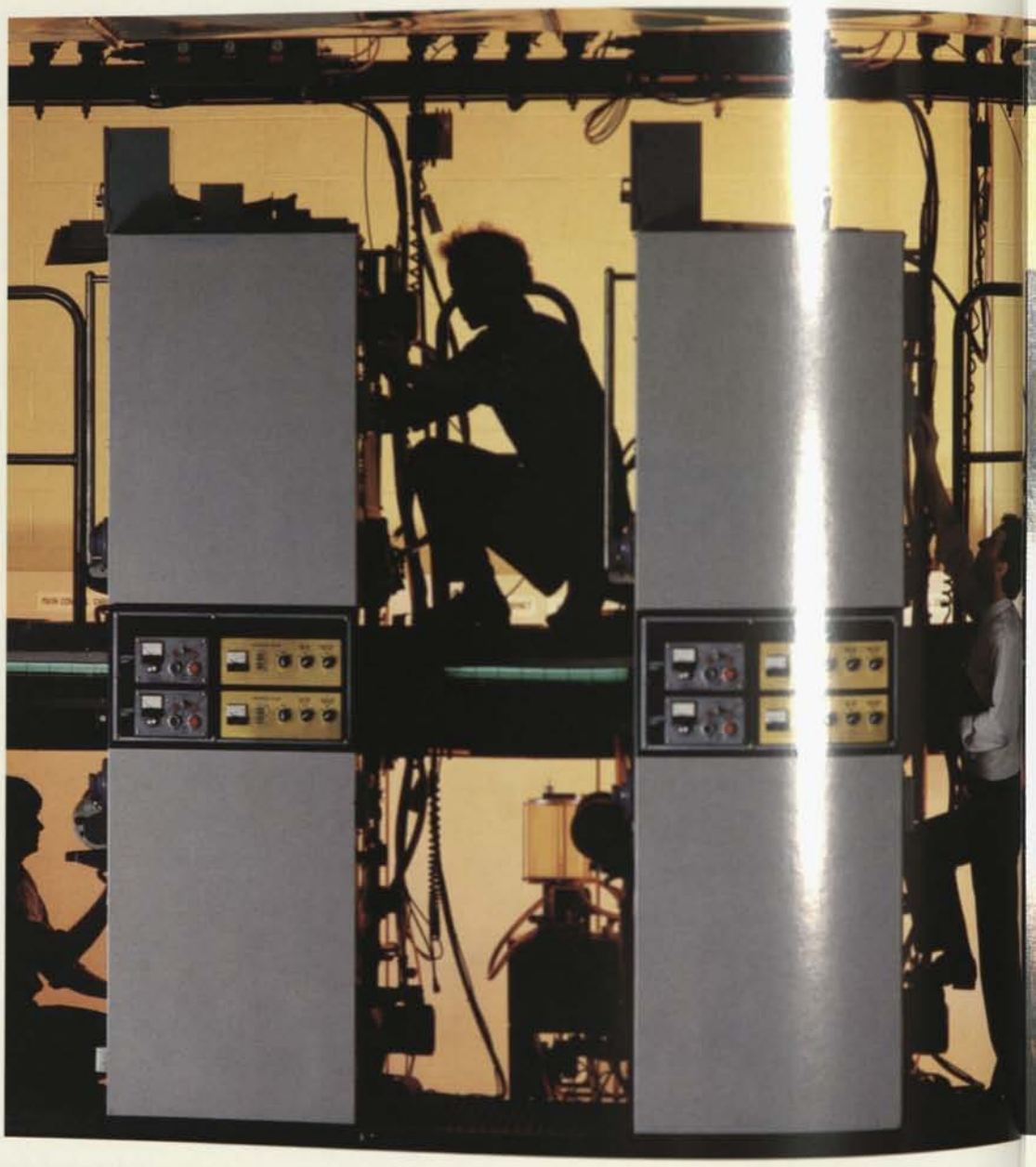
BP North America Petroleum Inc., of Houston, TX, a wholly-owned subsidiary of the British Petroleum Company, p.l.c., the U.K.'s largest corporation, uses a cluster of VAX computers linked to a worldwide network to manage the dynamics of trading crude oil and petroleum products.



Digital Network Architecture & DECnet □ In the early 1970s, we began development of the Digital Network Architecture (DNA). The first step was DECnet, a very advanced and complete protocol for integrating similar or different computers in a network. DECnet has become probably the most widely used networking protocol in the world, with more than 35,000 installations.

VAX and VMS □ In the mid-1970s, we began developing an architecture for a 32-bit computer – VAX – which would be equally as effective as a desktop machine as it was a large data center machine. The VAX architecture was designed to last for many, many years. Most importantly, VAX was designed to work effectively in networks.

To maximize the efficiency and effectiveness of our networks, and to fully exploit the functionality and versatility of a single hardware architecture, we concurrently developed a single software system – VMS – that would have one powerful version of each programming language and that could work as effortlessly in networks as in single systems. It is the VMS software that ties together all of our computers, clusters and networks. And with it come literally thousands of applications which have been written over the years. There are also security features built into VMS which afford significant protection to systems and stored data. For these reasons, we believe that VMS is the best proprietary software system in the world and we plan to keep it that way. Digital also provides one of the world's best UNIX-based systems, called ULTRIX, for those customers who already have UNIX applications or who do not need the array of features or the networking capabilities of VMS. ULTRIX is based on UNIX Version 4.2, which is popular among academic and technical users, and will also run applications developed on UNIX Version 5.



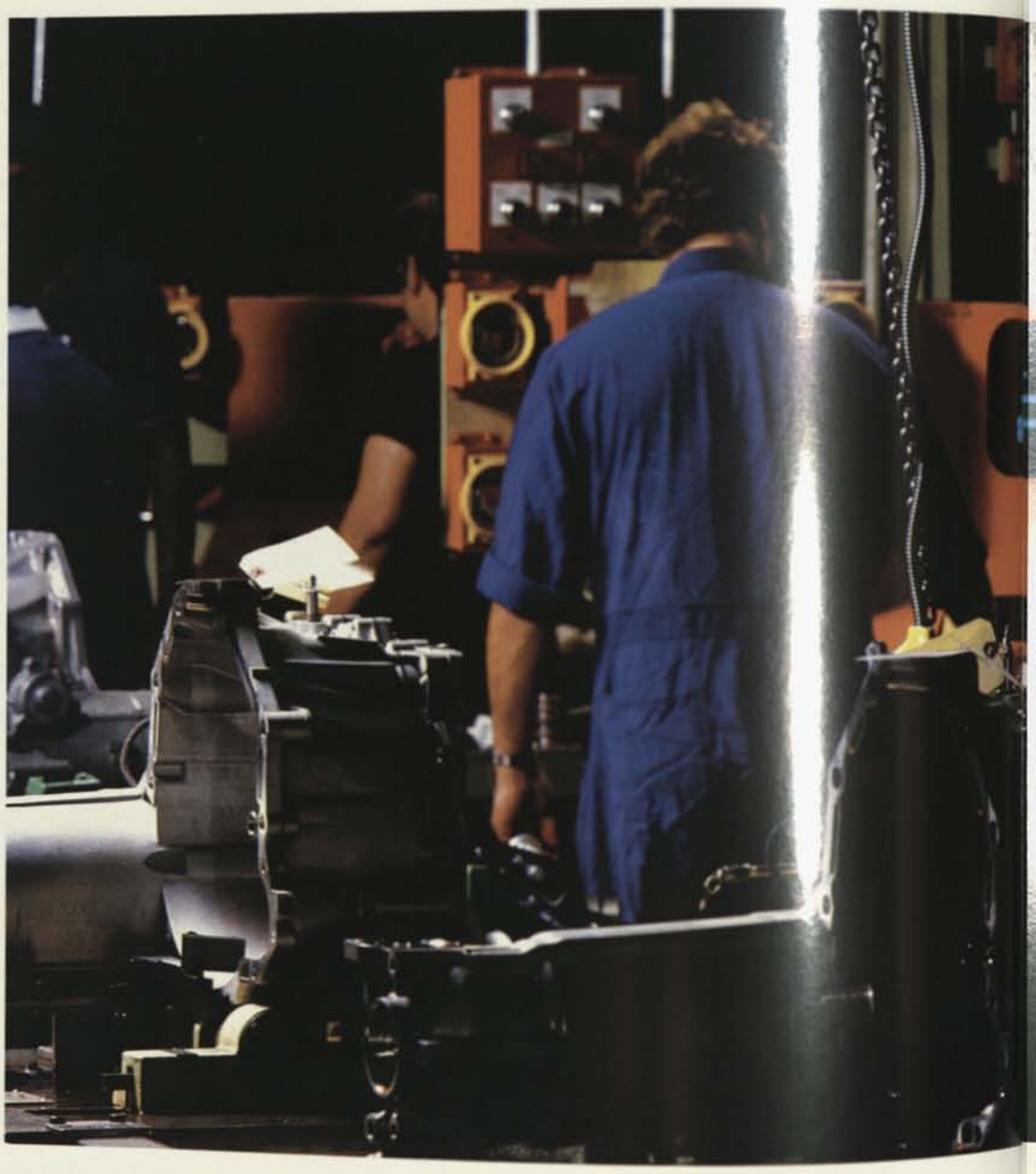
Acme Printing, Inc., has used Ethernet to build a network of VAX computers and workstations throughout its Medford, MA, production plant to fully automate the planning, estimating, scheduling, billing and job cost accounting of its high-quality, high-volume color printing operations.

Ethernet □ Later in the 1970s, Digital committed to Ethernet as the networking scheme for optimizing local resource utilization. We incorporated it into DNA, made it the key element in our networking strategy, and have directed a large portion of our development investment into the systems components required to make the implementation of Ethernet networks practical. Ethernet makes it easy to build reliable computer networks of any size that can be changed or expanded just as easily, as user needs require. These networks afford maximum efficiency in the use of expensive computer resources.

In 1985, Digital became the first computer manufacturer to extend the Ethernet approach from the baseband to the broadband environment. Baseband is used typically for data distribution; broadband can be used to distribute such communications services as video and voice, as well. Digital provides the equipment needed to tie Ethernet systems together around the world.

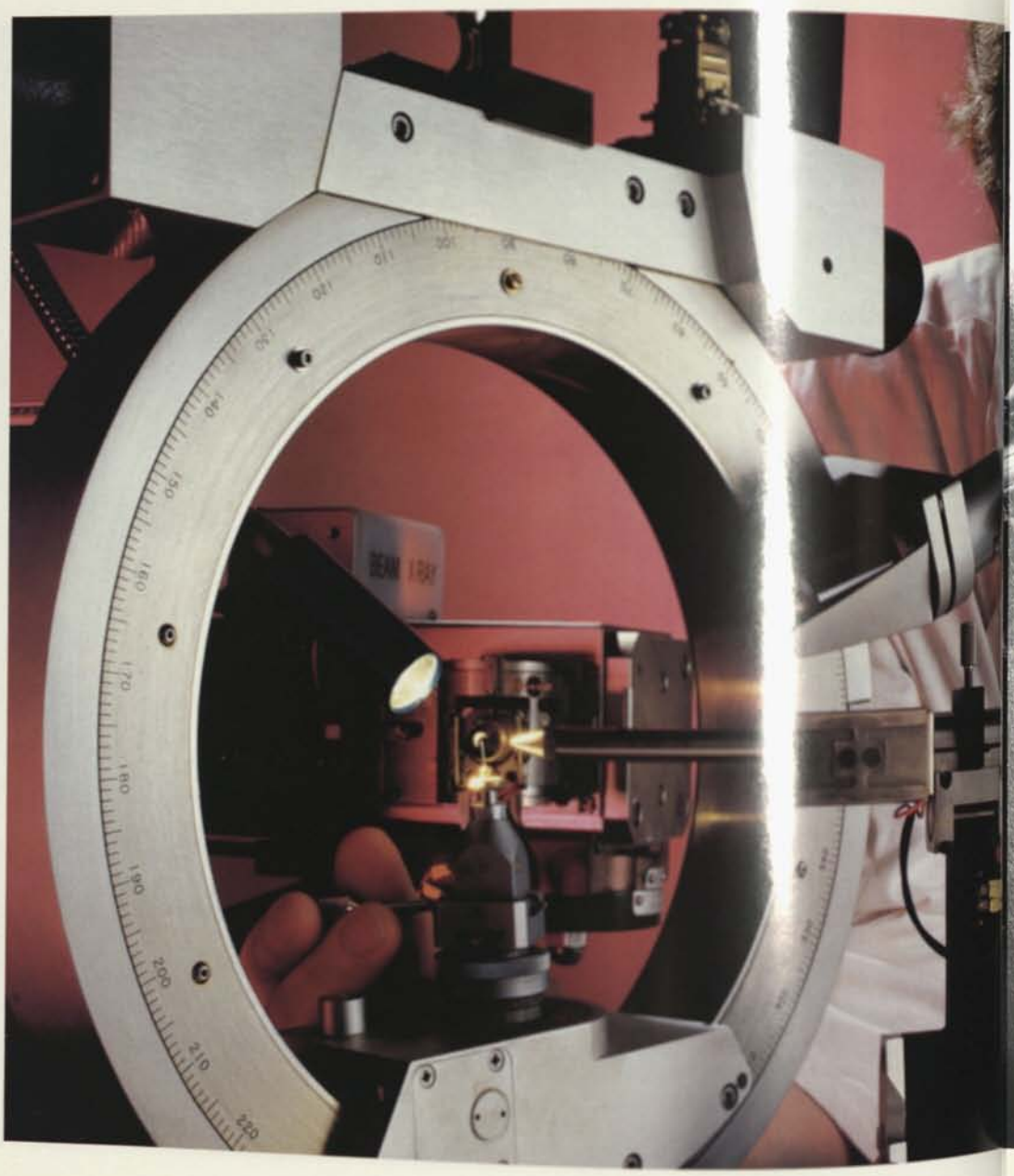
VAXclusters □ During the late 1970s, Digital also committed to the development of the unique multiprocessing technology we call VAXclusters. This technique permits the tying together of large numbers of VAX computers with one database to create a single, very large system. As many as 16 VAX computers can be linked in a cluster to provide more computing power than the largest mainframe systems.

VAXclusters permit users to take a "building blocks" approach to using computers of various sizes in combination with data storage devices to achieve optimum resource utilization and maximum return on investment.

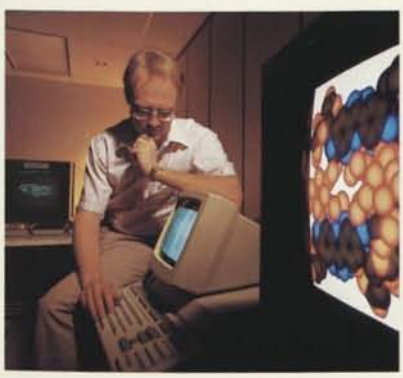


At Ford Motor Company's transmission plant in Livonia, MI, assembly, and quality testing are controlled by more than 500 manufacturing control devices, all linked and supported by VAX computers running BASEWAY, Digital's communications network for high-volume manufacturing operations.


VAX 8/785



At the world-renowned Fox Chase Cancer Center in Philadelphia, PA, 100 terminals and workstations distributed throughout the sprawling biomedical research complex are connected to a cluster of large VAX computers, affording easy access by scientific and clinical staff to a huge base of research and patient data.

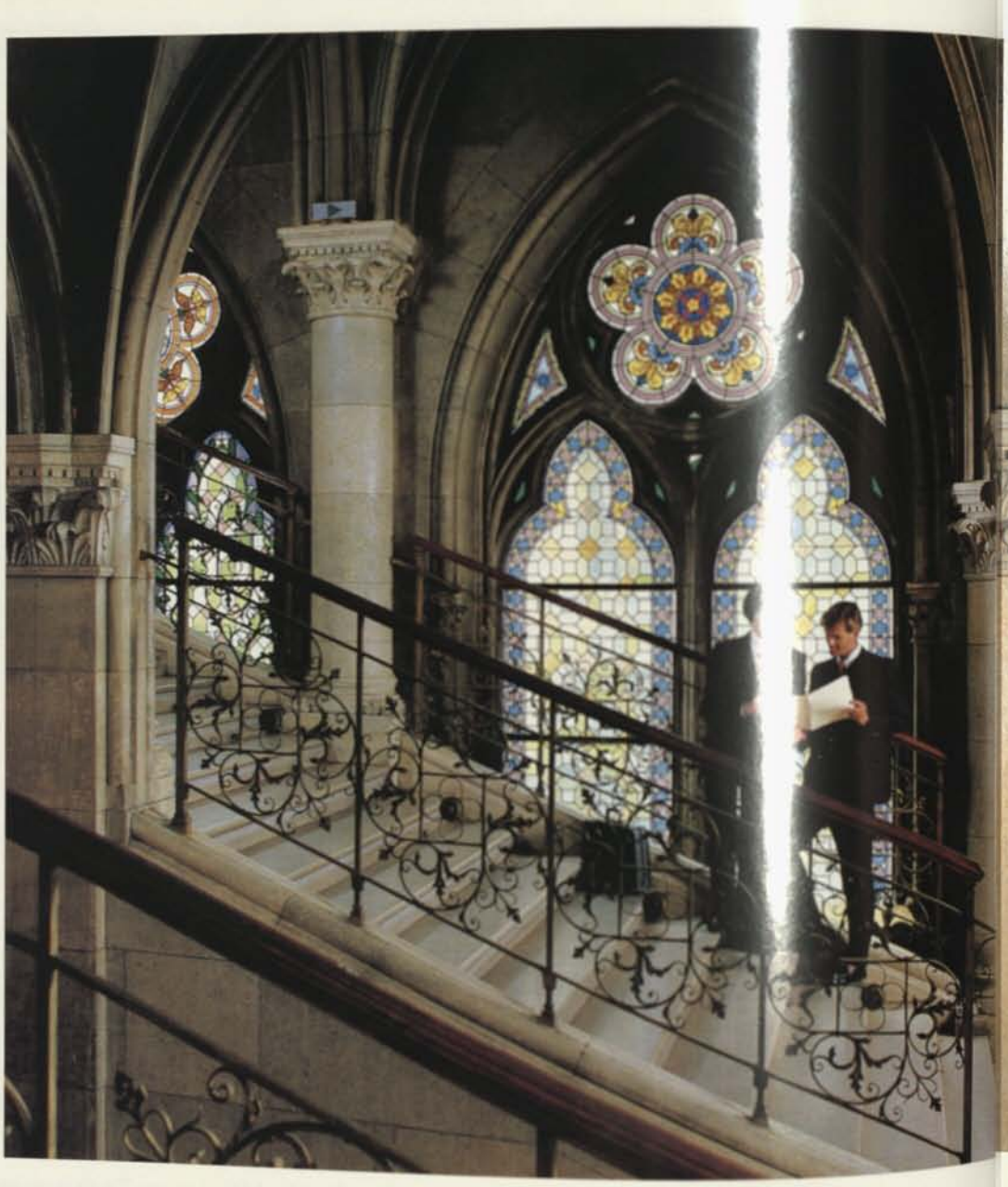


Open Architecture □ The Digital Network Architecture is based on the International Standards Organization's model for open system interconnection. In June 1985, Digital announced a three-year plan to have its networking products support the standards set forth in the ISO's Open Systems Interconnect model (OSI). This model is the international standards framework for configuring multi-vendor networks. Digital is the first U.S. computer company to commit its support to OSI. This move strengthens Digital's support for the Manufacturing Automation Protocol (MAP) being used by the automotive industry to build multi-vendor networks for factory automation. The modularity and discipline of DNA make it possible for Digital to support MAP and embrace OSI standards as they are completed.

Digital's DNA already allows customers to create integrated networks from their present array of computing resources, including those provided by other manufacturers. For example, a gateway to IBM's Standard Network Architecture (SNA) protects customers' investments in large IBM databases and data processing systems by allowing the IBM systems to serve as nodes in a Digital network.

Recently, Digital provided another important bridge to the IBM computing environment via an External Document Exchange capability which allows users of Digital office systems to access and edit text information residing in an IBM Distributed Office Support System (DISOSS) document library. Digital is the only vendor to offer this level of DISOSS integration with IBM.

Since 1977, DECnet, Digital's global networking protocol, has also supported the X.25 international networking standard, permitting the building of vast, worldwide networks.



The diverse governmental affairs of Austria's capital city, Vienna, have been fully automated on a network of VAX computers linked by Ethernet. Digital's comprehensive ALL-IN-1 office and information system is used to manage delivery of educational, medical and civic services to the city's two million residents.

Within the context of its networking strategy, Digital has developed a number of innovative products and programs designed to ensure that the computing needs of all its customers – large and small, end user and third party – are met as effectively and efficiently as possible. Here are a few:

ALL-IN-1 Office and Information System □ Digital's widely used integrated, multifunction office system provides easy access through any personal computer or terminal on the system to five standard office applications: word processing, electronic mail, time and resource management, information management, and business-specific applications. ALL-IN-1 permits the easy integration of non-standard applications, as well.

A-to-Z Integrated System □ Digital offers an innovative software package for Digital's multiuser MicroVAX II and MicroPDP-11 systems that makes it easy for Original Equipment Manufacturers (OEMs), software developers and other third parties to migrate the more than 1,600 VAX business software packages to the small business market and to integrate their specialized vertical applications with standard business applications such as accounting, word processing, spreadsheet, business graphics, report writing and list processing to provide total, tailored solutions to small businesses.

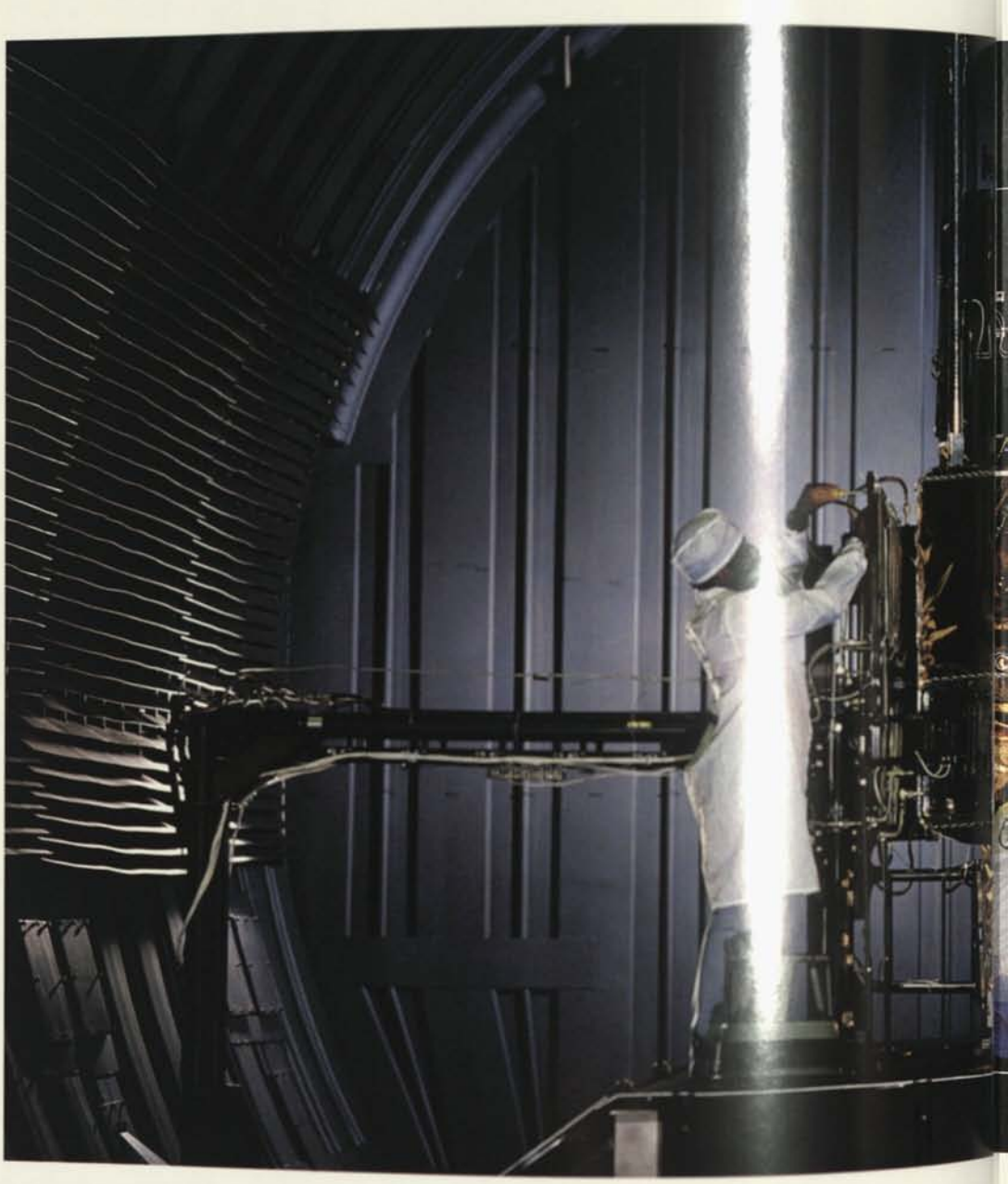
Artificial Intelligence □ Digital has been the leading supplier of Artificial Intelligence (AI) tools for several years, for its own use and for AI developers and end users, as well. The new AI VAXstation II system, the industry's first fully-integrated artificial intelligence workstation, provides program developers and end users with a powerful and versatile tool. It uses VAX LISP, Digital's version of

Westland Helicopters, Ltd., of Yeovil, England, a leading British manufacturer of aircraft for civilian and military markets, employs a large network of VAX and PDP-11 computers to integrate the design, fabrication, and testing of the more than 6,500 sheet metal components required to construct a helicopter fuselage.

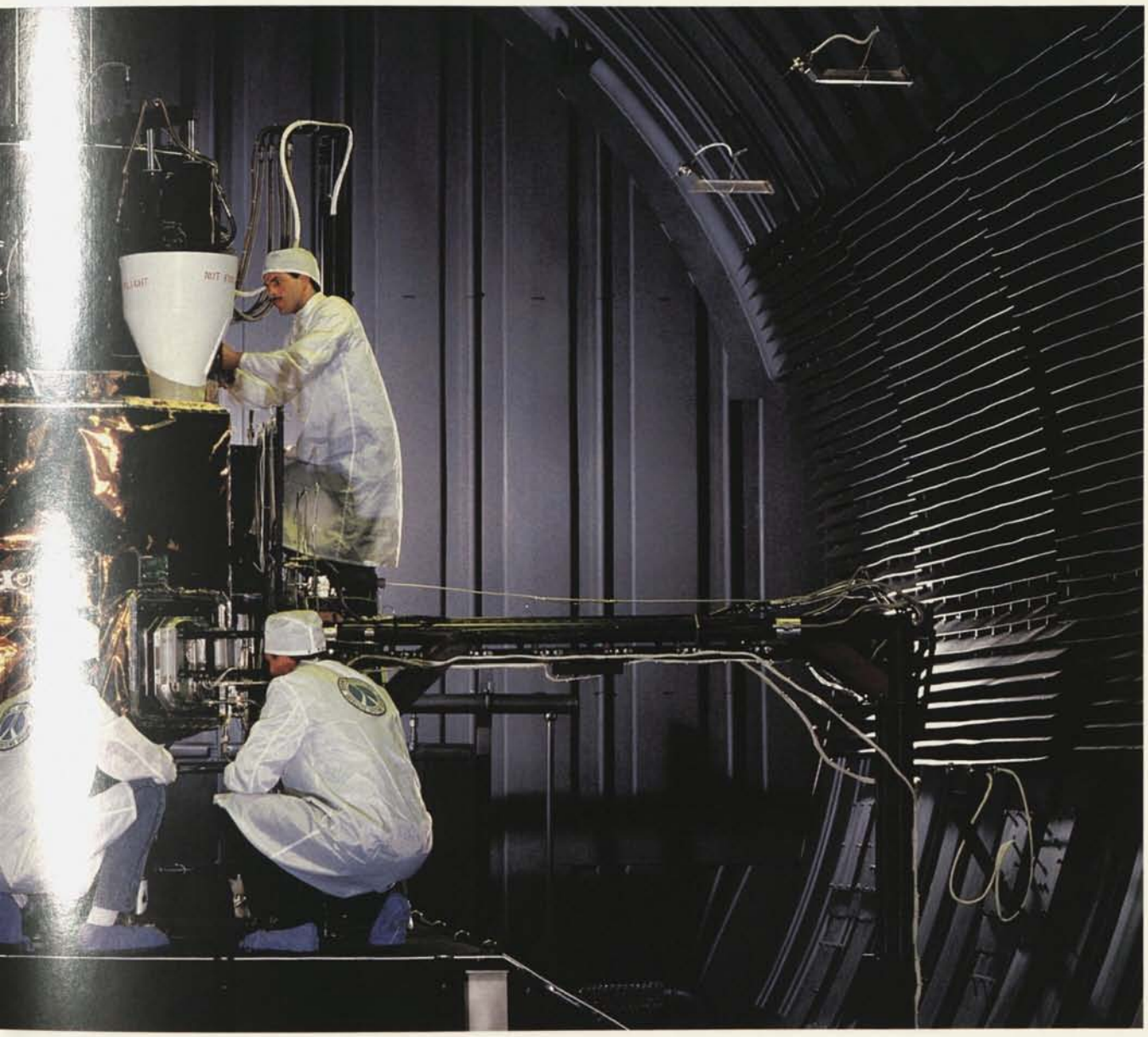
COMMON LISP, an emerging standard in all areas of AI development and implementation, and is targeted to commercial and industrial markets such as aerospace, petrochemical, government and finance, as well as academic scientific research.

BASEWAY □ Digital is the first major computer vendor to offer a software package specifically designed to integrate industrial controllers with manufacturing applications on the factory floor. Called BASEWAY, this VAX-based system provides plant managers, engineers and shop floor personnel with flexible networking and application-sharing capabilities through gateways that link such devices as robots, numerical control machines, process controllers and terminals into a true computer-integrated manufacturing environment. A PDP-11 based package, called DECtap, is available for small to medium manufacturing operations.

Data Security □ Digital has designed outstanding features into the latest version of its VMS software system which give systems managers new and better ways to control and monitor access to VAX systems and protect the integrity and security of stored data. Built-in safeguards against unauthorized access include automatic password checks, restrictions on login attempts, login time and password length. VMS also contains the ability to assign selective access to certain users and the discretionary exclusion of others. Tampering can be traced through an auditing facility, and security alarms can be set to signal attempts to gain unauthorized access to the system. There is also a VAX Encryption option available in the U.S. to users who require additional security. We believe that VMS offers the most effective security features available today.



Among its many diverse enterprises, Rockwell International Corporation operates one of the world's most sophisticated deep space simulation facilities at Seal Beach, CA. A VAXcluster networked with Ethernet controls development of satellites and their subsystems which are tested in this huge Thermal Vacuum Chamber.



Commerzbank, one of Europe's leading commercial banks, has built an extensive international banking system using a network of VAX computers and Ethernet to link ten foreign branches to its headquarters in Frankfurt, West Germany, for management of electronic fund transfers and other data processing applications.

Optical Disk Storage □ In May 1985, Digital introduced a compact data storage system capable of storing the data contained on 200,000 single-spaced typewritten pages, the equivalent of two complete sets of encyclopedia, on a read-only optical disk less than five inches in diameter. This system, which is designed for use with MicroVAX and VAXstation systems, dramatically lowers the cost of distributing and using very large volumes of information found in such reference publications as catalogues, service manuals, engineering drawings and legal references, all of which are usually available only in printed form, on microfiche or in on-line databases.

External Research □ Digital augments its own extensive research activities through cooperative agreements with a number of external organizations as a way of encouraging research in specific areas and keeping abreast of other areas which may be critical to the company's future. Through this Sponsored Research Program, the company provides substantial equipment grants to scores of the world's leading academic research institutions in return for sharing in their results. Digital currently supports 140 external research projects in such areas as Computer Aided Design and Manufacturing, Networking, Semiconductor Technology, Education, Human Factors and Artificial Intelligence, among many others.

Digital derives a variety of benefits from this program. The primary benefit is specific research results, prototypes or tools for potential use by Digital's engineering and manufacturing groups. Digital also gains insight into areas that might offer large potential payoff.

Cybermation, Inc., of Cambridge, MA, a leading supplier of design and cutting systems to the sheet metal industry, is among hundreds of OEMs who integrate Digital's computers into their own specialized systems. Firm uses MicroVAX II systems to automate a variety of computer-integrated manufacturing applications.

All efforts to exploit the latest technologies, design the best products and provide the best solutions are meaningless unless our customers are satisfied with the results of using Digital's products and with the level of our commitment to help them be successful by being responsive to their articulated needs.

To this end, Digital maintains a worldwide customer support organization of more than 30,000 maintenance, software support and training professionals deployed at more than 650 locations in 54 countries on five continents. Their goal is to maximize computer availability to customers and minimize cost of ownership.

Because different customers have different needs, Digital offers a comprehensive array of support services from which customers can choose. These include 24-hour, full service and as-needed contract coverage; automated telephone diagnosis of hardware and software products; and call-in centers for software consulting by telephone. Carry-in centers and a fleet of fully equipped mobile units provide service for small systems and terminals.

For customers whose needs are not met by Digital's standard products, the company maintains Special Systems facilities around the world that provide customized services in hardware and software design, applications programming, systems engineering, project management, and networking.

Digital maintains one of the world's largest private educational services organizations. The training curriculum encompasses more than 500 courses offered in 18 languages at 40 centers around the world. Self-paced courses, computer-based instruction and classes at customer sites are also offered.

Eastman Kodak Company, world leader in photographic film and photo-finishing and innovator in imaging technology, uses a network of VAX computers at its Fairlawn, NJ, Processing Laboratory to control the pricing and labeling of millions of photofinishing orders, and sorts each order to the appropriate retail dealer.

During the past year, Digital added new products and programs to its comprehensive offering of customer services:

An early-warning system is available that monitors the performance of single VAX systems, VAX networks and VAXclusters and warns system managers of hardware problems before they occur, thus averting the expense and inconvenience of unexpected downtime. The monitoring system, called VAXsim, allows one operator at a terminal to trace imminent hardware problems down to the device level. VAXsim detects and pinpoints them, allowing system managers to schedule preventive maintenance and avoid costly downtime.

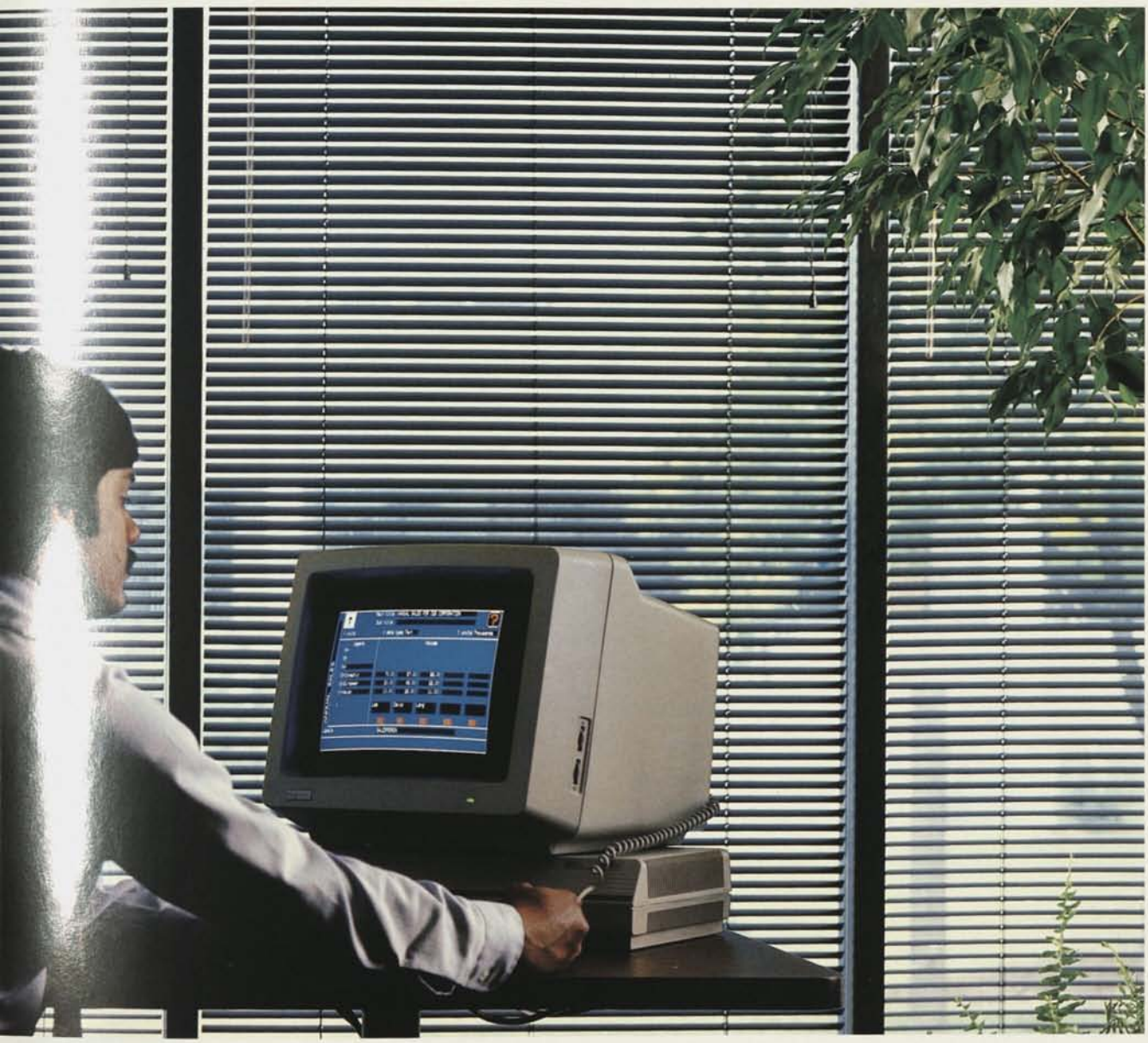
Digital broadened the coverage of its disaster recovery services which provide subscribers with back-up computing capabilities to replace their systems lost to storms, power outages or other disasters.

The company also began offering a new service which assists customers in the design, installation, and maintenance of broadband Ethernet networks.

A Corporate Quality Leadership Group was established during the year to review key customer satisfaction goals. Cross-functional teams evaluate our performance in the areas of installations, product reliability, and ease of doing business with Digital.

Recently, Digital's customer service organization was rated by an independent survey as the best among the ten major computer vendors. We are proud of this recognition and are challenged by it to continue development of innovative programs and new service technologies to ensure that customers' needs are met.

Carroon & Black, one of the world's largest insurance brokers, switched from conventional computing at its Nashville, TN, offices to a fully integrated network distributed throughout its world-wide organization. Ethernet links MicroxVAX IIs and a VAXcluster featuring a VAX 8600 into a single, powerful system.



Digital recognizes that it has important obligations to many people whose reasonable expectations the company must strive to meet. Customers expect Digital to provide reliable, high-quality products and services. Shareholders expect us to work hard to make their investments grow. Our employees expect the company to be a sensitive, supportive employer. The community at large expects Digital to be a thoughtful neighbor and responsible corporate citizen.

Digital is very proud of the dedication of its people around the world and seeks to recognize their accomplishments by providing programs that promote their personal and professional growth. These include continuing education, job enlargement training, management development, personal skills workshops, tuition refunds, scholarships and university courses at company facilities. All of these programs were expanded during the year to accommodate the steadily growing numbers of employees at all levels of the organization who seek to learn and grow, and we will continue to encourage their initiatives.

Digital remains seriously committed to programs which ensure that all employees have equal opportunities for hiring and advancement, and continues its aggressive affirmative action efforts to attract and develop minority and female employees. One of the most successful programs in this area involves partnerships with a number of minority universities to which Digital provides computer equipment and other resources to support the development of state-of-the-art science and technology curricula.

Digital encourages outside initiatives at the national, regional and local levels in all the areas of the world where our employees live and work. During the year, Digital broadened its community involvement through increased grants of cash and equipment to hundreds of educational, social, civic, cultural and health care programs.

A grant of VAX computer equipment was made to the Adam Walsh Child Resource Center, which is developing a nationwide research initiative to deal with issues of child abduction. Another new program, this one designed to promote self-sufficiency of the disabled, was supported with contributions of DECtalk voice synthesizers as technical aids to the blind and disabled.

Digital has always encouraged employee involvement by matching dollar-for-dollar their gifts to schools, hospitals, non-profit organizations and United Way programs. This year, for the first time, individual employee gifts matched by the company exceeded $1 million.

More than 400 scholarship grants were made to children of employees, to women and minorities pursuing careers in science and technology, and to college-bound students in Digital communities.

Digital takes seriously its obligations to its customers, its shareholders, its employees and to the community at large. As we grow, we look forward to increasing our support of the initiatives they take, and remain strongly committed to taking our own in meeting our corporate responsibilities.

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Financial Contents

Operations *(in millions except per share data)*	1985	1984	1983	1982
Revenues				
Equipment sales	$4,534.2	$3,831.1	$2,867.5	$2,793.7
Service and other revenues	2,152.1	1,753.3	1,404.4	1,087.1
Total operating revenues	6,686.3	5,584.4	4,271.9	3,880.8
Costs and Expenses				
Cost of equipment sales, service and other revenues	4,087.5	3,379.6	2,606.0	2,187.6
Research and engineering expenses	717.2	630.7	472.4	349.8
Selling, general and administrative expenses	1,431.8	1,179.5	830.6	758.6
Operating income	449.8	394.6	362.9	584.8
Interest expense	82.0	35.1	13.1	14.8
Interest income	(63.0)	(41.5)	(61.2)	(102.8)
Income before income taxes	430.8	401.0	411.0	672.8
Provision for income taxes	(15.9)[2]	72.2	127.4	255.6
Net income	$ 446.7	$ 328.8	$ 283.6	$ 417.2
Net income per share[1]	$ 7.42	$ 5.73	$ 5.00	$ 7.53
Weighted average shares outstanding	62.1	57.4	56.7	55.4
Financial Position *(in millions except per share data)*				
Inventories	1,756.2	1,852.2	1,353.8	1,137.4
Accounts receivable, net of allowances	1,539.0	1,527.3	1,125.0	807.6
Working capital	3,694.2	3,001.4	2,377.0	2,181.2
Property, plant and equipment, at cost	2,827.6	2,351.8	1,961.4	1,605.4
Total assets	6,368.9	5,593.3	4,541.1	4,024.0
Long-term debt	836.9	441.3	92.8	92.4
Stockholders' equity	4,554.6	3,979.2	3,541.3	3,164.5
Stockholders' equity per share	$ 76.87	$ 68.83	$ 62.84	$ 57.30
General Information and Ratios *(dollars in millions)*				
Current ratio	4.9:1	3.8:1	3.9:1	4.1:1
Additions to property, plant and equipment	$ 571.8	$ 452.1	$ 419.2	$ 511.2
Depreciation	$ 315.1	$ 252.6	$ 203.2	$ 152.6
Debt to debt plus equity ratio	15.5%	10.0%	2.6%	2.8%
Operating income as a percentage of total operating revenues	6.7%	7.1%	8.5%	15.1%
Income before income taxes as a percentage of total operating revenues	6.4%	7.2%	9.6%	17.3%
Effective tax rate	(3.7%)[2]	18%	31%	38%
Net income as a percentage of total operating revenues	6.7%	5.9%	6.6%	10.7%
Net income as a percentage of average stockholders' equity	10.5%	8.7%	8.5%	14.3%
Net income as a percentage of average total assets	7.5%	6.5%	6.6%	11.2%
Number of days sales of accounts receivable outstanding	75	83	82	73
Inventory turns	2.3	2.1	2.1	2.0
Number of employees at year-end	89,000	85,600	73,000	67,100
Revenues per average number of employees *(in thousands)*	$ 76.6	$ 70.4	$ 61.0	$ 59.7
Common shares outstanding *(in thousands)*	59,253	57,811	56,357	55,227
Shareholders at year-end	68,810	44,389	40,903	44,706
Common stock yearly high and low sales prices	126-77	100-65	130-63	110-67

[1] *See Note E of Notes to Consolidated Financial Statements*

[2] *Includes $63 million from the elimination of taxes provided for DISC earnings in years prior to 1984*

1981	1980	1979	1978	1977	1976	1975
$2,384.2	$1,779.4	$1,381.8	$1,128.1	$ 847.5	$ 586.7	$ 433.2
813.9	588.6	422.3	308.5	211.1	149.6	100.6
3,198.1	2,368.0	1,804.1	1,436.6	1,058.6	736.3	533.8
1,778	1,319.9	1,012.3	802.3	595.1	424.3	301.2
251	186.4	138.3	115.7	79.7	58.4	48.5
63.2	478.9	370.1	281.0	205.9	136.1	109.3
536	382.8	283.4	237.6	177.9	117.5	74.8
29	27.0	24.3	22.4	11.7	9.9	4.8
(60.4)	(53.8)	(35.8)	(12.3)	(10.2)	(11.8)	(3.6)
567	409.6	294.9	227.5	176.4	119.4	73.6
224	159.7	116.5	85.3	67.9	46.0	27.6
$ 343.3	$ 249.9	$ 178.4	$ 142.2	$ 108.5	$ 73.4	$ 46.0
$ 6.70	$ 5.45	$ 4.10	$ 3.40	$ 2.78	$ 1.98	$ 1.28
52.6	47.2	44.9	43.2	39.0	37.1	35.9
1,102.2	819.9	513.5	428.1	375.0	218.8	174.8
758.1	629.1	475.1	375.2	323.1	219.3	165.0
2,029.6	1,658.2	1,076.9	887.0	574.2	499.0	333.2
1,128	772.3	582.1	507.8	352.4	215.8	167.6
3,456	2,666.1	1,863.2	1,501.4	1,070.4	856.0	565.1
88	489.7	340.7	341.6	90.6	91.4	85.2
2,679	1,651.7	1,120.2	904.8	735.5	606.0	394.4
$ 49.	$ 36.25	$ 27.59	$ 22.69	$ 18.73	$ 15.61	$ 10.94
4.2	4.5:1	3.8:1	4.7:1	3.5:1	4.3:1	5.2:1
$ 398	$ 209.9	$ 93.9	$ 167.0	$ 143.2	$ 54.5	$ 45.9
$ 102.	$ 69.8	$ 57.7	$ 50.2	$ 28.5	$ 22.0	$ 16.9
3.2%	22.9%	23.3%	27.4%	11.0%	13.1%	17.8%
16.8%	16.2%	15.7%	16.5%	16.8%	16.0%	14.0%
17.7%	17.3%	16.4%	15.8%	16.7%	16.2%	13.8%
39.5%	39.0%	39.5%	37.5%	38.5%	38.5%	37.5%
10.7%	10.6%	9.9%	9.9%	10.3%	10.0%	8.6%
15.9%	18.0%	17.6%	17.3%	16.2%	14.7%	12.5%
11.2%	11.0%	10.6%	11.1%	11.3%	10.3%	9.2%
73	81	82	82	88	85	92
1.9	2.0	2.2	2.0	2.0	2.2	1.9
63,000	55,500	44,200	39,000	36,700	25,700	19,000
$ 54.0	$ 47.5	$ 43.4	$ 38.0	$ 33.9	$ 32.9	$ 29.2
54,348	45,568	40,606	39,873	39,259	12,944	12,022
39,948	35,144	28,835	25,868	22,738	15,442	15,033
110-57	82-53	57-44	55-38	60-39	60-36	43-15

Income and Expense Items as a Percentage of Total Operating Revenues

1983	1984	1985	Income and Expense Items	Percentage Changes 1984-85	1983-84	1982-83
67.1%	68.6%	**67.8%**	Equipment sales	**18%**	34%	3%
32.9%	31.4%	**32.2%**	Service and other revenues	**23%**	25%	29%
100.0%	100.0%	**100.0%**	Total operating revenues	**20%**	31%	10%
61.0%	60.5%	**61.1%**	Cost of sales, service and other revenues	**21%**	20%	19%
11.1%	11.3%	**10.8%**	Research and engineering expenses	**14%**	24%	35%
19.4%	21.1%	**21.4%**	Selling, general and administrative expenses	**21%**	32%	9%
8.5%	7.1%	**6.7%**	Operating income	**14%**	9%	(38%)
0.3%	0.6%	**1.2%**	Interest expense	**134%**	138%	(11%)
(1.4%)	(0.7%)	**(0.9%)**	Interest income	**52%**	(32%)	(40%)
9.6%	7.2%	**6.4%**	Income before income taxes	**7%**	(2%)	(39%)
3.0%	1.3%	**(0.3%)**	Income taxes	**(122%)**	(43%)	(50%)
6.6%	5.9%	**6.7%**	Net income	**36%**	16%	(32%)

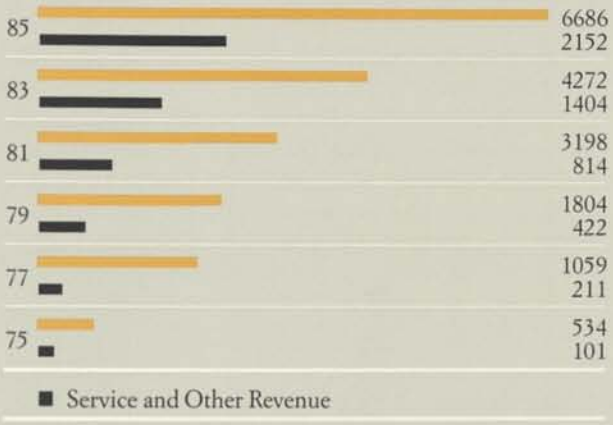
As an aid to understanding the Company's operating results, the above tables indicate the percentage relationships of income and expense items included in the Consolidated Statements of Income for the three fiscal years ended June 29, 1985 and the percentage changes in those items for such years.

The Company's total operating revenues for fiscal year 1985 increased by 20% compared with increases of 31% and 10% in the two preceding fiscal years. As fiscal 1985 began, the Company continued to benefit from the momentum provided by the broad-based economic recovery occurring both in the United States and overseas. However, as the year progressed, cutbacks in capital spending by many of our U.S. customers and growing weakness in the U.S. manufacturing sector resulted in the postponement of computer purchases. Overseas business grew substantially throughout the year despite the strength of the dollar and that demand in the computer and electronics sector of the U.S. economy had slackened.

The increase in revenues in fiscal 1985 can be attributed primarily to increased unit sales of the Company's broad set of products which are capable of networking or integrating many computers in an organization into a single system. The ability to interconnect computer systems from desktops to departments to the total organization has become increasingly attractive to existing and potential customers.

In fiscal 1985, service and other revenues, which principally include maintenance service, software revenues, customer training and the sale of replacement parts, grew 23%. For fiscal 1985, service and other revenues comprised 32% of total revenues compared with 31% in fiscal 1984 and 33% in fiscal 1983.

Total Operating Revenue **$ Millions**



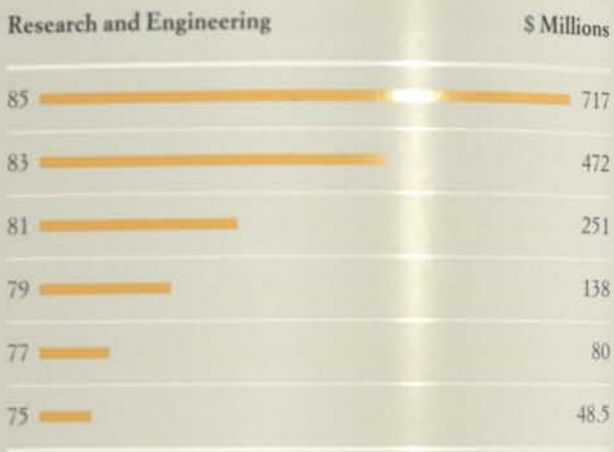
Non-United States Revenue **$ Millions**

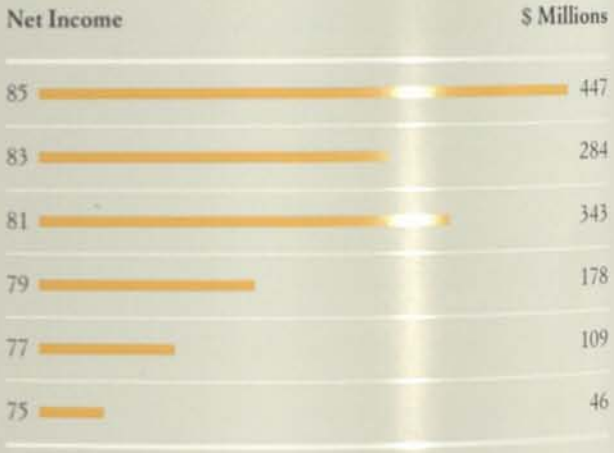
The cost of sales increased slightly as a percentage of total operating revenue in fiscal 1985 compared with fiscal years 1984 and 1983. The small increase reflects new product start-up costs and a level of sales that was less than planned.

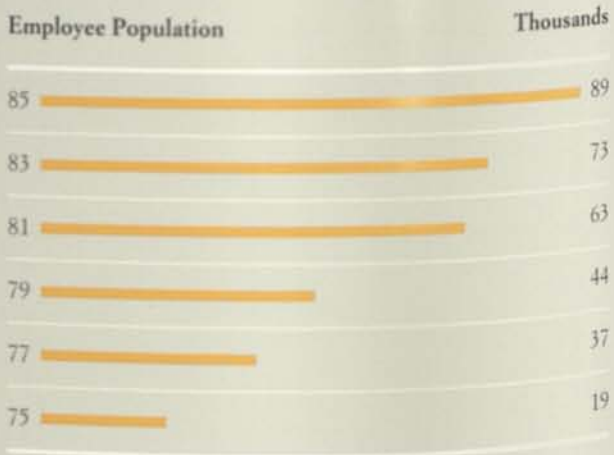
Research and engineering expenses grew 14% in fiscal 1985 and comprised 10.8% of total operating revenues compared with 11.3% in fiscal 1984 and 11.1% in fiscal 1983. Consistent with prior years, the Company intends to continue to invest aggressively in its research and engineering programs.

Many new products were introduced in 1985. Among them were the VAX 8600 "VENUS" computer, the largest and fastest processor in the VAX family, which extends Digital's integrated computing environment to the corporate data center. Also announced was the compact MicroVAX II, which is a complete VAX computer on a single VLSI chip, harnessing the power of a VAX-11/780 in a small computer for individual desks and departments. Implementation of the VAX architecture on a single chip also made possible VAXstation II, a powerful workstation that brings the VMS software system to the computer-aided design center.

These products, the results of major investments, represent truly significant technological achievements. However, their power and functionality really come from the vast array of VMS software currently available and from the systems and networking capabilities that make it possible to tie together all the computers located throughout a building, a dispersed location such as a campus, or throughout a global organization. Digital's VMS is the best, most complete proprietary software system in the world. It offers 15 major languages, programmer productivity, information management software, and literally thousands of applications. And, for those who do not need its extensive features and networking capabilities, Digital offers ULTRIX, which is the best UNIX-based software system available.







Expenses and Profit Margins (continued)

Digital is the world's leader in computer networks. We have installed more than 3,300 Ethernet local area networks to which customers have linked more than 100,000 computers, workstations and terminals. We have installed more than 35,000 DECnet wide area networks, as well.

Selling, general and administrative expenses increased to 24.2% of total operating revenues in fiscal 1985 compared with 21.1% in fiscal 1984 and 19.4% in fiscal 1983. Additions to sales and service personnel accounted for most of the increase over fiscal 1984.

Interest income increased in fiscal 1985 from fiscal 1984 levels due to a higher level of temporary cash investments. Interest expense increased due to an increase in debt, resulting principally from the issuance of $400 million of convertible subordinated debentures during the first fiscal quarter.

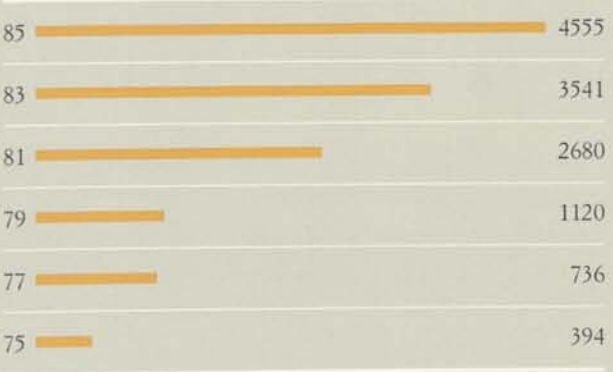
The Company's effective tax rate for fiscal 1985 declined due principally to the elimination of the taxes provided for DISC (Domestic International Sales Corporation) earnings in years prior to 1984. Prior to fiscal year 1984, the Company had provided for income taxes it anticipated would be paid in connection with its DISC earnings. This one-time benefit amounted to $63 million and was recorded in the first fiscal quarter. Excluding the one-time DISC benefit, the fiscal 1985 tax rate was 11%, compared with 18% in fiscal 1984. The decrease was principally due to investment tax credits and a higher level of activity in a number of the Company's foreign subsidiaries.

During the year, the total number of employees increased by 3,400, bringing the total number of employees at year end to 89,000. The increase in the employee population took place primarily in the sales and service organization. The number of employees in the manufacturing organization declined while the number of employees in the engineering organization increased slightly.

Inflation and Changing Prices

The preceding discussion and analysis are based on the Company's financial statements presented in historical dollars. See pages 56 through 59 for supplementary information on the Company's historical financial data adjusted for the effects of inflation and changing prices.

Total Stockholders' Equity — **$ Millions**



Availability of Funds to Support Current and Future Operations

The need for funds to support the Company's high rate of growth has historically caused it to use external financing to supplement internally generated funds. The Company anticipates the need to continue to use external financing in the future.

During the fiscal period 1983-1985, the total funds used to support operations and future growth exceeded the total funds generated from operations by $677 million, including $778 million in 1983-1984, partially offset by positive funds flow of $101 million in 1985. External financing during this three-year period consisted primarily of the proceeds generated from four debt offerings sold during fiscal 1984 and 1985. In March 1984, the Company issued $150 million of 11¾% guaranteed notes, due 1989, in Europe. This offering constituted the Company's first financing outside the United States. In April 1984, the Company issued $200 million of senior debt, in two pieces, in the United States: $100 million in 10-year 12⅝% notes and $100 million in 30-year 13% sinking fund debentures.

In September 1984, the Company is ed $400 million of 8% Convertible Subordinated D entures due 2009. From time to time, the Company ha nd may issue commercial paper to meet short-term o rational needs.

At the end of fiscal 1985, the Comp y's short-term and long-term debt totaled $851 millio p from $456 million at the end of fiscal 1984. Cash d temporary cash investments were $1,080 million at e end of fiscal 1985, compared to $476 million at the en of fiscal 1984. Unused lines of credit at the end of fiscal 1985 were $605 million, including revolving credit agreements of $480 million.

The Company believes its financial performance over the years, its low debt to debt-plus-equity ratio and its high credit rating leave it positione to obtain the financing required to support future rowth.

Common Stock Information

The Company's common stock is listed and traded on the New York Stock Exchange and the Pacific Stock Exchange. There were 74,833 stockholders of record as of August 1, 1985. The high and low quarterly sales prices for the past two fiscal years are presented as follows:

		1985
Fiscal Quarter	High	Low
First	**$101.500**	**$ 77.250**
Second	**111.000**	**89.250**
Third	**125.625**	**97.500**
Fourth	**109.625**	**82.250**

		1984
Fiscal Quarter	High	Low
First	$121.500	$ 94.000
Second	106.250	64.000
Third	94.250	70.375
Fourth	97.750	83.500

The Company has never declared a ash dividend. It has been the policy of the Company to se its earnings to finance expansion and growth. The payment of future dividends will rest with the discretion of the Board of Directors and will depend, among other things, upon the Company's earnings, capital requirements and financial condition. At present, the Company expects to retain all of its earnings for use in the business and has no present plans to pay a cash dividend.

Spendi g for Operations

Fiscal y r-end inventories declined 5% from the prior fiscal yc . Average year inventory turns of 2.3 times improv from the 2.1 times recorded in both fiscal 1984 an iscal 1983. Accounts receivable were essentially at same level as the previous year. Days sales in accounts eceivable outstanding (DSO) ended the year at 75 da down from 83 days at fiscal year-end 1984.

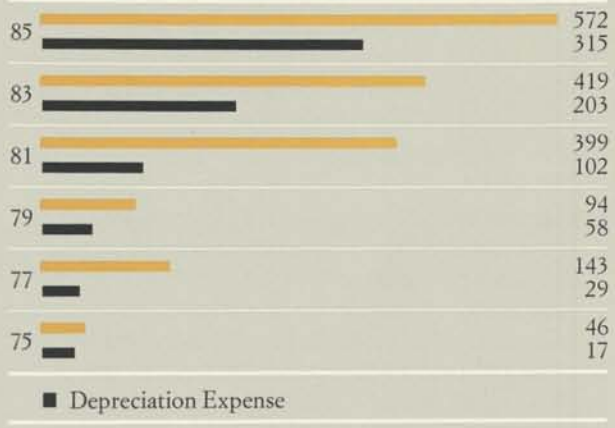
Capital s ending in fiscal 1985 totaled $572 million, an increase of $120 million from the amount spent in fiscal 1984. In fiscal 1985, $462 million of the capital spending was for equipment as the Company outfitted several recently completed facilities and continued to modernize and update its manufacturing, engineering and administrative facilities and field service operations. Spending for land and building additions totaled $69 million while leasehold improvements totaled $41 million.

The ratio f net income to average total assets was 7.5% in fiscal 1 5, 6.5% in fiscal 1984 and 6.6% in fiscal 1983.

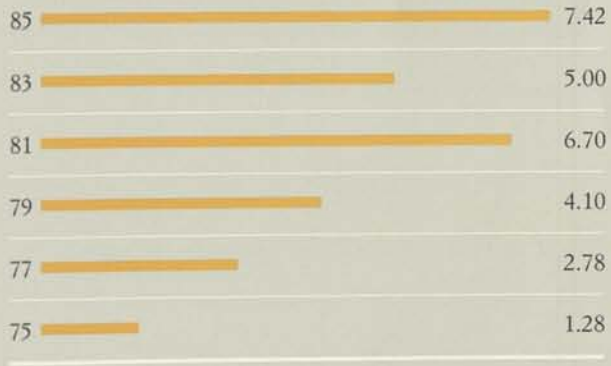
The Com ny added approximately 3 million square feet of b ding space worldwide in fiscal 1985, bringing the total ount of space to 29.3 million square feet, compare with 26.4 million square feet in fiscal 1984 and 23 m ion square feet in fiscal 1983. Most of the new spac was added overseas to support a higher level of sales. C nstruction began on one new building in Shrewsb y, Massachusetts during fiscal 1985. Construction progressed on several other buildings in the United States and overseas on which construction had begun in fiscal 1984. During fiscal 1985, the Company continued to consolidate its facilities in the United States in order to maximize the use of its owned facilities and lessen the need for smaller, leased facilities.

In fiscal 1986, capital spending is again expected to be concentrated in equipment as the Company continues to invest in capital projects to support the growth of its worldwide operations. While the actual spending level will be dependent on a variety of factors, including general economic conditions and the growth in demand for its products and services, the Company presently anticipates capital spending in fiscal 1986 to be equal to or greater than that of fiscal 1985.

Additions to Property, Plant & Equipment
Depreciation Expense **$ Millions**



Net Income Per Common Share **$**



Report of Management

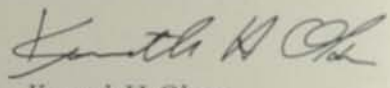
The Company's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of all the financial data included in this Annual Report. In preparing the financial statements, management makes informed judgments and estimates of the expected effects of events and transactions that are currently being reported.

Management maintains a system of internal accounting controls that is designed to provide reasonable assurance that assets are safeguarded and that transactions are executed and recorded in accordance with management's policies for conducting its business. This system includes policies which require adherence to ethical business standards and compliance with all laws to which the Company is subject. The internal controls process is continuously monitored by direct management review and an internal audit program under which periodic independent reviews are made.

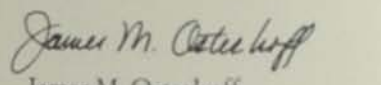
The Board of Directors, through its Audit Committee, is responsible for determining that management fulfills its responsibility with respect to the Company's financial statements and the system of internal accounting controls.

The Audit Committee meets periodically with representatives of management, the independent accountants and the Company's internal auditors to review audits, financial reporting, and internal control matters, and also meets with the Company's outside counsel on related matters. The independent accountants and the internal auditors have full and free access to the Audit Committee and periodically meet privately with the Audit Committee.

Coopers & Lybrand, independent Certified Public Accountants, have been engaged by the Board of Directors, with the approval of the stockholders, to examine the Company's financial statements. Their report appears below.



Kenneth H. Olsen
President



James M. Osterhoff
Vice President, Finance

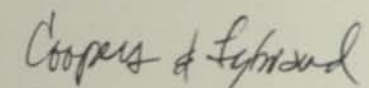
Report of Independent Certified Public Accountants

To The Stockholders and Directors,
Digital Equipment Corporation

We have examined the consolidated balance sheets of Digital Equipment Corporation as of June 29, 1985 and June 30, 1984 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three fiscal years in the period ended June 29, 1985. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Digital Equipment Corporation as of June 29, 1985 and June 30, 1984, and the consolidated results of its operations and the consolidated changes in its financial position for each of the three fiscal years in the period ended June 29, 1985 in conformity with generally accepted accounting principles applied on a consistent basis.

Boston, Massachusetts
August 6, 1985



Coopers & Lybrand

(in thousands except per share data)

	Year Ended		
	June 29, 1985	June 30, 1984	July 2, 1983
Revenues *(Notes A and B)*			
Equipment sales	**$4,534,165**	$3,831,073	$2,867,428
Service and other revenues	**2,152,151**	1,753,353	1,404,426
Total operating revenues	**6,686,316**	5,584,426	4,271,854
Costs and Expenses *(Notes A and I)*			
Cost of equipment sales, service and other revenues	**4,087,475**	3,379,632	2,605,970
Research and engineering expenses	**717,273**	630,696	472,392
Selling, general and administrative expenses	**1,431,769**	1,179,529	830,564
Operating income	**449,799**	394,569	362,928
Interest expense	**82,003**	35,096	13,078
Interest income	**(63,026)**	(41,477)	(61,195)
Income before income taxes	**430,822**	400,950	411,045
Income Taxes *(Notes A and C)*			
Provision for income taxes	**47,390**	72,171	127,423
Reversal of DISC taxes[1]	**(63,250)**	–	–
Total income taxes	**(15,860)**	72,171	127,423
Net income	**$ 446,682**	$ 328,779	$ 283,622
Net income per share *(Note E)*	**$ 7.42**	$ 5.73	$ 5.00
Weighted average shares outstanding *(Note E)*	**62,056**	57,364	56,676

[1]*Reversal of DISC taxes accrued prior to 1984 due to a change in U.S. tax law.*

The accompanying notes are an integral part of these financial statements.

Consolidated Balance Sheets

(in thousands)	June 29, 19[illegible]	June 30, 1984
Assets		
Current Assets		
Cash and temporary cash investments *(Note D)*	$1,080,1[illegible]	$ 476,150
Accounts receivable, net of allowance of $40,930 and $38,512	1,538,9[illegible]	1,527,257
Inventories *(Note A)*		
Raw materials	512,6[illegible]	456,490
Work-in-process	545,765	614,766
Finished goods	697,732	780,912
Total Inventories	1,756,167	1,852,168
Prepaid expenses	64,569	57,030
Net deferred Federal and foreign income tax charges	197,957	169,308
Total Current Assets	4,637,828	4,081,913
Property, Plant and Equipment, at cost *(Note A)*		
Land	97,4[illegible]	97,517
Buildings	745,8[illegible]	678,895
Leasehold improvements	190,6[illegible]	150,985
Machinery and equipment	1,793,6[illegible]	1,424,389
Gross Property, Plant and Equipment	2,827,6[illegible]	2,351,786
Less accumulated depreciation	1,096,6[illegible]	840,446
Net Property, Plant and Equipment	1,731,0[illegible]	1,511,340
Total Assets	$6,368,8[illegible]	$5,593,253
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks *(Note F)*	$ 12,251	$ 13,181
Accounts payable	185,202	278,111
Federal, foreign and state income taxes	267,900	312,871
Salaries, wages and related items	165,933	224,036
Deferred revenues and customer advances *(Note A)*	160,105	126,454
Current portion of long-term debt	1,411	1,374
Other current liabilities	150,807	124,517
Total Current Liabilities	943,609	1,080,544
Net deferred Federal and foreign income tax credits	33,704	92,180
Long-term debt *(Note G)*	836,945	441,313
Total Liabilities	1,814,258	1,614,037
Stockholders' Equity *(Note J)*		
Common stock, $1.00 par value; authorized 225,000,000 shares; issued and outstanding 59,252,782 and 57,811,416 shares	59,253	57,811
Additional paid-in capital	1,737,834	1,610,575
Retained earnings	2,757,512	2,310,830
Total Stockholders' Equity	4,554,599	3,979,216
Total Liabilities and Stockholders' Equity	$6,368,857	$5,593,253

The accompanying notes are an integral part of these financial statements.

(in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Stock-holders' Equity
July 3, 1982	$55,227	$1,417,715	$1,691,522	$3,164,464
Shares issued under stock option and purchase plans *(Note J)*	1,130	61,686		62,816
Restricted stock plans, charge to operations *(Note J)*		15,325		15,325
Stock option and purchase plans – excess Federal income tax benefits *(Note J)*		15,055		15,055
Net income – 1983			283,622	283,622
July 2, 1983	$56,357	$1,509,781	$1,975,144	$3,541,282
Shares issued under stock option and purchase plans *(Note J)*	1,454	75,065		76,519
Restricted stock plans, charge to operations *(Note J)*		17,499		17,499
Stock option and purchase plans – excess Federal income tax benefits *(Note J)*		8,230		8,230
Effect of exchange rate changes on net deferred income tax charges/credits			6,907	6,907
Net income – 1984			328,779	328,779
June 30, 1984	$57,811	$1,610,575	$2,310,830	$3,979,216
Shares issued under stock option and purchase plans *(Note J)*	1,442	93,786		95,228
Restricted stock plans, charge to operations *(Note J)*		20,420		20,420
Stock option and purchase plans – excess Federal income tax benefits *(Note J)*		13,053		13,053
Net income – 1985			446,682	446,682
June 29, 1985	**$59,253**	**$1,737,834**	**$2,757,512**	**$4,554,599**

The accompanying notes are an integral part of these financial statements.

(in thousands)	Year Ended		
	June 29, 1985	June 30, 19	July 2, 1983
Funds from Operations			
Net income	**$ 446,682**	$ 328,7	$283,622
Add – expenses not requiring funds in current period:			
Depreciation *(Note A)*	**315,075**	252,63	203,214
Disposal of property, plant and equipment	**37,020**	27,894	20,749
Restricted stock plans – charge to operations *(Note J)*	**20,420**	17,499	15,325
Deferred income tax provision *(Note C)*	**(87,125)**	(23,725)	32,587
Total funds from operations	**732,072**	603,078	555,497
Funds Used to Support Operations			
Increase (decrease) in working capital:			
Accounts receivable	**11,698**	402,22	317,478
Inventories	**(96,001)**	498,3	216,392
Prepaid expenses	**7,539**	18,5	92
Accounts payable	**92,909**	(64,38)	(71,679)
Income taxes	**44,971**	(91,0)	22,387
Other current liabilities	**(1,875)**	(102,4)	(74,168)
	59,241	661,2	410,502
Additions to property, plant and equipment	**571,784**	452,1	419,215
Effect of exchange rate changes on net deferred income tax charges/credits		(6,90)	
Total funds used to support operations	**631,025**	1,106,443	829,717
Net increase (decrease) in funds from operations	**101,047**	(503,365)	(274,220)
Funds Provided by Financing Sources			
Increase (decrease) in:			
Loans payable to banks *(Note F)*	**(930)**	(1,716)	2,556
Long-term debt	**(14)**	2,503	410
9 3/8% Debentures Due 2000	**(4,354)**	(4,000)	
11 3/4% Overseas Notes Due 1989		150,000	
13% Debentures Due 2014		100,000	
12.625% Notes Due 1994		100,000	
8% Conv Sub Debentures Due 2009	**400,000**		
Common stock issued under stock option and purchase plans *(Note J)*	**108,281**	76,519	62,816
Total funds from financing sources	**502,983**	423,306	65,782
Net increase (decrease) in cash and temporary cash investments	**604,030**	(80,059)	(208,438)
Cash and temporary cash investments at beginning of year	**476,150**	556,209	764,647
Cash and temporary cash investments at end of year	**$1,080,180**	$ 476,150	$556,209

The accompanying notes are an integral part of these financial statements.

Note A – Significant Accounting Policies

Principles of Consolidation ☐ The consolidated financial statements of the Company include the financial statements of the parent and its domestic and foreign subsidiaries, all of which are wholly-owned. All significant intercompany accounts and profits have been eliminated.

Translation of Foreign Currencies ☐ Assets and liabilities of foreign subsidiaries are translated into U.S. dollars at current exchange rates, except that inventories and property, plant and equipment are translated at historical rates. Income and expense items are translated at average rates of exchange prevailing during the year, except that cost of sales and depreciation are translated at historical rates. Exchange gains and losses arising from translation are included in income currently.

For foreign operations, the U.S. dollar continues to be the functional currency. Adoption of FAS No. 52 in 1984 had no significant impact on the Company's operating results. Retained earnings for fiscal 1984 have been increased by $6,907,000 for the difference in translation of net deferred income tax charges and credits.

The Company enters into forward exchange contracts to reduce the impact of foreign currency fluctuations on certain sales transactions and the asset and liability positions of foreign subsidiaries. The gains or losses on these contracts are included in income when the revenue from the sales is recognized and for assets and liabilities in the period in which the exchange rates change.

Revenue Recognition ☐ Revenues from equipment sales are recognized at the time the equipment is shipped. Service and other revenues are recognized ratably over the contractual period or as the services are performed.

Research and Engineering and Warranty Costs ☐ Research and engineering and warranty costs are expensed as incurred. The Company's accounting policies with respect to warranty costs result in approximately the same charge to expense as would accrual of such warranty costs at the time of sale.

Taxes ☐ In general, the Company's practice is to reinvest the earnings of its foreign subsidiaries in those operations and repatriation of retained earnings is done only when it is advantageous to do so. Applicable taxes are provided only on amounts planned to be remitted. Investment tax credits are treated as reductions of income taxes in the year in which the credits arise.

Inventories ☐ Inventories are stated at the lower of cost (first-in, first-out) or market.

Property, Plant and Equipment ☐ Depreciation expense is computed principally on the following basis:

Classification	Depreciation Lives and Methods
Buildings	33 years (straight-line)
Leasehold improvements .	Life of assets or term of lease, whichever is shorter (straight-line)
Machinery and equipment	8 and 10 years (sum-of-years), 4 and 5 years (double-declining balance)

Note B – International Operations

(in thousands)	Fiscal Year		
	1985	1984	1983
Revenues			
United States customers	**$4,078,286**	$3,628,594	$2,770,052
Intercompany	**1,373,578**	1,136,030	816,740
	5,451,864	4,764,624	3,586,792
Europe customers	**1,944,999**	1,462,319	1,074,853
Intercompany	**33,382**	9,137	–
	1,978,381	1,471,456	1,074,853
Canada, Far East, Americas customers	**663,031**	493,513	426,949
Intercompany	**545,968**	718,324	390,337
	1,208,999	1,211,837	817,286
Eliminations	**(1,952,928)**	(1,863,491)	(1,207,077)
Net revenue	**$6,686,316**	$5,584,426	$4,271,854
Income			
United States	**$ 224,464**	$ 230,522	$ 169,802
Europe	**202,646**	137,763	127,568
Canada, Far East, Americas	**102,837**	123,364	69,404
Eliminations	**(80,148)**	(97,080)	(3,846)
Income from operations	**449,799**	394,569	362,928
Interest income	**63,026**	41,477	61,195
Interest expense	**(82,003)**	(35,096)	(13,078)
Income before income taxes	**$ 430,822**	$ 400,950	$ 411,045
Assets			
United States	**$4,277,296**	$4,287,682	$3,384,140
Europe	**1,419,708**	1,166,193	828,087
Canada, Far East, Americas	**834,295**	819,735	547,756
Corporate assets *(temporary cash investments)*	**982,655**	449,319	563,979
Eliminations	**(1,145,097)**	(1,129,676)	(782,877)
Total assets	**$6,368,857**	$5,593,253	$4,541,085

Industry ☐ The Company's business consists of the design, manufacture, sale and service of computers and associated peripheral equipment, and related software and supplies.

International Operations ☐ Sales and marketing operations outside the United States are conducted principally through sales subsidiaries in Canada, Europe, Central and South America and the Far East; by direct sales from the parent corporation and through various representative and distributorship arrangements.

The Company's international manufacturing operations include plants in Canada, the Far East and Western Europe. The products of these manufacturing plants are sold to the Company's international sales subsidiaries, the parent corporation or other international manufacturing plants for further processing.

Intercompany transfers between geographic areas are accounted for at prices which are designed to be representative of unaffiliated party transactions.

Note B – International Operations (continued)

Sales to unaffiliated customers outside of the United States, including U.S. export sales, were $2,641,863,000 for the year ended June 29, 1985, $1,977,794,000 for the year ended June 30, 1984, and $1,542,779,000 for the year ended July 2, 1983, which represented 40%, 35%, and 36%, respectively, of total operating revenues.

The retained earnings of substantially all of the Company's international subsidiaries have been reinvested to support operations. These accumulated retained earnings, before elimination of intercompany transactions, aggregated $1,090,299,000 at June 29, 1985, $939,891,000 at June 30, 1984, and $722,140,000 at July 2, 1983.

Note C – Income Taxes

Income before income taxes for domestic and foreign operations was as follows:

(in thousands)	Year Ended		
	June 29, 1985	June 30, 1984	July 2, 1983
Domestic	**$210,970**	$219,908	$288,437
Foreign	**219,852**	181,042	122,608
Total	**$430,822**	$400,950	$411,045

The total provisions for income taxes were at rates less than the U.S. Federal statutory tax rate for the following reasons:

	1985	1984	1983
U.S. Federal statutory tax rate	**46.0%**	46.0%	46.0%
Tax benefit of manufacturing operations in *(a)*:			
Puerto Rico	**(5.6)**	(5.7)	(5.0)
Ireland	**(11.8)**	(12.4)	(4.4)
Singapore	**(2.4)**	(1.4)	(0.2)
Investment tax credits	**(5.7)**	(4.0)	(5.5)
Research and engineering credit	**(5.3)**	(5.4)	(5.4)
DISC	**(17.5)**	(2.2)	–
Other	**(1.4)**	3.1	5.5
	(3.7%) *(b)*	18.0%	31.0%

(a) Consolidated net income includes income of a domestic manufacturing subsidiary operating in Puerto Rico and of foreign manufacturing subsidiaries operating in Ireland and Singapore. Under Puerto Rican law, the subsidiary is subject to tax at a rate of approximately 9% on its manufacturing earnings through fiscal 1995. Remitted earnings are not subject to U.S. Federal income taxes, but are subject to Puerto Rican withholding taxes at rates not in excess of 10%, less a partial credit for taxes paid to Puerto Rico. Under Irish law, the income from products manufactured for export is exempt from Irish taxes through April 1990. Under Singaporean law, the income from manufacturing certain products is wholly exempt from Singaporean taxes through March 1991 and partially exempt through December 1996. The income tax benefits per common share attributable to the tax status of these subsidiaries for the years ended June 29, 1985, June 30, 1984, and July 2, 1983 were $1.38, $1.36, and $.69, respectively.

(b) The Deficit Reduction Act of 1984 provides that no U.S. taxes will be charged on the undistributed earnings of the DISC. Prior to fiscal year 1984, the Company had provided for income taxes in connection with its

Note C – Income Taxes (continued)

DISC earnings. As a result of the change in the law eliminating the taxes on DISC earnings prior to 1984, the Company's 1985 fiscal year income tax expense was reduced by $63,250,000.

The effective tax rate for fiscal year 1985 would have been 11% exclusive of the adjustment for the benefit of prior years' DISC taxes.

The components of the provisions for U.S. Federal and foreign income taxes were as follows:

(in thousands)	Year Ended		
	June 29, 1985	June 30, 1984	July 2, 1983
U.S. Federal:			
Currently payable	**$ 3,761**	$ 35,526	$ 32,317
Deferred	**13,483**	4,968	48,541
Reversal of DISC deferred taxes	**(63,250)**	–	–
Total	**$(46,006)**	$ 40,494	$ 80,858
Foreign:			
Currently payable	**$ 54,055**	$ 35,2[illegible]	$ 27,944
Deferred	**(32,230)**	(18,5[illegible])	8,329
Total	**$ 21,825**	$ 16,6[illegible]	$ 36,273
State income taxes	**$ 8,321**	$ 15,0[illegible]	$ 10,292
Total income taxes	**$(15,860)**	$ 72,1[illegible]	$127,423

Deferred tax expense results from timing differences in the recognition of revenues and expenses for tax and financial reporting purposes. The sources of these timing differences in the years ended June 29, 1985, June 30, 1984 and July 2, 1983, and the tax effect of each were as follows:

(in thousands)	Year Ended		
	June 29, 1985	June 30, 1984	July 2, 1983
Inventory related transactions	**$(50,924)**	$(60,660)	$ (3,766)
Installment sales, principally intercompany, and financing leases	**12,999**	(1,640)	(2,964)
DISC profits	**(68,540)**	241	3,079
Depreciation	**17,940**	17,997	13,962
Tax benefit transfers	**28,296**	28,946	31,695
Other	**(21,768)**	1,500	14,864
Total	**$(81,997)**	$(13,616)	$ 56,870

In connection with its normal examinations of the Company's 1978 through 1981 tax returns, the Internal Revenue Service has proposed adjustments. The Company believes its judgments in these matters have been appropriate and intends to contest certain of the adjustments proposed by the IRS. In addition, the Company believes any adjustments which might result would not have a material effect on the financial statements.

Note C–In me Taxes (continued)

The Comp entered into "Safe Harbor" leases as defined un the Economic Recovery Tax Act of 1981. In accorda with the provisions of the agreements, the Compa made payments of $105,576,000, which amounts ha been recorded as investments in tax benefits. Th e investments have been reduced by permanent tax s vings of $95,758,000. The remaining unrecovered cost is amortized by an interest method over the periods during which the Company has the use of additional temporary tax savings. While there is a cash flow benefit, there is no significant impact on net income.

See Note A of Notes to Consolidated Financial Statements for further explanation of the Company's income tax accounting policies.

Note D–Cash and Temporary Cash Investments

The Compan 's policy is to invest cash in income-producing t porary cash investments. Accordingly, uninvested c h balances are kept at minimum levels. Temporary c h investments are valued at cost, which approximates market, and principally include certificates of deposit, time deposits and repurchase agreements.

Note E–Ne ncome Per Share and Dividends

Net income r share is based on the weighted average number common shares and, if their aggregate dilutive effe is material, common share equivalents outstanding uring the year. In fiscal 1985, common share equivalents were attributable to convertible debt and stock options. In fiscal 1984 and 1983 common share equivalents were attributable to stock options.

No cash dividends have ever been paid by the Company.

Note F–Short-Term Debt

Short-term debt and related interest rates were as follows:

(in thousands)	**June 29, 1985**		June 30, 1984	
		Average Interest Rate		Average Interest Rate
Loans payable to banks	**$12,251**	**12.7%**	$13,181	21.1%

Short-term debt at year end was principally denominated in foreign currencies. The maximum aggregate short-term debt outstanding at any month-end was $37,854,000 during fiscal 1985, and $265,569,000 during fiscal 1984. Average short-term borrowings during these years, computed on a month-end basis, were $21,905,000 and $138,261,000, respectively. The average interest rate based on a weighted average of the stated month-end rates was 11.6% in fiscal 1985 and 10.2% in fiscal 1984.

The Company has revolving credit agreements totaling $480,000,000. These commitments are available on a revolving basis until March 1987, converting at such time to term loans with final maturities in March 1991. Borrowing rates under these commitments vary with the prime rate, domestic money market rates or the London Interbank Offer Rate. Although there are no compensating balance requirements under these agreements,

Note F–Short-Term Debt (continued)

commitment fees on the unused portion of the commitment approximate 3% compensating balances. These credit arrangements were unused at June 29, 1985.

Unused lines of credit for short-term financing were $125,436,000 at June 29, 1985 and $267,151,000 at June 30, 1984. At June 29, 1985, $26,000,000 of these lines of credit required the payment of facility fees.

Although there are no compensating bala e requirements under these agreements, facility fee n the unused portion of the commitment appro mate 3% compensating balances.

None of the cash reflected in the balance eets at June 29, 1985 and June 30, 1984 was requi d as compensating balances.

Note G–Long-Term Debt

Long-term debt, exclusive of current maturities, consisted of the following:

(in thousands)	**June 29, 1985**	June 30, 1984
Lease obligations payable 1985-2000 (7.5%-9.00%)*(a)*	**$ 7,215**	$ 7,520
Collateralized obligations maturing serially to 1993 (5.4%)*(b)*	**5,340**	5,950
Sinking Fund Debentures due 2000 (9 3/8%)*(c)*	**66,646**	71,000
Sinking Fund Debentures due 2014 (13%)*(d)*	**100,000**	100,000
Notes due 1994 (12 5/8%)*(e)*	**100,000**	100,000
Overseas Finance Notes due 1989 (11 3/4%)*(f)*	**150,000**	150,000
Convertible Subordinated Debentures due 2009 (8%)*(g)*	**400,000**	–
Other	**7,744**	6,843
	$836,945	$441,313

Principal payments required during the next five fiscal years are as follows: 1986–$1,411,000; 1987–$6,579,000; 1988–$6,147,000; 1989–$156,201,000; 1990–$6,249,000.

(a) Weighted average interest rate at Jun 29, 1985 of 7.9%.

(b) Interest rate shown is the weighted rage rate at June 29, 1985.

(c) Sinking Fund Debentures were issu by the Company in March 1975. Sinking fund pa ents of $4 million are required in each of the fisc ears 1985-1999. The Company at its option may inc se the sinking fund payments up to an additional $4 llion in each such year. The Debentures are rede able at the option of the Company at any time, as a w le or in part, at 109 3/8% of the principal amount d ring the year beginning March 15, 1975, and at declining percentages each year thereafter. The Indenture for the Debentures also contains certain restrictions on future borrowings and dividend distributions.

(d) Sinking Fund Debentures were issued by the Company in April 1984. Sinking Fund payments of $4.5 million are required in each of the fiscal years 1995-2013. The Company at its option may increase the sinking fund payments up to an additional $6.75 million in each such year. The Debentures are redeemable at the option of the Company at any time, as a whole or in part, at 113% of the principal amount during the year beginning April 15, 1984, and at declining percentages each year thereafter. However, prior to April 15, 1994, the Company may not redeem any of the Debentures from the proceeds of funds borrowed at an interest rate less than 13.05% per annum. The Indenture for the Debentures also contains certain restrictions on future borrowings and sales and leasebacks.

Note G – Long-Term Debt (continued)

(e) Notes were issued by the Company in April 1984. The Notes are redeemable on or after April 15, 1991, at any time prior to maturity, at the option of the Company, as a whole or from time to time in part, at a redemption price equal to the principal amount thereof, together with interest accrued to the redemption date. The Indenture for the Notes also contains certain restrictions on future borrowings and sales and leasebacks.

(f) Notes were issued in March 1984 by Digital Equipment Overseas Finance N.V. The notes are unconditionally guaranteed by Digital Equipment Corporation, and may be redeemed in whole at any time at their principal amount, plus accrued interest if certain events occur involving United States or Netherlands Antilles taxes.

(g) On September 13, 1984 the Company issued $400,000,000 of 8% Convertible Subordinated Debentures. The Debentures are subordinated in right of payment to all present and future senior indebtedness, as defined, and are convertible, subject to prior redemption, into shares of common stock at $114 per share at any time up to and including the maturity date of September 1, 2009.

Annual sinking fund payments to redeem $14.4 million principal amount of the Debentures are required beginning on September 1, 1995. In each case, the sinking fund redemption price is the principal amount of the Debentures, plus accrued interest to the date of redemption. In addition, the Debentures are redeemable at the option of the Company, at any time, in whole or in part beginning at 108% of the principal amount of the Debentures through August 31, 1985 and at prices which decrease annually thereafter to August 31, 1994 and thereafter at 100% of the principal amount, together with accrued interest to the date of redemption. However, prior to September 16, 1986 the Debentures may not be redeemed unless certain conditions are met.

Note H – Leases

Minimum annual rentals under noncancelable leases (which are principally for leased regional sales offices and manufacturing space) for the fiscal years listed are as follows:

(In thousands)	
1986	$134,501
1987	$114,514
1988	$ 93,393
1989	$ 68,246
1990	$ 49,735
Later years	$206,209
Total minimum lease payments	$666,598

Total rental expense for the fiscal years ended June 29, 1985, June 30, 1984 and July 2, 1983 amounted to $223,434,000, $175,055,000, and $145,303,000, respectively.

Note I–Pension Plans and Other Retirement Benefits

The Company and its subsidiaries have pension plans covering substantially all of their employees. Total pension expense was $114,053,000 in fiscal 1985, $95,463,000 in fiscal 1984, and $89,766,000 in fiscal 1983. Annual contributions are made to the plans equal to the amounts accrued for pension expense. There was no unfunded past service liability as of June 29, 1985.

A comparison of accumulated plan benefits and plan net assets for the Company's domestic defined benefit plans and for those foreign subsidiaries with defined benefit plans, determined as of the beginning of each respective fiscal year is presented in the accompanying table. Foreign subsidiaries with insured plans have been excluded from this information.

(in thousands)	**1985**	1984
Actuarial present value of accumulated plan benefits:		
Vested	**$158,417**	$125,748
Nonvested	**38,190**	33,082
	$196,607	$158,830
Net assets available for benefits	**$461,600**	$382,354

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 6% for both 1985 and 1984.

In addition to providing pension benefits, the Company provides certain medical, dental and life insurance benefits for retired employees. Substantially all of Company's domestic employees may become eligible for those benefits if they reach normal retirement age while working for the Company. The cost of retiree health care and life insurance benefits is recognized as expense as claims are paid. For fiscal 1985 those costs totaled $436,000. The majority of Company's foreign subsidiaries do not offer such benefits to retirees. Of those that do, the amounts are immaterial.

Note J – Stock Plans

Restricted Stock Options □ Under its Restricted Stock Option and Purchase Plans, the Company has granted certain officers and key employees options, which are exercisable upon grant, to purchase common stock at a price determined by the Board of Directors. Shares purchased under the plans are generally subject to repurchase options and restrictions on sales which lapse over an extended time period not exceeding 10 years.

Information concerning activity during the three fiscal years ended June 29, 1985 follows:

		Options Outstanding	
	Shares Reserved For Future Grants	Shares	Average Price Per Share
July 3, 1982	5,204,396	3,840,257	$31.05
Options granted	(1,154,130)	1,154,130	82.82
Options exercised	–	(487,154)	23.66
Options cancelled	133,020	(133,020)	33.07
Options terminated	(18,657)	–	–
July 2, 1983	4,164,629	4,374,213	$45.47
Options granted	(1,708,090)	1,708,090	63.02
Options exercised	–	(439,604)	24.22
Options cancelled	309,013	(309,013)	46.18
Options terminated	(19,680)	–	–
June 30, 1984	2,745,872	5,333,686	$52.80
Options granted	(1,480,960)	1,480,960	69.00
Options exercised	–	(490,988)	32.61
Options cancelled	216,232	(216,232)	53.73
Options terminated	(5,914)	–	–
June 29, 1985	**1,475,230**	**6,107,426**	**$58.32**

At the time these options are exercised, the common stock account is increased by the par value ($1 per share) of the shares sold and the remaining portion of the proceeds is credited to additional paid-in capital. The excess of the fair market value of the shares on the grant date over the option price is charged to operations each year as the restrictions lapse. Such charges to operations amounted to $20,420,000 in fiscal 1985, $17,499,000 in fiscal 1984 and $15,325,000 in fiscal 1983. The amount deductible for Federal income taxes exceeds the amount charged to income for book purposes. The Federal income tax benefits relating to this difference have been credited to additional paid-in capital.

Employee Stock Purchase Plans □ Under the Company's Employee Stock Purchase Plans, all United States and certain international employees may be granted options to purchase common stock at 85% of market value on the first or last business day of the six month payment period, whichever is lower. Common stock reserved for future grants aggregated 1,093,194 shares at June 29,1985 and 1,961,690 shares at June 30, 1984. There were 868,496 shares issued at an average price of $81.60 in fiscal 1985 and 988,930 shares at $59.87 in fiscal 1984. There have been no charges to income in connection with the options other than incidental expenses related to the issuance of the shares. Federal income tax benefits relating to such options have been credited to additional paid-in capital.

Employee Stock Ownership Plan □ The Employee Stock Ownership Plan ("ESOP") and a related trust were established in 1982. The Company intends to make contributions of stock or cash to the trust equivalent to not more than ½% of the base salaries (not in excess of $100,000 salary for any single employee) of substantially all U.S. employees for calendar years 1986 and 1987. Federal tax law generally allows a tax credit for the Company equal to the full value of the contribution.

Quarterly Financial Data (unaudited)

Selected quarterly financial data for fiscal 1985 and fiscal 1984 is set forth below:

(in millions except per share data)	Total Operating Revenues	Gross Profit	Income Before Income Taxes	Income	Net Income Per Share[1]
1985					
First Quarter	**$1,515.3**	**$ 598.2**	**$103.8**	$144.2	**$2.45**
Second Quarter	**1,628.0**	**653.8**	**134.9**	110.3	**1.81**
Third Quarter	**1,691.1**	**658.9**	**98.6**	91.7	**1.52**
Fourth Quarter	**1,851.9**	**687.9**	**93.5**	100.5	**1.66**
Total Year	**$6,686.3**	**$2,598.8**	**$430.8**	$446.7	**$7.42**
1984					
First Quarter	$1,074.3	$ 394.0	$ 23.7	$ [illegible].9	$ .28
Second Quarter	1,423.8	569.6	120.1	[illegible].5	1.41
Third Quarter	1,430.8	575.8	131.5	1[illegible].8	1.76
Fourth Quarter	1,655.5	665.4	125.7	1[illegible].6	2.28
Total Year	$5,584.4	$2,204.8	$401.0	$3[illegible].8	$5.73

[1]*The fluctuation in the market price of the Company's stock and the anti-dilution provisions of Accounting Principles Board Op[illegible]n 15 (with respect to the application of the treasury stock method for the incremental shares related to stock option common stock equivalents) ca[illegible] the total of the individual quarters to be different from the yearly total.*

Information on the Effects of Inflation (unaudited)

General Background ☐ To provide readers of financial statements with information on the estimated effects of inflation, the Financial Accounting Standards Board issued Statement No. 33 as amended by Statement No. 82. It is entitled Financial Reporting and Changing Prices, and requires disclosure of certain experimental information on the effects of inflation on business enterprises.

Current cost accounting is intended to measure the effect of changes in specific prices by substituting the current cost of resources for the actual acquisition costs. Changes in specific prices were principally based on external price indexes closely related to the resources being measured, internally developed indexes and recent production cost experience.

Consolidated Statement of Income Adjusted for the Effects of Inflation ☐ The amounts reported in the statement of income have been adjusted for depreciation expense and the inventory component of cost of sales in arriving at the net income amounts adjusted for current costs. Revenues and all other operating expenses are considered to reflect the average price levels for the year, and accordingly have not been adjusted.

Although the adjustments for depreciation expense and the inventory component of cost of sales affect the pretax income amounts, no adjustments have been made to the respective provisions for income taxes.

Information on the Effects of Inflation (unaudited) (continued)

The adjustments to depreciation and cost of sales included in the adjusted net income amounts were as follows:

(in millions)	Adjustment for Changes in Specific Prices (current costs)
Depreciation expense	$9.7
Cost of sales, exclusive of depreciation	(5.6)
Total decrease in net income	$4.1

The adjustment to depreciation reduces net income because the Company's property, plant and equipment have been adjusted upwards reflecting the replacement of historical costs by costs adjusted for specific estimated current costs.

Historical cost of sales and cost of sales under the current cost method are relatively the same and, as a result, the difference in net income is immaterial.

Purchasing Power of Net Monetary Assets ☐ Net monetary assets are cash and temporary cash investments and fixed dollar claims to money. The purchasing power of the Company's net monetary assets declined because of inflation by $33.8 million in fiscal 1985, as measured by the change in the Consumer Price Index.

Current Cost of Inventories and Property, Plant and Equipment ☐ The current cost of inventories and property, plant and equipment, net of accumulated depreciation, and the corresponding historical cost amounts at June 29, 1985 were as follows:

(in millions)	Inventories	Property, Plant and Equipment, Net
Current Cost	$1,759.8	$1,946.0
Historical Cost	$1,756.2	$1,731.0
Difference	$ 3.6	$ 215.0

The current cost of inventories is essentially the same as the corresponding historical cost, which is reflective of the higher costs which would be incurred if the fiscal 1985 year-end inventories were to be replaced at the expected current costs. This is not necessarily a fair measure of the expected inflation effect on fiscal 1986 cost of sales, since the 1986 cost of sales will include the lower historical costs in inventory at the end of fiscal 1985, as well as the cost of products manufactured and sold in fiscal 1986, which are different and have different costs from those in inventory at the end of fiscal 1985.

Net property, plant and equipment at current costs exceeded the corresponding historical cost by $215.0 million. The current cost method assumes replacement of all the Company's property, plant and equipment as of June 29, 1985. However, the Company's property, plant and equipment are relatively new, with 83% of it having been acquired in the last 5 fiscal years. Consequently, the Company's future capital expenditures will be principally to expand, rather than replace, existing capacity.

The increase in current cost of inventories during fiscal 1985 was $178.9 million, and the increase in property, plant and equipment was $56.1 million. The increases during fiscal 1985, measured by the general inflation rate, were $62.8 million for inventories and $66.2 million for property, plant and equipment.

Consolidated Statement of Income and Changes in Stockholders' Equity Adjusted for the Effects of Inflation

For the Year Ended June 29, 1985		Adjusted for Inflation
(in millions except per share data)	As Reported	Current Costs
Total operating revenues	$6,686.3	$6,686.3
Cost of equipment sales, services and other revenues *(a)*	3,884.7	3,879.1
Depreciation expense	315.1	324.8
Other expenses *(a)*	2,055.7	2,055.7
Provision for income taxes	(15.9)	(15.9)
Net income	$ 446.7	$ 442.6
Net income per share	$ 7.42	$ 7.36
Stockholders' equity at June 30, 1984	$3,979.2	$4,046.4
Net income as reported above	446.7	442.6
Decline in purchasing power of net monetary assets	–	(33.8)
Reduction of general price level increase over specific price level increase of inventories and property, plant and equipment	–	105.9
Increase in common stock and additional paid-in capital	128.7	128.7
Stockholders' equity at June 29, 1985	$4,554.6	$4,689.8

(a) Excludes depreciation expense

Five-Year Comparison of Selected Financial Data Adjusted for Effects of Inflation

The inflation-adjusted data shown below has been expressed in average fiscal 1985 dollars (based on the average Consumer Price Index for each fiscal year), to provide comparability between years in terms of dollars of equivalent purchasing power. Corresponding historical cost amounts, as reported, are also shown to allow their comparison to the inflation adjusted data.

(in millions except per share data)	**1985**	1984	1983	1982	1981
Total operating revenues					
As reported	**$6,686.3**	$5,584.4	$4,271.9	$3,880.8	$3,198.1
Net income					
As reported	**446.7**	328.8	283.6	417.2	343.3
In current costs	**442.6**	456.5	369.2	404.5	380.5
Net income per share					
As reported	**7.42**	5.73	5.00	7.53	6.70
In current costs	**7.36**	7.96	6.51	7.29	7.44
Net assets at year end					
As reported	**4,554.6**	3,979.2	3,541.3	3,164.5	2,679.7
In current costs	**4,689.8**	4,046.4	3,875.3	3,594.2	3,388.0
Decline in purchasing power of net monetary assets	**(33.8)**	(35.4)	(25.6)	(68.2)	(64.8)
Reduction (excess) of general price level increase over specific price level increase of inventories and property, plant and equipment	**105.9**	(366.8)	(165.6)	(208.8)	(142.0)
Market price per common share as reported at year end	**94.63**	84.00	121.50	66.00	101.19
Average Consumer Price Index (1967 = 100.0)	**316.8**	304.9	294.1	281.9	259.4

Adjusted data on dividends per common share is not presented, because no cash dividends have ever been paid by the Company

Kenneth H. Olsen
President and Director

John L. Alexanderson
Vice President, Peripherals and Supplies Group

Don K. Busiek
Vice President, Corporate Software Services

George A. Chamberlain, 3rd
Vice President, Engineering and
Manufacturing Finance

Henry J. Crouse
Vice President, Manufacturing Europe

James G. Cudmore
Vice President, Group Manager, Product Operations

William R. Demmer
Vice President, Mid-Range Systems Business Group

Pier-Carlo Falotti
Vice President, Field Operations – Europe

Samuel H. Fuller
Vice President, Research and Architecture

Rose Ann Giordano
Vice President, Large Systems Marketing

Robert M. Glorioso
Vice President, High Performance Systems and Clusters

David W. Grainger
Vice President, Area Manager, Western and
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William J. Heffner
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Winston R. Hindle, Jr.
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Robert C. Hughes
Vice President, Business and Office Systems Marketing

Ilene B. Jacobs
Treasurer

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Jeffrey C. Kalb
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and Technologies

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Jack MacKeen
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Albert E. Mullin, Jr.
Vice President, Corporate Relations

James M. Osterhoff
Vice President, Finance

Jean-Claude Peterschmitt
Vice President, Chairman Europe

Richard Poulsen
Vice President, Field Service

Bruce J. Ryan
Controller

F. Grant Saviers
Vice President, Storage Systems

Edward A. Schwartz
Vice President, General Counsel and Secretary

Joel Schwartz
Vice President, Educational Marketing

John J. Shields
Vice President, Group Manager, Sales, Services
and International

Godfrey S. Shingles
Vice President, Managing Director,
United Kingdom Region

Charles E. Shue
Vice President, Area Manager, Northeast States

John L. Sims
Vice President, Corporate Personnel

John F. Smith
Vice President, Engineering and Manufacturing

Peter J. Smith
Vice President, Computer Aided Engineering
and Manufacturing

Officers (continued)

William D. Strecker
Vice President, Engineering Project Strategy and Architecture

Harvey L. Weiss
Vice President, Area Manager, Mid-Atlantic and Southern States

William G. Witmore
Vice President, General International Area

Richard H. Yen
Vice President, Far East Engineering and Manufacturing

Directors

Vernon R. Alden
Director of several organizations

Philip Caldwell
Senior Managing Director of Shearson Lehman Brothers Inc. and Director of several corporations

Arnaud de Vitry
Chairman of the Board and Chief Executive Officer, Eureka SICAV (French Investment Company)

Georges F. Doriot
Retired Chairman of the Board of American Research and Development Corporation (Venture Capital Investment Company)

William H. McLean
Engineering consultant and Director of several corporations

Kenneth H. Olsen
President, Digital Equipment Corporation

Dorothy E. Rowe
Retired Senior Vice President and Treasurer of American Research and Development Corporation (Venture Capital Investment Company)

Corporate Consulting Engineers

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Senior Corporate Consultant, Computer Systems

Richard I. Hustvedt
Corporate Consultant, Operating Systems

Alan Kotok
Corporate Consultant, High Performance Computers

Jesse Lipcon
Corporate Consultant, Micro Systems

Mike Riggle
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William D. Strecker
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Investor Information

The Company's common stock is listed and traded on the:
New York Stock Exchange
Pacific Stock Exchange
(Ticker Symbol "DEC")

Unlisted trading privileges have been granted by the:
Boston Stock Exchange
Cincinnati Stock Exchange
Midwest Stock Exchange
Philadelphia Stock Exchange

The Company maintains an Investor Relations office to assist shareholders. Investors' inquiries are welcome, by telephone or letter.

Inquiries relating to investment in Digital Equipment Corporation should be directed to:
Albert E. Mullin, Jr.
Vice President, Corporate Relations
Digital Equipment Corporation
111 Powdermill Road (K10)
Maynard, MA 10754
(617) 493-5350

Digital Equipment Corporation's Annual Report on Form 10-K for the fiscal year ended June 29, 1985, including schedules thereto, which is filed with the Securities and Exchange Commission, will be sent without charge upon written request. The Company's annual report, filings with the Securities and Exchange Commission, interim reports and additional information about the Company and its products can be obtained by addressing:
Digital Equipment Corporation
Inquiry Section
10 Forbes Road NR03-1/M1
Northboro, MA 01532
(617) 351-4401

Financial community information and requests to be placed on the Company's mailing list should be directed to:
Digital Equipment Corporation
Investors Relations – ML
111 Powdermill Road (K10)
Maynard, MA 01754
(617) 493-8246

Inquiries of an administrative nature relating to shareholder accounting records, stock transfer, change of address, and employee purchases should be directed to:
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Photo on page 2 taken by Phillip A. Harrington/Fran Heyl Associates.

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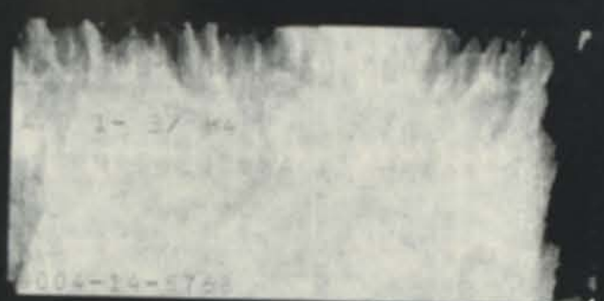


DIGITAL EQUIPMENT CORPORATION
MAYNARD, MASSACHUSETTS 01754

DIGITAL EQUIPMENT CORPORATION
ANNUAL REPORT 1986

Corporate Profile

Digital Equipment Corporation is one of the world's largest manufacturers of networked computer systems and associated peripheral equipment and the leader in systems integration with its networks, communications and software products. The Company's products are used worldwide in a variety of applications and programs, including scientific research, computation, communications, education, data analysis, industrial control, timesharing, commercial data processing, graphic arts, word processing, personal computing, health care, instrumentation, engineering and simulation.

Financial Highlights

Fiscal Year	1986	1985	% Change
Total operating revenues	**$7,590,357,000**	$6,686,316,000	+ 14
Net income	**$ 617,420,000**	$ 446,682,000	+ 38
Net income per share	**$4.81**	$3.71	+ 30
Total stockholders' equity	**$5,727,827,000**	$4,554,599,000	+ 26
Stockholders' equity per share	**$ 44.54**	$ 38.43	+ 16

Annual Meeting of Stockholders

The Annual Meeting of Stockholders will be held at 11:00 A.M., Thursday, November 6, 1986, at the New England Life Hall, 225 Clarendon Street, Boston, Massachusetts. Stockholders of record on September 8, 1986 will be entitled to vote at this meeting.

Contents

On the Cover ▪ *Under the banner, "Digital Has It Now!," DECworld '86 attracted more than 20,000 customers to Boston in February for the industry's largest-ever single-company trade show. By any measure the most successful marketing event in the company's history, DECworld's 400 exhibits showcased Digital's broad range of fully integrated network solutions.*

To our Shareholders, Customers, Employees and Friends:

Fiscal 1986 was a good year for Digital. During a time when the computer industry was slow, we grew in revenues and profits, with a significant improvement in our use of assets.

We solidified our position as the leader in high-speed computer networks. We introduced more important new products than in any comparable period in the company's history. And, to get us even closer to our customers, we realigned our marketing organization to give it an industry-specific focus with solutions that directly address customer needs.

Digital's Board of Directors was expanded during the year with the addition of Robert R. Everett, recently retired president of The MITRE Corporation and a renowned computer pioneer who helped lead development of the Whirlwind computer at MIT in the 1950s. We are privileged to have Mr. Everett's distinguished technical credentials and management skills at our disposal.

Digital has undertaken a difficult mission. Our goal is to connect all parts of an organization – the office, the factory floor, the laboratory, the engineering department – from the desktop to the data center. We can connect everything within a building; we can connect a group of buildings on the same site or at remote sites; we can connect an entire organization around the world. We propose to connect a company from top to bottom with a single network that includes the shipping clerk, the secretary, the manager, the vice president, even the president.

The difficulty of our mission goes beyond the technical challenges involved. Change also becomes an important factor. Progressive companies analyze their organizations, understand their goals and then completely change the way they run their business in order to make them more competitive and more effective in pursuing their goals. They recognize the benefits of tying their entire company together with a single computer network that is as accessible and easy to use as a telephone system.

But for many other companies the change to open, company-wide computer networks is happening more slowly because of traditional centralized computing approaches. Without meaning to, those in charge of such companies stifle the involvement and creativity of many of their people by restricting the availability and flow of information throughout the organization.

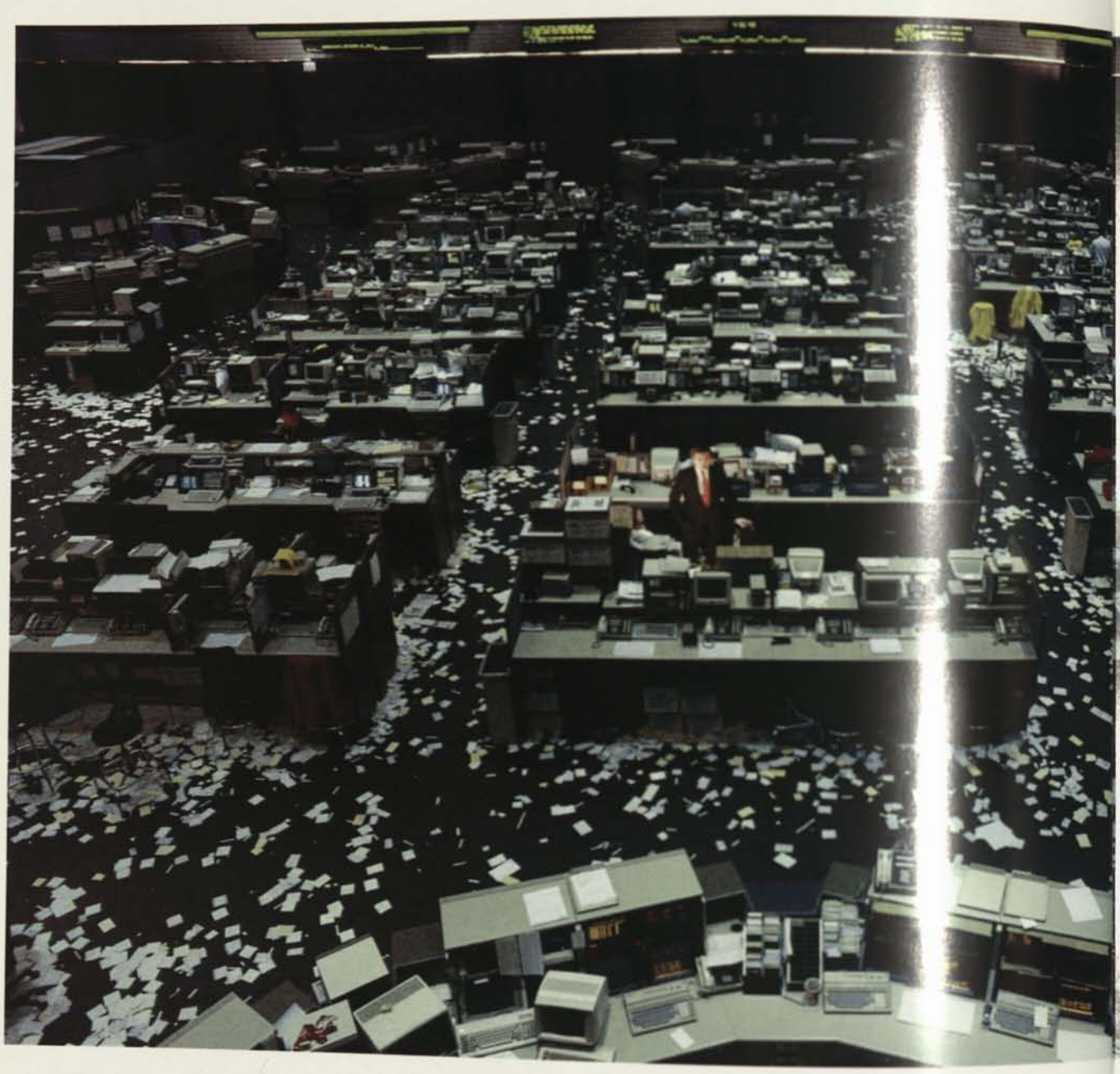
In the organization of the future that we propose, the free flow of information creates excitement and motivation and enthusiasm, and helps unify the company. The information becomes a strong internal catalyst and a powerful competitive tool.

Today's Digital is very much this kind of organization. We have become a truly unified company with one clear strategy and one strong message, and everyone in the company is working toward a common goal. And yet, we have been able to retain a strong entrepreneurial spririt. We have achieved this by creating the kind of organization we are proposing for the future, one which is tied together by an accessible, easy to use computer network.

Included later in this report are comments from some of our customers for whom Digital's ability to interconnect their organizations – and in some instances to link them to others – has created a significant competitive advantage.

All of us at Digital are far more excited about our products and the future than at any time in the past. We have more ideas than we've ever had on how to improve current products and develop new ones – so many, in fact, that we need to use great discipline to limit our development activities to only those products which will contribute directly to our mission.

Kenneth H. Olsen, President
September 8, 1986



The information that an organization possesses is being recognized as a corporate asset every bit as valuable as its buildings, inventory, people and technology. It needs to be managed efficiently and effectively to maximize its value and create a competitive advantage for its owner.

The problem no longer is just collecting, processing and storing data. Today's organizations are challenged to convert the data into useful information and to communicate in a timely fashion to those parts of the organization where it is needed. They also recognize that there are significant advantages in being able to share workloads among the various levels of the organization. And they must be able to do this easily and cost-effectively.

Digital has spent most of the last 20 years strategically developing computer networks to meet these needs, using just one computer architecture, one software system and one simple interconnect technology. The result is a wide range of fully compatible products and services that simplify the planning, building, modification, expansion, merging, maintenance and management of local and global networks to meet the information management needs of organizations of any size.

"As the third-largest stock exchange in the world, we planned for growth when we rebuilt our trading floor, anticipating a doubling of trading volume over the next several years. The VAXclusters and Ethernet local area networks are flexible enough to support this increased activity. We merely add systems, where needed, without disrupting trading. They also enable us to share data directly with information distributors, such as Reuters, around the world."

Kevin M. Kane, Vice-President,
Corporate Marketing; Midwest Stock Exchange, Inc., Chicago

To fulfill our vision of how computers should serve their users, Digital has been doggedly pursuing a very explicit strategy for developing all the components and skills needed to build fully integrated, easy-to-use high-speed computer networks. It has taken much discipline, much hard work and an enormous investment to produce a set of products, all of them available today, which make it possible for users to build computer networks of almost any size and scope, from a few desktop systems linked by a single wire within the same room to ones involving hundreds of large, powerful computers spread throughout a vast global organization.

DNA ▪ Development of the Digital Network Architecture (DNA) began in the early 1970s with DECnet, a very advanced protocol for integrating similar or different computers in a network. We believe that DECnet is the most widely used networking protocol in the world.

VAX ▪ Next, in the mid-1970s, came the architecture for VAX, which we designed to be as effective as a desk top machine as it was a large data center system. We designed it to last for many, many years but, most importantly, we designed it to work effectively in networks.

"We compete in a global marketplace, where our success depends on how open and efficient a market we are. To that end, the Exchange underwent the Big Bang of deregulation in October. In little more than 24 months, we had to create a new market reporting system that was fast, reliable, based on proven technology, and expandable to meet future needs. We installed VAXclusters and an Ethernet/DECnet network as the heart of that new system."

George Hayter, Divisional Director, Information Services; The Stock Exchange, London

The idea of concentrating on a single architecture was very different from the standard industry practice of developing different architectures and software systems for different sizes and classes of computers. Instead, with VAX, Digital provides a stable, predictable environment that encompasses a range of systems from very small to very large.

With the introduction of the first VAX system in 1977, Digital introduced a computing architecture that could be – and would be – implemented on very large systems and on a single microprocessor chip. The idea was to make it possible for a user to move applications from one system to another; to be able to run an application developed on one VAX system on any other VAX system, thereby eliminating the cost and inconvenience of software conversion.

VMS • To maximize the effectiveness of our networks, and to fully exploit the functionality and versatility of a single VAX hardware architecture, we concurrently developed a single software system – VMS – that would have one powerful version of each programming language and that could work as effortlessly in networks as in single systems.

It is VMS that ties together all of our computers, clusters and networks. VMS provides a consistent user and programmer environment that significantly reduces staffing, training and program maintenance costs. The value of this environment was quickly recognized by software developers and third parties selling applications solutions. They have developed a wealth of software to complement and supplement the applications developed by Digital. Literally thousands of applications are available on VMS.

There are also security features built into VMS which provide significant protection to systems and stored data. For all these reasons, we believe that VMS is the best software system in the world.

ULTRIX ▪ Digital also provides one of the world's best UNIX-based systems, called ULTRIX, for those customers who already have UNIX applications or do not need the array of features or the networking capabilities of VMS. Digital is the first major vendor to deliver a UNIX operating system that provides a native 4.2 BSD (Berkeley Software Division) environment with System V compatibility.

"For more than 20 years we have used Digital's computers to help create the largest worldwide distribution network for news and financial information. Our subscribers operate in a competitive, global market. They require fast and reliable information gathering and distribution services. Digital's VAX computers and network architecture allow us to create the network we need to meet those demands; it grows as we do, without disrupting service."

Martin Davids, European Technical Development Manager; Reuters Ltd., London

VAXclusters ▪ Also key to Digital's networking strategy are VAXclusters, a unique technology developed in response to the rapid growth and constant change that characterize business today. As growth and change accellerate, users must buy larger systems and rewrite their applications as they move them from one system to the next.

VAXclusters eliminate this problem by linking high-speed computers sharing a common database to deliver more power and performance than the largest mainframes. Up to 16 VAX computers and needed storage disks can be added at any time without disrupting ongoing operations. The entire VAXcluster is managed as a single system. Because VAXclusters permit a "building block" approach to using computers of various sizes in combination with storage devices, users can achieve optimum resource utilization and maximum return on investment.

Ethernet ▪ In the late 1970s, Digital committed to Ethernet as a key element in its networking strategy, and we have directed a large portion of our development investment into the systems components required to make the implementation of Ethernet networks practical. Ethernet makes it easy to build computer networks of any size that can be changed or expanded just as easily,

as user needs require. The ease and flexibility afford maximum efficiency in the use of expensive computer resources.

Digital's approach to building networks with Ethernet is quite simple. Just as telephone lines, low-speed data lines and, where needed, video cable are wired throughout a building, so is Ethernet. Using Digital's wiring scheme, called DECconnect, all four of these communications technologies can be accessed easily through a single wallplate. Wallplates can be installed anywhere in a building, making the assembly of a high-speed computer network as easy as plugging in an appliance.

Because of the inherent simplicity of this approach, networks can be built easily in any environment – office, factory, laboratory, engineering department, computer room. And they can be built at any level of an organization. To illustrate, we use a simple model to define the various levels which make up a typical organization:

Not surprisingly, the first level is the *individual*. A number of individuals – they can also be devices such as robots or laboratory equipment – all performing a similar task or using the same database, constitute a *workgroup*. In turn, one or more workgroups make up a *department*, and the sum of these entities is the *organization*.

Within this organization, Ethernet can be used to build networks of any size, from the simplest local hookups to the largest, most global networks. And all of these local networks can be fully integrated into a single, seamless network. For example, a simple office network could consist of a small number of linked personal computers. Or it could be a small VAX system supporting a number of individuals using word processors. On the factory floor, a VAX system could support a network of robots or machine tools; the laboratory network could support terminals used in experiments, and the engineering network could support workstations.

In the foregoing examples, the same simple method is used to build each network: the devices being supported are connected directly to Ethernet which, in turn, is connected to a VAX system.

This approach allows the creation of a single network consisting of as few or as many computer systems as the current local workload requires. The user can connect a few personal computers or workstations into a simple local network; smaller systems can be connected to larger ones, or large systems to each other. The options are virtually unlimited.

Digital's computers, used throughout the Lockheed Corporation, are helping ensure smooth material flow to keep production of the largest aircraft in the West on schedule. At peak production, one C-5B will roll out of Lockheed-Georgia's Marietta plant every ten days. VAXclusters and PDP-11s control the precise cutting and machining of thousands of separate parts making up the airframe and skin.

With Ethernet all the functions within an organization can easily be merged into a single, seamless network. With Ethernet, you can literally plug anything in anywhere and it is immediately on the network. And because Ethernet is a "throughway," rather than a chain or a ring, devices can be added or removed without interrupting traffic on the network.

Second Generation of VAX ▪ The company introduced seven new second-generation VAX systems in a period of eight months, thereby completing the replacement of the original industry-standard 700-series VAX systems that debuted in 1977. Following is the current line-up of 8000-series VAX processors. Included are two midrange systems that were announced as this report was being prepared. Introduction dates and power comparisons with the de facto standard created by the original VAX-11/780 are shown in parentheses.

▪ VAX 8800: the highest-performance computer system ever produced by the company, delivering up to 12 times the power of the original VAX-11/780. It is designed for use in such compute-intensive areas as seismic analysis, image processing, artificial intelligence, circuit design, simulation and high-energy physics. (January 1986,–12X)

"Our hospital clients operate in an increasingly competitive market with both regulatory agencies and insurance companies pressuring them to control costs. Integrating such diverse information as patient care data and financial, staffing, and market data rapidly and efficiently allows a hospital to maintain quality care and remain competitive. We and our customers rely on VAX computers to provide fast and reliable information systems, and a responsive service organization, in an environment where peoples' lives are at stake."

Stephen Macaleer, Vice-President;
Shared Medical Systems Corporation, Malvern, Pennsylvania

- VAX 8700: a high-performance system suitable for industrial and scientific applications requiring very large memory and data transfer rates. It is particularly suited to management information systems, scientific or financial modeling and data acquisition. (August 1986–6X)

- VAX 8650: a large and powerful system that combines fast throughput, high system availability and operating economy, making it popular in office automation, computer-integrated manufacturing and management information systems. (December 1985–6X)

- VAX 8600: the first member of the second generation, it brought VAX power and functionality for the first time to the largest compute-intensive applications. It is popular in commercial data processing, administrative and information management systems and transactional processing, as well as in the scientific, research and engineering communities. (October 1984–4X)

- VAX 8550: provides high-performance computing in a very compact package. It is an excellent system for large departments that want to support general purpose office information systems, simulation or computer-aided design. (August 1986–6X)

- VAX 8500: a compact system designed for multiuser customers in all technical and commercial markets. It is particularly suited to users who need midrange power but who are faced with space and facility constraints. (April 1986–3X)

- VAX 8300: a low-cost, midrange system that brings VAX power and versatility to compute-intensive applications such as simulation, image processing and computer-aided design and where cost and compactness are important criteria. (January 1986–1.9X)

- VAX 8200: as powerful as the original VAX-11/780, but at half the price. It is an ideal departmental system in office, manufacturing, commercial and scientific applications.

Each member of this new second generation of systems is designed within the same proven VAX architecture and each employs the same VMS software system. Thus, a program written on one VAX system can run on any other VAX system, including MicroVAX, without modification, giving any VAX user access to the industry's most comprehensive offering of networking products and to the more than 3,000 applications that have been written on VMS.

"Operating in one of the fastest-growing regions of the country, we require a flexible data network that can provide key corporate information to the people who need it instantly at their fingertips. Our decision support system, based on ALL-IN-1 Office and Information Systems software running on VAX and MicroVAX II computers, provides such information as the status of the telecommunications network, traffic load through our long distance switching centers, and quality control indexes for service and repair orders – maintaining accountability and customer service."

David J. Baker, Manager, Office Automation Systems; United Telephone Company of Florida, Altamonte Springs, Florida

In addition to the seven new second-generation VAX systems, Digital introduced scores of other new products during the year, each an implementation of the integrated network strategy on which the company has been building for many years. Each is designed to work within the Digital networking environment and each addresses a specific information management need. Here are a few of the highlights of the most prolific new product year in our history:

LAN Bridge 100 • This important connectivity product dramatically extends the ability to build and connect Ethernet local area networks (LANs). Previously, local networks were usually limited to the confines of a single room or a small building. This bridge makes it possible to interconnect several local networks into a single, virtually seamless network capable of supporting thousands of computers, workstations, printers and other devices.

The bridge also directs message traffic dynamically within a local network or between networks to ensure optimum utilization. Intradepartmental messages are kept within the local segment, and those messages intended for other departments are passed along to other segments.

MicroVAX Enhancements ▪ During the year, two of Digital's most important integrated software systems, ALL-IN-1 and A-to-Z, were made available for the MicroVAX II system:

The ALL-IN-1 Office and Information System is a comprehensive set of integrated office software for workgroups and departments in large organizations. It offers word processing, electronic mail, desk management, time management and other office functions through one menu on a single terminal or an industry-standard personal computer. It can also be customized to include departmental data and information processing applications.

The A-to-Z Integrated Software System was developed to allow Original Equipment Manufacturers (OEMs), software developers and resellers to pursue significant new opportunities to reach new classes of potential customers among small businesses by being able to offer more than 1600 higher quality business software packages available on Digital's computers.

AI VAXstation ▪ Digital's AI VAXstation is the industry's first fully integrated artificial intelligence (AI) workstation. Based on the MicroVAX II, this system provides a practical and inexpensive development tool in the fast-

growing "knowledge engineering" field. It offers such features as multitasking, multiwindowing and high-resolution graphics on a large, easy-to-read screen. This new system is popular in a wide variety of commercial, technical and industrial markets, including aerospace, petrochemicals, government, finance and education. And because it is a VAX, applications developed on the AI VAXstation can run on any other computer in the VAX family.

This workstation is evidence of Digital's commitment to maintain its leadership in the artificial intelligence market. The company offers a wide range of AI software tools, including VAX LISP, Digital's version of the emerging standard AI language; ADA an AI language widely used in government projects and VAX OPS5, a language used by customers with expertise in knowledge engineering. The company also introduced three additional high-performance VAXstation systems, each of which combines high-resolution color graphics with full VAX power and functionality for applications in the electronics, laboratory, petroleum and government markets.

VMS/SNA • VMS/SNA is a low-cost software product that links Digital's MicroVAX-based systems directly to computing environments using the IBM Systems Network

"We depend on talented people using the best technologies available to keep us competitive. Our VAXcluster in New York receives foreign exchange currency rates directly from Reuters VAX system in Europe. This VAX-to-VAX system link gives our FOREX traders a ten-second edge in identifying profit positions in Eurocurrency arbitrage. In a market as volatile as currency trading, that competitive edge can make all the difference."

Jay Pomrenze (left), Senior Vice-President, Foreign Exchange and Kevin McGilloway, Senior Vice-President, Technology; Bankers Trust Company, New York, New York

Architecture (SNA). Intended for traditional MIS and data processing centers, this product allows users to take advantage of VAX power and versatility while still being able to access large IBM databases. For example, local workgroups can use MicroVAX or VAXstation as their primary computer and still gain direct access to an SNA environment.

DECconnect ▪ DECconnect, Digital's strategy for wiring a building, provides a simple means of integrating all the communications options needed in a user environment today and in the future, and makes them easily accessible through a single wallplate. DECconnect, then, makes the building of Ethernet networks as easy as plugging in an appliance.

Enhanced DECnet-DOS ▪ Enhanced DECnet DOS Software allows an IBM PC, PC/AT and IBM PC/XT to participate via DECnet as full members of a Digital network with all the benefits of remote file transfer and network management usually associated with Digital networks.

VAXstation II/GPX ▪ This powerful system is Digital's first technical workstation for the UNIX marketplace. It provides high-performance color capabilities, sophisti-

At Volvo Car Corporation, networks and VAX computers are used in virtually every step of production, from design and testing to manufacture. The company's new Uddevalla, Sweden, manufacturing plant is being designed to function competitively well into the 21st century with the most advanced CIM (Computer Integrated Manufacturing) technologies available, run entirely on VAXclusters.

cated windowing, multiple graphics interfaces and a choice of networking options – all essential features in the computer-aided design, manufacturing and engineering markets to which it is targeted. It supports ULTRIX, Digital's implementation of standard UNIX, as well as Digital's VMS operating system.

VAXstation II/RC • This entry-level member of the VAXstation family is designed for primary applications in such areas as electronics, mechanical design, and software development, where users require high performance and extensive networking capabilities at modest system cost.

Standard Network Packages • As the result of extensive involvement with our customers in helping them plan, build and maintain the networks they need for effective information management throughout their organizations, we have assembled seven standard network packages which are designed to solve a majority of the connectivity problems most commonly encountered in creating computer networks at any level of an organization. Each package facilitates the building of high-speed data networks to link an assortment of personal computers and workstations to departmental or corporate computers.

- Package One is for low-speed communications. It connects terminals or personal computers into a local area network within a workgroup. It can link 16 offices, and can eventually expand to serve a maximum of 64 offices.

- Package Two is for high-speed communications. It is also for use at the workgroup level. It uses ThinWire Ethernet cable to link workstations and personal computers, including IBM products, in 16 offices. It, too, can be expanded to serve a maximum of 64 offices.

- Package Three permits the linking of up to 64 offices on the same floor. It requires that the components of Packages One and Two be located in the same equipment room on the same floor.

- Package Four is designed to link different floors within a building or different buildings within a site, using either coaxial cable or fiber-optic connection. One variation of this package connects buildings up to 10 miles apart.

- Package Five connects up to eight computers within a computer room. It uses Digital Ethernet communications controllers, permitting any central processor or standard system to be incorporated into this package.

- Package Six lets a Digital computer network communicate with an IBM SNA network. For example, it allows users of IBM 3270 terminals within the SNA environment to access the VAX system. A total of nine access routines are available, including Gateway Management, Remote Job Entry, Terminal or Printer Emulation and IBM's DISOSS Document Exchange.

- Package Seven provides interconnection among multiple buildings. It permits users within a Digital network environment to access remote network users over an X.25 public data network or a DECnet private network.

Each of these new packages can be used alone or in combination with other packages. Each package consists of the appropriate hardware, software, installation, services and a one-year warranty.

As this report was being prepared, Digital announced three important new products that warrant mention here:

"Our image processing system, which has become the de facto standard for oceanographic satellite remote sensing research, creates color photographs portraying surface temperature, current, winds, and chlorophyll content from more than two billion bytes of information fed daily to our network of VAX and MicroVAX II computers. These exceedingly complex images are compiled from millions of observations and cover thousands of squares miles of geography. The images are then shared, through a DECnet network, with 16 major ocean research institutions around the world."

Drs. Otis B. Brown (opposite) and Robert H. Evans (above), Rosenstiel School of Marine and Atmospheric Science; University of Miami, Florida

PC ALL-IN-1 ▪ This easy-to-use MicroVAX-based system allows up to 30 previously isolated personal computers to be linked into an office workgroup network. These PCs can run thousands of industry-standard applications, enjoy the use of shared resources and have access to the other systems throughout the network. Multiple workgroup networks can be linked into a single departmental network to provide the benefits of ALL-IN-1 to thousands of users.

VAX/VMS Services for MS-DOS ▪ This new software product is specifically designed for users of the popular Microsoft MS-DOS applications packages. It combines the resources of Digital's VAX/VMS and MS-DOS into a network environment that integrates personal and organizational computing.

VAXmate ▪ Digital's newest personal computer is the first in the industry to be designed from the ground up for networking and information sharing. It is IBM PC/AT compatible, offering users industry standard personal computing, plus the ability to share information with other VAXmates, with larger Digital systems and, through gateways, with IBM SNA networks.

"Our customers look to us, as one of the largest printing and design firms in the world, for innovation and cost savings. We developed PACREATE, an automated package design system, to operate on a network of VAX and MicroVAX II computers. Using more than 6,000 package types, we can custom design all aspects of packaging, from size, shape, and materials to labeling, manufacture, and retail display. The final design is sent over our network to production facilities, cutting design development time from an average of one month to one-half day."

Yasuo Kubota (seated), Manager, Engineering Research Laboratory; Dai Nippon Printing Co., Ltd., Tokyo

From the beginning, customer satisfaction has been a primary corporate goal at Digital. We recognize that all efforts to apply the latest technologies, design the best products and provide the best solutions are meaningless unless Digital's customers are satisfied with the results they get from using our products. They must feel satisfied, too, with the level of our commitment to help them be successful, not just by being responsive to their current needs but by anticipating future needs, as well.

More recently, Digital has made the commitment to be the world's leading supplier of computer networks. This means offering the best networking strategy supported by the best hardware, software and communications products. It also means providing the best network support services. Delivering on this latter commitment has also become a primary corporate goal at Digital.

One of our major challenges is to confront increasingly complex product designs and rapidly decreasing life cycles between the introduction of major systems. To succeed here – that is, to meet customer expectations – requires sophisticated maintenance and support systems, even though the inherent reliability of these products is very high and getting higher all the time.

In support of Digital's commitment to its customers around the quality and quantity of support services and the ease with which they can be accessed, Digital maintains a worldwide customer support organization of more than 30,000 maintenance and software support personnel deployed at more than 650 locations in 54 countries on five continents. Their goal is to maximize computer availability to our customers and minimize cost of ownership.

Because different customers have different needs, Digital offers a comprehensive array of support services from which customers can choose. These include 24-hour, full service and as-needed contract coverage; automated telephone diagnosis of hardware and software products; and call-in centers for software consulting. Carry-in centers and a fleet of fully equipped mobile units provide service for small systems and terminals.

For customers whose needs are not met by Digital's standard products, the company maintains Special Systems facilities around the world that provide customized services in hardware and software design, applications programming, systems engineering, project management and networking.

To support the new DECconnect wiring system, we developed a flexible set of coordinated services to assist U.S. and Canadian users in analyzing their computer environment and data communications wiring needs. Called DECsite, the program helps in the planning, designing and building of new computer facilities and in the renovation of existing sites.

Recognizing that most of Digital's customers maintain computer networks that include equipment from other vendors, the company has instituted NETcare, an integrated service program that provides customers with a single point of contact for all multivendor networks that include Digital systems, regardless of the mixture of hardware, vendors or technologies involved.

An early-warning system is available that monitors the performance of single VAX systems, VAX networks and VAXclusters and warns system managers of hardware problems before they occur, thereby averting the expense and inconvenience of unexpected downtime. This monitoring system, called VAXsim, allows one operator at a terminal to trace imminent hardware problems down to the device level. VAXsim pinpoints them, allowing system managers to schedule preventive maintenance and avoid costly downtime.

Starting with a single PDP-11 computer nearly five years ago, Intasun Travel (International Leisure Group PLC) delivered instant reservation confirmations to travel agents. The company, headquartered in London, now operates its own airline and confirms reservations for two million travelers annually to more than 1,300 resorts and hotels around the world. With one of the largest VAXclusters in Europe at the heart of its system, Intasun has become one of the world's leading travel wholesalers.

Digital offers what it believes to be the most comprehensive portfolio of disaster recovery services available from any major vendor. One program, called Recover-all, provides subscribers with back-up computing capabilities to replace their systems lost to storms, power outages or other disasters. Digital was the first – and we believe still the only – vendor to offer such a program.

To ensure that its employees and customers are kept abreast of the latest technologies, products and applications, Digital maintains one of the world's largest private educational services organizations. Its curriculum encompasses more than 500 courses offered in 18 languages by 600 instructors at 40 training centers around the world. Self-paced courses, computer-based instruction and classes at customer sites are also offered.

Again this year, Digital's customer service organization was rated by an independent survey and several industry consultants as the best among the major computer vendors. We are gratified by this recognition, and are challenged by it to continue to work as hard as we can to ensure that our customers' needs are met and that Digital's Customer Services group does, indeed, remain the best in the industry in the view of those whose opinions of us matter most: our customers.

"Our organization is a network of women – 175,000 members, living in more than 2,000 communities around the U.S., who share common concerns. With the VAX computer in our Washington, D.C., headquarters, we provide instantaneous and broad-based networking to keep in touch with our members and put them in contact with each other, revolutionizing the way women communicate with one another on issues important to themselves, their communities, and the nation."

Sarah Harder (seated), President, American Association of University Women (AAUW) and Chairman of the Board, AAUW Educational Foundation; Elsie M. Smith (left), Chairman of Research and Projects Awards Panel, AAUW Educational Foundation; Maureen O'Hara, recipient of 1986 Recognition Award for Young Scholars from the AAUW Educational Foundation.

Digital recognizes that it has important obligations to many people whose reasonable expectations the company must strive to meet. Customers expect Digital to be a reliable supplier of high quality products and services. Shareholders expect the company to work hard to make their investments grow. Our employees expect the company to be a sensitive and supportive employer. The community at large expects Digital to be a thoughtful neighbor and responsible corporate citizen. The company is firmly committed to meeting all of these expectations.

Digital is very proud of the dedication of its employees around the world, who now number 95,000. The company seeks to recognize their accomplishments by promoting their personal and professional growth through support of such programs as continuing education, job enlargement training, management development, personal skills workshops, tuition refunds, scholarships and university courses at company facilities. All of these programs were expanded during the year to accommodate the steadily growing numbers of employees at all levels of the organization who seek to learn and grow, and we will continue to encourage and support their initiatives.

Digital remains seriously committed to programs which ensure that all employees have equal opportunities for hiring and advancement. The company has continued to aggressively pursue affirmative action programs to attract and develop minority and female employees. One of the most successful programs in this area involves partnerships with a number of minority universities to which Digital provided computer equipment and other resources to support the development of state-of-the-art science and technology curricula. Another related program provided individual scholarships to almost 100 female and minority college students.

Digital encourages outside initiatives at the national, regional and local levels in all the areas of the world where our employees live and work. During the year, the company broadened its community involvement through increased grants of cash and equipment to hundreds of educational, social, civic, cultural and health care programs. The following programs typify the company's involvements.

Digital continued to support the Florida-based Adam Walsh Child Resource Center and its national initiatives in behalf of missing and exploited children. Grants of

DECtalk voice-synthesis equipment were made to 230 not-for-profit organizations around the world to provide the disabled with access to technology. Other grants provided support in such areas as research and therapy for children, homeless shelters, AIDS research, and the President's Committee for the Employment of the Handicapped.

Digital made major underwriting commitments to a number of important national and local programs, headed by its support for the sixth consecutive year of "Evening At Pops," the top-rated PBS Television concert series featuring the Boston Pops Orchestra. The company also became a major underwriter of the aerospace exhibit in the Smithsonian's National Air & Space Museum, the national tour of an exhibit of Artificial Intelligence being staged in Boston's Museum of Science, and a major new travelling exhibition of American watercolors assembled by the Worcester, Mass. Art Museum. Digital also donated equipment to the fund-raising auctions at 30 public television stations. And, as part of its "Valuing Differences" program, the company provided major funding for a first-ever ethnic summer festival in Boston.

In the area of education, the company made grants to scores of graduate schools, colleges and universities as a way of encouraging research in specific areas and keeping abreast of other areas which may be critical to the company's future. This involvement is also meant to encourage the technological advancement of women and minorities.

A major grant to the Springfield, Mass. public school system will help create a computer network in its high school to promote development of student skills in such areas as creative writing, special and bilingual education and laboratory experiments.

Digital also made more than 400 scholarship grants to children of employees, to women and minorities pursuing careers in science and technology, and to college-bound students in Digital communities. Thirty-one children of employees received National Merit Scholarship support from the company, making Digital's National Merit program the third largest in the nation.

Digital has always encourage its employees to become involved in the community b natching dollar-for-dollar their individual gifts t chools, hospitals, other not-for-profit organizations l United Way programs. Donations by individual em ees to more than 3,000 qualifying organizations anc 7 United Way campaigns, combined with matching fu from the company, exceeded $6 million.

Digital takes seriously its ob tions to its customers, its shareholders, its employe nd to the community at large. As we grow, we look ward to increasing our support for the initiatives th ake, and the company remains strongly committed t mounting its own initiatives, as well, in meeting its co porate responsibilities.

• This year marks the 25th a iversary of the Digital Equipment Computer Users ciety (DECUS), the industry's largest, most active and, 're proud to say, most thoughtful and supportive u group. DECUS members, now more than 90,000 stron ound the world, are a great help in keeping our pr ct strategies on course and we look forward to cont ng that partnership.

FINANCIAL CONTENTS

Operations *(in millions except per share data)*	1986	1985	1984	1983
Revenues				
Equipment sales	$4,961.9	$4,534.2	$3,831.1	$2,867.5
Service and other revenues	2,628.5	2,152.1	1,753.3	1,404.4
Total operating revenues	7,590.4	6,686.3	5,584.4	4,271.9
Costs and Expenses				
Cost of equipment sales, service and other revenues	4,282.1	4,087.5	3,379.6	2,606.0
Research and engineering expenses	814.2	717.2	630.7	472.4
Selling, general and administrative expenses	1,665.4	1,431.8	1,179.5	830.6
Operating income	828.7	449.8	394.6	362.9
Interest expense	88.1	82.0	35.1	13.1
Interest income	(116.9)	(63.0)	(41.5)	(61.2)
Income before income taxes	857.5	430.8	401.0	411.0
Provision for income taxes	240.1	(15.9)[2]	72.2	127.4
Net income	$ 617.4	$ 446.7	$ 328.8	$ 283.6
Net income per share[1]	$ 4.81	$ 3.71	$ 2.87	$ 2.50
Weighted average shares outstanding	130.8	124.1	114.7	113.4
Financial Position *(in millions except per share data)*				
Inventories	1,199.8	1,756.2	1,852.2	1,353.8
Accounts receivable, net of allowances	1,903.3	1,539.0	1,527.3	1,125.0
Working capital	4,222.7	3,694.2	3,001.4	2,377.0
Property, plant and equipment, at cost	3,262.7	2,827.6	2,351.8	1,961.4
Total assets	7,173.3	6,368.9	5,593.3	4,541.1
Long-term debt	333.2	836.9	441.3	92.8
Stockholders' equity	5,727.8	4,554.6	3,979.2	3,541.3
Stockholders' equity per share	$ 44.54	$ 38.43	$ 34.42	$ 31.42
General Information and Ratios *(dollars in millions)*				
Current ratio	4.9:1	4.9:1	3.8:1	3.9:1
Quick ratio	3.5:1	2.8:1	1.9:1	2.0:1
Additions to property, plant and equipment	$ 564.2	$ 571.8	$ 452.1	$ 419.2
Depreciation	$ 384.0	$ 315.1	$ 252.6	$ 203.2
Debt to debt plus equity ratio	5.5%	15.5%	10.0%	2.6%
Operating income as a percentage of total operating revenues	10.9%	6.7%	7.1%	8.5%
Income before income taxes as a percentage of total operating revenues	11.3%	6.4%	7.2%	9.6%
Effective tax rate	28.0%	(3.7%)[2]	18.0%	31.0%
Net income as a percentage of total operating revenues	8.1%	6.7%	5.9%	6.6%
Net income as a percentage of average stockholders' equity	12.0%	10.5%	8.7%	8.5%
Net income as a percentage of average total assets	9.1%	7.5%	6.5%	6.6%
Number of days sales of accounts receivable outstanding	79	75	83	82
Inventory turns	2.9	2.3	2.1	2.1
Number of employees at year-end	94,700	89,000	85,600	73,000
Common shares outstanding *(in thousands)*	128,591	59,253	57,811	56,357
Shareholders at year-end	76,860	68,810	44,389	40,903
Common stock yearly high and low sales prices	$ 94-46	$ 63-39	$ 50-33	$ 65-32

[1] *See Note E of Notes to Consolidated Financial Statements.*

[2] *Includes elimination of DISC taxes of $63M accrued prior to 1984.*

1982	1981	1980	1979	1978	1977	1976
$2,79[illegible]7	$2,384.2	$1,779.4	$1,381.8	$1,128.1	$ 847.5	$ 586.7
1,08[illegible]1	813.9	588.6	422.3	308.5	211.1	149.6
3,88[illegible]8	3,198.1	2,368.0	1,804.1	1,436.6	1,058.6	736.3
2,18[illegible]	1,778.7	1,319.9	1,012.3	802.3	595.1	424.3
34[illegible]	251.2	186.4	138.3	115.7	79.7	58.4
75[illegible]	632.2	478.9	370.1	281.0	205.9	136.1
58[illegible]	536.0	382.8	283.4	237.6	177.9	117.5
1[illegible]3	29.2	27.0	24.3	22.4	11.7	9.9
(102.8)	(60.6)	(53.8)	(35.8)	(12.3)	(10.2)	(11.8)
672.8	567.4	409.6	294.9	227.5	176.4	119.4
255.6	224.1	159.7	116.5	85.3	67.9	46.0
$ 417.2	$ 343.3	$ 249.9	$ 178.4	$ 142.2	$ 108.5	$ 73.4
$ 3.76	$ 3.35	$ 2.73	$ 2.05	$ 1.70	$ 1.39	$ 0.99
110.9	105.1	94.3	89.9	86.5	78.0	74.1
1,13[illegible]	1,102.2	819.9	513.5	428.1	375.0	218.8
80[illegible]	758.1	629.1	475.1	375.2	323.1	219.3
2,18[illegible]	2,029.8	1,658.2	1,076.9	887.0	574.2	499.0
1,66[illegible]	1,128.4	772.3	582.1	507.8	352.4	215.8
4,02[illegible]	3,456.1	2,666.1	1,863.2	1,501.4	1,070.4	856.0
9[illegible]1	88.4	489.7	340.7	341.6	90.6	91.4
3,16[illegible]	2,679.7	1,651.7	1,120.2	904.8	735.5	606.0
$ 28[illegible]	$ 24.65	$ 18.12	$ 13.79	$ 11.35	$ 9.37	$ 7.80
4[illegible]1	4.2:1	4.5:1	3.8:1	4.7:1	3.5:1	4.3:1
2.[illegible]1	2.3:1	2.6:1	2.3:1	2.8:1	1.8:1	2.8:1
$ 511.2	$ 398.5	$ 209.9	$ 93.9	$ 167.0	$ 143.2	$ 54.5
$ 152.6	$ 102.1	$ 69.8	$ 57.7	$ 50.2	$ 28.5	$ 22.0
2.8%	3.2%	22.9%	23.3%	27.4%	11.0%	13.1%
15.1%	16.8%	16.2%	15.7%	16.5%	16.8%	16.0%
17.3%	17.7%	17.3%	16.4%	15.8%	16.7%	16.2%
38.0%	39.5%	39.0%	39.5%	37.5%	38.5%	38.5%
10.7%	10.7%	10.6%	9.9%	9.9%	10.3%	10.0%
14.3%	15.9%	18.0%	17.6%	17.3%	16.2%	14.7%
11.2%	11.2%	11.0%	10.6%	11.1%	11.3%	10.3%
73	73	81	82	82	88	85
2.0	1.9	2.0	2.2	2.0	2.0	2.2
67,100	63,000	55,500	44,200	39,000	36,700	25,700
55,227	54,348	45,568	40,606	39,873	39,259	12,944
44,706	39,948	35,144	28,835	25,868	22,738	15,442
$ 55-34	$ 55-29	$ 41-27	$ 29-22	$ 28-19	$ 30-20	$ 30-18

Income and Expense Items as a Percentage of Total Operating Revenues				Percentage Changes		
1984	1985	1986	Income and Expense Items	1985-86	1984-85	1983-84
68.6%	67.8%	65.4%	Equipment sales	9%	18%	34%
31.4%	32.2%	34.6%	Service and other revenues	22%	23%	25%
100.0%	100.0%	100.0%	Total operating revenues	14%	20%	31%
60.5%	61.1%	56.5%	Cost of sales, service and other revenues	5%	21%	30%
11.3%	10.8%	10.7%	Research and engineering expenses	14%	14%	34%
21.1%	21.4%	21.9%	Selling, general and administrative expenses	16%	21%	42%
7.1%	6.7%	10.9%	Operating income	84%	14%	9%
0.6%	1.2%	1.1%	Interest expense	7%	134%	168%
(0.7%)	(0.9%)	(1.5%)	Interest income	86%	52%	(32%)
7.2%	6.4%	11.3%	Income before income taxes	99%	7%	(2%)
1.3%	(0.3%)	3.2%	Income taxes	1614%	(122%)	(43%)
5.9%	6.7%	8.1%	Net income	38%	36%	16%

As an aid to understanding the Company's operating results, the above tables indicate the percentage relationships of income and expense items included in the Consolidated Statements of Income for the three fiscal years ended June 28, 1986 and the percentage changes in those items for such years.

Revenues

The C npany's total operating revenues for fiscal year 1986 i reased by 14% compared with increases of 20% in 198 nd 31% in 1984. The Company continued to be aff ed by a protracted downturn in the computer indus Customer spending was cautious, particularly in the manufacturing sector. However, many new produ and a growing recognition of the Company's netwo g capabilities led to an increase in market share. e Company now has the products and skills requir to build high-speed local networks anywhere in an org zation. It is the Company's goal to tie together every p t of an organization from the desktop to the data ce ter.

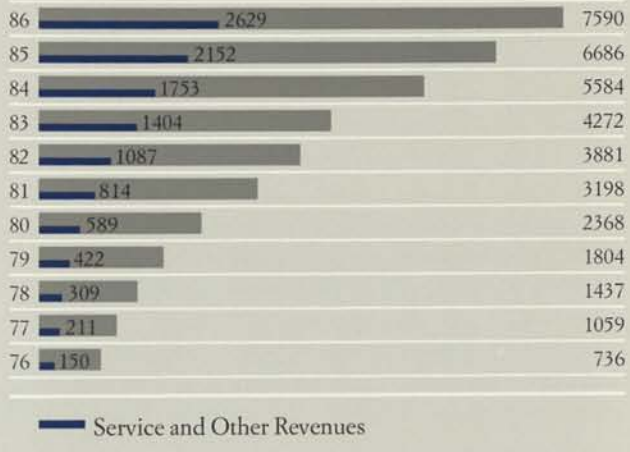
Demand from customers overseas remained strong throughout the year. Non-U.S. revenues accounted for 42% of total operating revenues in 1986 compared with 40% in 1985 and 35% in 1984.

An im rtant factor in the Company's revenue growth in fiscal 6 was the extension of the range of compatible VAX c puter systems provided by several new products introc d during the year. Excellent customer acceptance immediate availability of the new products were reflec n the fiscal year's results.

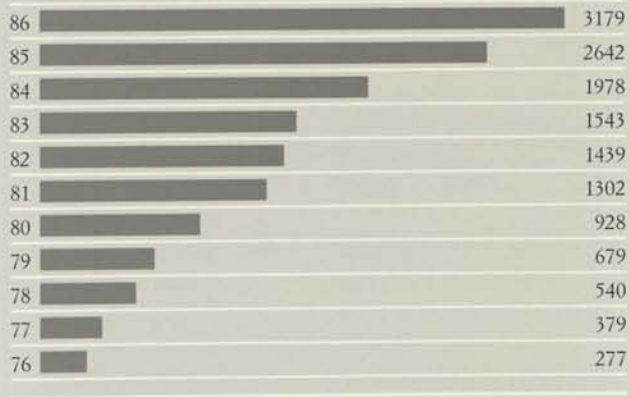
Anot actor contributing to revenue growth was the Comp 's ability to supply simple, cost effective solutions s expanding customer base. All of the Company's h ware and software products have been designed withi e same modular architecture. This allows them to wo together in networks in virtually any combination and to work with products from other major computer vendors. Customers value this unique product feature because it provides them with considerable flexibility and cost effectiveness in implementing their computer strategies.

In fiscal 1986, service and other revenues, which principally include maintenance service, software revenues, customer training and the sale of replacement parts, grew by 22%. Service and other revenues comprised 35% of total revenues in fiscal 1986, compared with 32% in 1985 and 31% in 1984.

Total Operating Revenues **$ Millions**



Non-United States Revenues **$ Millions**



Expenses and Profit Margins

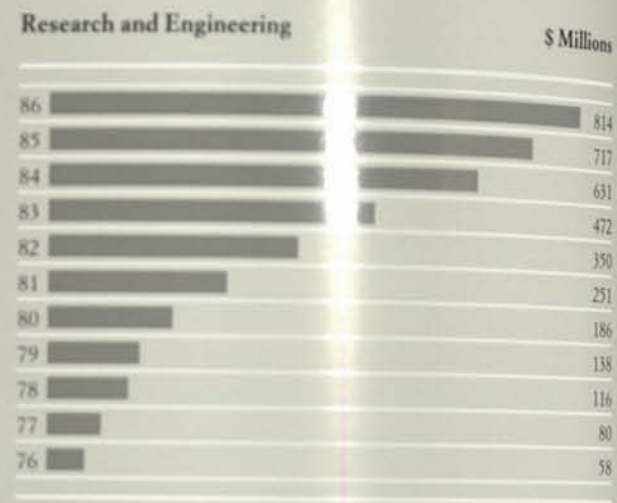
The cost of sales as a percentage of operating revenues decreased in fiscal 1986 compared with the prior two years. This reflected a higher proportion of revenues from new products, increased manufacturing efficiencies, cost reductions, reduced inventory levels and an improved mix of service and other revenues. As a result, operating income increased by 84%, compared with increases of 14% and 9% in the two preceding fiscal years.

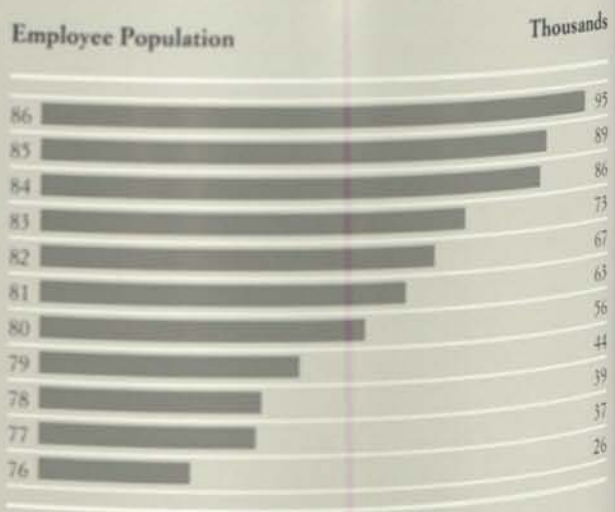
Research and engineering expenses grew 14% in fiscal 1986 and comprised 10.7% of total operating revenues compared with 10.8% in 1985 and 11.3% in 1984. The Company is primarily involved with applied research and engineering and has approximately 5,700 professional employees involved in various research, engineering and programming activities.

The Company's investment in research and engineering, over $2 billion in the last three years, resulted in the introduction of several new hardware, software, and service products in 1986. Among them were the VAX 8800, the Company's highest performance VAX system, which is designed to solve problems in such areas as seismic analysis, image processing, artificial intelligence and high-energy physics. Also announced were the VAX 8500, 8300 and 8200, second generation mid-range offerings, which have extensive applications, including commercial and office automation. The introduction of the VAX 8550 and VAX 8700 computer systems shortly after the close of the fiscal year completed Digital's systematic replacement of its 11/700-series of VAXes.

The Company also introduced during the year a series of workstation products including the AI VAXstation, a Micro-VAX-based system for artificial intelligence applications, and the entry-level VAXstation II/RC, which provides compute-intensive performance and networking. These complement other members of the VAXstation family, the VAXstation II, VAXstation II/GPX and the VAXstation 500 series, which were also introduced during the year.

The attractiveness of these products lies in the networking capabilities that allow customers to tie together computers in one global network and in the volume of VMS software available for VAX computers. The Company offers the ability to interconnect personal computers and workstations, mid-range systems and large mainframes into a single network that ties together an entire organization.





Expenses and Profit Margins (continued)

Selling, general and administrative expenses increased to 21.5% of total operating revenues in fiscal 1986 compared with 21.4% in 1985 and 21.1% in 1984. Additions to sales and service personnel accounted for most of the increase over fiscal 1985.

Interest income increased in fiscal 1986 from fiscal 1985 levels due to a higher level of cash available for investment. Interest expense increased somewhat, reflecting an $11 million premium for the early redemption of $100 million of 13% Sinking Fund Debentures issued in fiscal 1984.

The Company's effective tax rate for fiscal 1986 was 28%. Excluding a one-time DISC (Domestic International Sales Corporation) benefit of $63 million, the fiscal 1985 effective tax rate was 11%. In fiscal 1984 the effective tax rate was 18%. The increase in the effective tax rate for fiscal 1986 resulted primarily from improved profitability in the U.S. and the scheduled expiration of certain U.S. tax credits.

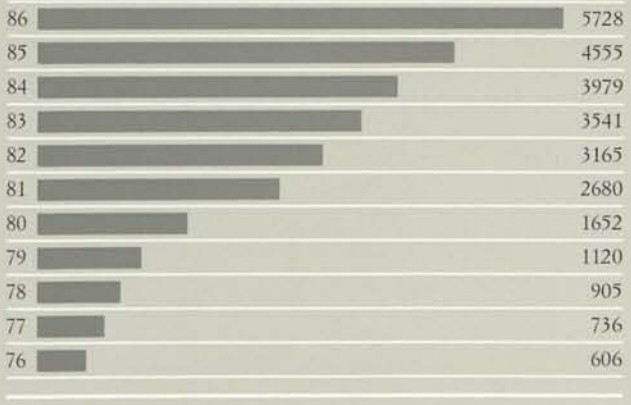
During the year, the total number of employees increased by 5,700, bringing the total number of employees at year end to 94,700. The increase in the employee population took place primarily in the sales and service organization. As was the case in fiscal 1985, the number of employees in manufacturing declined while the number of employees in the engineering organization increased slightly.

The ratio of net income to average stockholders' equity (ROE) was 12% in fiscal 1986, 10.5% in fiscal 1985, and 8.7% in fiscal 1984.

Inflation and Changing Prices

The preceding discussion and analysis are based on the Company's financial statements presented in historical dollars. See pages 51 and 52 for supplementary information on the Company's historical financial data adjusted for the effects of inflation and changing prices.

Total Stockholders' Equity **$ Millions**



Availability of Funds to Support Current and Future Operations

The requirement for funds to support the Company's operations has historically been met with internally generated funds supplemented with external financing. During fiscal 1986, internally generated funds were more than sufficient to support operations.

During the three year fiscal period 1984-1986, funds generated from operations exceeded funds used to support operations by $391 million. In 1986, funds generated from operations were $793 million, compared with $101 million generated in 1985. In 1984, $503 million was required for operations. The higher level of funds generated from operations in 1986 was a result of improvements in the Company's profitabilty and asset management.

The Company reduced long-term debt during fiscal 1986 by $500 million through the call and subsequent conversion to equity of $400 millon of 8% Convertible Subordinated Debentures and the redemption of $100 million of 13% Sinking Fund Debentures.

Cash and temporary cash investments rose to $1,911 million at the end of fiscal 1986 from $1,080 million at the end of 1985. Unused lines of credit at the end of fiscal 1986 were $379 million, including revolving credit agreements of $240 million.

The Company believes its improved profitabilty coupled with its low debt to debt-plus-equity ratio and high credit rating leave it well positioned to obtain funds sufficient to meet future requirements.

Common Stock Information

The Company's common stock is listed and traded on the New York Stock Exchange, Pacific Stock Exchange and several European stock exchanges. There were 76,944 stockholders of record as of August 1, 1986. The high and low quarterly sales prices for the past two fiscal years are presented below. The 1985 stock prices have been adjusted to reflect the two-for-one stock split effected May 9, 1986.

		1986
Fiscal Quarter	High	Low
First	$ [illegible]	$45 7/8
Second	[illegible]5/8	51 1/4
Third	[illegible]7/8	65 7/8
Fourth	[illegible]5/8	76

		1985
Fiscal Quarter	High	Low
First	$ 03/4	$38 5/8
Second	53 1/2	44 5/8
Third	62 7/8	48 3/4
Fourth	54 7/8	41 1/8

Spending for Operations

Fiscal y r-end inventories declined 32% from the prior year. A age year inventory turns of 2.9 times improved from th .3 times and 2.1 times recorded in 1985 and 1984, r ectively. Accounts receivable grew 24%, reflecti rise in equipment sales and the effects of currency t slation. The increase in days sales in accounts receival outstanding to 79 from 75 in fiscal 1985 is more th accounted for by currency translation. Days sales ou nding improved in the United States.

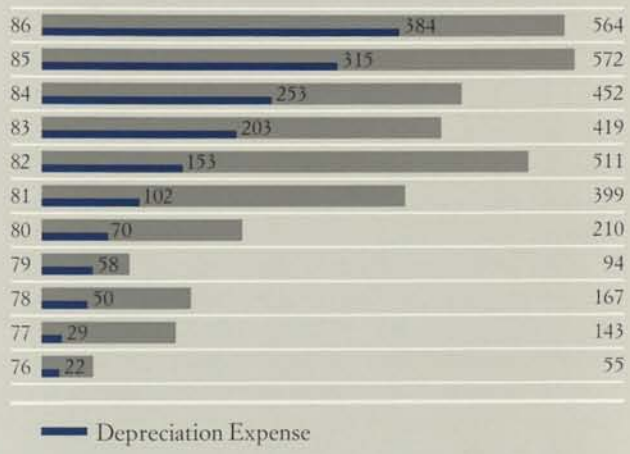
Capital nding in fiscal 1986 totaled $564 million, down sl tly from the $572 million spent in 1985. In fiscal 1986 $423 million of the capital spending was for equipment as the Company continued to invest in support of new products and technology development. Spending for land and building additions totaled $92 million, and leasehold improvements totaled $49 million.

The rati of net income to average net total assets (ROA) was 9.1 in fiscal 1986, 7.5% in 1985 and 6.5% in 1984.

The Co any added approximately 3 million square feet of buil space worldwide in fiscal 1986, bringing the total ar nt of space to 32.3 million square feet, compared v 29.3 million square feet in 1985 and 24.5 million sq feet in 1984. Most of the new space in 1986 was ad overseas to support a higher level of sales.

The Co any's actual capital spending level in fiscal 1987 w e dependent on a variety of factors, including genera nomic conditions and the growth in demand for its p ducts and services.

Additions to Property, Plant & Equipment
Depreciation Expense **$ Millions**



Net Income Per Common Share **$**

Report of Management

The Company's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of all the financial data included in this Annual Report. In preparing the financial statements, management makes informed judgments and estimates of the expected effects of events and transactions that are currently being reported.

Management maintains a system of internal accounting controls that is designed to provide reasonable assurance that assets are safeguarded and that transactions are executed and recorded in accordance with management's policies for conducting its business. This system includes policies which require adherence to ethical business standards and compliance with all laws to which the Company is subject. The internal controls process is continuously monitored by direct management review and an internal audit program under which periodic independent reviews are made.

The Board of Directors, through its Audit Committee, is responsible for determining that management fulfills its responsibility with respect to the Company's financial statements and the system of internal accounting controls.

The Audit Committee meets periodically with representatives of management, the independent accountants and the Company's internal auditors to review audits, financial reporting, and internal control matters, and also meets with the Company's outside counsel on related matters. The independent accountants and the internal auditors have full and free access to the Audit Committee and periodically meet privately with the Audit Committee.

Coopers & Lybrand, independent Certified Public Accountants, have been engaged by the Board of Directors, with the approval of the stockholders, to examine the Company's financial statements. Their report appears below.

Kenneth H. Olsen
President

James M. Osterhoff
Vice President, Finance

Report of Independent Certified Public Accountants

To The Stockholders and Directors,
Digital Equipment Corporation

We have examined the consolidated balance sheets of Digital Equipment Corporation as of June 28, 1986 and June 29, 1985 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three fiscal years in the period ended June 28, 1986. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Digital Equipment Corporation as of June 28, 1986 and June 29, 1985, and the consolidated results of its operations and the consolidated changes in its financial position for each of the three fiscal years in the period ended June 28, 1986 in conformity with generally accepted accounting principles applied on a consistent basis.

Boston, Massachusetts
July 28, 1986

Coopers & Lybrand

Consolidated Statements of Income

(in thousands except per share data)

	Year Ended		
	June 28, 1986	June 29, 1985	June 30, 1984
Revenues *(Notes A and B)*			
Equipment sales	**$4,961,861**	$4,534,165	$3,831,073
Service and other revenues	**2,628,496**	2,152,151	1,753,353
Total operating revenues	**7,590,357**	6,686,316	5,584,426
Costs and Expenses *(Notes A and I)*			
Cost of equipment sales, service and other revenues	**4,282,099**	4,087,475	3,379,632
Research and engineering expenses	**814,138**	717,273	630,696
Selling, general and administrative expenses	**1,665,411**	1,431,769	1,179,529
Operating income	**828,709**	449,799	394,569
Interest expense	**88,079**	82,003	35,096
Interest income	**(116,899)**	(63,026)	(41,477)
Income before income taxes	**857,529**	430,822	400,950
Income Taxes *(Notes A and C)*			
Provision for income taxes	**240,109**	47,390	72,171
Reversal of DISC taxes	**–**	(63,250)	–
Total income taxes	**240,109**	(15,860)	72,171
Net income	**$ 617,420**	$ 446,682	$ 328,779
Net income per share *(Note E)*	**$ 4.81**	$ 3.71	$ 2.87
Weighted average shares outstanding *(Note E)*	**130,792**	124,112	114,728

The accompanying notes are an integral part of these financial statements.

Consolidated Balance Sheets

(in thousands)	June 28, 1986	June 29, 1985
Assets		
Current Assets		
Cash and temporary cash investments *(Note D)*	$1,9 ,933	$1,080,180
Accounts receivable, net of allowance of $52,439 and $40,930	1,9 ,287	1,538,955
Inventories *(Note A)*		
Raw materials	3 ,308	512,670
Work-in-process	5 ,863	545,765
Finished goods	3 ,585	697,732
Total Inventories	1,1 ,756	1,756,167
Prepaid expenses	,274	64,569
Net deferred Federal and foreign income tax charges	2 ,998	197,957
Total Current Assets	5,30 ,248	4,637,828
Property, Plant and Equipment, at cost *(Note A)*		
Land	118,074	97,492
Buildings	809,245	745,825
Leasehold improvements	232,021	190,692
Machinery and equipment	2,103,339	1,793,623
Gross Property, Plant and Equipment	3,262,679	2,827,632
Less accumulated depreciation	1,39 ,601	1,096,603
Net Property, Plant and Equipment	1,86 ,078	1,731,029
Total Assets	$7,1 ,326	$6,368,857
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks *(Note F)*	$ 1 ,697	$ 12,251
Accounts payable	25 ,565	185,202
Federal, foreign and state income taxes	13 ,558	267,900
Salaries, wages and related items	15 ,160	165,933
Deferred revenues and customer advances *(Note A)*	25 ,790	160,105
Current portion of long-term debt	,500	1,411
Other current liabilities	25 ,265	150,807
Total Current Liabilities	1,083,535	943,609
Net deferred Federal and foreign income tax credits	28,809	33,704
Long-term debt *(Note G)*	333,155	836,945
Total Liabilities	1,445,499	1,814,258
Stockholders' Equity *(Notes G, J and K)*		
Common stock, $1.00 par value; authorized 225,000,000 shares; issued and outstanding 128,591,361 and 59,252,782 shares	128,591	59,253
Additional paid-in capital	2,224,304	1,737,834
Retained earnings	3,374,932	2,757,512
Total Stockholders' Equity	5,727,827	4,554,599
Total Liabilities and Stockholders' Equity	$7,173,326	$6,368,857

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Stockholders' Equity

(in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Total Stock-holders' Equity
July 2, 1983	$ 56,357	$1,509,781	$1,975,144	$3,541,282
Shares issued under stock option and purchase plans *(Note J)*	1,454	75,065		76,519
Restricted stock plans, charge to operations *(Note J)*		17,499		17,499
Stock option and purchase plans – excess Federal income tax benefits *(Note J)*		8,230		8,230
Effect of exchange rate changes on net deferred income tax charges/credits			6,907	6,907
Net income – 1984			328,779	328,779
June 30, 1984	$ 57,811	$1,610,575	$2,310,830	$3,979,216
Shares issued under stock option and purchase plans *(Note J)*	1,442	93,786		95,228
Restricted stock plans, charge to operations *(Note J)*		20,420		20,420
Stock option and purchase plans – excess Federal income tax benefits *(Note J)*		13,053		13,053
Net income – 1985			446,682	446,682
June 29, 1985	$ 59,253	$1,737,834	$2,757,512	$4,554,599
Shares issued under stock option and purchase plans *(Note J)*	**2,125**	**116,285**		**118,410**
Restricted stock plans, charge to operations *(Note J)*		**21,155**		**21,155**
Stock option and purchase plans – excess Federal income tax benefits *(Note J)*		**20,522**		**20,522**
Two-for-One stock split in form of 100% stock dividend *(Note K)*	**60,200**	**(60,200)**		–
8% Convertible Subordinated Debentures converted into Common Stock *(Note G)*	**7,013**	**388,708**		**395,721**
Net income – 1986			**617,420**	**617,420**
June 28, 1986	**$128,591**	**$2,224,304**	**$3,374,932**	**$5,727,827**

The accompanying notes are an integral part of these financial statements.

Consolidated Statements of Changes in Financial Position

(in thousands)	Year Ended		
	June 28, 1986	June 29, 1985	June 30, 1984
Funds from Operations			
Net income	**$ 617,420**	$ 446,6[illegible]2	$ 328,779
Add–expenses not requiring funds in current period:			
Depreciation *(Note A)*	**384,044**	315,0[illegible]5	252,631
Disposal of property, plant and equipment	**44,112**	37,0[illegible]0	27,894
Restricted stock plans–charge to operations *(Note J)*	**21,155**	20,4[illegible]0	17,499
Deferred income tax provision *(Note C)*	**(13,936)**	(87,1[illegible]5)	(23,725)
Total funds from operations	**1,052,795**	732,0[illegible]2	603,078
Funds Used to Support Operations			
Increase (decrease) in working capital:			
Accounts receivable	**364,332**	11,698	402,220
Inventories	**(556,411)**	(96,001)	498,338
Prepaid expenses	**20,705**	7,539	18,546
Accounts payable	**(74,363)**	92,909	(64,383)
Income taxes	**130,342**	44,971	(91,051)
Other current liabilities	**(189,459)**	(1,875)	(102,459)
	(304,854)	59,241	661,211
Additions to property, plant and equipment	**564,205**	571,78[illegible]	452,139
Effect of exchange rate changes on net deferred income tax charges/credits			(6,907)
Total funds used to support operations	**259,351**	631,0[illegible]	1,106,443
Net increase (decrease) in funds from operations	**793,444**	101,0[illegible]	(503,365)
Funds Provided by Financing Sources			
Increase (decrease) in:			
Loans payable to banks *(Note F)*	**6,446**	(9[illegible])	(1,716)
Long-term debt *(Note G)*	**(144)**	(1[illegible])	2,503
9 3/8% Debentures due 2000 *(Note G)*	**(3,646)**	(4,35[illegible])	(4,000)
11 3/4% Overseas Notes due 1989 *(Note G)*			150,000
13% Debentures due 2014 *(Note G)*	**(100,000)**		100,000
12 5/8% Notes due 1994 *(Note G)*			100,000
8% Conv Sub Debentures due 2009 *(Note G)*	**(400,000)**	400,000	
Common stock issued under stock option and purchase plans *(Note J)*	**138,932**	108,281	76,519
Common stock issued upon conversion of 8% Convertible Subordinated Debentures *(Note G)*	**395,721**		
Total funds from financing sources	**37,309**	502,983	423,306
Net increase (decrease) in cash and temporary cash investments	**830,753**	604,030	(80,059)
Cash and temporary cash investments at beginning of year	**1,080,180**	476,150	556,209
Cash and temporary cash investments at end of year	**$1,910,933**	$1,080,180	$ 476,150

The accompanying notes are an integral part of these financial statements.

Note A – Significant Accounting Policies

Principles of Consolidation The consolidated financial statements of the Company include the financial statements of the parent and its domestic and foreign subsidiaries. All significant intercompany accounts and profits have been eliminated.

Translation of Foreign Currencies For foreign operations, the U.S. dollar continues to be the functional currency. Assets and liabilities of foreign subsidiaries are translated in U.S. dollars at current exchange rates, except that inventories and property, plant and equipment are translated at historical rates. Income and expense items are translated at average rates of exchange prevailing during the year, except that cost of sales and depreciation are translated at historical rates. Exchange gains and losses arising from translation are included in income currently.

The Company enters into forward exchange contracts to reduce the impact of foreign currency fluctuations on operations and the asset and liability positions of foreign subsidiaries. The gains or losses on these contracts are included in income when the operating revenues and expenses are recognized and for assets and liabilities in the period in which the exchange rates change.

Revenue Recognition Revenues from equipment sales are recognized at the time the equipment is shipped. Service and other revenues are recognized ratably over the contractual period or as the services are performed.

Research and Engineering and Warranty Costs Research and engineering and warranty costs are expensed as incurred. The Company's accounting policies with respect to warranty costs result in approximately the same charge to expense as would be incurred if such warranty costs were accrued at the time of sale.

Taxes In general, the Company's practice is to reinvest the earnings of its foreign subsidiaries in those operations and repatriation of retained earnings is done only when it is advantageous to do so. Applicable taxes are provided only on amounts planned to be remitted. Investment tax credits are treated as reductions of income taxes in the year in which the credits arise.

Inventories Inventories are stated at the lower of cost (first-in, first-out) or market.

Property, Plant and Equipment Depreciation expense is computed principally on the following basis:

Classification	Depreciation Lives and Methods
Buildings	33 years (straight-line)
Leasehold improvements . .	Life of assets or term of lease, whichever is shorter (straight-line)
Machinery and equipment	8 and 10 years (sum-of-years), 4 and 5 years (double-declining balance)

Note B – International Operations

(in thousands)	Year Ended		
	June 28, 1986	June 29, 1985	June 30, 1984
Revenues			
United States customers	**$ 4,472,195**	$ 4,078,286	$ 3,628,594
Intercompany	**1,354,339**	1,373,578	1,136,030
	5,826,534	5,451,864	4,764,624
Europe customers	**2,259,743**	1,944,999	1,462,319
Intercompany	**82,649**	33,382	9,137
	2,342,392	1,978,381	1,471,456
Canada, Far East, Americas customers	**858,419**	663,031	493,513
Intercompany	**577,934**	545,968	718,324
	1,436,353	1,208,999	1,211,837
Eliminations	**(2,014,922)**	(1,952,928)	(1,863,491)
Net revenue	**$ 7,590,357**	$ 6,686,316	$ 5,584,426
Income			
United States	**$ 342,657**	$ 224,464	$ 230,522
Europe	**405,636**	202,646	137,763
Canada, Far East, Americas	**207,187**	102,837	123,364
Eliminations	**(126,771)**	(80,148)	(97,080)
Income from operations	**828,709**	449,799	394,569
Interest income	**116,899**	63,026	41,477
Interest expense	**(88,079)**	(82,003)	(35,096)
Income before income taxes	**$ 857,529**	$ 430,822	$ 400,950
Assets			
United States	**$ 3,911,491**	$ 4,277,296	$ 4,287,682
Europe	**1,817,584**	1,419,708	1,166,193
Canada, Far East, Americas	**815,067**	834,295	819,735
Corporate assets *(temporary cash investments)*	**2,035,557**	982,655	449,319
Eliminations	**(1,406,373)**	(1,145,097)	(1,129,676)
Total assets	**$ 7,173,326**	$ 6,368,857	$ 5,593,253

Industry The Company's business consists of the design, manufacture, sale and service of computers and associated peripheral equipment, and related software and supplies.

International Operations Sales and marketing operations outside the United States are conducted principally through sales subsidiaries in Canada, Europe, Central and South America and the Far East; by direct sales from the parent corporation and through various representative and distributorship arrangements. The Company's international manufacturing operations include plants in Canada, the Far East and Western Europe. The products of these manufacturing plants are sold to the Company's international sales subsidiaries, the parent corporation or other international manufacturing plants for further processing.

Intercompany transfers between geographic areas are accounted for at prices which are designed to be representative of unaffiliated party transactions.

Sales to unaffiliated customers outside of the United States, including U.S. export sales, were $3,179,143,000 for the year ended June 28, 1986, $2,641,863,000 for the year ended June 29, 1985, and $1,977,794,000 for the year ended June 30, 1984, which represented 42%, 40%, and 35%, respectively, of total operating revenues. The retained earnings of substantially all of the Company's international subsidiaries have been reinvested to support operations. These accumulated retained earnings, before elimination of intercompany transactions, aggregated $1,473,081,000 at June 28, 1986, $1,090,299,000 at June 29, 1985, and $939,891,000 at June 30, 1984.

Note C – Income Taxes

Income before income taxes for domestic and foreign operations was as follows:

(in thousan...)	Year Ended		
	June 28, 1986	June 29, 1985	June 30, 1984
Domesti...	**$382,708**	$210,970	$219,908
Foreign	**474,821**	219,852	181,042
Total	**$857,529**	$430,822	$400,950

The tota... provisions for income taxes were at rates less than the U.S. Federal statutory tax rate for the following reasons:

	1986	1985	1984
U.S. Federal statutory tax rate	**46.0%**	46.0%	46.0%
Tax benefit of manufacturing operations in *(a)*:			
Puerto Rico	**(3.9)**	(5.6)	(5.7)
Ireland	**(7.4)**	(11.8)	(12.4)
Singapore	**(1.4)**	(2.4)	(1.4)
Investment tax credits	**(2.8)**	(5.7)	(4.0)
Research and engineering credit	**(0.9)**	(5.3)	(5.4)
DISC	**–**	(17.5)	(2.2)
Other	**(1.6)**	(1.4)	3.1
	28.0%	(3.7)% *(b)*	18.0%

(a) ...nsolidated net income includes income of a dome... manufacturing subsidiary operating in Puerto Rico a... of foreign manufacturing subsidiaries operating in ...land and Singapore. Under Puerto Rican law, the su...diary is subject to tax at a rate of approximately 9% on ...s manufacturing earnings through fiscal 1995. Remitted earnings are not subject to U.S. Federal income taxes, but are subject to Puerto Rican withholding taxes at rates not in excess of 10%, less a partial credit for taxes paid to Puerto Rico. Under Irish law, the income from products manufactured for export is exempt from Irish taxes through April 1990. Under Singaporean law, the income from manufacturing certain products is wholly exempt from Singaporean taxes through March 1991 and partially exempt through December 1996. The income tax benefits per common share attributable to the tax status of these subsidiaries for the years ended June 28, 1986, June 29, 1985, and June 30, 1984 were $.83, $.69, and $.68, respectively.

(b) The Deficit Reduction Act of 1984 provides that no U.S. taxes will be charged on the undistributed earnings of the DISC. Prior to fiscal year 1984, the Company had provided for income taxes in connection with its DISC earnings. As a result of the change in the law eliminating the taxes on DISC earnings prior to 1984, the Company's 1985 fiscal year income tax expense was reduced by $63,250,000. The effective tax rate for fiscal year 1985 would have been 11% exclusive of the adjustment for the benefit of prior years' DISC taxes.

Note C–Income Taxes (continued)

The components of the provisions for U.S. Federal and foreign income taxes were as follows:

(in thousands)

	June 28, 1986	June 29, 1985	Year Ended June 30, 1984
U.S. Federal:			
Currently payable	$ 93,028	$ 3 61	$35,526
Deferred	15,310	13 83	4,968
Reversal of DISC deferred taxes	–	(63 50)	–
Total	$108,338	$(46 06)	$40,494
Foreign:			
Currently payable	$123,727	$54,055	$35,225
Deferred	(10,147)	(32,230)	(18,584)
Total	$113,580	$21,825	$16,641
State income taxes	$ 18,191	$ 8,321	$15,036
Total income taxes	$240,109	$(15,860)	$72,171

Deferred tax expense results from timing differences in the recognition of revenues and expenses for tax and financial reporting purposes. The sources of these timing differences in the years e ded June 28, 1986, June 29, 1985 and June 30, 1984 nd the tax effect of each were as follows:

(in thousands)

	June 28, 1986	June 29, 1 5	Year Ended June 30, 1984
Inventory related transactions	$ 5,686	$(50, 4)	$(60,660)
Installment sales, principally intercompany, and financing leases	6,572	12, 9	(1,640)
DISC profits	(2,975)	(68,5 0)	241
Depreciation	4,075	17,940	17,997
Tax benefit transfers	26,745	28,296	28,946
Other	(34,940)	(21,768)	1,500
Total	$ 5,163	$(81,997)	$(13,616)

In connection with its normal examinations of the Company's 1980 through 1981 tax returns, the Internal Revenue Service has proposed adjustments. The Company believes its judgments in these matters have been appropriate and intends to contest certain of the adjustments proposed by the IRS. In addition, the Company believes any adjustments which might result would not have a material effect on the financial statements.

During 1982, the Company entered into "Safe Harbor" leases as defined under the Economic Recovery Tax Act of 1981. Payments are recorded as investments in tax benefits and are reduced by permanent tax savings. There is no significant impact on net income but there is a cash flow benefit.

See Note A of Notes to Consolidated Financial Statements for further explanation of the Company's income tax accounting policies.

Note D – Cash and Temporary Cash Investments

Temporary cash investments are valued at cost, which approximates market, and principally include certificates of deposit, time deposits, commercial paper and repurchase agreements. None of the cash reflected in the balance sheets at June 28, 1986 and June 29, 1985 was required as compensating balances.

Note E – Net Income Per Share and Dividends

Net income per share is based on the weighted average number of common shares and, if their aggregate dilutive effect is material, common share equivalents outstanding during the year, after giving retroactive effect to a two-for-one stock split effected May 9, 1986. In fiscal 1986 and 1985, common share equivalents were attributable to convertible debt and stock options. In fiscal 1984 common share equivalents were attributable to stock options.

Cash dividends have never been paid by the Company.

Note F – Short-Term Debt

Short-term debt and related interest rates were as follows:

(in thousands)	**June 28, 1986**		June 29, 1985	
		Average Interest Rate		Average Interest Rate
Loans payable to banks	**$18,697**	**21.4%**	$12,251	12.7%

Short-term debt at year-end was principally denominated in foreign currencies. High interest rates on Brazilian and Mexican short-term debt were a major influence on the year-end interest rate. The maximum aggregate short-term debt outstanding at any month-end was $64,203,000 during fiscal 1986, and $37,854,000 during fiscal 1985. Average short-term borrowings during these years, computed on a month-end basis, were $33,544,000 and $21,905,000, respectively. The average interest rate based on a weighted average of the stated month-end rates was 13.0% in fiscal 1986 and 11.6% in fiscal 1985.

The Company has revolving credit agreements totaling $240,000,000. There were no borrowings under these agreements. These commitments are available on a revolving basis until March 1987. At that time the Company can choose to convert any outstanding balances into term loans with final maturities in March 1991.

Additionally, the Company had unused lines of credit for short-term financing of $138,682,000 at June 28, 1986 and $125,436,000 at June 29, 1985.

Note G – Long-Term Debt

Long-term debt, exclusive of current maturities, consisted of the following:

(in thousands)	**June 28, 1986**	June 29, 1985
Lease obligations payable 1986-2000 (7.5%-9.00%) *(a)*	**$ 6,607**	$ 7,215
Collateralized obligations maturing serially to 1993 (5.4%) *(b)*	**4,695**	5,340
Sinking Fund Debentures due 2000 (9⅜%) *(c)*	**63,000**	66,646
Sinking Fund Debentures due 2014 (13%) *(d)*	**–**	100,000
Notes due 1994 (12⅝%) *(e)*	**100,000**	100,000
Overseas Finance Notes due 1989 (11¾%) *(f)*	**150,000**	150,000
Convertible Subordinated Debentures due 2009 (8%) *(g)*	**–**	400,000
Other	**8,853**	7,744
	$333,155	$836,945

Principal payments required during the next five fiscal years are as follows: 1987 – $3,500,000; 1988 – $6,478,000; 1989 – $156,560,000; 1990 – $6,608,000; 1991 – $6,131,000.

(a) Weighted average interest rate at June 28, 1986 and June 29, 1985 of 7.9%.

(b) Interest rate shown is the weighted average rate at June 28, 1986 and June 29, 1985.

(c) Sinking Fund Debentures were issued by the Company in March 1975. Sinking fund payments of $4 million are required in each of the fiscal years 1985-1999. The Company at its option may increase the sinking fund payments up to an additional $4 million in each such year. The Debentures are currently redeemable at the option of the Company at any time, as a whole or in part, at 104.219% of the principal amount and at declining percentages each year thereafter until 1995 when they are redeemable at par. The Indenture for the Debentures also contains certain restrictions on future borrowings and dividend distributions.

(d) Sinking Fund Debentures were issued by the Company in April 1984. The Company called the Debentures for redemption on June 19, 1986 at the call price of 111.267% of the principal amount plus accrued interest. The premium of $11.3 million was charged to interest expense.

(e) Notes were issued by the Company in April 1984. The Notes are redeemable on or after April 15, 1991, as a whole or in part, at a redemption price equal to the principal amount plus accrued interest. The Indenture for the Notes also contains certain restrictions on future borrowings and sales and leasebacks.

(f) Notes were issued in March 1984 by Digital Equipment Overseas Finance N.V.. The Notes are unconditionally guaranteed by Digital Equipment Corporation. They are not redeemable unless certain events occur involving United States or Netherlands Antilles tax laws.

(g) On September 13, 1984 the Company issued $400,000,000 of 8% Convertible Subordinated Debentures. The Company called the Debentures for redemption on April 17, 1986 at the call price of 107.2% of the principal amount plus accrued interest. At the election of the Debentureholders, substantially all of the Debentures were converted into shares of Common Stock of the Company at the conversion rate (without giving effect to the stock split referred to in Note K) of one share of Common Stock for each $114 principal amount of Debentures.

Note H – Leases

Minimum annual rentals under noncancelable leases (which are principally for leased real estate, vehicles and equipment) for the fiscal years listed are as follows:

Fiscal Years	*(in thousands)*
1987	$167,925
1988	$139,421
1989	$103,075
1990	$ 74,651
1991	$ 57,602
Later years	$286,770
Total minimum lease payments	$829,444

Total rental expense for the fiscal years ended June 28, 1986, June 29, 1985, and June 30, 1984 amounted to $257,695,000, $223,434,000, and $175,055,000, respectively.

Note I – Pension Plans and Other Retirement Benefits

The Company and its subsidiaries have pension plans covering substantially all of their employees. Total pension expense was $111,778,000 in fiscal 1986, $114,053,000 in fiscal 1985, and $95,463,000 in fiscal 1984. In fiscal 1986 the Company revised certain actuarial assumptions of its domestic plan to more closely reflect recent past and expected future experience. The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 7.5% in 1986 and 6.0% in 1985. Effective July 1, 1985 the company improved the past service benefits for participants of the domestic plan. It is the Company's policy to make contributions to the plans to the extent that such contributions are tax deductible. There was no unfunded past service liability as of June 28, 1986.

A comparison of accumulated plan benefits and plan net assets for the Company's domestic defined benefit plans and for those foreign subsidiaries with defined benefit plans, determined as of the beginning of each respective fiscal year is presented in the accompanying table. Foreign subsidiaries with insured plans have been excluded from this information.

(in thousands)	**1986**	1985
Actuarial present value of accumulated plan benefits:		
Vested	**$223,298**	$158,417
Nonvested	**41,923**	38,190
	$265,221	$196,607
Net assets available for benefits	**$667,669**	$461,600

In addition to providing pension benefits, the Company provides certain medical, dental and life insurance benefits for retired employees. Substantially all of the Company's domestic employees may become eligible for those benefits if they reach normal retirement age while working for the Company. The cost of retiree health care and life insurance benefits is recognized as an expense as claims are paid. For fiscal 1986 and 1985, these costs totaled $422,519 and $436,000 respectively. The majority of the Company's foreign subsidiaries do not offer such benefits to retirees. Of those that do, the amounts are immaterial.

Note J – Stock Plans

Restricted Stock Options • Under its Restricted Stock Option and Purchase Plans, the Company has granted certain officers and key employees options, which are exercisable upon grant, to purchase common stock at a price determined by the Board of Directors. Shares purchased under the plans are generally subject to repurchase options and restrictions on sales which lapse over an extended time period not exceeding 10 years.

On November 8, 1985, the Company's stockholders approved the 1985 Restricted Stock Option Plan (the "1985 Plan") providing for the issuance of 18,000,000 shares of Common Stock under the Plan through December 31, 1990. The granting of additional options under the 1976 Plan terminated upon approval of the 1985 Plan.

Information concerning activity during the three fiscal years ended June 28, 1986 follows:

		Options Outstanding	
	Shares Reserved For Future Grants	Shares	Average Price Per Share
July 2, 1983	8,329,258	8,748,426	$22.74
Options granted	(3,416,180)	3,416,180	31.51
Options exercised	–	(879,208)	12.11
Options cancelled	618,026	(618,026)	23.09
Options terminated	(39,360)	–	–
June 30, 1984	5,491,744	10,667,372	$26.40
Options granted	(2,961,920)	2,961,920	34.50
Options exercised	–	(981,976)	16.30
Options cancelled	432,464	(432,464)	26.87
Options terminated	(11,828)	–	–
June 29, 1985	2,950,460	12,214,852	$29.16
Options granted	(580,900)	580,900	38.54
Options exercised	–	(1,086,786)	22.57
Options cancelled	243,186	(243,186)	30.14
Options terminated	(2,675,046)	–	–
Options authorized	18,000,000	–	–
June 28, 1986	**17,937,700**	**11,465,780**	**$30.24**

At the time these options are exercised, the common stock account is increased by the par value ($1 per share) of the shares sold and the remaining portion of the proceeds is credited to additional paid-in capital. The excess of the fair market value of the shares at the grant date over the option price is charged to operations each year as the restrictions lapse. Such charges to operations amounted to $21,155,000 in fiscal 1986, $20,420,000 in fiscal 1985, and $17,499,000 in fiscal 1984. The amount deductible for Federal income taxes exceeds the amount charged to income for book purposes. The Federal income tax benefits relating to this difference have been credited to additional paid-in capital.

Employee Stock Purchase Plans • Under the Company's Employee Stock Purchase Plans, all United States and certain international employees may be granted options to purchase common stock at 85% of market value on the first or last business day of the six month payment period, whichever is lower. On November 8, 1985, the shareholders amended the Employee Stock Purchase Plan to increase the number of shares subject to options by 5,000,000 shares. Common stock reserved for future grants aggregated 5,358,655 shares at June 28, 1986, and 2,186,388 shares at June 29, 1985. There were 1,827,733 shares issued at an average price of $43.73 in fiscal 1986 and 1,736,992 shares at $40.80 in fiscal 1985. There have been no charges to income in connection with the options other than incidental expenses related to the issuance of the shares. Federal income tax benefits relating to such options have been credited to additional paid-in capital.

Employee Stock Ownership Plan • The Employee Stock Ownership Plan (ESOP) and a related trust were established in 1982. Federal tax law generally allows a tax credit for the Company equal to ½% of the base salaries (not in excess of $100,000 salary for any single employee) of substantially all U.S. employees. The Company's contributions of stock or cash to the trust equal the amount allowed as a Federal tax credit.

Note K – Common Stock Split

On May 9, 1986 the Company effected a two-for-one stock split in the form of a 100% stock dividend to shareholders of record at the close of business on April 18, 1986. These financial statements have been restated, where appropriate, to show the retroactive effect of the stock split.

Quarterly Financial Data (unaudited)

Selected quarterly financial data for the years ended June 28, 1986 and June 29, 1985 is set forth below:

(in millions except per share data)	Total Operating Revenues	Gross Profit	Income Before Income Taxes	Income	Net Income Per Share
1986					
First Quarter	**$1,623.9**	**$ 659.6**	**$ 97.7**	**$ 72.3**	**$0.60**
Second Quarter	**1,862.5**	**773.8**	**183.9**	**136.1**	**1.08**
Third Quarter	**1,928.3**	**851.2**	**237.2**	**170.4**	**1.32**
Fourth Quarter	**2,175.7**	**1,023.7**	**338.7**	**238.6**	**1.81**
Total Year	**$7,590.4**	**$3,308.3**	**$857.5**	**$617.4**	**$4.81**
1985					
First Quarter	$1,515.3	$ 598.2	$103.8	$144.2	$1.22[1]
Second Quarter	1,628.0	653.8	134.9	110.3	0.90
Third Quarter	1,691.1	658.9	98.6	91.7	0.76
Fourth Quarter	1,851.9	687.9	93.5	100.5	0.83
Total Year	$6,686.3	$2,598.8	$430.8	$446.7	$3.71

[1] *Includes elimination of DISC taxes of $63 million, or $.53 per share.*

Information on the Effects of Inflation (unaudited)

The following information required and prepared in accordance with standards of the Financial Accounting Standards Board is intended to help users of financial statements understand the effects of general price changes (inflation) and changes in specific prices, on the Company's operations.

The effect of changes in specific prices is estimated by valuing inventories and property, plant and equipment at currently prevailing prices, using external and internally developed price indexes and recent production cost experience.

Net Monetary Assets The purchasing power of the Company's net monetary assets (cash and temporary cash investments and fixed dollar claims to money) declined because of inflation by $30.1 million in fiscal 1986, as measured by the change in the Consumer Price Index.

Inventories and Property, Plant and Equipment The current cost of inventories and property, plant and equipment, net of accumulated depreciation and the corresponding historical cost amounts at June 28, 1986 were as follows:

(in millions)	Inventories	Property, Plant and Equipment, Net
Current Cost	$1,156.8	$2,261.4
Historical Cost	$1,199.8	$1,867.1
Difference	$ (43.0)	$ 394.3

Information on the Effects of Inflation (unaudited) (continued)

The current cost method assumes replacement of all the Company's property, plant and equipment as of June 28, 1986. However, the Company's property, plant and equipment are relatively new, with 77% of it having been acquired in the last 5 fiscal years. Consequently, the Company's future capital expenditures will be principally to expand, rather than to replace, existing capacity.

Statement of Income The income statement shown below has been restated in average fiscal 1986 dollars after reflecting depreciation and cost of sales at the current costs prevailing in each respective year. Although the adjustments for depreciation expense and the inventory component of cost of sales affected the pretax income amounts, no adjustments have been made to the respective provisions for income taxes. Giving effect to these adjustments, 1986 net income was $232.2 million more than net income as reported.

Five Year Comparison of Selected Financial Data Adjusted for the Effects of Inflation

(in millions except per share data)	As Reported	In Average Fiscal 1986 Dollars				
	1986	1986	1985	1984	1983	1982
Total operating revenues	**$7,590.4**	$ 7,590.4	$6,880.2	$5,969.7	$4,733.3	$4,486.2
Cost of equipment sales, service and other revenues	**4,060.5**	3,794.9	3,991.4	3,322.1	2,690.2	2,498.0
Depreciation expense	**384.0**	417.4	334.2	282.3	239.0	178.2
Other expenses	**2,288.4**	2,288.4	2,115.5	1,818.5	1,243.0	1,098.2
Provision for income taxes	**240.1**	240.1	(16.3)	77.1	111.2	295.6
Net income	**$ 617.4**	$ 849.6	$ 455.4	$ 469.7	$ 309.9	$ 416.2
Net income per share	**$ 4.81**	$ 6.58	$ 3.78	$ 4.09	$ 2.35	$ 3.75
Loss from decline in purchasing power of net monetary assets		$ 30.1	$ 34.8	$ 36.4	$ 26.3	$ 70.2
Change in specific prices – net of general inflation		$ (161.8)	$ 109.0	$ (377.4)	$ (170.4)	$ (214.9)
Stockholders' equity at end of year	**$5,727.8**	$6,042.8	$4,825.8	$4,163.7	$3,987.7	$3,698.4
Actual market price per common share at end of year		$85.69	$47.32	$42.00	$60.75	$33.00
Average Consumer Price Index (1967 = 100)		326.0	316.8	304.9	294.1	281.9

Note: All per share data for prior years has been adjusted to reflect a two-for-one stock split distributed on May 9, 1986 to shareholders of record at the close of business on April 18, 1986.

Officers

Kenneth H. Olsen
President and Director

Winston R. Hindle, Jr.
Senior Vice President, Corporate Operations

John J. Shields
Senior Vice President, Sales and Services, Industry/Channels Marketing, International

John F. Smith
Senior Vice President, Engineering, Manufacturing and Product Marketing

John L. Alexanderson
Vice President, Peripherals and Supplies Group

Don K. Busiek
Vice President, Corporate Software Services

George A. Chamberlain, 3rd
Vice President, Engineering, Manufacturing and Marketing Finance

Henry J. Crouse
Vice President, Manufacturing Europe

James G. Cudmore
Vice President, Group Manager, Product Operations

William R. Demmer
Vice President, Mid-Range Systems Business Group

Pier Carlo Falotti
Vice President, President and Chief Executive–Europe

Samuel H. Fuller
Vice President, Research and Architecture

Rose Ann Giordano
Vice President, Information Systems Business Group

Robert M. Glorioso
Vice President, High Performance Systems and Clusters

David W. Grainger
Vice President, Corporate Field Service

William C. Hanson
Vice President, Manufacturing Operations

William J. Heffner
Vice President, Systems Software Group

Robert C. Hughes
Vice President, Service Industry Marketing

Donato A. Infante, Jr.
Vice President, Manufacturing Information and Technology

Ilene B. Jacobs
Vice President and Treasurer

William R. Johnson, Jr.
Vice President, Distributed Systems

Jeffrey C. Kalb
Vice President, Group Manager, Low-End Systems and Technologies

Edward A. Kramer
Vice President, New Computing Structures

John C. MacKeen
Vice President, Group Manager Channels Marketing

Edward B. McDonough
Vice President, GIA Manufacturing and Engineering

Kevin C. Melia
Vice President, Manufacturing Materials and Corporate Distribution

Albert E. Mullin, Jr.
Vice President, Corporate Relations

James M. Osterhoff
Vice President, Finance

Robert B. Palmer
Vice President, Group Manager, Semiconductor Operations

Jean-Claude Peterschmitt
Vice President, Chairman, Board of Directors–Europe

Richard Poulsen
Vice President, General International Area

Bruce J. Ryan
Vice President and Corporate Controller

F. Grant Saviers
Vice President, Storage Systems

Edward A. Schwartz
Vice President, General Counsel and Secretary

Godfrey S. Shingles
Vice President, Managing Director, United Kingdom Region

Charles E. Shue
Vice President, U.S. Sales

John L. Sims
Vice President, Personnel and Administration

Peter J. Smith
Vice President, Product Marketing

Officers (continued)

David L. Stone
Vice President, International Engineering and Strategic Resources

William D. Strecker
Vice President, Product Strategy and Architecture

Harvey L. Weiss
Vice President, U.S. Operations and Government Systems Group

William G. Witmore
Vice President, Basic Industry Marketing

Richard H. Yen
Vice President, GIA Manufacturing and Engineering

Donald P. Zereski
Vice President, U.S. Field Service

Directors

Vernon R. Alden
Director of several organizations

Philip Caldwell
Senior Managing Director of Shearson Lehman Brothers Inc., and Director of several corporations

Arnaud de Vitry
Chairman of the Board and Chief Executive Officer, Eureka SICAV (French Investment Company)

Georges F. Doriot
Retired Chairman of the Board of American Research and Development Corporation (Venture Capital Investment Company)

Robert R. Everett
Retired President of The MITRE Corporation

William H. McLean
Engineering consultant and Director of several corporations

Kenneth H. Olsen
President, Digital Equipment Corporation

Dorothy E. Rowe
Retired Senior Vice President and Treasurer of American Research and Development Corporation (Venture Capital Investment Company)

Corporate Consulting Engineers

David N. Cutler
Senior Corporate Consultant, Computer Systems

Roger Heinen, Jr.
Corporate Consultant, Software Systems

Richard I. Hustvedt
Corporate Consultant, Operating Systems

Alan Kotok
Corporate Consultant, High Performance Computers

Butler W. Lampson
Corporate Consultant, Corporate Research and Architecture

Anthony G. Lauck
Corporate Consultant, Networks & Communications

Jesse Lipcon
Corporate Consultant, Micro Systems

Mahendra R. Patel
Corporate Consultant, Technical Director Distributed Systems

Mike Riggle
Senior Corporate Consultant, Storage Systems

Robert E. Stewart
Corporate Consultant, Advanced Vax Engineering

William D. Strecker
Senior Corporate Consultant, Computer Architecture

Robert M. Supnik
Corporate Consultant, VLSI Development

Headquarters

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146 Main Street
Maynard, Massachusetts 01754
Telephone: (617) 897-5111
Telex: 4430127 Digital ACT

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International (Europe)
12 Avenue des Morgines
Case Postale 510
CH-1213 Petit-Lancy 1, Geneva
Switzerland
Telephone: (022) 87 41 11
Telex: 845-422593 DEC CH

General International Area Headquarters
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100 Nagog Park
Acton, Massachusetts 01720
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Telex: 4430127 Digital ACT

Canadian Headquarters
Digital Equipment of Canada, Ltd.
100 Herzberg Road
Kanata, Ontario, Canada K2K 2A6
Telephone: (613) 592-5111
Telex: 53-4955 Digital KAN

Investor Information

The Company's common stock is listed and traded on the

New York Stock Exchange
Pacific Stock Exchange
(Ticker Symbol "DEC")

In Europe: Swiss Stock Exchanges of Zurich, Geneva, and Basel; and the German Stock Exchanges of Frankfurt, Munich, and Berlin.

Unlisted trading privileges have been granted by the:

Boston Stock Exchange
Cincinnati Stock Exchange
Midwest Stock Exchange
Philadelphia Stock Exchange
In Europe: Luxembourg Stock Exchange

The Company maintains an Investor Relations office to assist shareholders. Investors' inquiries are welcome, by telephone or letter.

Inquiries relating to investment in Digital Equipment Corporation should be directed to:

Albert E. Mullin, Jr.
Vice President, Corporate Relations
Digital Equipment Corporation
111 Powdermill Road (N9)
Maynard, MA 01754
(617) 493-5350

Digital Equipment Corporation's Annual Report on Form 10-K for the fiscal year ended June 28, 1986, including schedules thereto, which is filed with the Securities and Exchange Commission, will be sent without charge upon written request. The Company's annual report, filings with the Securities and Exchange Commission, interim reports and additional information about the Company and its products can be obtained by addressing:

Digital Equipment Corporation
Inquiry Section
10 Forbes Road NR02-1/H3
Northboro, MA 01532
(617) 351-4401

Financial community information and requests to be placed on the Company's mailing list should be directed to:

Digital Equipment Corporation
Investor Relations – ML
111 Powdermill Road (K10)
Maynard, MA 01754
(617) 493-8246

Investor Information (continued)

Inquiries of an administrative nature relating to shareholder accounting records, stock transfer, change of address, and employee purchases should be directed to:

Digital Equipment Corporation
Investor Services
111 Powdermill Road (L12)
Maynard, MA 01754
(617) 493-5213

Transfer Agent and Registrar
for Common Stock
Morgan Guaranty Trust Company is the principal stock transfer agent and registrar, and maintains the shareholder accounting records. The agent will respond to questions on change of ownership, lost stock certificates, consolidation of accounts and change of address.

A change of address should be reported promptly by sending a signed and dated note or postcard to Morgan Shareholder Services Trust Company. Shareholders should state the name in which the stock is registered, account number, as well as the old and new addresses.

Morgan Shareholder Services Trust Company
30 West Broadway
New York, NY 10007

Digital Equipment Corporation customers who have questions and/or problems relating to their account should contact the Customer Assistance Department at (617) 493-7161.

Trustees and Registrars
For 9⅜% Sinking Fund Debentures due 2000
United States Trust Company
45 Wall Street
New York, NY 10005

Trustees and Registrars
For 12⅝% Notes due 1994
The Chase Manhattan Bank, N.A.
1 New York Plaza
New York, NY 10081

Paying Agents and Registrars
For 11¾% Guaranteed Notes due 1989
Morgan Guaranty Trust Company of New York
30 West Broadway
New York, NY 10015

Auditors
Coopers & Lybrand
One Post Office Square
Boston, MA 02109
(617) 574-5000

Legal Counsel
Testa, Hurwitz & Thibeault
53 State Street
Exchange Place
Boston, MA 02109
(617) 367-7500

DIGITAL EQUIPMENT CORPORATION
MAYNARD, MASSACHUSETTS 01754

digital

Digital Equipment Corporation

digital

Annual Report 1987

Corporate profile

Digital Equipment Corporation is the world's leading manufacturer of networked computer systems and associated peripheral equipment, and is the leader in systems integration with its networks, communications, services and software products. The Company's products are used worldwide in a variety of applications and programs, including scientific research, computation, communications, education, data analysis, industrial control, timesharing, commercial data processing, graphic arts, word processing, personal computing, health care, instrumentation, engineering and simulation.

Financial highlights

Fiscal Year	**1987**	1986	% Change
Total operating revenues...	**$ 9,389,444,000**	$ 7,590,357,000	+24
Net income.....	**$ 1,137,435,000**	$ 617,420,000	+84
Net income per share.....	**$ 8.53**	$ 4.81	+77
Total stockholders' equity..	**$ 6,293,471,000**	$ 5,727,827,000	+10
Stockholders' equity per share.....	**$ 49.87**	$ 44.54	+12
Return on equity	**18.9%**	12.0%	
Return on assets.....	**14.6%**	9.1%	

Annual meeting of stockholders

The Annual Meeting of Stockholders will be held at 11:00 A.M., Thursday, November 5, 1987, at the World Trade Center, Commonwealth Pier, 164 Northern Avenue, Boston, Massachusetts 02210. Stockholders of record on September 8, 1987 will be entitled to vote at this meeting.

Contents

To our Shareholders:

We are pleased to report that Digital's operating revenues grew 24% and net income increased 84% during the 1987 Fiscal Year. Our return on shareholder equity climbed from 12% to 19% in the same period.

In Fiscal 1987, over 8,000 customer locations worldwide were newly networked using Digital's Ethernet technology; our customers attached more than 125,000 devices directly to their Digital Ethernet networks in the factory, the office and the laboratory. We have given these organizations the ability to change the way they do business.

In the thirty years since the company was founded, we've invested hundreds of millions of dollars in the software and components that make an elegantly simple system for tying together departments, and entire organizations, into an integrated network. By concentrating our resources on one strategy, we've generated a system of networking that has helped Digital achieve high growth during the computer industry slowdown of the last few years.

We offer equipment, services, and knowledge, and combine them to deliver a total solution. This makes it possible to build and manage fully distributed computer networks that are easy to expand and maintain, protecting customer investments in software, hardware, and training.

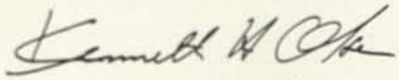
Networking is one of the most complex technologies in the world today. To design and develop it to work on a wide range of configurations of equipment, and do all that is expected by users across whole organizations, takes an enormous amount of discipline, documentation, support, and commitment. Yet, good networking requires little effort on the part of the user.

Networking has helped us to simplify our business, provide better information to our customers, use less inventory, and be more profitable. It has given us a message that is truly exciting and satisfying to present to organizations that use our systems.

We are continuing to improve our technology and develop new technology, making it better, faster, and less expensive for the user. We have a big challenge ahead in helping enterprises see what networking can do for them.

■ I want to pay tribute to General Georges Doriot, a friend and mentor of Digital since its inception, who passed away in June. In 1957, as the head of American Research and Development Corporation, he provided the investment capital to start Digital. He served as a member of Digital's Board of Directors since 1972.

General Doriot's goal was to nurture, encourage, and help businesses. His influence on Digital was quiet, cautious, often indirect, but very effective. He guided us toward excellence. In the General's philosophy, excellence includes sensitivity and graciousness to others. In the workplace, it includes a sense of responsibility to the entire organization instead of mere individual gain. His thinking and Digital's history and values are intertwined. He will be missed and remembered by all of us who knew him well.



Kenneth H. Olsen, President
September 1, 1987

NEARLY TEN YEARS AFTER THE INTRODUCTION OF THE FIRST VAX COMPUTER, DIGITAL SHIPPED ITS 100,000TH VAX SYSTEM – A VAX 8800 COMPUTER WITH TWELVE TIMES THE PERFORMANCE OF THE ORIGINAL VAX-11/780. THIS NEW VAX IS BEING USED BY STANDARD OIL PRODUCTION COMPANY'S DALLAS TECHNICAL DATA CENTER FOR OIL EXPLORATION AND PRODUCTION COMPUTING.

Every successful enterprise has a vision, mission, or goal – a focus that brings the whole organization together.

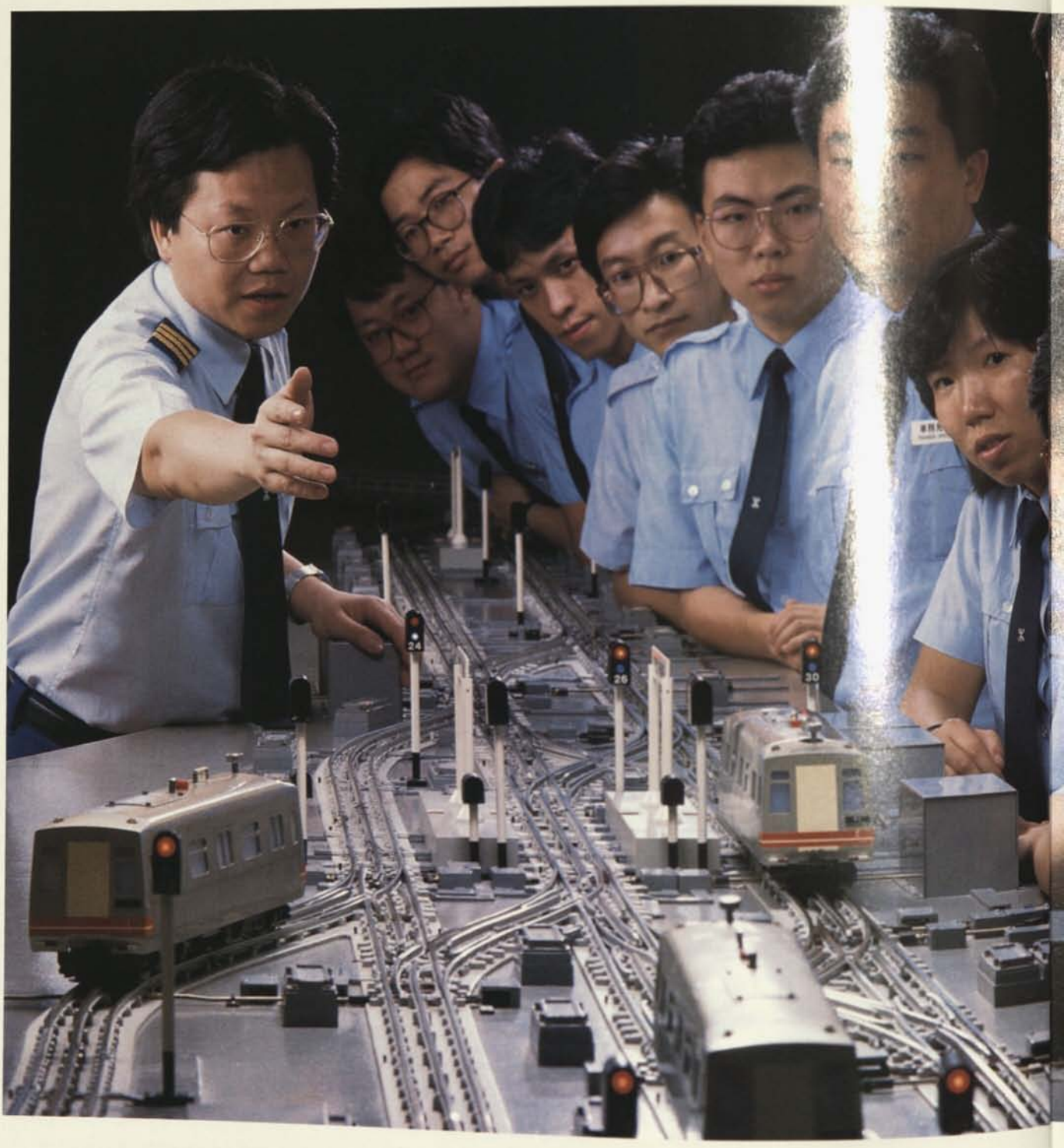
Digital has such a vision. We see computers as a technology that can help our customers reach their goals. Working with these customers, Digital is helping them build corporate-wide information networks for critical areas of their business, so the entire enterprise will work as a single team.

Building such systems requires an open but very disciplined approach to computing.

Disciplined, because it is based on a single, consistent architecture that extends from the desktop to the datacenter.

Open, because it provides a stable computing environment, so programs – whether developed by Digital, by the customer, or by independent software companies – can be integrated into a single network. In effect, the network is the system.

This "one company, one network" vision is shared by leading industrial, commercial, service, educational, health-care, and governmental organizations worldwide. This Annual Report is their story.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SHARING THE VISION:

INTEGRATING ENTERPRISE, DEPARTMENT, AND WORKGROUP

A FULLY INTEGRATED NETWORK OF VAX AND PDP-11 COMPUTERS HELPS THE MASS TRANSIT RAILWAY CORPORATION OF HONG KONG MEET THE TRANSPORTATION NEEDS OF NEARLY TWO MILLION PEOPLE EVERY DAY. THE SYSTEMS HANDLE RAILWAY SIGNALING, PROPERTY MANAGEMENT, ACCOUNTING, MAINTENANCE RECORDS, STORES INVENTORY CONTROL, AND OTHER DUTIES.

Understanding the Consumer: A Goal for Enterprise Integration

From the elegant Unilever House on the banks of the River Thames in London, Unilever manages one of the largest groups of consumer products businesses in the world. Networks of VAX computers help to manage Unilever's diverse research, marketing, order processing, and distribution operations.

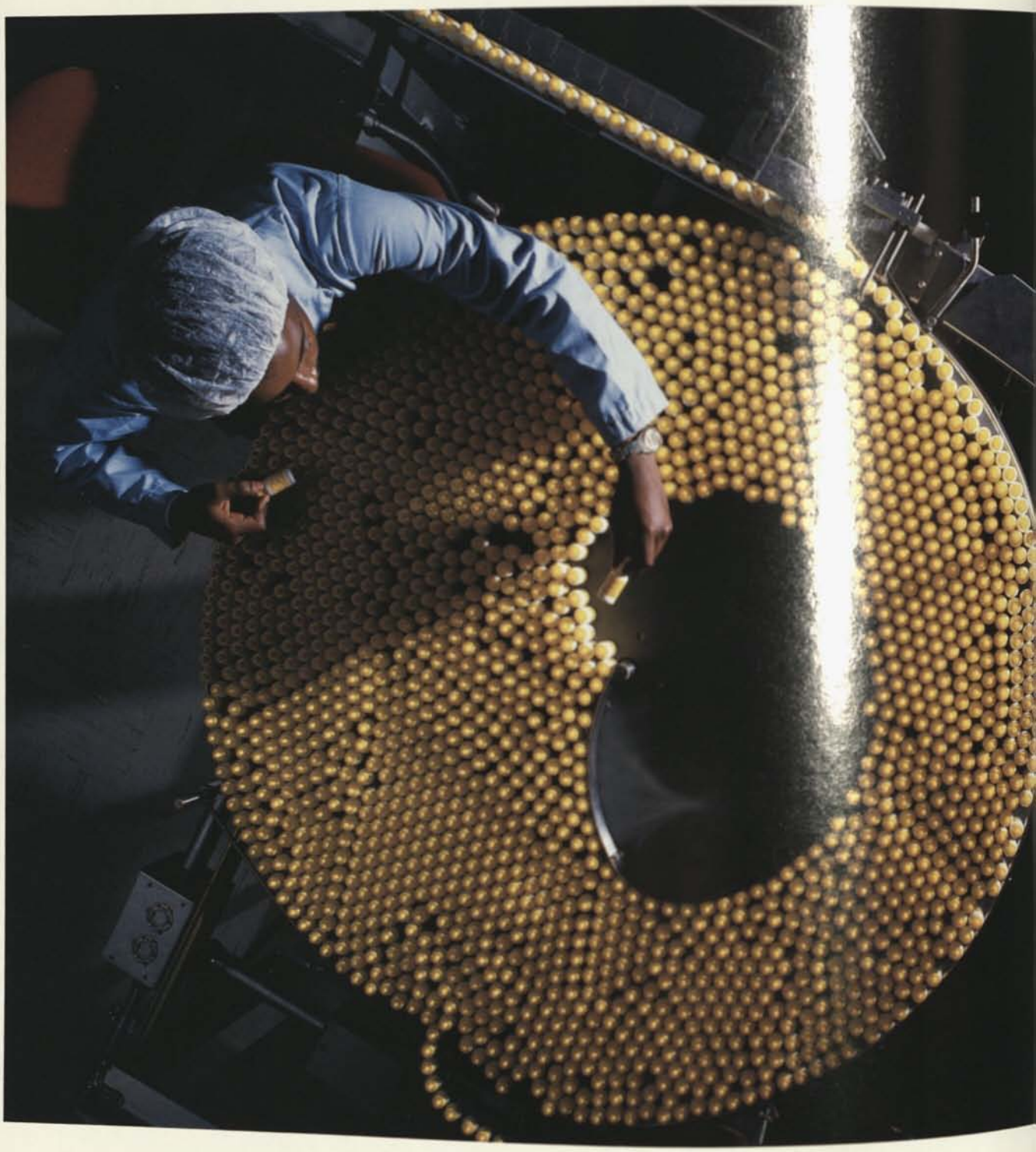
Unilever's success comes from "understanding the consumer." This isn't easy when you are a business with a 25-billion-dollar turnover selling hundreds of brands in seventy-five countries.

Unilever's worldwide research program has to be integrated with marketing and manufacturing on a market-by-market, product-by-product basis. The market for Lipton Tea in the U.S. is very different from the market for PG Tips Tea in the U.K.

Managing this diversity requires both a worldwide research network and individual computer networks to support product and market development at the subsidiary level.

Many of these networks are built around Digital systems, which handle sales, marketing, and order processing applications critical to understanding and responding to the consumer and to building brand loyalty.

Like Unilever, Digital bases its business on understanding the customer. We recognize that networks have to reflect the way our customers work, have to integrate the enterprise, the department, and the workgroup.



No department is an island

MERCK SHARP & DOHME, THE U.S. PHARMACEUTICAL DIVISION OF MERCK & CO., INC., WEST POINT, PENNSYLVANIA, USES AUTOMATION FOR EFFICIENCY AND QUALITY CONTROL. AUTOMATED SYSTEMS SUPPORT MANUFACTURING, MATERIALS MANAGEMENT, AND QUALITY CONTROL OPERATIONS. A MAJOR EMPHASIS IS PLACED ON BROADENING AND INTEGRATING THESE SYSTEMS.

Departmental performance has to be measured against corporate objectives. This mandates a level of interdepartmental coordination and cooperation wherein information can flow across departmental boundaries.

At Merck, manufacturing is expected to produce – to the highest-quality standards – hundreds of different products in a cost-efficient manner.

To meet these expectations, Merck has made major investments in researching and developing integrated – yet highly flexible – automation solutions designed to maintain quality standards. By melding in-house and third-party software with different technologies, Merck has become a leader in automated manufacturing.

Many of the third-party applications that Merck uses on its VAX computers were developed by independent software houses with whom Digital has cooperative marketing agreements. They know that the applications they develop will work in the customer's network environment – integrating different departments into a single organization. The time and money they invest in the development of this VAX software is protected against premature obsolescence because these applications will run – without change – on all VAX systems.

WORKGROUP COMPUTING, A KEY TO PROJECT MANAGEMENT

ONE OF THE LARGEST AEROSPACE GROUPS IN THE WORLD, BRITISH AEROSPACE HAS INTEGRATED DIGITAL SOLUTIONS THROUGHOUT ITS OPERATIONS. VAX AND VAXSTATION SYSTEMS ARE USED TO SIMULATE, DESIGN, TEST, AND BUILD A FULL RANGE OF PRODUCTS AND TO SUPPORT MORE THAN A THOUSAND ALL-IN-1 USERS IN THE BRITISH AEROSPACE OFFICES.

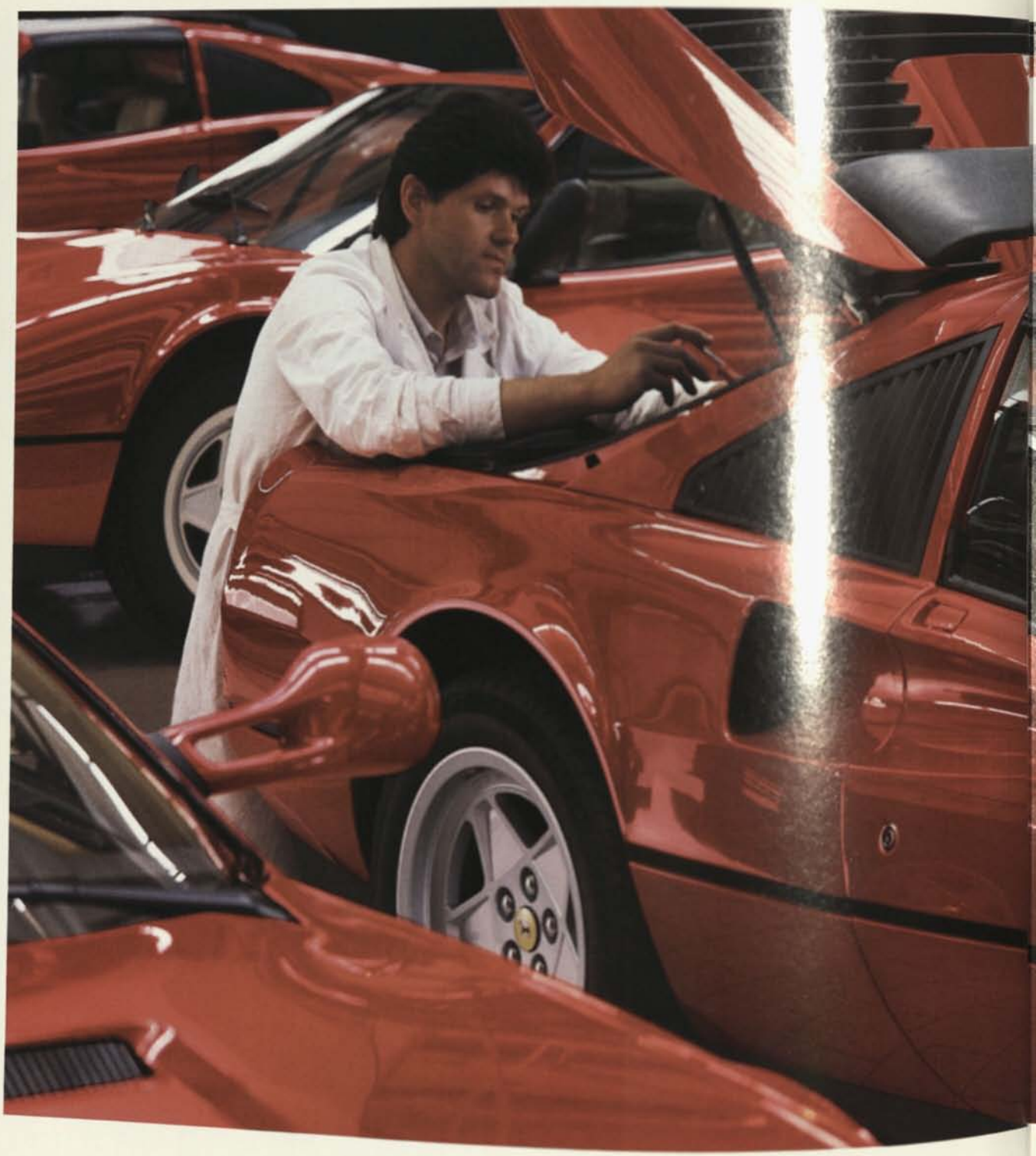
It is one thing to identify a market niche, quite another to design and build a product to fit into it before the competition does.

British Aerospace saw the need for a new class of quiet, fuel-efficient, intermediate-range, 80- to 100-passenger aircraft. The company developed the BAe-146.

Designing "the world's quietest jetliner" required the organization of engineering talent and computer power. At British Aerospace, over 2,000 Digital workstations and terminals and 200 VAX computers at 13 sites are used by the thousands of engineers involved in aircraft, avionic, and space development.

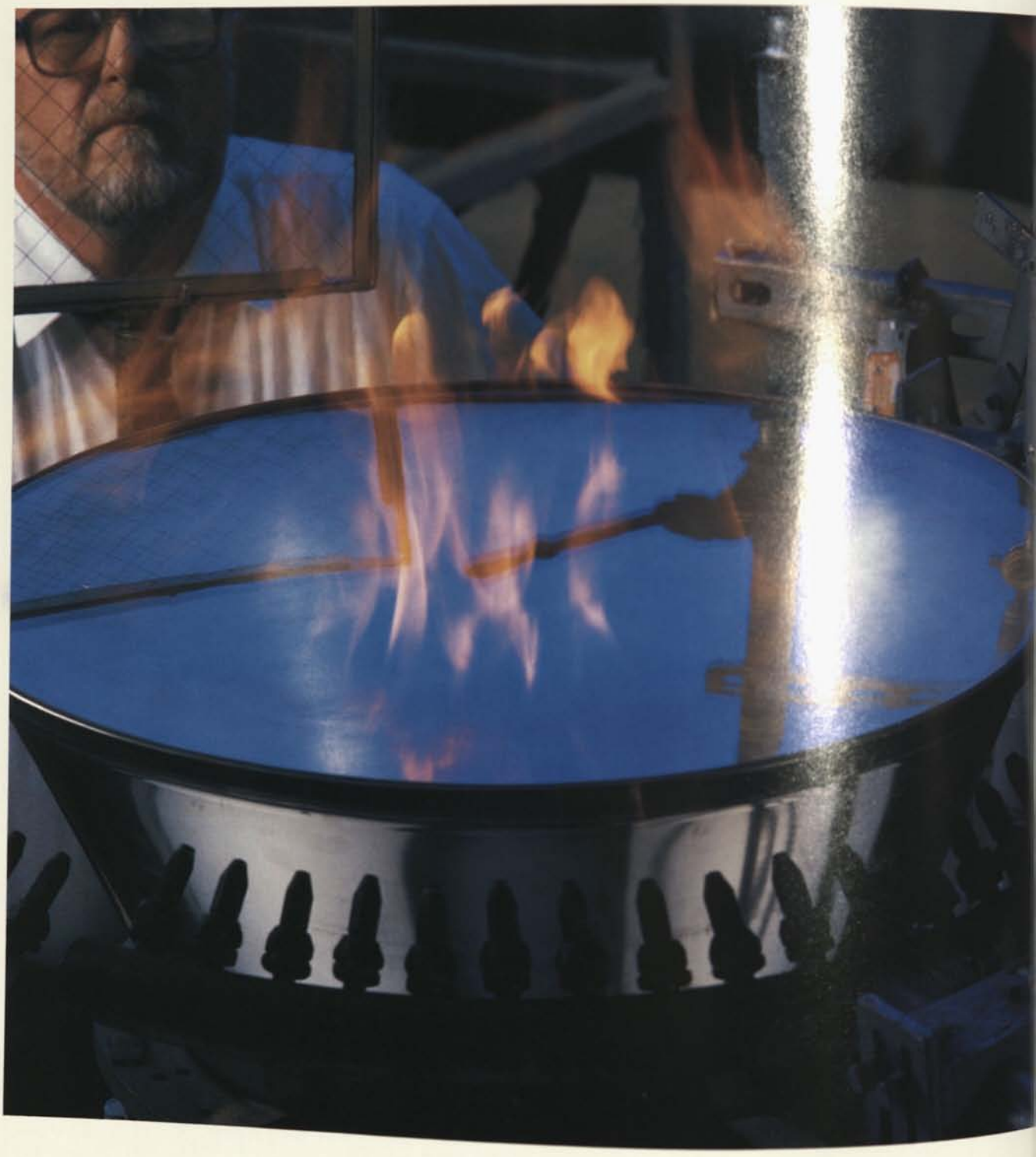
Working with Digital, British Aerospace is now organizing people and computers in the feasibility stage of the proposed HOTOL (Horizontal Take Off and Landing) satellite launch vehicle.

Tackling a major project like this within budgets and schedules takes teamwork. With Local Area VAXclusters, everyone on a project team can share information and computer resources. In effect, Digital workstations and the larger computers used by each engineering team are organized into a single, manageable system, so everyone has up-to-the-minute information. Each VAXcluster, in turn, can become part of a larger network.



The basic industries: a focus on design, manufacturing, and distribution

In Maranello, Italy, 1,800 craftsmen and engineers and a network of VAX and PDP-11 computers work together to build seventeen very special cars each day. The Ferrari combines hand-crafted coachwork with computer design and computer-accurate manufacturing for performance and quality seldom matched.



Taking trial and error out of the design process

WITHOUT ELECTRON TUBES THERE WOULD BE NO TELEVISION, COMPUTER TERMINALS, OR RADAR. AT THE THOMSON ELECTRON TUBES AND DEVICES CORPORATION PLANT IN DOVER, NEW JERSEY, ELECTRON TUBES ARE MANUFACTURED FOR A WIDE VARIETY OF DEMANDING APPLICATIONS IN BROADCASTING, COMPUTER GRAPHICS, AVIONICS, COMMUNICATIONS, AND MEDICAL ELECTRONICS.

In developing complex electronic components and systems, one of the keys to cost containment is getting the design right the first time.

Using computer tools, a semiconductor chip or even an entire system can be simulated and tested before it is ever built.

By using computers to take the "trial and error" out of product development, Paris-based Thomson S.A., one of the world's largest electronics companies, has established an international reputation for innovation in semiconductors, industrial and consumer electronics, communications, and avionics.

The concept goes beyond Computer Aided Design. Using large VAXclusters, Thomson engineers are able to model complex systems before they are built. Designs can be tested and fine-tuned before going to the expense of building a physical prototype. This cuts down on the number of engineering change orders that typically follow a new product as it moves from design to production.

The concept of simulating new designs is not confined to large electronics companies like Thomson and Digital. The same tools can be used to model the performance of a new automobile or the operation of an entire production line.

MANUFACTURING:

A COMPETITIVE ADVANTAGE

GE MANUFACTURES ITS INDUSTRY-LEADING LINE OF DISHWASHERS IN ONE OF SIX FACTORIES ON A 1,000-ACRE SITE IN LOUISVILLE, KENTUCKY. THE FACILITIES ARE TIED TOGETHER WITH AN ETHERNET NETWORK, WHILE VAX COMPUTER SYSTEMS CONTROL FACTORY AND WAREHOUSE AUTOMATION AND ARE USED FOR ENGINEERING AND DATA COLLECTION APPLICATIONS.

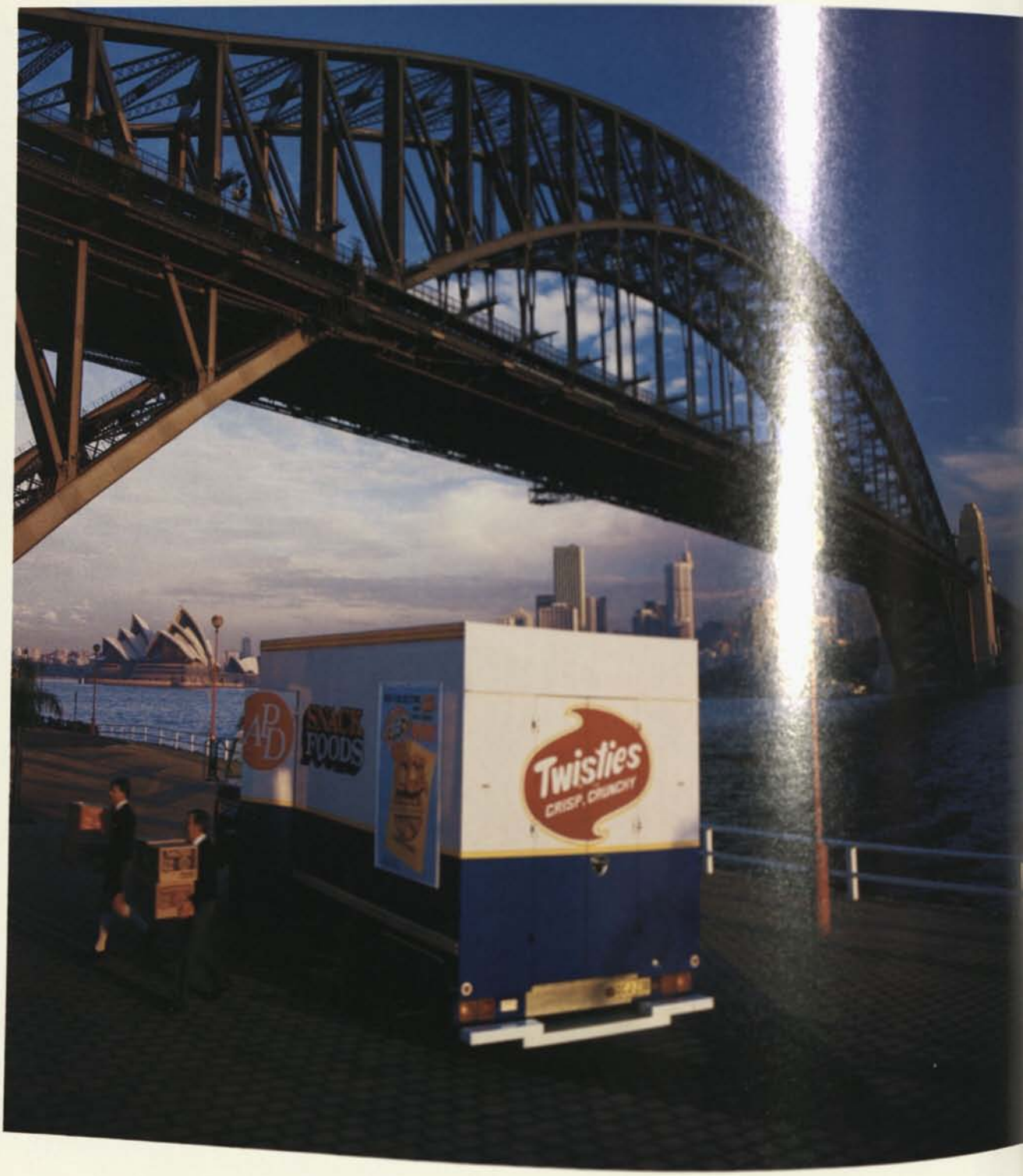
When the GE Appliance business set out to build a dishwasher that would set an industry standard, it recognized that it not only had to design a better product, but also a manufacturing plant that could meet rigid quality standards.

GE's leadership in the dishwasher business – it has a better than 40-percent share of market – is a direct result of this management commitment to quality and customer satisfaction. Instead of looking at design and manufacturing as separate activities, GE designed its new dishwashers – and the Louisville, Kentucky, plant that would build them – in parallel. So the quality designed-in is built-in.

A VAX-based Plant Quality Information System collects test and inspection measurement data for each unit at key points along the manufacturing line. Problems are identified as they occur, and immediate corrective action is taken.

A network of VAXstations and VAX systems was also used in the design process.

The concept of involving manufacturing early in the design process is very familiar to Digital. We follow the same approach to quality in the design and manufacture of our VAX computer systems.


Twisties
CRISP, CRUNCHY

IN A TYPICAL WEEK, AMATIL LIMITED OF SYDNEY, AUSTRALIA, PRODUCES AND DISTRIBUTES EIGHT MILLION PACKAGES OF SNACK FOODS. HAND-HELD DATA ENTRY TERMINALS ARE USED TO TRACK ORDERS, PRODUCE INVOICES, AND FEED CURRENT DATA FROM A FLOPPY DISK ONTO A VAX-BASED DISTRIBUTION SYSTEM EACH EVENING, FOR CLOSE ANALYSIS OF BUSINESS ACTIVITIES.

Australia is about the size of the continental U.S., but its population is less than that of New York. This creates a unique challenge for AMATIL Limited, a Sydney-based manufacturer and distributor of tobacco, beverages, snack foods, poultry, and communications and packaging products.

With hundreds of different products – many of them highly perishable – sold throughout the continent, success requires both imaginative marketing and effective inventory and logistical controls. That combination has boosted AMATIL's annual revenue to nearly two billion dollars (Australian).

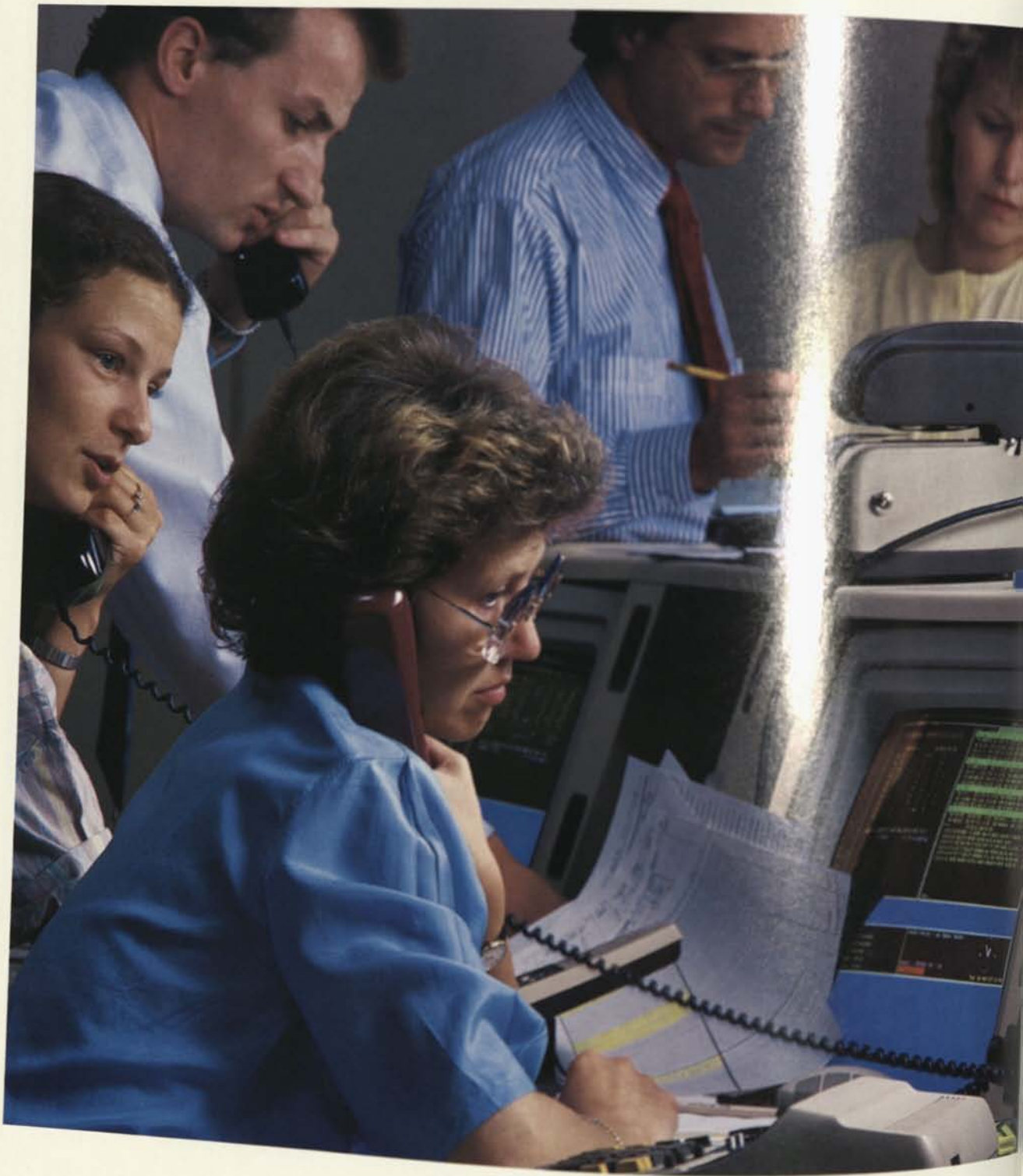
AMATIL's business strategy is a network strategy. A network – based on a local area Ethernet and a wide area DECnet of 25 VAX computers – helps provide the necessary controls to manage this geographically dispersed enterprise. The network includes two VAXclusters and over 400 on-line terminals – from Auckland, New Zealand, to Hobart, Tasmania.

Geography plays a part in Digital's business, too. If it weren't for our 450 service offices around the world we would never be able to support the continental and intercontinental networks that so many of our customers depend on to run their day-to-day business.

THE SERVICE INDUSTRIES:

SELLING INTO THE EMERGING CONSUMER ECONOMY

AT HOUSTON LIGHTING & POWER COMPANY, THE EIGHTH-LARGEST ELECTRIC UTILITY IN THE UNITED STATES, VAX COMPUTER SYSTEMS ARE USED FOR DATA ACQUISITION, TEST APPLICATIONS, AND OFFICE AUTOMATION. OVER 1000 HL&P EMPLOYEES ARE REGULAR USERS OF DIGITAL'S ALL-IN-1 INTEGRATED OFFICE INFORMATION SYSTEM.



BUILDING A 24-HOUR GLOBAL TRADING NETWORK

CITICORP INVESTMENT BANK TRADERS IN FRANKFURT, WEST GERMANY, USE VAXSTATION II/GPX WORKSTATIONS TO INSTANTLY ANALYZE TRENDS ON ALL THE MAJOR MONEY MARKETS. BY 1990, IT IS ESTIMATED THAT CITICORP WILL HAVE 3,000 DIGITAL WORKSTATIONS ON TRADING FLOORS WORLDWIDE, MAKING THE 24-HOUR ELECTRONIC MARKETPLACE A REALITY.

The emergence of a 24-hour-a-day, worldwide money market is forcing corporate treasurers and money managers to reassess existing banking relationships.

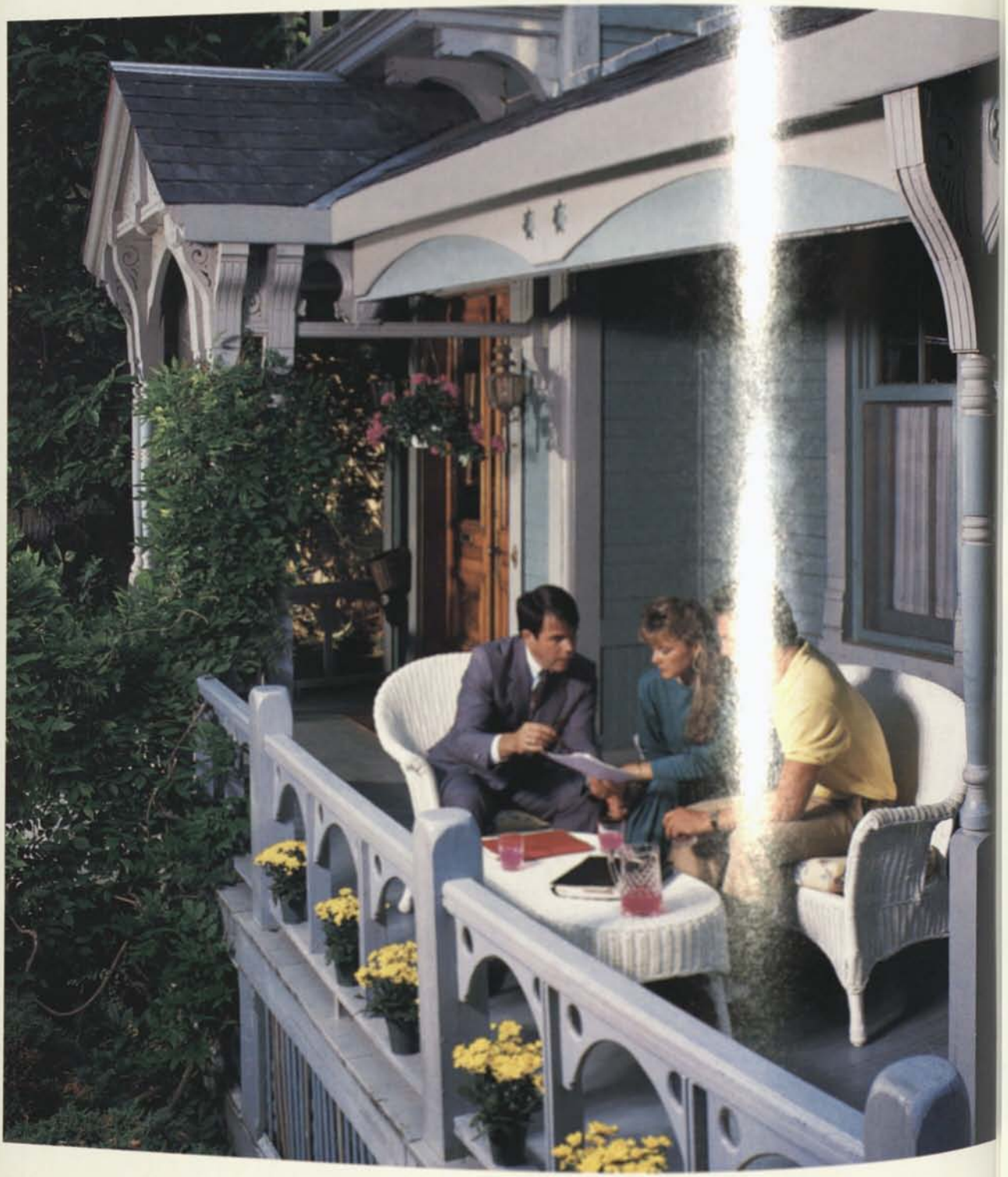
According to Chief Information Officer Harold Rich, Citicorp Investment Bank's Global Trader network is helping make this market. Once fully implemented, "any customer will be able to trade any currency or security on any exchange, any place in the world, at any time of the day, by making a telephone call to a Citicorp trader."

The trader, with a single computer workstation – a VAXstation – can access and analyze activity on all major money markets, execute buy/sell orders, and move funds from market to market and currency to currency.

Citicorp's "one bank, one network" approach has proven to be an effective business strategy.

By providing corporate money managers with direct access to the major money markets through the Global Trader network, Citicorp is helping them manage currency and investment positions, reduce costs, and dry up float.

Like Citicorp, Digital recognizes that, in a service-oriented economy, every network has to serve the ultimate consumer.



AFFINITY MARKETING:

LEVERAGING THE

CUSTOMER BASE

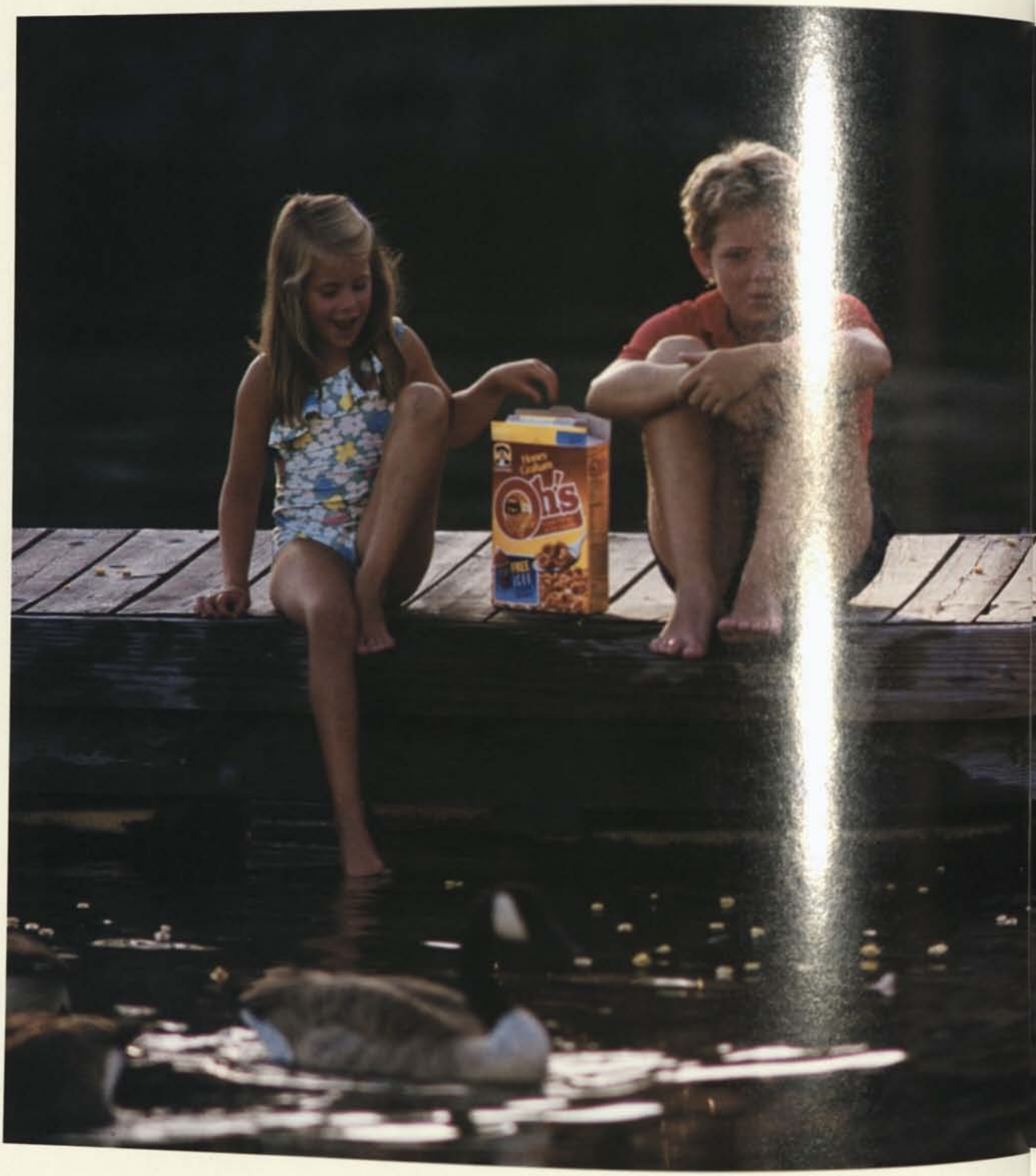
ONE HUNDRED AND FIFTY LONDON LIFE INSURANCE SALES OFFICES ARE IN THE PROCESS OF INSTALLING VAXMATE AND MICROVAX II COMPUTERS TO PERFORM CUSTOMER NEEDS ANALYSES. THIS VAST NETWORK, WHICH IS MANAGED FROM HEADQUARTERS IN LONDON, ONTARIO, USES DIGITAL'S VMS/SNA NETWORKING CAPABILITIES.

Insurance companies are now selling a variety of products into their customer base. They see their policyholders as an "affinity group" with a demonstrated interest in building a secure financial future.

Ontario-based London Life, the leading provider of insurance to individual Canadians, saw the opportunity. Using VAXmate computers which run industry-standard personal computer software and operate as full-fledged members of a VAX computer network, London Life representatives at regional offices across Canada provide their English- and French-speaking customers with solutions to meet their financial security needs.

Using a VAXmate, London Life representatives can sit down with customers and, on the spot, analyze their needs. They can provide sales illustrations and product comparisons in French or English, so customers can balance alternatives and make informed decisions.

Like London Life, Digital focuses on customer needs rather than force-fitting customer requirements to a particular product "solution." For example, you can't force-fit a Canadian insurance company into an English-language solution when it is selling into a bilingual market.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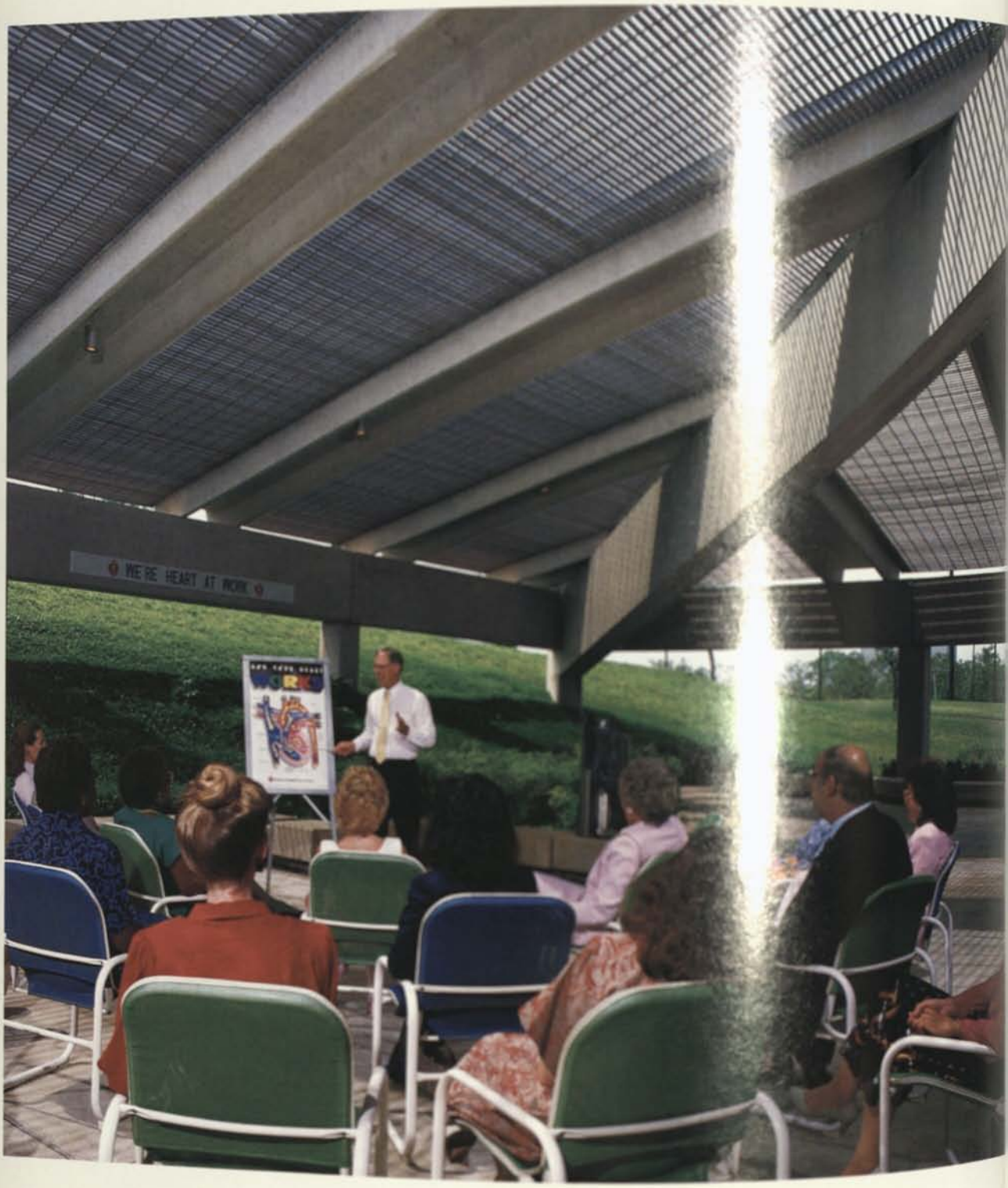
BUILDING FOR THE FUTURE:

THE IMPORTANCE OF

PEOPLE AND IDEAS

THE QUAKER OATS COMPANY, A MARKET LEADER IN BREAKFAST CEREALS AND MANY OTHER GROCERY CATEGORIES, IS INTRODUCING VAX COMPUTERS AND ETHERNET LOCAL AREA NETWORKS INTO 12 PLANTS. AT SHIREMANSTOWN, PENNSYLVANIA, WHERE QUAKER GRANOLA DIPPS ARE MADE, DAILY AND WEEKLY REPORTS HAVE HELPED REDUCE CULLAGE AND IMPROVE YIELDS.


WE'RE HEART AT WORK

People can make the difference

THE OFFICE OF MIS AT THE AMERICAN HEART ASSOCIATION IS CONCERNED NOT ONLY WITH PROVIDING SERVICE AT ITS NATIONAL CENTER IN DALLAS, BUT TO ITS 55 STATE AND METROPOLITAN AFFILIATES AND 1,800 LOCAL DIVISIONS. THESE GROUPS USE VAX, MICROVAX II AND RAINBOW COMPUTERS, IN COMBINATION WITH SOFTWARE DEVELOPED BY AHA, FOR A VARIETY OF TASKS.

Last year caring people gave 151 million dollars to the American Heart Association. Digital computers at the association's Dallas headquarters and at affiliates nationwide work together to administer the many programs and track the contributions that support them. These computers also help the association control expenses so that every available penny is used to fight heart disease.

People make the difference at Digital, too. More than anything else, people are responsible for our success. Digital's 110,500 employees share a vision of the ways computers can make this a better world and a recognition of the importance of the customer to their own success and the success of the company.

As individuals and as a company, we've been able to make a real contribution to the communities in which we live and work.

Digital matches, dollar for dollar, employee gifts to schools, nonprofit organizations, and United Way programs. We actively support educational, health-care, civic, social, and cultural programs at the national, regional, and local levels. During the past year, in addition to external research grants, we donated more than 22 million dollars in cash and equipment to nonprofit institutions around the world.

ON "THE INFINITE VOYAGE" CAMERAS WILL TAKE THE TELEVISION VIEWER TO THE EDGE OF SPACE, THE BOTTOM OF THE SEA, AND TO THE INTERIOR OF THE HUMAN BODY. UTILIZING LOCATION PHOTOGRAPHY, COMPUTER ANIMATION, AND SPECIAL EFFECTS, THIS THREE-YEAR TELEVISION SERIES WILL TELL THE MANY STORIES BEHIND NEW IDEAS AND TECHNOLOGY.

Discovery, invention, and innovation – in both the arts and the sciences – is a never-ending process. This process is reflected in "The Digital Discovery Series."

As a company we are making a major commitment to bringing great ideas, accomplishments, and questions into focus. As part of "The Digital Discovery Series" we are underwriting "The Infinite Voyage," a major television series focused on science and nature. Produced in association with The National Academy of Sciences, "The Infinite Voyage" will be released simultaneously on the Public Broadcasting System and commercial stations. The first program is scheduled for October 1987. Additional episodes will be premiered on a quarterly basis over the next three years.

As the leading manufacturer of computers for advanced research and development, Digital continually searches for new ideas and new technologies. We are a research and development company. We play a key role in the establishment of industry standards that make it easier for different computer systems to work together. For example, we invested over a billion dollars to develop the networking products used with Ethernet.

All these activities reflect our belief in the future.

Customers like GE, Unilever, Citicorp, and London Life want their computer company to work with them as a business partner in developing corporate networks.

These expectations define the mission of Digital's service organization. Quality and reliability are the first priorities for both the customer and for Digital. This year we became the first major manufacturer to offer a full-year warranty on all systems.

But it is not enough to provide quality products; those products have to be backed by an organization in which everyone feels personally responsible for building a lasting and mutually profitable relationship with the customer. The 35,000 professionals who work in our educational service, field service, and software service organizations play a key role in building customer satisfaction.

Every Monday morning more than 5,000 individuals enroll in educational programs at the 100 Digital Training Centers around the world where they use Digital-produced course materials and documentation written in 17 languages. In addition, specialized programs have been developed to support customers who operate multinational networks.

Our Computer Special Systems Group maintains manufacturing facilities around the world to provide the custom hardware needed to solve unique customer problems.

Another vital support service is our Cooperative Marketing Program. Digital has formal working relationships with more than 120 independent software and system developers, who have expertise and experience in specialized applications – from process control for an entire petrochemical plant to retail point-of-sale systems. And since these applications are all based on a common hardware/software platform, they all work together to provide complete solutions systems for the customer.

The breadth of Digital's software commitment can be seen at a Digital Application Center for Technology (A.C.T.). Seventeen of these Centers have been established in major North American and European markets. Networked together, these Centers provide a problem-solving environment for industry consultants, systems specialists, and customers. The Centers also have an industry focus. In New York, for example, the A.C.T. is focused on financial services projects. The Detroit A.C.T. concentrates on automotive applications, the Washington A.C.T. on governmental applications.

As more and more applications are developed for Digital systems, and as more organizations recognize the value of integrating computer resources in enterprise-wide networks, the vision shared by Digital and its customers has become a reality. The network has become the system.

Financial contents

Operations *(in millions except per share data)*	1987	1986	1985	1984
Revenues				
Product sales[1]	$6,254.2	$5,103.0	$4,530.0	$3,804.1
Service and other revenues[1]	3,135.2	2,487.4	2,156.3	1,780.3
Total operating revenues	9,389.4	7,590.4	6,686.3	5,584.4
Costs and Expenses				
Cost of product sales, service and other revenues	4,513.9	4,282.1	4,087.5	3,379.6
Research and engineering expenses	1,010.4	814.2	711.3	630.7
Selling, general and administrative expenses	2,253.1	1,665.4	1,437.3	1,179.5
Operating income	1,612.0	828.7	449.2	394.6
Interest expense	45.2	88.1	87.0	35.1
Interest income	(122.1)	(116.9)	(65.0)	(41.5)
Income before income taxes	1,688.9	857.5	430.8	401.0
Provision for income taxes	551.5	240.1	(15.9)[4]	72.2
Net income	$1,137.4	$ 617.4	$ 446.7	$ 328.8
Net income per share[2,3]	$ 8.53	$ 4.81	$ 3.71	$ 2.87
Weighted average shares outstanding	133.3	130.8	124.1	114.7
Financial Position *(in millions except per share data)*				
Inventories	$1,452.9	$1,199.8	$1,756.2	$1,852.2
Accounts receivable, net of allowances	2,312.2	1,903.3	1,539.1	1,527.3
Working capital	4,376.6	4,222.7	3,699.2	3,001.4
Property, plant and equipment, at cost	3,859.3	3,262.7	2,827.6	2,351.8
Total assets	8,407.4	7,173.3	6,369.9	5,593.3
Long-term debt	269.3	333.2	831.1	441.3
Stockholders' equity	6,293.5	5,727.8	4,555.6	3,979.2
Stockholders' equity per share[3]	$ 49.87	$ 44.54	$ 36.71	$ 34.42
General Information and Ratios *(dollars in millions)*				
Current ratio	3.4:1	4.9:1	4.9:1	3.8:1
Quick ratio	2.4:1	3.5:1	2.8:1	1.9:1
Additions to property, plant and equipment	$ 748.4	$ 564.2	$ 571.8	$ 452.1
Depreciation	$ 434.7	$ 384.0	$ 315.1	$ 252.6
Debt to debt plus equity ratio	4.1%	5.5%	15.5%	10.0%
Operating income as a percentage of total operating revenues	17.2%	10.9%	6.7%	7.1%
Income before income taxes as a percentage of total operating revenues	18.0%	11.3%	6.4%	7.2%
Effective tax rate	32.7%	28.0%	(3.7%)[4]	18.0%
Net income as a percentage of total operating revenues	12.1%	8.1%	6.7%	5.9%
Net income as a percentage of average stockholders' equity	18.9%	12.0%	10.5%	8.7%
Net income as a percentage of average total assets	14.6%	9.1%	7.5%	6.5%
Number of days sales of accounts receivable outstanding	78	79	75	83
Inventory turns	3.4	2.9	2.3	2.1
Number of employees at year-end	110,500	94,700	89,000	85,600
Common shares outstanding *(in thousands)*	126,187	128,591	59,253	57,811
Shareholders at year-end	99,379	76,860	68,810	44,389
Common stock yearly high and low sales prices	$ 174-82	$ 94-46	$ 63-39	$ 50-33

[1] *Reclassified for comparative purposes.*
[2] *See Note B of Notes to Consolidated Financial Statements.*

1983	1982	1981	1980	1979	1978	1977
$2 827.7	$2,738.5	$2,312.9	$1,736.4	$1,337.7	$1,078.1	$ 809.9
144.2	1,142.3	885.2	631.6	466.4	358.5	248.7
271.9	3,880.8	3,198.1	2,368.0	1,804.1	1,436.6	1,058.6
806.0	2,187.6	1,778.7	1,319.9	1,012.3	802.3	595.1
472.4	349.8	251.2	186.4	138.3	115.7	79.7
330.6	758.6	632.2	478.9	370.1	281.0	205.9
562.9	584.8	536.0	382.8	283.4	237.6	177.9
13.1	14.8	29.2	27.0	24.3	22.4	11.7
(61.2)	(102.8)	(60.6)	(53.8)	(35.8)	(12.3)	(10.2)
411.0	672.8	567.4	409.6	294.9	227.5	176.4
127.4	255.6	224.1	159.7	116.5	85.3	67.9
$ 283.6	$ 417.2	$ 343.3	$ 249.9	$ 178.4	$ 142.2	$ 108.5
$ 2.50	$ 3.76	$ 3.35	$ 2.73	$ 2.05	$ 1.70	$ 1.39
113.4	110.9	105.1	94.3	89.9	86.5	78.0
$1 153.8	$1,137.4	$1,102.2	$ 819.9	$ 513.5	$ 428.1	$ 375.0
925.0	807.6	758.1	629.1	475.1	375.2	323.1
2177.0	2,181.2	2,029.8	1,658.2	1,076.9	887.0	574.2
1661.4	1,605.4	1,128.4	772.3	582.1	507.8	352.4
4141.1	4,024.0	3,456.1	2,666.1	1,863.2	1,501.4	1,070.4
92.8	92.4	88.4	489.7	340.7	341.6	90.6
3241.3	3,164.5	2,679.7	1,651.7	1,120.2	904.8	735.5
$ 31.42	$ 28.65	$ 24.65	$ 18.12	$ 13.79	$ 11.35	$ 9.37
3.9:1	4.1:1	4.2:1	4.5:1	3.8:1	4.7:1	3.5:1
2.0:1	2.3:1	2.3:1	2.6:1	2.3:1	2.8:1	1.8:1
$ 419.2	$ 511.2	$ 398.5	$ 209.9	$ 93.9	$ 167.0	$ 143.2
$ 203.2	$ 152.6	$ 102.1	$ 69.8	$ 57.7	$ 50.2	$ 28.5
2.6%	2.8%	3.2%	22.9%	23.3%	27.4%	11.0%
8.5%	15.1%	16.8%	16.2%	15.7%	16.5%	16.8%
9.6%	17.3%	17.7%	17.3%	16.4%	15.8%	16.7%
31.0%	38.0%	39.5%	39.0%	39.5%	37.5%	38.5%
6.6%	10.7%	10.7%	10.6%	9.9%	9.9%	10.3%
8.5%	14.3%	15.9%	18.0%	17.6%	17.3%	16.2%
6.6%	11.2%	11.2%	11.0%	10.6%	11.1%	11.3%
82	68	73	81	82	82	88
2.1	2.0	1.9	2.0	2.2	2.0	2.0
73,000	67,100	63,000	55,500	44,200	39,000	36,700
56,357	55,227	54,348	45,568	40,606	39,873	39,259
40,903	44,706	39,948	35,144	28,835	25,868	22,738
$ 65-32	$ 55-34	$ 55-29	$ 41-27	$ 29-22	$ 28-19	$ 30-20

[3]Per share data adjusted to reflect two-for-one stock split in May 1986.
[4]Includes elimination of DISC taxes of $63M accrued prior to 1984.

Income and Expense Items as a Percentage of Total Operating Revenues				Percentage Changes		
1985	1986	**1987**	Income and Expense Items	**1986-87**	1986-86	1984-85
67.8%	67.2%	**66.6%**	Product sales	**23%**	3%	19%
32.2%	32.8%	**33.4%**	Service and other revenues	**26%**	5%	21%
100.0%	100.0%	**100.0%**	Total operating revenues	**24%**	4%	20%
57.7%	52.4%	**40.5%**	Cost of product sales	**(5%)**	2%	20%
68.3%	64.6%	**63.2%**	Service expense and cost of other revenues	**23%**	9%	22%
61.1%	56.5%	**48.0%**	Total cost of operating revenues	**5%**	5%	21%
10.8%	10.7%	**10.8%**	Research and engineering expenses	**24%**	14%	14%
21.4%	21.9%	**24.0%**	Selling, general and administrative expenses	**35%**	16%	21%
6.7%	10.9%	**17.2%**	Operating income	**95%**	84%	14%
1.2%	1.1%	**0.5%**	Interest expense	**(49%)**	7%	134%
(0.9%)	(1.5%)	**(1.3%)**	Interest income	**5%**	86%	52%
6.4%	11.3%	**18.0%**	Income before income taxes	**97%**	99%	7%
(0.3%)	3.2%	**5.9%**	Income taxes	**130%**	1414%	(122%)
6.7%	8.1%	**12.1%**	Net income	**84%**	73%	36%

Prior years reclassified for comparative purposes.

As an aid to understanding the Company's operating results, the above tables indicate the percentage relationships of income and expense items included in the Consolidated Statements of Income for the three years ended June 27, 1987 and the percentage changes in those items for such years. Components of total cost of operating revenues are shown as percentages of their related revenues.

Revenues

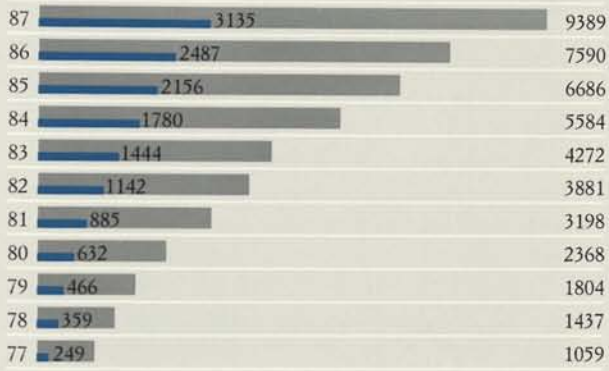
The Company's total operating revenues for fiscal year 19[illegible] increased by 24% compared with increases of 14[illegible] in 1986 and 20% in 1985. There were several reasons for this improvement. The Company continued to see broad market acceptance of its networked computer systems, which enable customers to solve today's critical business problems. Revenues were also spurred by a steady flow of new products, encompassing hardware, software, networking and services. The majority of these products were immediately available at introduction. In addition, substantial increases in personnel were made to the sales, service, software and marketing organizations to expand and better service the customer base.

The attractiveness of the Company's products lies in their networking capability that provides customers with an elegantly simple way of tying together parts of an organization with a computer network. The Company expects the demand for this type of capability to grow as organizations see the productivity enhancements and efficiency of quality networks.

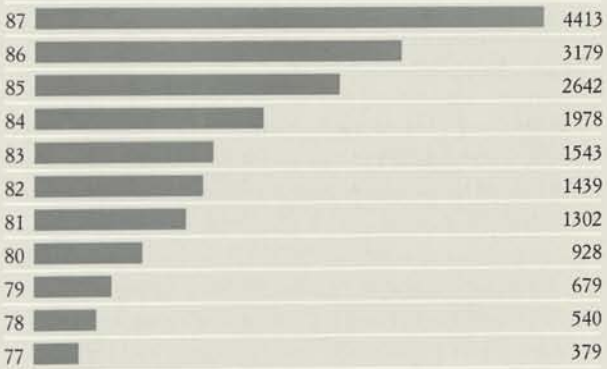
Demand from customers overseas, particularly in Western Europe, was very strong as was the case during the previous year. In the U.S., customer demand also improved over the previous year. This was especially evident in the services industries.

In fiscal 1987, service and other revenues, which principally include maintenance service, software support and consulting services, customer training and the sale of replacement parts, grew by 26%. Service and other revenues comprised 33% of total revenues in fiscal years 1987 and 1986 and 32% of total revenues in fiscal 1985.

Total Operating Revenues **$ Millions**



Non-United States Revenues **$ Millions**



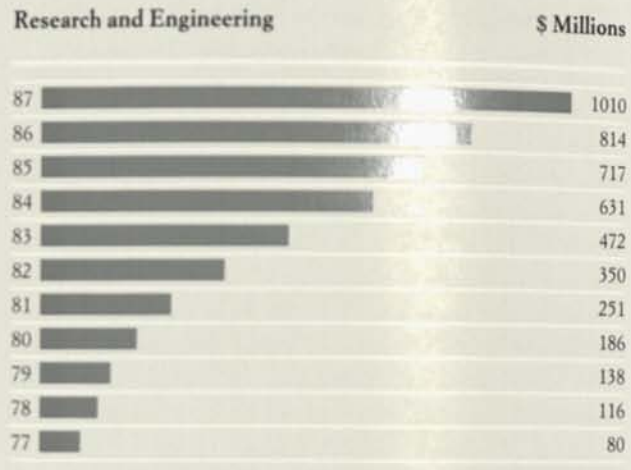
Expenses and Profit Margins

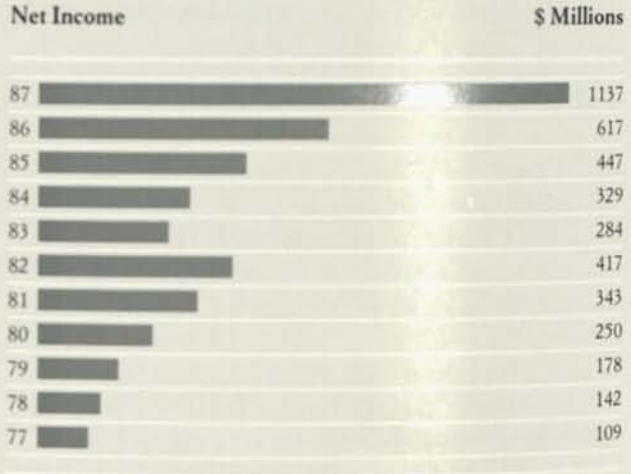
The total cost of sales as a percentage of operating revenues decreased in fiscal 1987 compared with the prior two years. This was reflected primarily in a lower cost of product sales as a percentage of product revenues. The major factors contributing to this reduction were increased sales, a larger proportion of revenues from more profitable new products, manufacturing efficiencies, cost reductions and improved inventory turnover performance. Service expense as a percentage of service and other revenues was slightly lower than the prior two years.

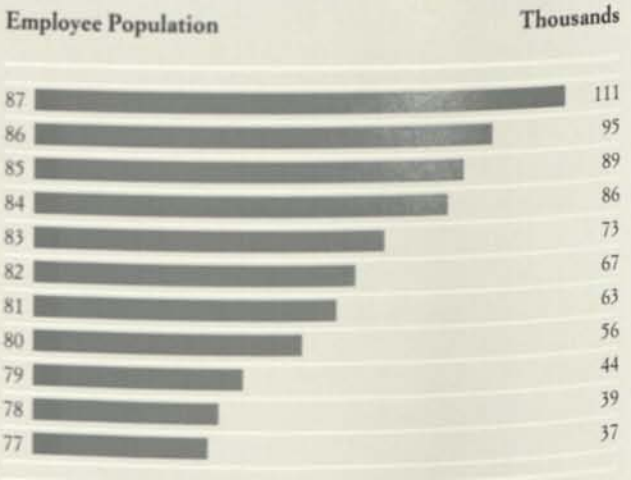
Research and engineering expenses grew 24% in fiscal 1987 and comprised 10.8% of total operating revenues compared with 10.7% in 1986 and 10.8% in 1985. The Company is primarily involved with applied research and engineering and has approximately 7,000 professional employees involved in various research, engineering and software development activities.

The Company's investment in research and engineering has totalled more than $2.5 billion over the last three years, and exceeded $1 billion in 1987. This ongoing investment maintained the momentum of the Company's new hardware, software, and service products introduced during 1987. Among them were the VAX 8974 and 8978 systems, two mainframe class VAX systems which feature the most powerful central computing environments available from Digital, and the SA 482 Storage Array, a new high-capacity disk storage product. The VAX/Supercomputer Gateway, announced jointly with Cray Research, Inc., enhances the link between the VAX computing environment and Cray supercomputers.

In the midrange, the new VAX 8250, 8350, and 8530 systems offer up to a 40% improvement in price performance over earlier models. For work group computing, the MicroVAX 2000 and VAXstation 2000 were announced early in the fiscal year. Also announced was the Local Area VAXcluster, an extension of the VAXcluster to the MicroVAX family. Just prior to the close of the fiscal year, price performance improvements were announced on several low-end machines along with an expanded capacity Local Area VAXcluster and color VAXstations, positioning the Company as a major participant in the highly competitive workstation market.







Expenses and Profit Margins (continued)

Two major networking products were announced during the year. The DECnet/SNA Data Transfer Facility provides high-speed, bi-directional information and file transfer between a Digital VAX-based system and IBM's SNA environment. The METROWAVE bridge is a microwave link for Ethernet local area networks separated by physical barriers such as highways or rivers, or where the cost of installing cable is too great.

VAXmate, PC ALL-IN-1, and VAX/VMS Services for MS-DOS extended the VAX networked computing environment to users of stand-alone PCs. Eighteen different products and services, including ruggedized VAX systems for the manufacturing environment, were announced, reinforcing the Company's capabilities in integrated manufacturing solutions.

Selling, general and administrative expenses increased to 24% of total operating revenues in fiscal 1987 compared with 21.9% in 1986 and 21.4% in 1985. An increase in the number of sales and service personnel accounted for most of the increase over fiscal 1986.

Operating income increased by 95%, compared with increases of 84% and 14% in the two preceding fiscal years, reflecting the moderate growth in cost of operating revenues as compared with the growth in total operating revenues.

Interest income increased in fiscal 1987 from fiscal 1986 levels reflecting a higher level of cash available for investment. Interest expense declined, due to the redemption and conversion of long-term debt in fiscal years 1986 and 1987.

The Company's effective tax rate for fiscal 1987 was 32.7%, up from 28% in fiscal 1986. Excluding a one-time DISC (Domestic International Sales Corporation) benefit of $63 million, the fiscal 1985 effective tax rate was 11%. The increase in the effective tax rate for both fiscal 1986 and 1987 resulted primarily from improved profitability in the U.S. and the expiration of certain U.S. tax credits.

The changes made by the Tax Reform Act of 1986, including the retroactive provisions, did not have a material impact on the financial results of the Company for the 1987 fiscal year. A reduced U.S. statutory income tax rate, provided in the legislation, is expected to reduce the Company's corporate tax rate for the 1988 fiscal year.

In September, 1986 the Financial Accounting Standards Board (FASB) issued an Exposure Draft, "Accounting for Income Taxes." The proposed changes, if adopted, would effect the Company's present method of accounting for income taxes. The changes, depending on the provisions included in the final statement, could have a material effect on the Company's results of operations and increase the Company's income tax expense.

The Company monitors the effect of inflation on its business and believes that low U.S. inflation rates in recent years have had minimal impact on its results of operations.

During the year, the number of employees increased by 15,800 bringing the total number of employees at year end to 110,500. The largest increases were in the sales, service and manufacturing organizations.

The ratio of net income to average stockholders' equity (ROE) was 18.9% in fiscal 1987, 12% in fiscal 1986, and 10.5% in fiscal 1985.

Availability of Funds to Support Current and Future Operations

Funds to support the Company's operations have historically been met with internally generated funds supplemented with external financing. During fiscal 1987, internally generated funds were more than sufficient to support operations.

During the three year fiscal period 1985-1987, funds generated from operations exceeded funds used to support operations by $1,773 million. In 1987, net funds generated from operations were $881 million, compared with $791 million in 1986 and $101 million in 1985. The higher level of funds generated from operations in 1987 was primarily the result of continued improvements in the Company's profitability.

The Company reduced long-term debt by $64 million during fiscal 1987 through sinking fund payments and subsequent redemption of all of its outstanding 9 3/8% Sinking Fund Debentures.

In November 1986, the Board of Directors authorized the repurchase of up to 5,000,000 shares of the Company's common stock on the open market. The purpose of the repurchase program was to provide shares to meet the requirements of the employee stock plans. During fiscal 1987, the Company purchased 5,000,000 shares at a total cost of $782 million. The shares, held as treasury stock, are being issued under the employee stock plans.

Cash and temporary cash investments rose to $2,118 million at the end of fiscal 1987 from $1,911 million at the end of 1986. Unused lines of credit at the end of fiscal 1987 were $451 million.

The Company believes its improved profitability coupled with its low debt to debt-plus-equity ratio and high credit rating leave it well positioned to obtain funds sufficient to meet future requirements.

Common Stock Information

The Company's common stock is listed and traded on the New York Stock Exchange, Pacific Stock Exchange and several European stock exchanges. There were 99,379 stockholders of record as of June 27, 1987. The high and low quarterly sales prices for the past two fiscal years are presented below.

		1987
Fiscal Quarter	High	Low
First	$105 1/8	$ 81 3/4
Second	109	88 1/2
Third	172 7/8	104 1/2
Fourth	174 1/2	148 3/4

		1986
Fiscal Quarter	High	Low
First	$ 56	$ 45 7/8
Second	68 3/8	51 1/4
Third	86 7/8	65 7/8
Fourth	93 5/8	76

Total Stockholders' Equity — **$ Millions**

Spending for Operations

Fiscal year-end inventories increased 21% from the prior year. Average year inventory turns of 3.4 times improved from the 2.9 times and 2.3 times recorded in 1986 and 1985, respectively. Accounts receivable grew 21% reflecting the rise in product sales. Days sales in accounts receivable outstanding decreased to 78 days from days in the previous year.

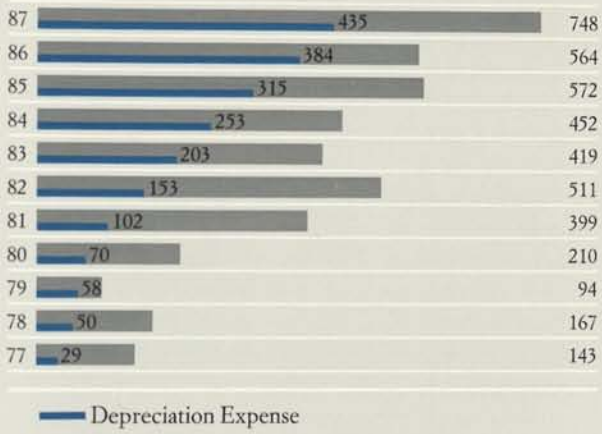
Capital spending in fiscal 1987 totalled $748 million, compared with $564 million in 1986. In fiscal 1987, $551 million of the capital spending was for equipment as the Company continued to invest in support of new products and technology development. Spending for land and building additions totalled $115 million, and leasehold improvements totalled $82 million.

The ratio of net income to average net total assets (ROA) was 14.6% in fiscal 1987, 9.1% in 1986 and 7.5% in 1985.

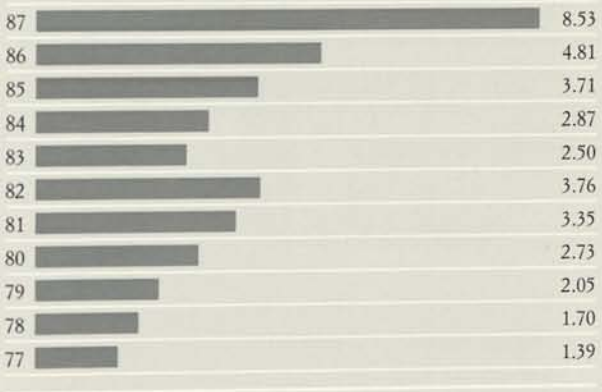
The Company added approximately 1.3 million square feet of building space worldwide in fiscal 1987, bringing the total amount of space to 33.6 million square feet, compared with 32.3 million square feet in 1986 and 29.3 million square feet in 1985.

The Company expects that its capital spending level in fiscal 1988 will exceed that of fiscal 1987. The actual level of spending will be dependent on a variety of factors, including general economic conditions and the growth in demand for the Company's products and services.

Additions to Property, Plant & Equipment
Depreciation Expense **$ Millions**



Net Income Per Common Share **$**



Report of Management

The Company's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of all the financial data included in this Annual Report. In preparing the financial statements, management makes informed judgments and estimates of the expected effects of events and transactions that are currently being reported.

Management maintains a system of internal accounting controls that is designed to provide reasonable assurance that assets are safeguarded and that transactions are executed and recorded in accordance with management's policies for conducting its business. This system includes policies which require adherence to ethical business standards and compliance with all laws to which the Company is subject. The internal controls process is continuously monitored by direct management review and an internal audit program under which periodic independent reviews are made.

The Board of Directors, through its Audit Committee, is responsible for determining that management fulfills its responsibility with respect to the Company's financial statements and the system of internal accounting controls.

The Audit Committee meets periodically with representatives of management, the independent accountants and the Company's internal auditors to review audits, financial reporting, and internal control matters, and also meets with the Company's outside counsel on related matters. The independent accountants and the internal auditors have full and free access to the Audit Committee and periodically meet privately with the Audit Committee.

Coopers & Lybrand, independent Certified Public Accountants, have been engaged by the Board of Directors, with the approval of the stockholders, to examine the Company's financial statements. Their report appears below.

Kenneth H. Olsen
President

James M. Osterhoff
Vice President, Finance

Report of Independent Certified Public Accountants

To The Stockholders and Directors,
Digital Equipment Corporation

We have examined the consolidated balance sheets of Digital Equipment Corporation as of June 27, 1987 and June 28, 1986 and the related consolidated statements of income, stockholders' equity and changes in financial position for each of the three fiscal years in the period ended June 27, 1987. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Digital Equipment Corporation as of June 27, 1987 and June 28, 1986, and the consolidated results of its operations and the consolidated changes in its financial position for each of the three fiscal years in the period ended June 27, 1987 in conformity with generally accepted accounting principles applied on a consistent basis.

Boston, Massachusetts
July 22, 1987

Coopers & Lybrand

Consolidated Statements of Income

(in thousands except per share data)

	Year Ended		
	June 27, 1987	June 28, 1986	June 29, 1985
Revenues *(Notes A and C)*			
Product sales	**$6,254,187**	$5,102,961	$4,530,011
Service and other revenues	**3,135,257**	2,487,396	2,156,305
Total operating revenues	**9,389,444**	7,590,357	6,686,316
Costs and Expenses *(Notes A and D)*			
Cost of product sales	**2,532,259**	2,675,438	2,615,384
Service expense and cost of other revenues	**1,981,635**	1,606,661	1,472,091
Research and engineering expenses	**1,010,438**	814,138	717,273
Selling, general and administrative expenses	**2,253,105**	1,665,411	1,431,769
Operating income	**1,612,007**	828,709	449,799
Interest expense	**45,203**	88,079	82,003
Interest income	**(122,149)**	(116,899)	(63,026)
Income before income taxes	**1,688,953**	857,529	430,822
Income Taxes *(Notes A and E)*			
Provision for income taxes	**551,518**	240,109	47,390
Reversal of DISC taxes	**–**	–	(63,250)
Total income taxes	**551,518**	240,109	(15,860)
Net Income	**$1,137,435**	$ 617,420	$ 446,682
Net income per share *(Note B)*	**$ 8.53**	$ 4.81	$ 3.71
Weighted average shares outstanding *(Note B)*	**133,305**	130,792	124,112

The accompanying notes are an integral part of these financial statements.
Prior years reclassified for comparative purposes.

(in thousands)	June 27, 1987	June 28, 1986
Assets		
Current Assets		
Cash and temporary cash investments *(Note F)*	$2,118,29	$1,910,933
Accounts receivable, net of allowance of $69,280 and $52,439	2,312,18	1,903,287
Inventories *(Note A)*		
Raw materials	405,11	339,308
Work-in-process	526,48	523,863
Finished goods	521,32	336,585
Total Inventories	1,452,91	1,199,756
Prepaid expenses	119,15	85,274
Net deferred Federal and foreign income tax charges	198,46	206,998
Total Current Assets	6,201,060	5,306,248
Property, Plant and Equipment, at cost *(Note A)*		
Land	148,480	118,074
Buildings	889,755	809,245
Leasehold improvements	294,630	232,021
Machinery and equipment	2,526,457	2,103,339
Gross Property, Plant and Equipment	3,859,322	3,262,679
Less accumulated depreciation	1,732,028	1,395,601
Net Property, Plant and Equipment	2,127,294	1,867,078
Other assets, net *(Note G)*	79,032	–
Total Assets	$8,407,38	$7,173,326
Liabilities and Stockholders' Equity		
Current Liabilities		
Bank loans and current portion of long-term debt *(Note H)*	$ 4,87	$ 22,197
Accounts payable	430,575	259,565
Federal, foreign and state income taxes	328,134	137,558
Salaries, wages and related items	229,623	151,160
Deferred revenues and customer advances *(Note A)*	475,925	253,790
Other current liabilities	355,375	259,265
Total Current Liabilities	1,824,505	1,083,535
Net deferred Federal and foreign income tax credits	20,118	28,809
Long-term debt *(Note H)*	269,292	333,155
Total Liabilities	2,113,915	1,445,499
Stockholders' Equity *(Notes I and J)*		
Common stock, $1.00 par value; authorized 450,000,000 shares; issued 130,008,231 shares and 128,591,361 shares	130,008	128,591
Additional paid-in capital	2,352,939	2,224,304
Retained earnings	4,410,242	3,374,932
Treasury stock at cost, 3,821,669 shares	(599,718)	–
Total Stockholders' Equity	6,293,471	5,727,827
Total Liabilities and Stockholders' Equity	$8,407,386	$7,173,326

The accompanying notes are an integral part of these financial statements.
Prior year reclassified for comparative purposes.

(in thousands)	**June 27, 1987**	June 28, 1986	June 29, 1985
Funds from Operations			
Net income	**$1,137,435**	$ 617,420	$ 446,682
Add–expenses not requiring funds in current period:			
Depreciation and amortization *(Notes A and G)*	**436,118**	384,044	315,075
Disposal of property, plant and equipment	**53,456**	44,112	37,020
Restricted stock plans–charged to operations *(Note I)*	**20,653**	21,155	20,420
Deferred income tax provision *(Note E)*	**(158)**	(13,936)	(87,125)
Total funds from operations	**1,647,504**	1,052,795	732,072
Funds Used to Support Operations			
Increase (decrease) in working capital:			
Accounts receivable	**408,901**	364,332	11,698
Inventories	**253,163**	(556,411)	(96,001)
Prepaid expenses	**33,919**	20,705	7,539
Accounts payable	**(171,010)**	(74,363)	92,909
Income taxes	**(190,576)**	130,342	44,971
Deferred revenues and customer advances	**(222,135)**	(93,685)	(33,651)
Other current liabilities	**(174,573)**	(93,685)	31,813
	(62,311)	(302,765)	59,278
Additions to property, plant and equipment	**748,359**	564,205	571,784
Increase in other assets	**80,463**	–	–
Total funds used to support operations	**766,511**	261,440	631,062
Net increase in funds from operations	**880,993**	791,355	101,010
Funds Provided (Used) by Financing Sources			
Bank loans and current portion of long-term debt *(Note H)*	**(17,324)**	8,535	(893)
Long-term debt *(Note H)*	**(863)**	(144)	(14)
9⅜% Debentures due 2000 *(Note H)*	**(63,000)**	(3,646)	(4,354)
13% Debentures due 2014	**–**	(100,000)	–
8% Conv Sub Debentures due 2009	**–**	(400,000)	400,000
Common stock issued under stock option and purchase plans *(Note I)*	**189,346**	138,932	108,281
Common stock issued upon conversion of 8% Convertible Subordinated Debentures	**–**	395,721	–
Purchase of Treasury stock *(Note J)*	**(781,790)**	–	–
Total funds from financing sources	**(673,631)**	39,398	503,020
Net increase in cash and temporary cash investments	**207,362**	830,753	604,030
Cash and temporary cash investments at beginning of year	**1,910,933**	1,080,180	476,150
Cash and temporary cash investments at end of year	**$2,118,295**	$1,910,933	$1,080,180

The accompanying notes are an integral part of these financial statements.
Prior years reclassified for comparative purposes.

Consolidated statements of stockholders' equity

(in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total Stock-holders' Equity
June 30, 1984	$ 57,811	$1,610,575	$2,310,830		$3,979,216
Shares issued under stock option and purchase plans *(Note I)*	1,442	93,786			95,228
Restricted stock plans, charge to operations		20,420			20,420
Stock option and purchase plans – excess Federal income tax benefits *(Note I)*		13,053			13,053
Net income – 1985			446,682		446,682
June 29, 1985	$ 59,253	$1,737,834	$2,757,512		$4,554,599
Shares issued under stock option and purchase plans *(Note I)*	2,125	116,285			118,410
Restricted stock plans, charge to operations		21,155			21,155
Stock option and purchase plans – excess Federal income tax benefits *(Note I)*		20,522			20,522
Two-for-One stock split in form of 100% stock dividend	60,200	(60,200)			–
8% Convertible Subordinated Debentures converted into Common stock *(Note H)*	7,013	388,708			395,721
Net income – 1986			617,420		617,420
June 28, 1986	$128,591	$2,224,304	$3,374,932		$5,727,827
Purchase of 5,000,000 shares of Treasury stock *(Note J)*				$(781,790)	(781,790)
Shares issued under stock option and purchase plans *(Note I)*	1,417	65,466	(102,125)	182,072	146,830
Restricted stock plans, charge to operations		20,653			20,653
Stock option and purchase plans – excess Federal income tax benefits *(Note I)*		42,516			42,516
Net income – 1987			1,137,435		1,137,435
June 27, 1987	$130,008	$2,352,939	$4,410,242	$(599,718)	$6,293,471

The accompanying notes are an integral part of these financial statements.

Note A – Significant Accounting Policies

Principles of Consolidation □ The consolidated financial statements of the Company include the financial statements of the parent and its domestic and foreign subsidiaries. All significant intercompany accounts and profits have been eliminated.

Translation of Foreign Currencies □ For foreign operations, the U.S. dollar continues to be the functional currency. Assets and liabilities of foreign subsidiaries are translated into U.S. dollars at current exchange rates, except that inventories and property, plant and equipment are translated at historical rates. Income and expense items are translated at average rates of exchange prevailing during the year, except that cost of sales and depreciation are translated at historical rates. Exchange gains and losses arising from translation are included in current income.

The Company enters into forward exchange contracts to reduce the impact of foreign currency fluctuations on operations and the asset and liability positions of foreign subsidiaries. The gains or losses on these contracts are included in income when the operating revenues and expenses are recognized and for assets and liabilities the period in which the exchange rates change.

Revenue Recognition □ Revenues from product sales are recognized at the time the product is shipped. Service and other revenues are recognized ratably over the contractual period or as the services are performed. During 1987, the Company extended the warranty of certain products for one year and recognizes the related revenue over that period.

Warranty Costs □ Warranty costs are expensed as incurred. The warranty costs result in the same charge to expense as would be incurred if such warranty costs were accrued at the time of revenue recognition.

Taxes □ In general, the Company's practice is to reinvest the earnings of its foreign subsidiaries in those operations and repatriation of retained earnings is done only when it is advantageous to do so. Applicable taxes are provided only on amounts planned to be remitted. Investment tax credits are treated as reductions of income taxes in the year in which the credits arise.

Inventories □ Inventories are stated at the lower of cost (first-in, first-out) or market.

Property, Plant and Equipment □ Depreciation expense is computed principally on the following basis:

Classification	Depreciation Lives and Methods
Buildings	33 years (straight-line)
Leasehold Improvements	Life of assets or term of lease, whichever is shorter (straight-line)
Machinery and Equipment	8 and 10 years (sum-of-years), 4 and 5 years (double-declining balance)

Note B – Net Income Per Share and Dividends

Net income per share is based on the weighted average number of common shares and common share equivalents outstanding during the year. In the fiscal year ended June 27, 1987, common share equivalents were attributable to stock options. In the fiscal years ended June 28, 1986 and June 29, 1985, common share equivalents were attributable to convertible debt and stock options.

Cash dividends have never been paid by the Company.

Note C – International Operations

(in thousands)	Year Ended		
	June 27, 1987	June 28, 1986	June 29, 1985
Revenues			
United States customers	**$ 5,016,606**	$ 4,472,195	$ 4,078,286
Intercompany	**1,921,043**	1,354,339	1,373,578
	6,937,649	5,826,534	5,451,864
Europe customers	**3,252,482**	2,259,743	1,944,999
Intercompany	**114,582**	82,649	33,382
	3,367,064	2,342,392	1,978,381
Canada, Far East, Americas customers	**1,120,356**	858,419	663,031
Intercompany	**659,204**	577,934	545,968
	1,779,560	1,436,353	1,208,999
Eliminations	**(2,694,829)**	(2,014,922)	(1,952,928)
Net revenue	**$ 9,389,444**	$ 7,590,357	$ 6,686,316
Income			
United States	**$ 758,795**	$ 342,657	$ 224,464
Europe	**634,543**	405,636	202,646
Canada, Far East, Americas	**278,359**	207,187	102,837
Eliminations	**(59,690)**	(126,771)	(80,148)
Income from operations	**1,612,007**	828,709	449,799
Interest income	**122,149**	116,899	63,026
Interest expense	**(45,203)**	(88,079)	(82,003)
Income before income taxes	**$ 1,688,953**	$ 857,529	$ 430,822
Assets			
United States	**$ 4,627,838**	$ 3,911,491	$ 4,277,296
Europe	**2,246,333**	1,817,584	1,419,708
Canada, Far East, Americas	**843,067**	815,067	834,295
Corporate assets *(temporary cash investments)*	**1,979,470**	2,035,557	982,655
Eliminations	**(1,289,322)**	(1,406,373)	(1,145,097)
Total assets	**$ 8,407,386**	$ 7,173,326	$ 6,368,857

Industry □ The Company's business consists of the design, manufacture, sale and service of networked computer systems, associated peripheral equipment, and related network, communications, and software products.

International Operations □ Sales and marketing operations outside the United States are conducted principally through sales subsidiaries in Canada, Europe, Central and South America and the Far East; by direct sales from the parent corporation and through various representative and distributorship arrangements. The Company's international manufacturing operations include plants in Canada, the Far East and Western Europe. The products of these manufacturing plants are sold to the Company's international sales subsidiaries, the parent corporation or other international manufacturing plants for further processing.

Intercompany transfers between geographic areas are accounted for at prices which are designed to be representative of unaffiliated party transactions.

Sales to unaffiliated customers outside of the United States, including U.S. export sales, were $4,412,527,000 for the year ended June 27, 1987, $3,179,143,000 for the year ended June 28, 1986, and $2,641,863,000 for the year ended June 29, 1985, which represented 47%, 42%, and 40%, respectively, of total operating revenues. The retained earnings of substantially all of the Company's international subsidiaries have been reinvested to support operations. These accumulated retained earnings, before elimination of intercompany transactions, aggregated $2,070,337,000 at June 27, 1987, $1,473,081,000 at June 28, 1986, and $1,090,299,000 at June 29, 1985.

Note D – Pension Plans and Other Retirement Benefits

The Company and its subsidiaries have defined benefit pension plans covering substantially all employees. Pension cost is based on estimated benefit payment formulas. The benefits are based on years of service and compensation during the employee's career. Pension expense amounted to $110,365,000 for the year ended June 27, 1987, $111,778,000 for the year ended June 28, 1986 and $114,053,000 for the year ended June 29, 1985. In fiscal 1987 the Company and its principal subsidiaries implemented Statement of Financial Accounting Standards No. 87 – Employers' Accounting for Pensions. As a result, the actuarial costing method was changed from the aggregate to the projected unit credit method and certain actuarial assumptions were revised. The net effect of these changes was not significant.

It is the Company's policy to make contributions to the plans to the extent that such contributions are tax deductible. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The assets of the plans include corporate equity and debt securities, government securities and real estate.

The following table provides information on the status of the U.S. pension plan and certain non-U.S. plans which in aggregate represent approximately 91% of the total pension expense of the Company and its subsidiaries. For the U.S. pension plan, the assumed discount rate in computing the projected benefit obligation was 8.5%, the assumed rate of compensation increase was 6.5%, and the assumed annual rate of return on plan assets was 9.5%. For the non-U.S. plans, the assumed discount rate in computing the projected benefit obligation ranged from 5.0% to 9.0%, the assumed rate of compensation increase ranged from 5.8% to 7.5%, and the assumed annual rate of return on plan assets ranged from 5.5% to 10%. For the U.S. pension plan, the measurement date was March 31, 1987. For the non-U.S. plans, the measurement date ranged from March 31, 1987 to June 27, 1987.

The actuarial present value of accumulated benefit obligations at the beginning of the fiscal year ended June 28, 1986 was $265,221,000 including $223,298,000 of vested benefits. These amounts reflected a weighted average assumed rate of return on plan assets and a weighted average assumed rate of compensation increase of 6.5%. The fair value of plan assets (excluding insured plans) at the beginning of the fiscal year ended June 28, 1986 was $667,669,000.

In addition to providing pension benefits, the Company provides certain medical, dental and life insurance benefits for retired employees. Substantially all of the Company's domestic employees may become eligible for those benefits if they reach normal retirement age while working for the Company. The cost of retiree health care and life insurance benefits is recognized as an expense as claims are paid. These costs totaled $864,000 for the fiscal year ended June 27, 1987, $423,000 for the fiscal year ended June 28, 1986, and $6,000 for the fiscal year ended June 29, 1985. The majority of the Company's foreign subsidiaries do not offer such benefits to retirees. Of those that do, the amounts are immaterial.

The funded status as of the year-end measurement date was as follows:

(in thousands)	
Actuarial present value of benefit obligations:	
Vested benefit obligation	$ (310,590)
Accumulated benefit obligation	$ (368,572)
Projected benefit obligation	$(1,054,853)
Plan assets at fair value	1,354,197
Plan assets in excess of projected benefit obligation	299,344
Contributions made after measurement date but before end of fiscal year	11,283
Unrecognized net gain	(98,373)
Unrecognized net asset at transition	(160,820)
Pension cost recognized on the balance sheet	$ 51,434

Net periodic pension cost for fiscal 1987 included the following components:

Service cost-benefits earned during the period	$ 126,977
Interest cost on projected benefit obligation	67,695
Actual return on plan assets	(187,541)
Net amortization and deferral	93,272
Net periodic pension cost	$ 100,403
Total net periodic pension cost for all pension plans	$ 110,365

Note E – Income Taxes

Income before income taxes for domestic and foreign operations was as follows:

(in thousands)

			Year Ended
	June 27, 1987	June 28, 1986	June 29, 1985
Domestic	**$ 832,638**	$382,708	$210,970
Foreign	**856,315**	474,821	219,852
Total	**$1,688,953**	$857,529	$430,822

The total provisions for income taxes were at rates less than the U.S. Federal statutory tax rate for the following reasons:

	1987	1986	1985
U.S. Federal statutory tax rate	**46.0%**	46.0%	46.0%
Tax benefit of manufacturing operations in: (a)			
Puerto Rico	**(3.4)**	(3.9)	(5.6)
Ireland	**(4.1)**	(7.4)	(11.8)
Singapore	**(1.5)**	(1.4)	(2.4)
Investment tax credits	**.1**	(2.8)	(5.7)
Research and engineering credit	**(1.1)**	(0.9)	(5.3)
DISC	**–**	–	(17.5)
Other	**(3.3)**	(1.6)	(1.4)
	32.7%	28.0%	(3.7)% (b)

(a) The Company's manufacturing subsidiary operating in Puerto Rico is subject to tax at a rate of approximately 7% on its manufacturing earnings through fiscal 1995. The income from products manufactured for export by the Company's Irish manufacturing subsidiary is exempt from Irish taxes through April 1990. The income from certain products manufactured by the Company's Singaporean manufacturing subsidiary is wholly exempt from Singaporean taxes through March 1991 and partially exempt through December 1996.

(b) As a result of the Deficit Reduction Act of 1984 which eliminated the taxes on DISC earnings prior to 1984, the Company's 1985 fiscal year income tax expense was reduced by $63,250,000. The effective tax rate for fiscal year 1985 would have been 11% exclusive of the adjustment for the benefit of prior years' DISC taxes.

Note I – Stock Plans

Restricted Stock Options □ Under its Restricted Stock Option and Purchase Plans, the Company has granted certain officers and key employees options, which are exercisable upon grant, to purchase common stock at a price determined by the Board of Directors. Shares purchased under the plans are generally subject to repurchase options and restrictions on sales which lapse over an extended time period not exceeding 10 years.

On November 8, 1985, the Company's stockholders approved the 1985 Restricted Stock Option Plan (the "1985 Plan") providing for the issuance of 18,000,000 shares of Common stock under the Plan through December 31, 1990.

Information concerning activity during the three years ended June 27, 1987 follows:

		Options Outstanding	
	Shares Reserved For Future Grants	Shares	Average Price Per Share
June 30, 1984	5,491,744	10,667,372	$26.40
Options Granted	(2,961,920)	2,961,920	34.50
Options Exercised	–	(981,976)	16.30
Options Cancelled	432,464	(432,464)	26.87
Options Terminated	(11,828)	–	–
June 29, 1985	2,950,460	12,214,852	$29.16
Options Granted	(580,900)	580,900	38.54
Options Exercised	–	(1,086,786)	22.57
Options Cancelled	243,186	(243,186)	30.14
Options Terminated	(2,675,046)	–	–
Options Authorized	18,000,000	–	–
June 28, 1986	17,937,700	11,465,780	$30.24
Options Granted	(2,805,620)	2,805,620	56.00
Options Exercised	–	(1,036,517)	25.30
Options Cancelled	231,682	(231,682)	34.20
Options Terminated	(198,132)	–	–
June 27, 1987	**15,165,630**	**13,003,201**	**$36.12**

At the time these options are exercised, the common stock account is increased by the par value ($1 per share) of the shares sold and the remaining portion of the proceeds is credited to additional paid-in capital. The excess of the fair market value of the shares on the grant date over the option price is charged to operations each year as the restrictions lapse. Such charges to operations amounted to $20,653,000 in the fiscal year ended June 27, 1987, $21,155,000 in the fiscal year ended June 28, 1986, and $20,420,000 in the fiscal year ended June 29, 1985. The amount deductible for Federal income taxes exceeds the amount charged to income for book purposes. The Federal income tax benefits relating to this difference have been credited to additional paid-in capital.

Employee Stock Purchase Plans □ Under the Company's Employee Stock Purchase Plans, all United States and certain international employees may be granted the opportunity to purchase common stock at 85% of market value on the first or last business day of the six month payment period, whichever is lower. Common stock reserved for future grants aggregated 3,937,958 shares at June 27, 1987, and 5,358,655 shares at June 28, 1986. There were 1,420,697 shares issued at an average price of $83.16 during the fiscal year ended June 27, 1987 and 1,827,733 shares at $47.73 during the fiscal year ended June 28, 1986. There have been no charges to income in connection with the options other than incidental expenses related to the issuance of the shares. Federal income tax benefits relating to such options have been credited to additional paid-in capital.

Employee Stock Ownership Plan □ The Employee Stock Ownership Plan (ESOP) and a related trust, which were established in 1982, were terminated due to the Tax Reform Act of 1986, which eliminated the allowable Federal tax credit. All stock or cash held by the trust was distributed to the employees on May 12, 1987.

Note J – Treasury Stock

During the year, the Company purchased on the open market 5,000,000 shares of its common stock, or approximately 4% of the outstanding shares, at an aggregate purchase price of $781,790,000, or $156.36 per share.

All of the acquired shares are held as common stock in treasury for distribution to employees under the Employee Stock Purchase Plans and Restricted Stock Option Plans. The difference between the average acquisition cost of the shares and the proceeds is charged to retained earnings.

Note K – Leases

Minimum annual rentals under noncancelable leases (which are principally for leased real estate, vehicles and equipment) for the fiscal years listed are as follows:

Fiscal Years	*(in thousands)*
1988	$209,463
1989	166,795
1990	127,121
1991	94,231
1992	66,402
Later years	280,704
Total minimum lease payments	$944,716

Total rental expense for the fiscal years ended June 27, 1987, June 28, 1986, and June 29, 1985 amounted to $335,518,000, $257,695,000, and $223,434,000 respectively.

Quarterly Financial Data (unaudited)

Selected quarterly financial data for the years ended June 27, 1987 and June 28, 1986 is set forth below:

(in millions except per share data)	Total Operating Revenues	Gross Profit	Income Before Income Taxes	Net Income	Net Income Per Share
1987					
First Quarter	**$2,038.5**	**$1,011.9**	**$ 294.6**	$ 2.6	**$1.37**
Second Quarter	**2,271.8**	**1,176.5**	**423.8**	0.0	**2.02**
Third Quarter	**2,410.1**	**1,260.6**	**460.2**	07.6	**2.29**
Fourth Quarter	**2,669.0**	**1,426.6**	**510.4**	77.2	**2.85**
Total Year	**$9,389.4**	**$4,875.6**	**$1,689.0**	$ 37.4	**$8.53**
1986					
First Quarter	$1,623.9	$ 659.6	$ 97.7	$ 72.3	$0.60
Second Quarter	1,862.5	773.8	183.9	136.1	1.08
Third Quarter	1,928.3	851.2	237.2	170.4	1.32
Fourth Quarter	2,175.7	1,023.7	338.7	238.6	1.81
Total Year	$7,590.4	$3,308.3	$ 857.5	$ 617.4	$4.81

Officers

Kenneth H. Olsen
President and Director

Winston R. Hindle, Jr.
Senior Vice President, Corporate Operations

John J. Shields
Senior Vice President, Sales, Services, Marketing and International

John F. Smith
Senior Vice President, Engineering, Manufacturing and Product Marketing

John L. Alexanderson
Vice President, Peripherals and Supplies Group

Don K. Busiek
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Vice President, Manufacturing, Engineering and Marketing Finance

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Vice President, Group Manager

James G. Cudmore
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Vice President, Mid-Range Systems Business Group

Pier Carlo Falotti
Vice President, President and Chief Executive Officer – Europe

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Vice President, Research

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Vice President, Systems Software Group

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Vice President, Service Industry Marketing

Donato A. Infante, Jr.
Vice President, Manufacturing Information and Technology

Ilene B. Jacobs
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Vice President, Distributed Systems Engineering and Marketing

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Vice President, Channels Marketing

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Vice President, GIA Operations

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Vice President, Manufacturing Materials and Corporate Distribution

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Vice President, Corporate Relations

James M. Osterhoff
Vice President, Finance

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Vice President, Group Manager, Semiconductor Operations

Richard Poulsen
Vice President, General International Area

Bruce J. Ryan
Vice President and Corporate Controller

F. Grant Saviers
Vice President, Storage Systems

Edward A. Schwartz
Vice President, General Counsel and Secretary

Godfrey S. Shingles
Vice President, Managing Director, United Kingdom Region

Charles E. Shue
Vice President, U.S. Sales

John L. Sims
Vice President, Strategic Resources

Peter J. Smith
Vice President, Product Marketing

Officers (continued)

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Vice President, International Engineering and Strategic Resources

William D. Strecker
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Harvey L. Weiss
Vice President, U.S. Operations and Government Systems Group

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Vice President, Basic Industry Marketing

Richard H. Yen
Vice President, GIA Manfacturing and Engineering

Donald P. Zereski
Vice President, U.S. Field Service

Directors

Vernon R. Alden
Director of several organizations

Philip Caldwell
Senior Managing Director of Shearson Lehman Brothers Inc., and Director of several corporations

Arnaud de Vitry
Chairman of the Board and Chief Executive Officer, Eureka SICAV (French Investment Company)

Robert R. Everett
Retired President of The MITRE Corporation

William H. McLean
Engineering consultant and Director of several corporations

Kenneth H. Olsen
President, Digital Equipment Corporation

Dorothy E. Rowe
Retired Senior Vice President and Treasurer of American Research and Development Corporation (Venture Capital Investment Company)

Corporate Consulting Engineers

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Senior Corporate Consultant, Computer Systems

Roger Heinen, Jr.
Corporate Consultant, Software Systems

Richard I. Hustvedt
Corporate Consultant, Operating Systems

Alan Kotok
Corporate Consultant, High Performance Computers

Butler W. Lampson
Corporate Consultant, Corporate Research and Architecture

Anthony G. Lauck
Corporate Consultant, Networks & Communications

Jesse Lipcon
Corporate Consultant, Micro Systems

Mahendra R. Patel
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Investor Information

The Company's common stock is listed and traded on the:

New York Stock Exchange
Pacific Stock Exchange
(Ticker Symbol "DEC")

In Europe: Swiss Stock Exchanges of Zurich, Geneva, and Basel; and the German Stock Exchanges of Frankfurt, Munich, and Berlin.

Unlisted trading privileges have been granted by the:

Boston Stock Exchange
Cincinnati Stock Exchange
Midwest Stock Exchange
Philadelphia Stock Exchange
In Europe: Luxembourg Stock Exchange

The Company maintains an Investor Relations office to assist shareholders. Investors' inquiries are welcome, by telephone or letter.

Inquiries relating to investment in Digital Equipment Corporation should be directed to:

Albert E. Mullin, Jr.
Vice President, Corporate Relations
Digital Equipment Corporation
111 Powdermill Road (N9)
Maynard, MA 01754-1418
(617) 493-5350

Digital Equipment Corporation's Annual Report on Form 10-K for the fiscal year ended June 27, 1987, including schedules thereto, which is filed with the Securities and Exchange Commission, will be sent without charge upon written request. The Company's annual report, filings with the Securities and Exchange Commission, interim reports and additional information about the Company and its products can be obtained by addressing:

Digital Equipment Corporation
Inquiry Section
444 Whitney Street NR202-1/H3
Northboro, MA 01532-2597
(617) 351-4401

Financial community information and requests to be placed on the Company's mailing list should be directed to:

Digital Equipment Corporation
Investor Relations – ML
111 Powdermill Road (K10)
Maynard, MA 01754-1418
(617) 493-8246

Investor Information (continued)

Inquiries of an administrative nature relating to shareholder accounting records, stock transfer, change of address, and employee purchases should be directed to:

Digital Equipment Corporation
Investor Services
111 Powdermill Road (L12)
Maynard, MA 01754-1418
(617) 493-5213

Transfer Agent and Registrar
for Common Stock
Morgan Guaranty Trust Company is the principal stock transfer agent and registrar, and maintains the shareholder accounting records. The agent will respond to questions on change of ownership, lost stock certificates, consolidation of accounts and change of address.

A change of address should be reported promptly by sending a signed and dated note or postcard to Morgan Shareholder Services Trust Company. Shareholders should state the name in which the stock is registered, account number, as well as the old and new addresses.

Morgan Shareholder Services Trust Company
30 West Broadway
New York, NY 10007

Digital Equipment Corporation customers who have questions and/or problems relating to their account should contact the Customer Assistance Department at (617) 493-7161.

Trustees and Registrars
For 12⅝% Notes due 1994
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