Digital Equipment Corporation
Annual Report 1988

A window provides a unique view of the outside world. In this Annual Report, four international business leaders share their views of the challenges facing large organizations. And, now, with the introduction of DECwindows, one desktop device can provide windows into every corner of the enterprise. Users of Digital desktop systems and terminals can share the rewards of working together. They can monitor, interact with, and control VMS, UNIX,™ and MS-DOS™ programs running anywhere on the network, opening a different "window" on the display for each application.

Kenneth H. Olsen, President

To Our Shareholders,
Employees, And Customers:

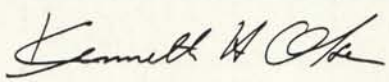
Each year we survey our customers to see how we are doing. I am pleased to tell you that customer satisfaction has reached record levels, leading to revenue increases and profitability for Digital that exceeded those of the computer industry as a whole.

In today's global competition, we see successful organizations, large or small, as more distributed and less hierarchical. Information needs to be placed in the hands of the individual, and be available simultaneously across the enterprise. A growing number of organizations worldwide are adopting Digital's enterprise-wide, network computing strategy. By providing solutions at the user level and interconnecting systems in a multivendor environment – from workstations through departmental systems to globally distributed transaction processing networks – we help our customers become more competitive than ever before.

Probably the most significant factor in our success over the years has been our disciplined approach to the VAX/VMS hardware and software environment. From the beginning, our design discipline for each hardware and software component has enabled us to modernize them continually without redesigning the system. VAX/VMS is the only hardware/software system that has such clear architectural definition for development and growth. Software written ten years ago will work on today's newest VAX computers; software written today will work on VAX computers many years from now. The resulting computing environment provides unmatched flexibility and protects the customer's investment.

Lately there has been considerable interest in an "open operating system." As one of the founders of the Open Software Foundation (OSF), Digital is participating enthusiastically in the development of the OSF User Interchange Standards. As computer users, as well as computer system providers, we understand the productivity advantage our customers receive by using standard interfaces, protocols, and languages to manage their information, whether in document, picture, or voice form. Digital, therefore, is committed to having its products, VMS and ULTRIX, meet all information interchange standards.

Our goal is to provide customers with the most productive computing environment possible so they can realize the rewards of an enterprise that works together.



Kenneth H. Olsen, President

September 1, 1988

Tommaso Zanzotto
President
Travel and Travel Management
Services, U.S.A.
American Express Travel Related
Services Company, Inc.

Sandra Kurtz
Founder and C[illegible]n
ASK Computer [illegible]s Inc.

Stanley L. Cornelison
Managing Partner
Worldwide
Management Information
Consulting Practice
Arthur Andersen & Co.

Digital Understands
The Rewards Of Working Together.

In this Annual Report, four Digital customers share their thoughts on the business issues that face any large organization. Nine other customers tell how they address those issues.

One theme runs through these stories – the rewards of working together. Each tells how computers and computer networks help focus the human, financial, and technological resources of an organization on critical business objectives.

"Working together" requires an imaginative yet disciplined approach to information technology. Digital has developed a well-defined but flexible framework to integrate desktop, workgroup, departmental, and datacenter systems.

This framework addresses the critical business and information management needs of our customers:

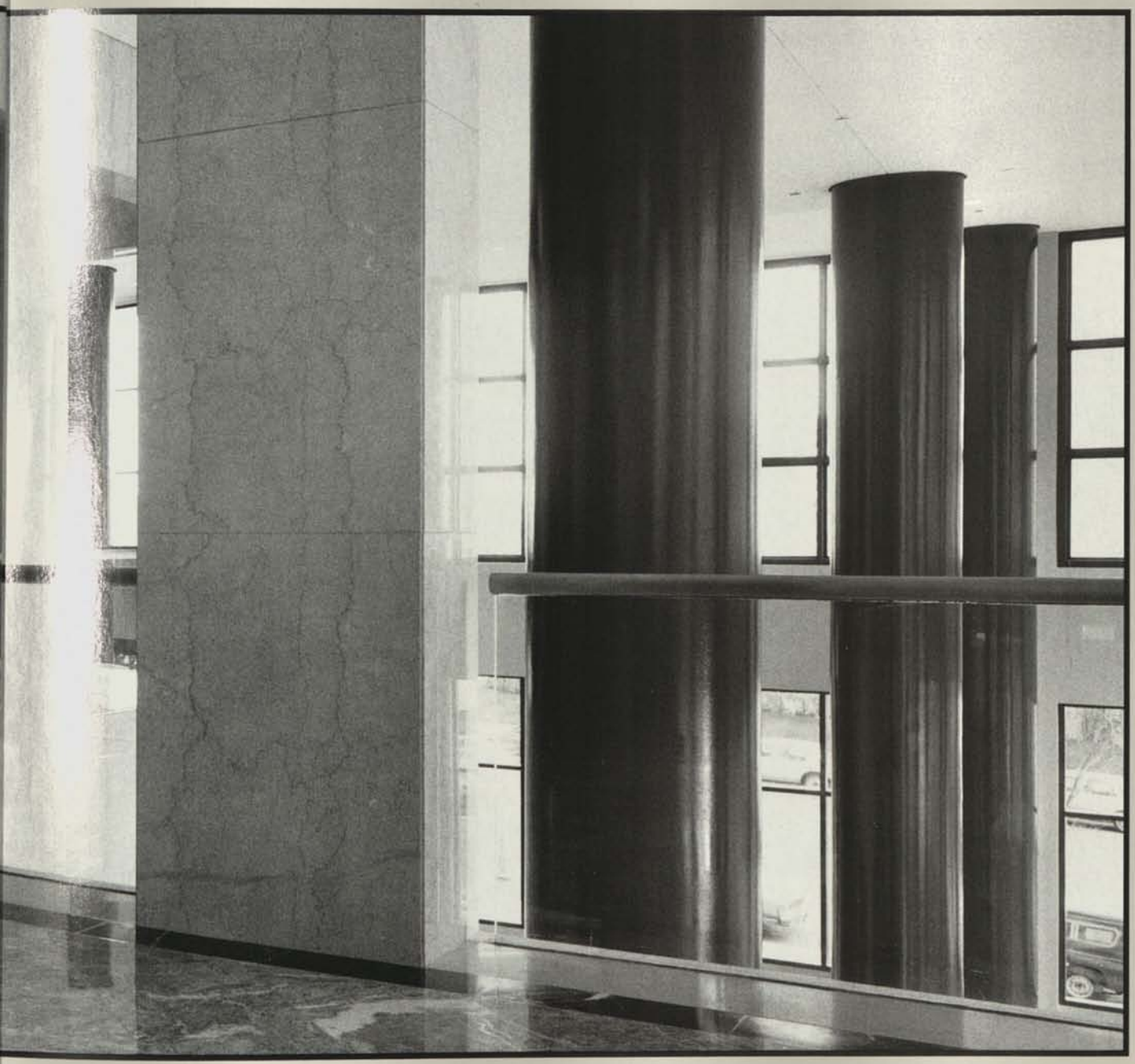
- Management needs enterprise-wide networking to make the entire organization more responsive to customer demands and new business opportunities.
- MIS needs a single, consistent development environment to shrink its application backlog.
- Users – whether they have terminals, personal computers, or workstations – need a single, consistent way to access applications and information. They need to be able to exchange information and share ideas within the workgroup and across the organization.

Digital's unique ability to address these needs underlies the customer stories in this Annual Report.

Beverly Clayton
Executive Director
Pittsburgh Supercomputing Center

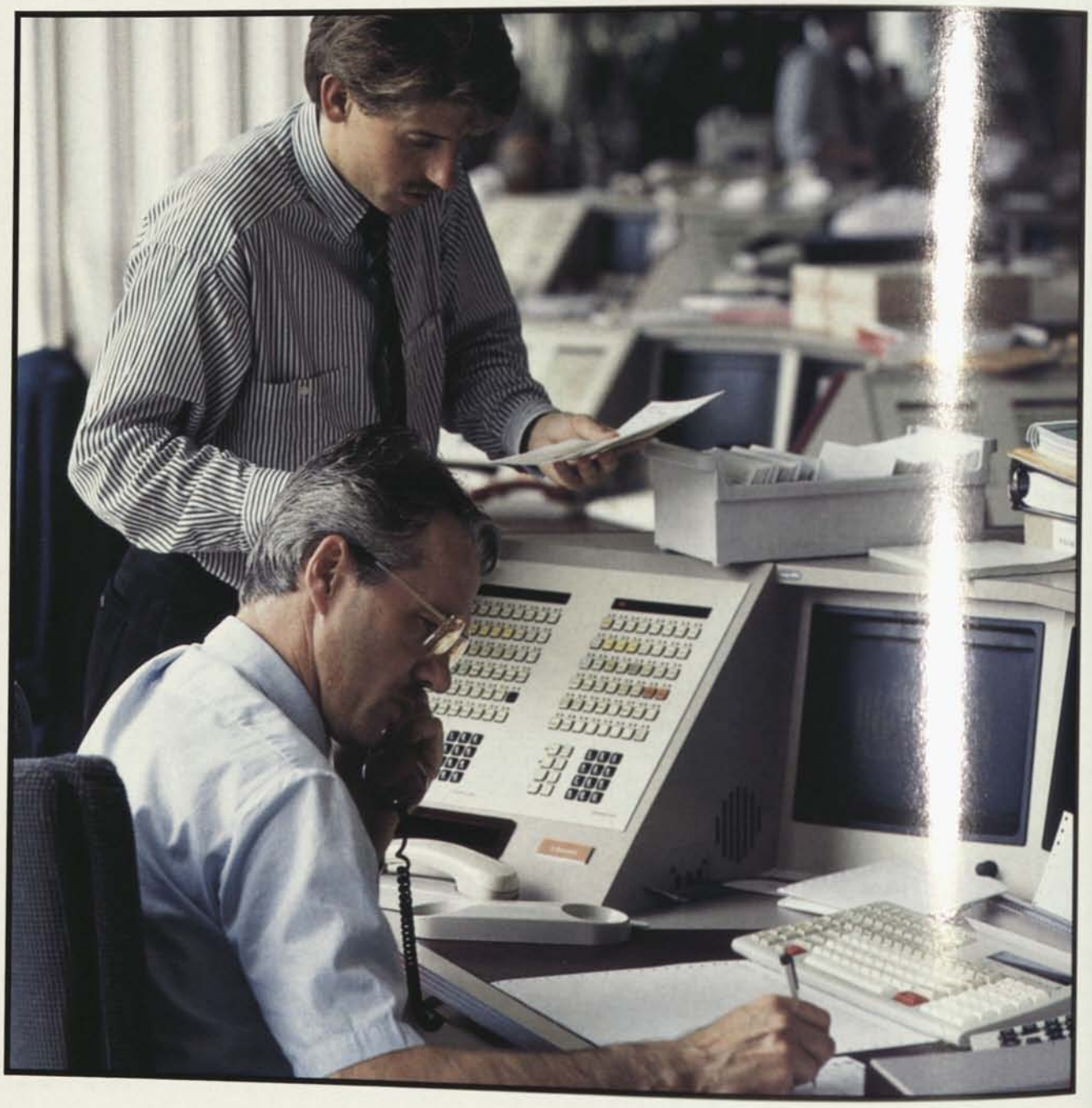
"There are no longer Japanese companies or American companies or German companies. We all compete in a single global market. Japanese executives carry American Express Cards. Hondas are built in the U.S. British Airways flies tourists to Spain. Italian banks finance Canadian paper companies. People, products, technologies, money, and ideas know no national boundaries."

Tommaso Zanzotto, President, Travel and Travel Management Services, U.S.A., American Express Travel Related Services Company, Inc.



American Express Travel Related Services Company, Inc., has been a Digital customer since 1973. Today, American Express' tour operations unit uses a network of Digital systems in New York, London, Hong Kong, Mexico City, Honolulu, and other cities to help travel agents plan holidays and make hotel, travel, theatre, and concert reservations around the world.

"Our foreign exchange data processing strategy is based on Digital's ability to provide an open-ended way to organize computer resources. Digital's open environment, cluster technology, and network architecture give us the flexibility to match computing resources to applications as they grow, are upgraded, or even down-sized – as they are centralized here in Zürich or distributed to our offices around the world." **Dr. Hubert Huschke,** Executive Vice President and Chief Information Officer, Union Bank of Switzerland



Switzerland is a small country. Like many Swiss banks, Union Bank of Switzerland's success has come from its ability to compete in the larger but rapidly changing world market.

That's meant opening UBS offices in other countries to serve multinational customers. It's meant building an international network where applications are distributed or replicated on different systems in different countries. And it's meant finding a way to build modular systems that can handle significant shifts in the type and volume of transactions in different offices.

UBS adopted a Digital strategy, building a network of VAX, VAXstation, and VAXcluster systems that work together transacting business in all the major money markets. As new financial instruments are developed or trading patterns change, UBS is able to scale-up, down-size, distribute, or replicate applications without obsoleting either hardware or software. This gives UBS a competitive edge. Once they develop an application for one VAX system it can run on any VAX system.

Digital is the only computer manufacturer to provide the flexibility of a single software environment that extends from the desktop to the datacenter. This environment supports uniprocessor and multiprocessor systems, as well as clusters, where large and small, new and old VAX processors actively share a large database.

Union Bank Of Switzerland: Replicating And Distributing Applications Internationally.

Digital Equipment: Modular Systems Provide The Environment For Growth.

"Everyone talks about technology transfer, but it only works in an environment where it's easy to share ideas. Glaxo is creating such an environment on an international scale, building a worldwide network for developing and clinically testing new pharmaceutical products. And new products have helped make Glaxo Inc. the fastest-growing pharmaceutical company in the United States." **Ernest Mario, Ph.D.,** Chairman and Chief Executive Officer, Glaxo Inc.

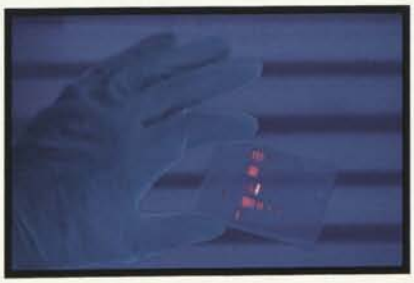
Gaining FDA approval for a new drug is an expensive and time-consuming business. It is not unusual for a major pharmaceutical company to spend ten years and 125 million dollars to develop and test a new product. Yet, even when FDA approval is finally won, there's no guarantee of its commercial success.

Glaxo Inc., the U.S. subsidiary of British-based Glaxo Holdings, p.l.c., and the fourth-largest prescription pharmaceutical company in the U.S., has found the prescription for success: design clinical studies that will properly position a product by showing that it fills a market need. To do this, research and marketing have to work together to see that clinical programs evaluate dose response, comparative efficacy, and treatment costs.

One of the rewards of working together: Glaxo's Zantac® (ranitidine hydrochloride)—an anti-ulcer medicine—has become the largest-selling prescription drug in the world.

A global computer network that integrates research, clinical testing, and marketing helps Glaxo build on this success by speeding the transfer of information between Glaxo Inc.'s headquarters and research center in North Carolina's Research Triangle Park and other Glaxo centers in England, Italy, Switzerland, and Canada.

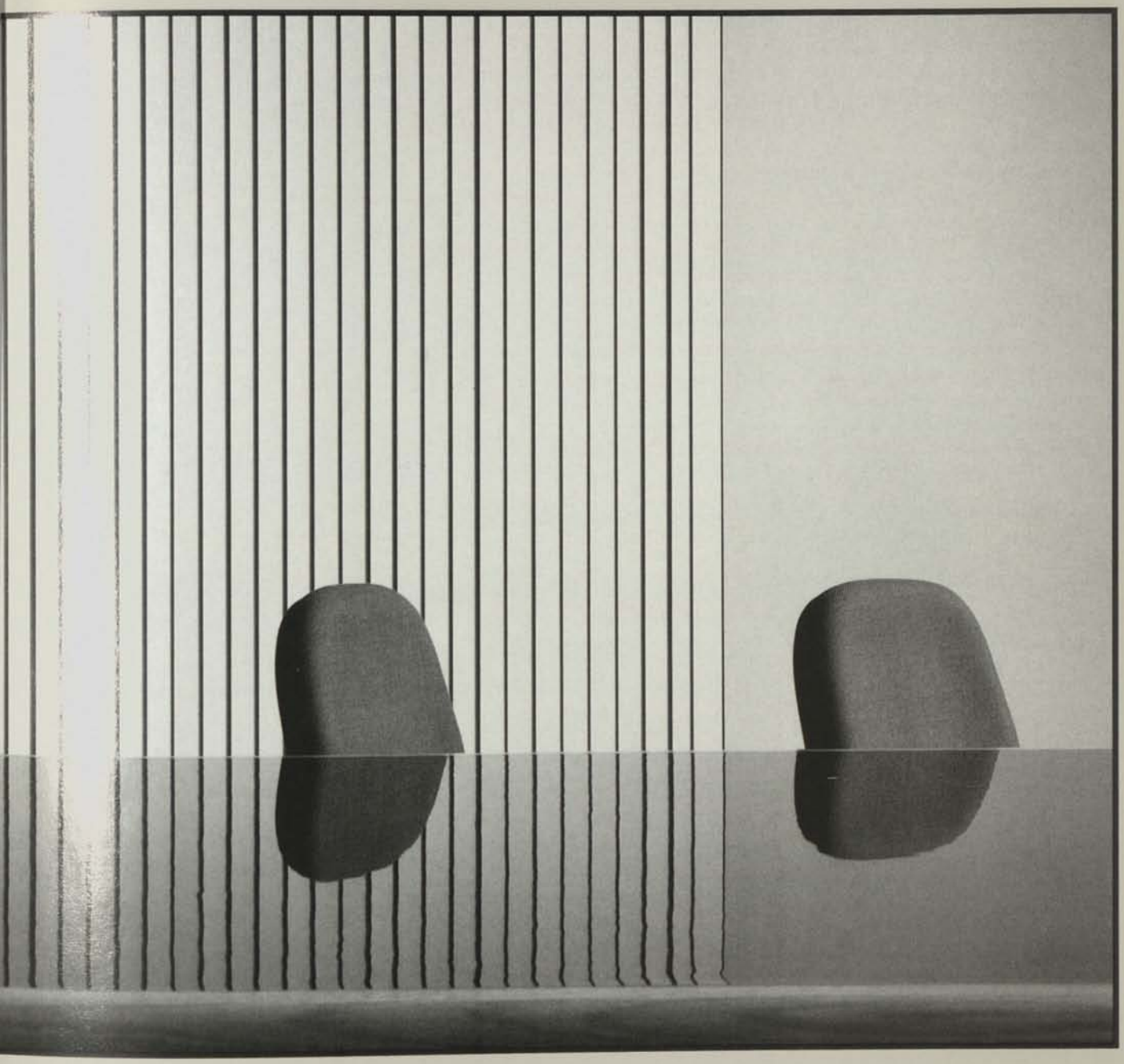
Glaxo Inc.:
Expediting Technology Transfer
And Product Development.



Digital Equipment:
Providing A Worldwide
Network For Sharing Ideas.

"Productivity means little unless you can build a better product or provide a better service. The key to competing in the global market is neither endless automation nor cheap labor. It's working smarter. It's controlling quality, not just controlling costs – so you can provide a better value than the competition."

Sandra Kurtzig, Founder and Chairman, ASK Computer Systems Inc.



ASK Computer Systems is a leading supplier of management information systems for manufacturing companies, and one of the more than 150 independent software and system developers active in Digital's Cooperative Marketing Programs. These vendors provide a wide range of specialized solutions that can be integrated into a DECnet/OSI network.

Automation is not enough. Many Digital customers are improving productivity through Computer Integrated Manufacturing (CIM) programs that combine automation with inventory management, quality control, and other manufacturing applications. CIM can provide the technological base needed to implement just-in-time delivery systems and zero-defect programs that further increase manufacturing productivity.

N.V. Philips, the Dutch electronics manufacturer based in Eindhoven, started to use Digital systems to control manufacturing costs and improve productivity long before CIM – Computer Integrated Manufacturing – became a widely accepted concept. As a result, Philips has been able to improve their position as Europe's leading manufacturer of consumer electronics.

From the start, Philips recognized that simply automating the factory floor does not address the whole problem. Production has to be coordinated with purchasing, inventory, and marketing. And quality management has to embrace all these functions, if warranty costs are to be reduced and a consumer franchise built.

Philips recognized the rewards of working together. They saw that computers – built by different manufacturers – working in product development, manufacturing, and marketing, had to be linked and that they had to work together. Digital systems work in an open networking environment. That's why they play an important role in Philips' networks.

The ability to deliver Computer Integrated Manufacturing solutions that work as part of enterprise-wide networks has made Digital the leader in the field.

N.V. Philips:
Integrating Manufacturing
With Marketing
And Product Development.

Digital Equipment:
Building Open Networks
To Make The Entire Enterprise
More Productive.

"Chemical process companies have always shown the highest dollar sales per employee of any segment of the manufacturing industry. This productivity is linked directly to the use of realtime computers to control petrochemical processes. But computers can also be used to improve professional and managerial productivity. At Hoechst, we've built a network so people can work together." **Dr. Johann Friederichs,** Director of Information & Communication, Hoechst AG

Hoechst is one of the world's largest chemical companies. The German-based company is also a pioneer in the use of electronic mail.

The Hoechst "Buroinformationsystem," a Digital ALL-IN-1 office information and communication system, helps over 500 key Hoechst managers, engineers, and scientists throughout Germany work together.

Although Digital is a primary supplier of office systems to Hoechst, non-Digital computers are used in some facilities. Users on many of these systems can exchange electronic mail messages with users of Digital systems.

Digital was the first computer manufacturer to develop an internetwork interface to meet the X.400 international communication standard. Hoechst was the first Digital customer to use the X.400 MAILbus interface for the interchange of electronic mail among public and private networks. For example, users on an IBM mail system at one Hoechst facility can now send messages to users on Digital ALL-IN-1 systems at other facilities, and in some cases those messages will travel over the Bundespost Datex-P public packet switched network.

The development of the X.400 MAILbus interface reflects Digital's commitment to international standards. DECnet is the only major networking system built around OSI standards. DECnet/OSI provides customers like Hoechst with the assurance that they will be able to continue to work together as they add computers compliant with international standards to their network.

oechst:
nproving Professional And
Aanagerial Productivity.

Digital Equipment:
Integrating Public And Private
Electronic Mail Systems.

"We wanted to improve productivity, increase sales per employee. That required installing a sales, inventory, and credit system in each of the 313 Toys "R" Us stores. Installation had to be scheduled so that it wouldn't interfere with the holiday rush – almost half of our sales are made in the eight weeks between the start of November and Christmas. That gave Digital six months to build the network. They delivered." **Charles Lazarus,** Chief Executive Officer, Toys "R" Us

In retailing, productivity is measured in dollars per employee and dollars per square foot of selling space. To increase productivity you must have the right items in the right stores at the right time. And you have to make shopping easy. In the toy business that can be a problem. Christmas checkout lines can seem interminable.

Toys "R" Us found the way to speed checkout lines, improve employee productivity, and track sales and inventory on a store-to-store, day-to-day basis. Each of the 313 Toys "R" Us stores is equipped with two MicroVAX computers networked to electronic cash registers and optical scanners at the point-of-sale, and to other VAX systems in twenty distribution centers around the country.

Given the seasonal nature of the toy business, the entire online transaction processing network had to be built in just six months because installation couldn't start until everything was straightened out after Christmas. Then, equipment had to be installed, software tested, network links established, and employees trained before the next Christmas rush. Working together, Toys "R" Us and Digital met the deadline. The whole network was up and running before Thanksgiving.

This year the network helped Toys "R" Us transact over $3 billion in sales. And it helped make this holiday season more profitable by improving productivity. Checkout lines moved faster. Price lookups were virtually eliminated. Stockouts were reduced. Even returns became easier to handle.

oys "R" Us:
inging Up More Dollars
er Employee.

Digital Equipment:
Improving Productivity
With On-Line
Transaction Processing.

"One of the greatest challenges facing a CEO is the allocation of resources. You must choose your opportunities carefully, yet aggressively. The key, as you work toward your vision, is to take intelligent risks, to try new directions and new approaches. With that, you must communicate your vision clearly and effectively so everyone in the organization has the same priorities and goals."

Stanley L. Cornelison, Managing Partner, Worldwide Management Information Consulting Practice, Arthur Andersen & Co.

In a professional services organization, users of industry-standard PCs and workstations must share information and access larger systems. Using Digital software, Arthur Andersen & Co. is linking the PCs used by members of its "Digital Practice" into its expanding VAX network.

"Someone once described construction as the business of pouring money into a hole in the ground. That's not the case in the construction of the Sydney Harbour Tunnel. We're confident we can come in on budget because we have the computer-based project management system needed to track every aspect of this $400 million (Australian) job." **Franco Belgiorno-Nettis,** Founder and Chairman, Transfield Construction

Digging a tunnel is probably the most demanding job a contractor can undertake. When you're working in a thirty-foot-wide tunnel under 100 feet of rock in a major residential area, or in a submerged concrete tube on the bed of Sydney Harbour, there's no room for error. It is not the kind of project in which lost time can be made up by throwing more workers and machines at the job.

The fifty-year-old bridge that dominates the Sydney skyline can no longer handle the traffic demands of this city of three and a half million people. As a consequence, the construction schedule for the Sydney Harbour Tunnel is tight–44 months, about half the time it took to complete the Holland Tunnel in New York. Transfield and its partner in the Harbour Tunnel project, Kumagai Gumi–Japan's leading construction company–are committed to an August 31, 1992, completion date and to building the tunnel without spoiling the "picture postcard" view of the Sydney Opera House.

One of the major contributions Transfield made to this joint venture was a sophisticated project management system. Running on a network of Digital computers, this system helps the construction team work together. Computers track every aspect of the job–budgets, schedules, and materials–so that the right resources are in the right place at the right time. The entire project management system is online. Everyone is working with the latest data so the entire job will come in on time and on budget.

nsfield Construction:
cating Resources
Joint Venture.

Digital Equipment:
Helping To Keep The Project
On Schedule.

"Effective police work involves considerable collecting, sharing, and sifting of information. For London we chose a network of 240 VAX computers to help the 27,000 officers and 16,000 civil staff of the Metropolitan Police work together. The system will provide local police stations – from Bow Street· Covent Garden in the centre to Heathrow on the outskirts – with immediate access to one of the largest distributed relational databases in Britain."

Roger Gregory, Director of Computing Services, London Metropolitan Police

The Metropolitan Police, with headquarters at New Scotland Yard, is responsible for an 800-square-mile area containing seven million people.

The Yard wanted to improve the handling of crime reports so that information would be readily available when and where it was needed. But there was no off-the-shelf software solution that met the specialized requirements of the Metropolitan Police. Digital provided the framework – the computers and the networking and systems software environment – around which SD-Scicon, the systems integrator chosen by the Metropolitan Police, could build a unique relational database system.

This kind of cooperative effort between Digital and a third-party organization is not unusual.

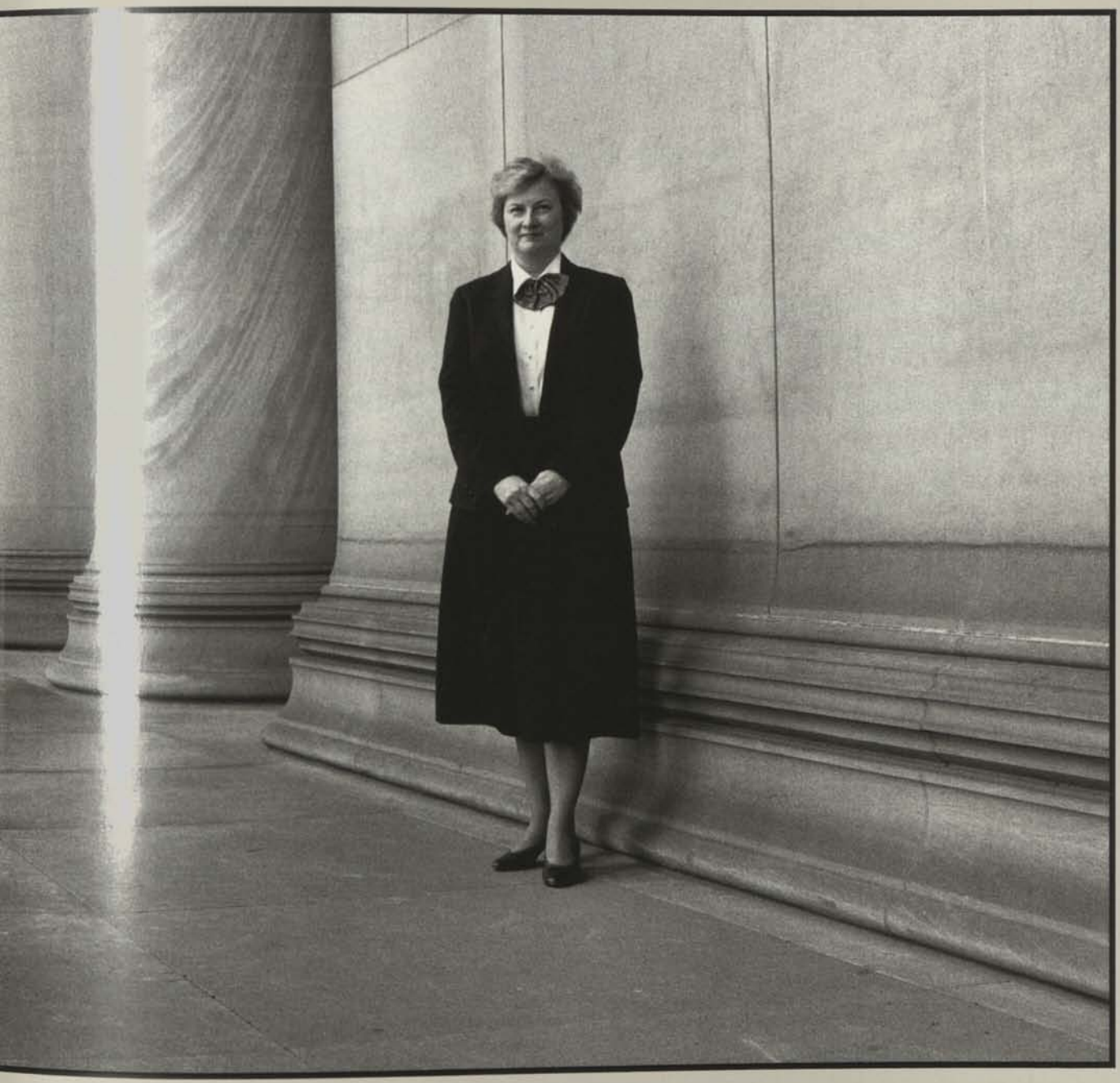
Digital understands the rewards of working together and has established formal working relationships with hundreds of software companies, telecommunications companies, and manufacturers of specialized hardware.

Many of these companies are household names like British Telecom/Mitel, Raytheon, Kodak, and Bankers Trust. Others are just as well known and respected in the industries they serve.

tland Yard:
king For
Right Solution.

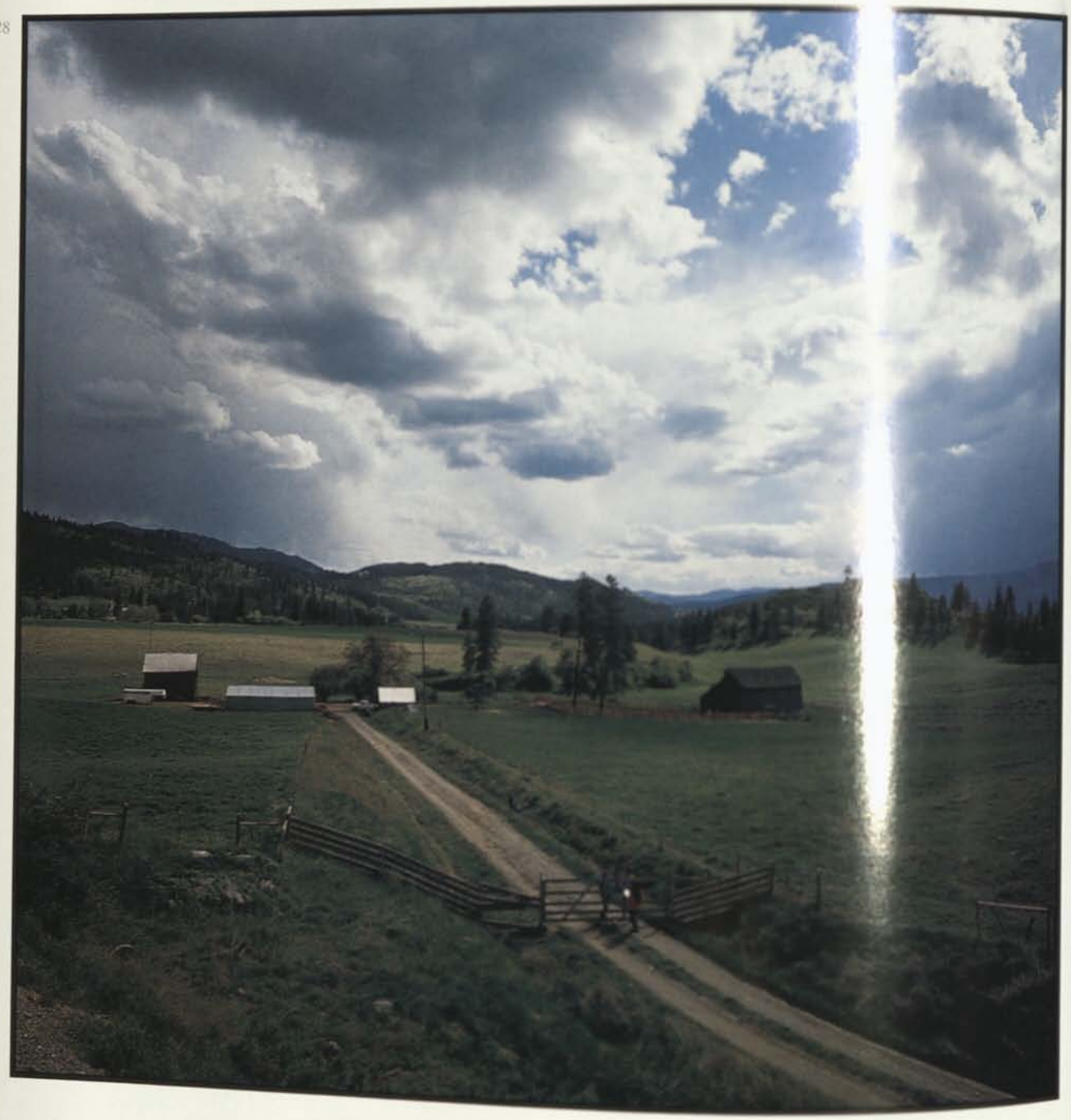
Digital Equipment
And Third Parties:
Combining Resources To
Solve Unique Problems.

"There are no longer easy answers. Scientists now work with masses of data and complex equations that would take hundreds of man-years to sort out or solve if it weren't for computers. Information technology is – by telescoping time – accelerating change. The impact on the way we see ourselves and the world we live in may be the only thing that's incalculable." **Beverly Clayton,** Executive Director, Pittsburgh Supercomputing Center



Research scientists at universities and commercial laboratories around the country are networked to one of the world's fastest computers, the CRAY X-MP™ at the Pittsburgh Supercomputing Center, through a Digital VAX Supercomputer Gateway. The Center is a unique collaboration of Carnegie Mellon University, the University of Pittsburgh, and Westinghouse Electric Corporation.

"The 1990 Census will mark the hundredth anniversary of the invention of Herman Hollerith's punched-card machine. This unit record device, first used in the 1890 Census, was a forerunner of the computer. The Census has always required the best technology. The 1990 Census will be collected with a distributed network of VAX systems." **John G. Keane,** Director, Bureau of the Census



The Bureau of the Census does more than count the population of the Spokane Indian Reservation, New York City, and every other community in the United States. It provides the statistical database for economic forecasts, business marketing plans, Congressional redistricting, federal aid to state and local governments, and other governmental and private studies. The amount of information that has to be gathered is staggering. When completed, the 1990 Census will be one of the largest, if not the largest, databases in the world, a database that the Federal Government will use to generate more than 2,000 statistical reports a year.

Digital is providing a nationwide and Bureau-wide network of over 450 MicroVAX and VAX systems, which will be used to capture, analyze, and summarize the data collected by an army of 400,000 census takers.

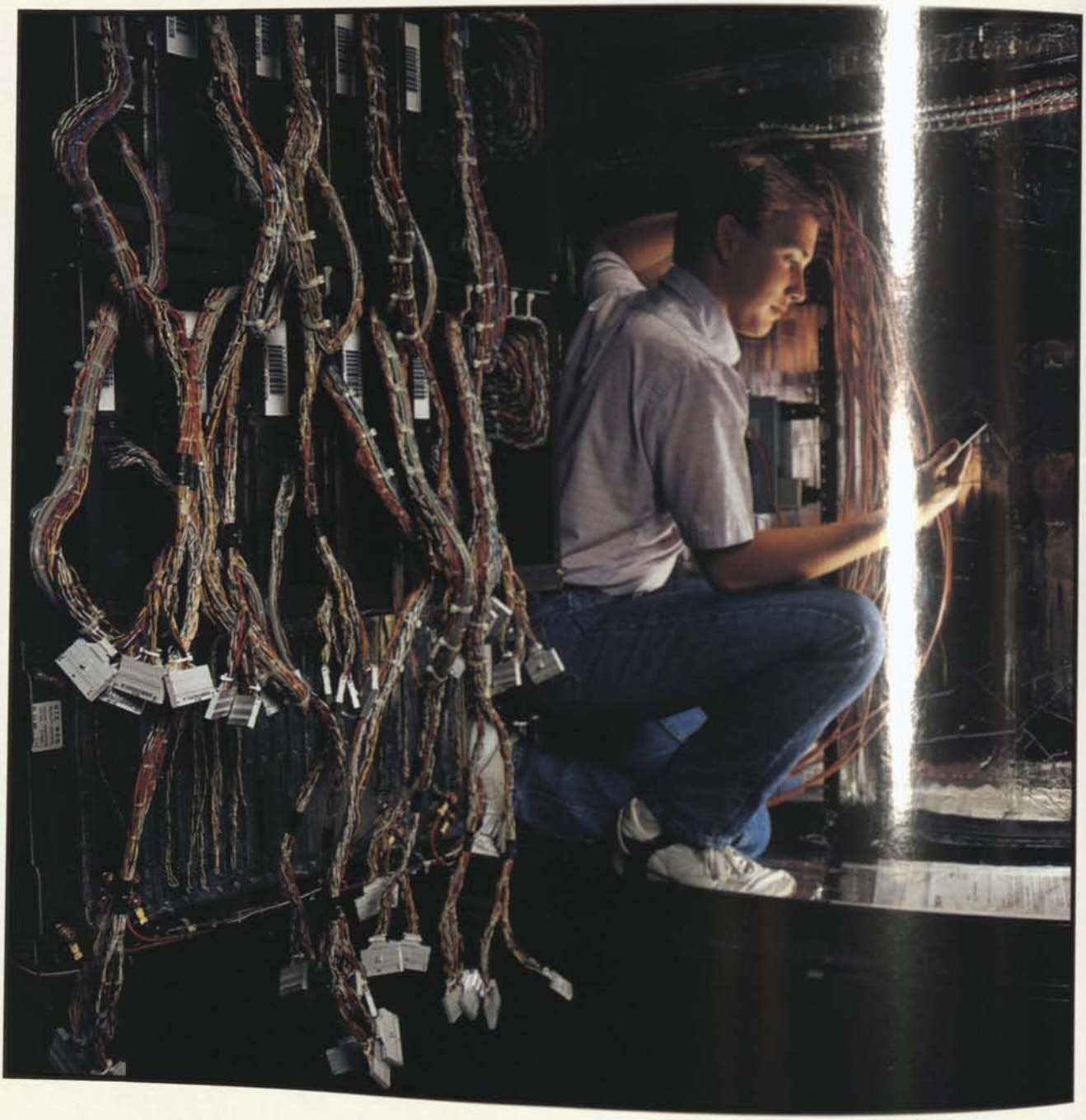
Digital is helping to plan and build the network. We're helping train Census personnel. And we're installing equipment. The Census Bureau is counting on Digital.

Building networks is a growing part of Digital's business. In large networking projects like this, Digital often acts as a general contractor providing network planning, installation, and maintenance.

U Census Bureau:
M suring Change
W A VAX Network.

Digital Equipment:
Building A Network
Across America.

"By the year 2000, data will account for more than 40 percent of the traffic carried over telephone lines. That's one reason Northern Telecom is working together with Digital to develop a technological base for integrating voice and data at the application level, so sharing information anywhere, anytime, and in any form will be as easy as using the phone." **Roy Merrills,** President, Northern Telecom Inc.



Northern Telecom is the world's leading supplier of fully digital telecommunications systems, including central office switches for telephone operating companies and private branch exchanges (PBXs) for private networks. Many of these switches are built by Nashville-based Northern Telecom Inc. These advanced systems direct both voice and data traffic. But to fully integrate computer and telephone networks, two more steps have to be taken. Voice and data must be integrated at the application level. And voice and data transmissions have to be multiplexed over high-speed communication lines.

Digital, Northern Telecom, and other leading telecommunications equipment manufacturers are working from a common blueprint. With CIT – Computer Integrated Telephony – a PBX and a VAX computer can exchange information and work together in a voice/data network. Northern Telecom and Digital were among the original sponsors of this technology.

At the same time, Digital, Northern Telecom, and other telecommunications equipment manufacturers are working with telephone operating companies around the world to implement ISDN – Integrated Services Digital Network – in which voice and data transmissions share the same high-speed circuits.

Standards are a prerequisite for these initiatives. By actively cooperating with international standards groups and other manufacturers of computers and telecommunications equipment, Digital is working toward the day when an organization will be able to integrate all its voice and data resources in a single enterprise-wide network.

Northern Telecom: Making The Connection Between Voice And Data.

Digital Equipment: Developing Standards To Facilitate Change.

The Digital Difference Is Open, Enterprise-Wide Networking.

Digital's success is based on building systems that ... together in an open network – systems that work together so the people ... use them can work together.

This year, to enhance and expand these open ... working capabilities, Digital spent $1.3 billion on research and develop... Particular emphasis was given four key areas:

DECwindows – The Desktop Interface.
Users should not have to contend with different op... ing systems running on different computers within the network. With D... windows software, users can run VMS, UNIX, and MS-DOS applications simul... neously from a desktop terminal, personal computer, or workstation, openin... a different "window" on the display for each application.

Integrating OLTP Into The Enterprise-Wide Netw... k.
Most online transaction processing (OLTP) systems ... on dedicated computers over dedicated networks. Digital has integrated ... TP into the mainstream. VAX systems can run OLTP applications simultane... y with other jobs. Data-center, departmental, and desktop computers all w... as a single, open-ended system. And, as OLTP and DBMS requirements gro... ere's economy of scale. Without changing software, extremely large and p... ful production systems can be built by clustering VAX computers. VAXclu... echnology combines incremental growth with high data and system ava... ity.

Reducing System And Support Costs.
Personnel represents about one-third of the cost of ... em ownership: as much as half the cost of building and maintaining a netw... Studies have shown that DECnet/OSI networks cost up to 50 percent less to ... rate than comparable networks from other major vendors. Similar savings ... n be found in system support costs.

There are a number of reasons for these savings. Digital systems are easy to program. Application software is readily available. Digital hardware and software are reliable. Digital was the first major computer vendor to offer a one-year warranty on all systems.

Working together with customers, other vendors, and independent software developers, Digital is providing the resources and information technology needed to integrate the enterprise. This requires a comprehensive approach to service and support – from strategic planning and design, through implementation and management, to migrating, replicating, and distributing applications to new systems. Included in this capability are consulting, online preventive maintenance, training, and the development of custom hardware and software products for unique customer requirements. These comprehensive service programs can help reduce system and support costs and the cost of network operations.

Supporting The Key Computing Environments.
Digital supports general-purpose and specialized operating environments including the VMS, MS-DOS, and UNIX operating systems.

The VMS operating system provides a rich general-purpose operating environment for simultaneous timesharing, office, realtime, batch, and online transaction processing. It supports local and wide area networks, VAXcluster systems, and symmetric multiprocessing. A program written for one system will run on any other system without change or recompilation.

MS-DOS is the most widely used operating system for personal computers. Digital not only builds systems that run MS-DOS and the leading personal computer application programs, but also adds value to IBM and Compaq PCs by providing the local and wide area networking, data management, and office information system software needed to integrate these desktop computers into corporate computing environments.

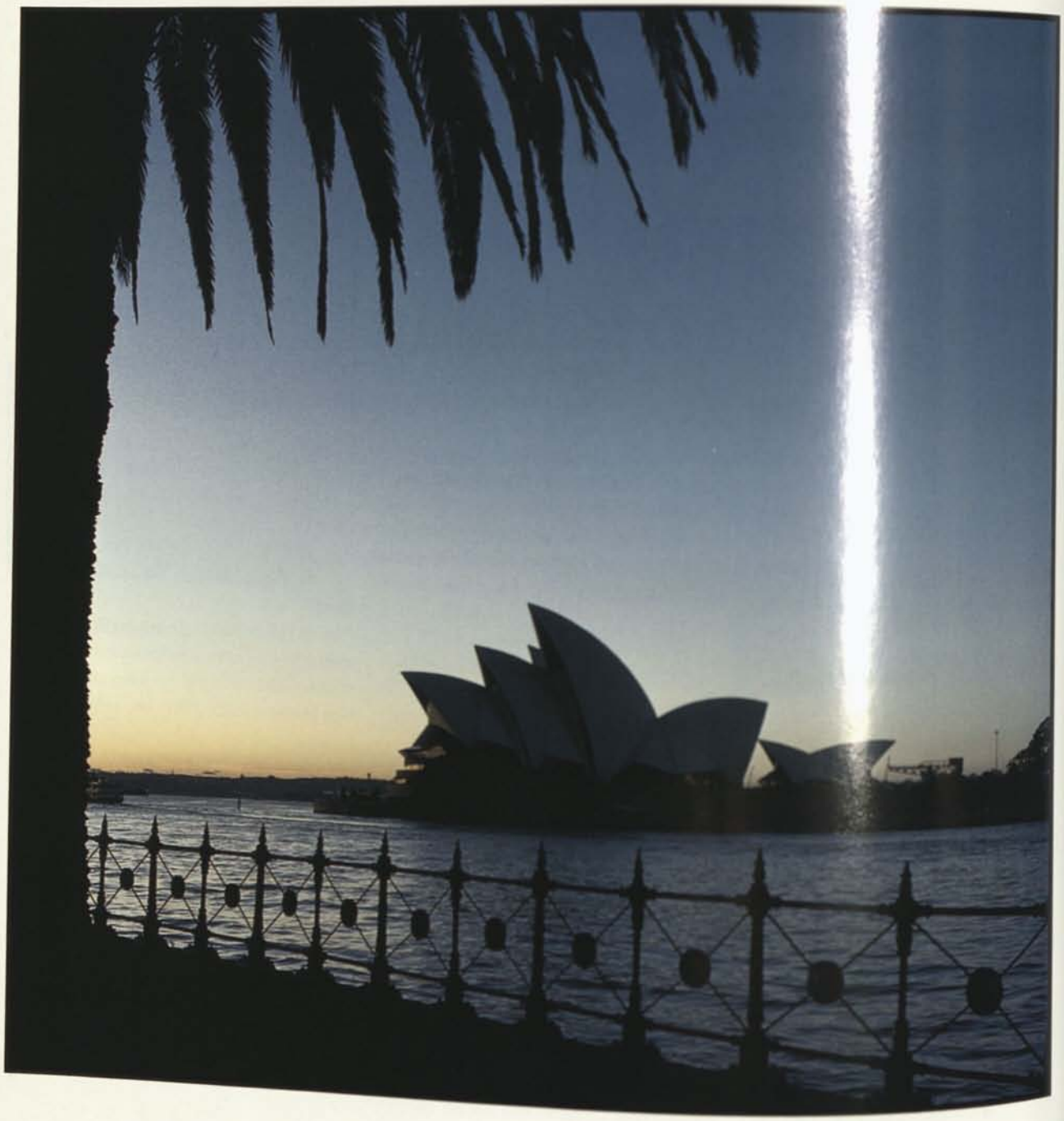
Digital also supports UNIX, an operating system used in education and in scientific and engineering applications. For the past nineteen years, Digital has been the world's leading supplier of UNIX hardware, software, and services.

But an open environment extends beyond operating systems. Digital is one of the founders and sponsors of the Open Software Foundation. The Foundation is establishing standards that will enable users to move network applications from systems built by one manufacturer to systems built by another.

The Success Of The Distributed Approach.
DECnet/OSI software provides a single, open network environment in which VMS, UNIX, and MS-DOS, and large mainframe and supercomputer systems can work together. Digital is committed to multivendor networking and the integration of DECnet with Open Systems Interconnect (OSI) and telecommunication standards.

Digital has developed products to link desktop terminals and IBM, Compaq, Olivetti, and other industry-standard personal computers into DECnet/OSI networks. Digital has developed "gateways" to link DECnet/OSI and IBM SNA networks and to provide VAX users with direct access to Cray supercomputers. In addition, Digital is working with Apple Computer, Inc., to establish standards for the integration of Macintosh™ computers and AppleTalk™ networks into enterprise-wide DECnet/OSI networks.

The success of this open approach to networking can be measured by the number of DECnet/OSI licenses Digital has issued – 144,000 at the end of fiscal 1988, making Digital the world's leading manufacturer of network computer systems.



The Rewards Of Working Together In Business And In The Community.

Each company featured in this Annual Report uses a Digital network to focus its resources on a mission-critical business problem. Like Digital, each is enjoying the rewards that come when everyone in the organization works together.

But these rewards are not limited to business. Digital and its 121,000 employees share the belief that they can make a difference and that computers can help make this a better world. That's why, in addition to external research grants, Digital donated more than $26 million in cash and equipment to nonprofit institutions throughout the world during the fiscal year.

Grants and scholarships were made to hundreds of educational institutions around the world. DECtalk units – which convert computer output to the spoken word – were donated to hundreds of organizations as a means of providing technological access to members of the disabled community. Digital is also a major supporter of the National Urban League and other organizations that open opportunities for minorities, women, and the disabled.

Digital supports the arts. The Corporation awarded The Museum of Fine Arts in Boston the largest corporate grant in the museum's history for "Monet In The 90s," a major international exhibition scheduled to open in 1990. Digital is underwriting the production of "The Infinite Voyage." This science program, seen on both public and commercial television, promotes a better understanding of the world we live in.

Many Digital employees are actively involved in educational, health-care, civic, social, and cultural programs at the national, regional, and local levels. Many work with the Adam Walsh Child Resource Center and a network of Digital computers to fight child abuse in the United States. Digital also matches, dollar for dollar, employee contributions to nonprofit organizations across the country.

As individuals, as a company, and as world citizens, we are seeing the rewards of working together.

Th x office at the Sydney Op House has a computer-ize icketing system based on a n work of systems donated by ital.

Digital donated a computer system to the World Health Organization in Geneva to provide worldwide electronic mail service.

Financial Contents

Eleven-year Financial Summary

Operations *(in millions except per share data)*	1988	1987	1986	1985
Revenues				
Product sales	$ 7,541.2	$6,254.2	$5,103.0	$4,530.0
Service and other revenues	3,934.2	3,135.2	2,487.4	2,156.3
Total operating revenues	11,475.4	9,389.4	7,590.4	6,686.3
Costs and Expenses				
Cost of product sales, service and other revenues	5,468.3	4,513.9	4,282.1	4,087.5
Research and engineering expenses	1,306.5	1,010.4	814.2	717.2
Selling, general and administrative expenses	3,065.6	2,253.1	1,665.4	1,431.8
Operating income	1,635.0	1,612.0	828.7	449.8
Interest income	143.6	122.1	116.9	63.0
Interest expense	37.8	45.2	88.1	82.0
Income before income taxes	1,740.8	1,688.9	857.5	430.8
Provision for income taxes	435.2	551.5	240.1	(15.9)[1]
Net income	$ 1,305.6	$1,137.4	$ 617.4	$ 446.7
Net income per share[1,2]	$ 9.90	$ 8.53	$ 4.81	$ 3.71
Weighted average shares outstanding	131.9	133.3	130.8	124.1
Financial Position *(in millions except per share data)*				
Inventories	$ 1,575.1	$1,452.9	$1,199.8	$1,756.2
Accounts receivable, net of allowance	2,592.2	2,312.2	1,903.3	1,539.0
Working capital	4,515.8	4,376.6	4,222.7	3,694.2
Property, plant and equipment, at cost	5,210.4	3,859.3	3,262.7	2,827.6
Total assets	10,111.6	8,407.4	7,173.3	6,368.9
Long-term debt	123.9	269.3	333.2	836.9
Stockholders' equity	7,510.4	6,293.5	5,727.8	4,554.6
Stockholders' equity per share[2]	$ 59.47	$ 49.87	$ 44.54	$ 38.43
General Information and Ratios *(dollars in millions)*				
Current ratio	2.9:1	3.4:1	4.9:1	4.9:1
Quick ratio	2.0:1	2.4:1	3.5:1	2.8:1
Additions to property, plant and equipment	$ 1,517.6	$ 748.4	$ 564.2	$ 571.8
Depreciation	$ 515.5	$ 434.7	$ 384.0	$ 315.1
Debt to debt plus equity ratio	1.6%	4.1%	5.5%	15.5%
Operating income as a percentage of total operating revenues	14.2%	17.2%	10.9%	6.7%
Income before income taxes as a percentage of total operating revenues	15.2%	18.0%	11.3%	6.4%
Effective tax rate	25.0%	32.7%	28.0%	(3.7%)[1]
Net income as a percentage of total operating revenues	11.4%	12.1%	8.1%	6.7%
Net income as a percentage of average stockholders' equity	18.9%	18.9%	12.0%	10.5%
Net income as a percentage of average total assets	14.1%	14.6%	9.1%	7.5%
Number of days sales of accounts receivable outstanding	75	78	79	75
Inventory turns	3.6	3.4	2.9	2.3
Number of employees at year-end	121,500	110,500	94,700	89,000
Common shares outstanding *(in thousands)*	126,290	126,187	128,591	59,253
Stockholders at year-end	103,162	99,379	76,860	68,810
Common stock yearly high and low sales prices	$ 199-99	$ 174-82	$ 94-46	$ 63-39

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

[2] *Per share data adjusted to reflect two-for-one stock split in May 1986.*

1984	1983	1982	1981	1980	1979	1978
$3,804.1	$2,827.7	$2,738.5	$2,312.9	$1,736.4	$1,337.7	$1,078.1
1,780.3	1,444.2	1,142.3	885.2	631.6	466.4	358.5
5,584.4	4,271.9	3,880.8	3,198.1	2,368.0	1,804.1	1,436.6
3,379.6	2,606.0	2,187.6	1,778.7	1,319.9	1,012.3	802.3
630.7	472.4	349.8	251.2	186.4	138.3	115.7
1,179.5	830.6	758.6	632.2	478.9	370.1	281.0
394.6	362.9	584.8	536.0	382.8	283.4	237.6
41.5	61.2	102.8	60.6	53.8	35.8	12.3
35.1	13.1	14.8	29.2	27.0	24.3	22.4
401.0	411.0	672.8	567.4	409.6	294.9	227.5
72.2	127.4	255.6	224.1	159.7	116.5	85.3
$ 328.8	$ 283.6	$ 417.2	$ 343.3	$ 249.9	$ 178.4	$ 142.2
$ 2.87	$ 2.50	$ 3.76	$ 3.35	$ 2.73	$ 2.05	$ 1.70
114.7	113.4	110.9	105.1	94.3	89.9	86.5
$1,852.2	$1,353.8	$1,137.4	$1,102.2	$ 819.9	$ 513.5	$ 428.1
1,527.3	1,125.0	807.6	758.1	629.1	475.1	375.2
3,001.4	2,377.0	2,181.2	2,029.8	1,658.2	1,076.9	887.0
2,351.8	1,961.4	1,605.4	1,128.4	772.3	582.1	507.8
5,593.2	4,541.1	4,024.0	3,456.1	2,666.1	1,863.2	1,501.4
441.3	92.8	92.4	88.4	489.7	340.7	341.6
3,979.2	3,541.3	3,164.5	2,679.7	1,651.7	1,120.2	904.8
$ 34.42	$ 31.42	$ 28.65	$ 24.65	$ 18.12	$ 13.79	$ 11.35
3.8:1	3.9:1	4.1:1	4.2:1	4.5:1	3.8:1	4.7:1
1.9:1	2.0:1	2.3:1	2.3:1	2.6:1	2.3:1	2.8:1
$ 452.1	$ 419.2	$ 511.2	$ 398.5	$ 209.9	$ 93.9	$ 167.0
$ 252.6	$ 203.2	$ 152.6	$ 102.1	$ 69.8	$ 57.7	$ 50.2
10.0%	2.6%	2.8%	3.2%	22.9%	23.3%	27.4%
7.1%	8.5%	15.1%	16.8%	16.2%	15.7%	16.5%
7.2%	9.6%	17.3%	17.7%	17.3%	16.4%	15.8%
18.0%	31.0%	38.0%	39.5%	39.0%	39.5%	37.5%
5.9%	6.6%	10.7%	10.7%	10.6%	9.9%	9.9%
8.7%	8.5%	14.3%	15.9%	18.0%	17.6%	17.3%
6.5%	6.6%	11.2%	11.2%	11.0%	10.6%	11.1%
83	82	73	73	81	82	82
2.1	2.1	2.0	1.9	2.0	2.2	2.0
85,600	73,000	67,100	63,000	55,500	44,200	39,000
57,811	56,357	55,227	54,348	45,568	40,606	39,873
44,389	40,903	44,706	39,948	35,144	28,835	25,868
$ 50-33	$ 65-32	$ 55-34	$ 55-29	$ 41-27	$ 29-22	$ 28-19

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

Income and Expense Items as a Percentage of Total Operating Revenues				Percentage Changes		
1986	1987	**1988**	Income and Expense Items	**1987-88**	1986-87	1985-86
67.2%	66.6%	**65.7%**	Product sales	**21%**	23%	13%
32.8%	33.4%	**34.3%**	Service and other revenues	**25%**	26%	15%
100.0%	100.0%	**100.0%**	Total operating revenues	**22%**	24%	14%
52.4%	40.5%	**40.3%**	Cost of product sales	**20%**	(5%)	2%
64.6%	63.2%	**61.7%**	Service expense and cost of other revenues	**22%**	23%	9%
56.5%	48.0%	**47.7%**	Total cost of operating revenues	**21%**	5%	5%
10.7%	10.8%	**11.4%**	Research and engineering expenses	**29%**	24%	14%
21.9%	24.0%	**26.7%**	Selling, general and administrative expenses	**36%**	35%	16%
10.9%	17.2%	**14.2%**	Operating income	**1%**	95%	84%
1.5%	1.3%	**1.3%**	Interest income	**18%**	5%	86%
1.1%	0.5%	**0.3%**	Interest expense	**(16%)**	(49%)	7%
11.3%	18.0%	**15.2%**	Income before income taxes	**3%**	97%	99%
3.2%	5.9%	**3.8%**	Provision for income taxes	**(21%)**	130%	1614%
8.1%	12.1%	**11.4%**	Net income	**15%**	84%	38%

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 July 2, 1988 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

In fiscal year 1988 the Company's growth was again above that of the overall computer industry. Total operating revenues for the year increased by 22%, following increases of 24% in 1987 and 14% in 1986. Product revenues, which account for two-thirds of the total, increased by 21% in 1988, following increases of 23% in 1987 and 13% in 1986. The year-to-year increase in revenues reflects the growing number of large organizations around the world that are implementing the Company's enterprise-wide computing solutions. The Company's growth during the period has been enhanced by a continual flow of new products.

During 1988, demand for the Company's MicroVAX and workstation products was particularly strong. In the mid-range, the Company's new VAX 6200 systems met with immediate customer acceptance, with over 500 systems shipped in just the first three months of production. At the high end of the Company's product offerings, more than 3000 VAX 8000 systems were shipped. Expanded sales, service, and marketing organizations also contributed to increased revenues.

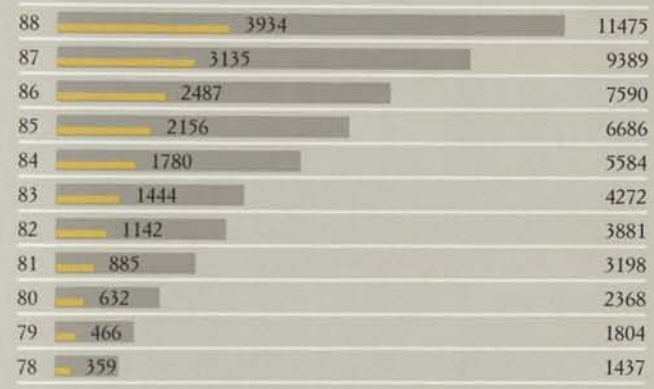
Although the revenue growth of the Company was strong for the year, concern with economic conditions and turmoil in the capital markets in the fall of 1987 caused some customers to reduce or delay computer purchases. This was evidenced by a slowing of demand for the Company's larger computer systems during the third quarter and softening demand in some industry sectors.

Continuing the trend of the last several years, growth in overseas demand outpaced that of the U.S. For the year, non-U.S. revenues accounted for approximately 50% of the Company's total revenues, the highest percentage in the Company's history. In the U.S., demand increased from customers in the discrete and process manufacturing sectors and remained firm in most of the services industries.

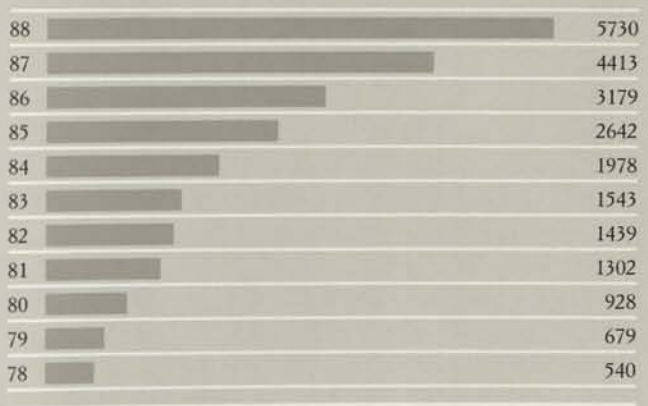
The Company expects that customers will increasingly look for computer systems that are distributed, flexible but disciplined, and tailored to the needs of an organization. The Company attributes much of its growth to its leadership position in offering integrated, networked computer systems and support.

In 1988, service and other revenues, which primarily include maintenance service, software support and consulting services, customer training and the sale of replacement parts, grew by 25%, following increases of 26% in 1987 and 15% in 1986. High levels of customer satisfaction and a comprehensive portfolio of customer services accounted for much of this growth.

Total Operating Revenues **$ Millions**



Non-United States Revenues **$ Millions**



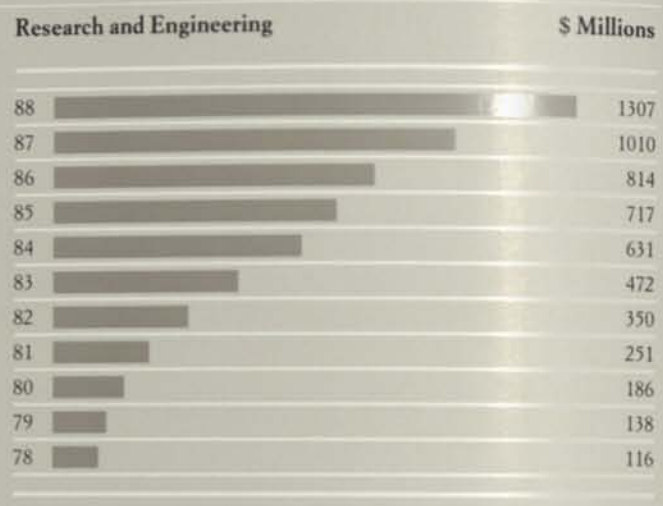
Expenses and Profit Margins

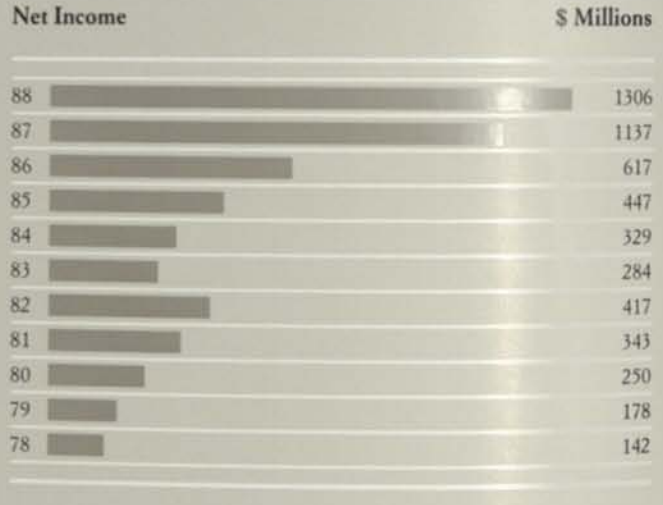
The Company's gross margin improved to 52.3% from 51.9% and 43.6% in the prior two years respectively. This is the third consecutive year that the Company's gross margins improved over the prior year for both products and services. The improvement in gross margins for 1988 is attributable primarily to increased sales.

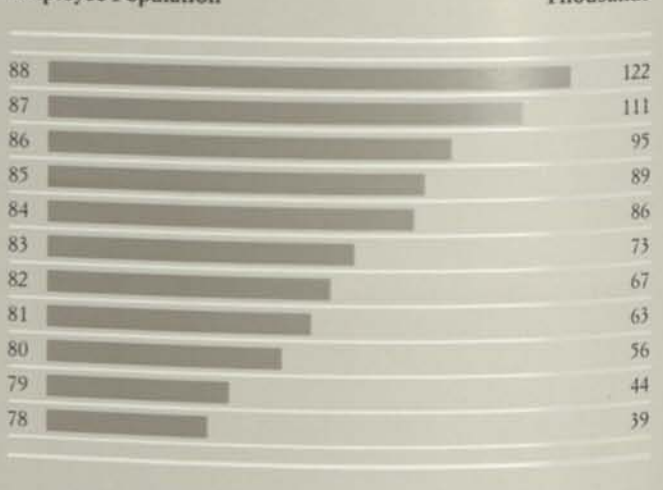
The Company has continued to invest aggressively in research and engineering, because it believes such investment is vital to its future growth and competitive position within the industry. Research and engineering expenses grew 29% in 1988 and comprised 11.4% of total operating revenues, compared with 10.8% in 1987 and 10.7% in 1986. The Company has traditionally put its emphasis on applied research and engineering which includes developing or enhancing computer systems, peripheral equipment, software and expanding product applications. The Company has approximately 7,800 professional employees involved in a number of research, engineering and programming activities around the world.

The Company's ongoing investment in research and engineering resulted in a number of new product introductions in 1988, sustaining the Company's revenue momentum. DECWORLD '87 provided the stage for the introduction of 26 new products, including a new generation of MicroVAX systems. The Company's commitment to multivendor networking and international standards was demonstrated by four networking announcements. Foremost of these was DECnet Phase V, the full implementation of which will virtually eliminate size restrictions for networks and allow for unlimited expansion. Also introduced were the RA82 and RA70 disk drives. In video terminals, the Company introduced the VT320, which incorporates a number of new features and is priced 30% lower than its predecessor.

Shortly after the close of the second quarter, the Company unveiled a sweeping strategy for the integration of competitive systems into DECnet/OSI networks. Digital's Network Application Support facilities will provide users of Apple Macintosh™ computers, industry-standard MS-DOS and OS/2 personal computers, UNIX-based systems, and Cray supercomputers, as well as users of desktop VAX/VMS systems and Digital VT terminals, with common application access, business communication, and information/resource-sharing services.







Expenses and Profit Margins

In a series of spring announcements, the Company introduced the high-end VAX 8000 series, mid-range VAX 6200 series and a new version of VAX system software, VMS 5.0. These products provide high system availability, simple upgrades and more processing power by adding symmetric multiprocessing and parallel processing capabilities to the VAX environment.

In the Company's fourth quarter, six new models were added to the VAXstation 2000 line. Available with either VMS or ULTRIX operating systems, the new workstations feature improved color, graphics and memory capabilities.

Just after the close of the year, the Company extended its enterprise-wide computing capabilities with the introduction of DECtp, a systems environment that makes transaction processing and information management systems easier and less expensive to develop, maintain and integrate with other applications across the enterprise. These products provide the functionality, performance, availability, security and service required for network transaction processing, while providing an open environment.

Several new and enhanced products make up part of the DECtp environment: the DECintact transaction monitor, which can execute more than 100 transactions per second on a single system; the SA600 Storage Array, with a capacity of 9.7 billion bytes and the fast access time and high reliability that are critical in transaction processing; a five-fold performance increase to VAX Rdb/VMS, a relational database management system that ensures transaction processing users of fast database updates and retrievals; and a number of data management products critical to meeting customers' transaction processing requirements.

The 36% year-to-year increase in selling, general and administrative expenses reflects the Company's investment for high growth and market share gain. Substantial investments were made in sales and sales support, marketing and advertising. These expenses increased to 26.7% of total operating revenues in 1988 compared with 24% in 1987 and 21.9% in 1986.

Operating income in 1988 was slightly higher than in the prior year, after increases of 95% and 84% in the two previous years. Less than anticipated revenue growth, particularly in the U.S., and a high level of operating expenses led to flat year-to-year results.

Interest income in 1988 increased from 1987 levels reflecting higher interest earned on the investment portfolio. Interest expense declined because of the redemption of long-term debt in 1987.

The Company's effective tax rate for 1988 was 25%, down from 32.7% in 1987. The decrease reflects a reduction in the U.S. statutory income tax rate enacted in the Tax Reform Act of 1986.

During December 1987, the Financial Accounting Standards Board issued a new accounting standard for income taxes, SFAS No. 96, which will require the Company to write off a portion of deferred income tax assets from the balance sheet. The Company must adopt SFAS No. 96 no later than the year ending June 30, 1990. When adopted the Company plans to restate prior years' results with most of the adjustment being charged to retained earnings. Management does not expect that the adoption of SFAS No. 96 will have a material impact on the Company's consolidated financial position and results of operations. There will be no cash flow impact from these adjustments.

During the year, the number of employees increased by 11,000, bringing the total number of employees at year-end to 121,500. The largest increases were in support of growth in the services businesses, for higher manufacturing volumes and new process technologies, for additional sales and sales support resources and for increased new product development activity.

The ratio of net income to average stockholders' equity (return on equity) was 18.9% in both 1988 and 1987 and 12% in 1986.

Availability of Funds to Support Current and Future Operations

The requirements for funds to support the Company's operations have historically been met with internally generated funds supplemented with external financing. During 1988, internally generated funds were sufficient to support operations.

During the three-year period of 1986-1988, funds generated from operations exceeded funds used to support operations by $1,834 million. In 1988, net funds generated from operations were $162 million, compared with $881 million in 1987 and $791 million in 1986. The decline in net funds generated from operations in 1988 reflected higher capital spending.

In January 1988, the Board of Directors authorized the repurchase of three million 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 1988, the Company purchased the three million shares at a total cost of $363 million. The shares are being held as treasury stock, pending their issuance under the employee stock plans.

Cash and temporary cash investments rose to $2,164 million at the end of 1988 from $2,118 million at the end of 1987. Unused lines of credit at the end of 1988 were $581 million.

The Company's financial performance, together with its substantial reserve debt capacity and high credit rating, leave it well positioned to obtain funds required for future growth.

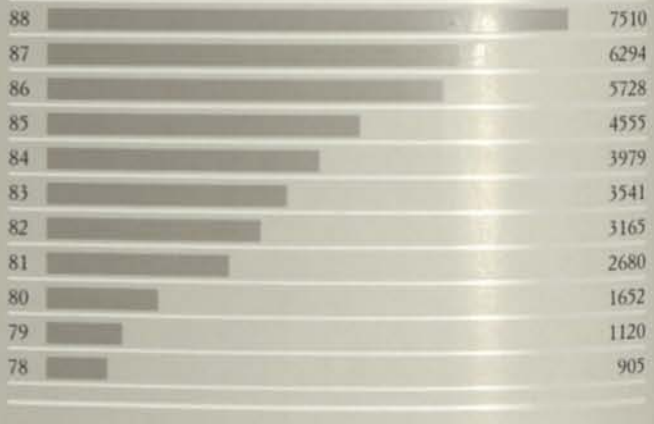
Common Stock Information

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 103,162 stockholders of record as of July 2, 1988. The high and low quarterly sales prices for the past two fiscal years are presented below.

		1988
Fiscal Quarter	High	Low
First	**$198¼**	**$157½**
Second	**199½**	**110**
Third	**144¾**	**103¾**
Fourth	**115⅞**	**99¼**

		1987
Fiscal Quarter	High	Low
First	$105⅛	$ 81¾
Second	109	88½
Third	172⅞	104½
Fourth	174½	148¾

Total Stockholders' Equity **$ Millions**



Spending for Operations

Throughout 1988, the Company maintained its strong financial position while continuing to invest for the future.

Investment in property, plant and equipment in 1988 totalled $1,518 million compared with $748 million in 1987. Of the total, $790 million was spent for equipment as the Company strived to ensure continued advances in capacity, efficiency and quality throughout its manufacturing, engineering, field service and administrative operations. Spending for land and buildings totaled $543 million. Much of this spending reflects the replacement of leased space with Company-owned facilities. Approximately 44% of the spending occurred overseas.

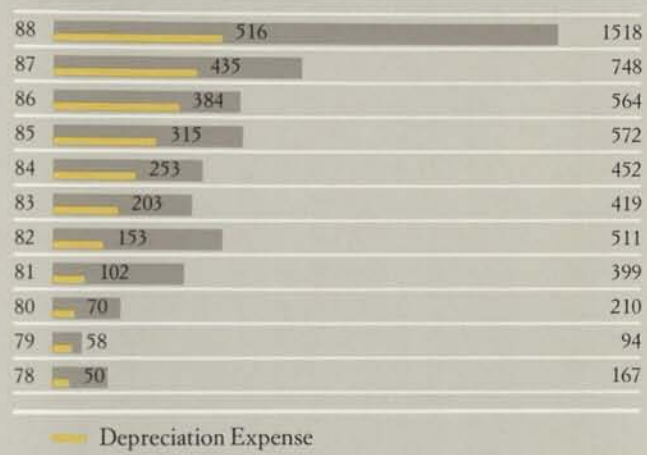
During the year inventories grew 8% from the prior year. Virtually all of the increase was in work-in-process inventories as the Company prepared for the production of a number of new products. Average year inventory turned 3.6 times, improved from the 3.4 times in 1987 and 2.9 times in 1986. Accounts receivable grew 12% in 1988, approximately half the rate of increase in operating revenues. Days sales in accounts receivable outstanding decreased to 75 days from 78 days in the prior year.

The ratio of net income to average total assets (return on assets) was 15.1% in 1988, 14.6% in 1987 and 9.1% in 1986. The increase in 1988 was due principally to asset growth, reflecting increased spending for property, plant and equipment.

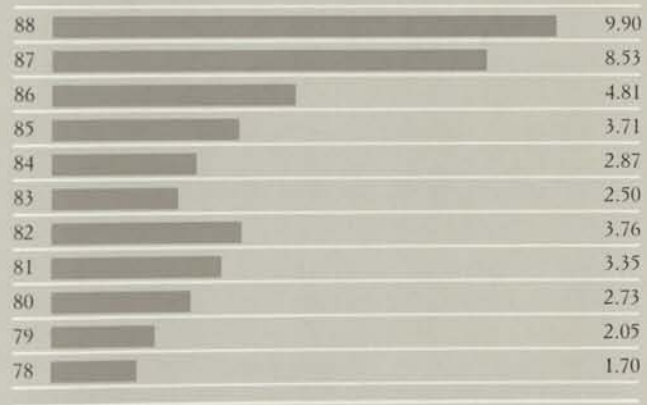
In 1988 the Company added approximately 4.9 million square feet of building space worldwide, bringing the total amount of space to 38.5 million square feet in over 1,100 facilities. This compares with 33.6 million square feet in 1987 and 32.3 million square feet in 1986.

The Company will continue to invest for the future and expects that its capital spending level in 1989 will exceed that of 1988. The actual level of spending, however, will be dependent on a variety of factors, including worldwide 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

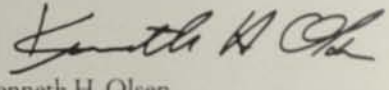
The Company's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of all the financial data included in this Annual Report. In preparing the financial statements, management makes informed judgments 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.

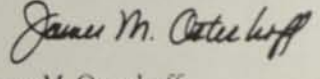
The Board of Directors, through its Audit Committee, is responsible for determining that management fulfills its responsibility with respect to the Company's financial statements and the system of internal accounting controls.

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

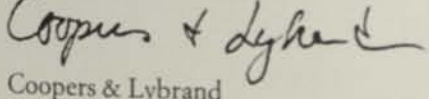
Report of Independent Certified Public Accountants

To The Stockholders and Directors,
Digital Equipment Corporation

We have audited the accompanying consolidated balance sheets of Digital Equipment Corporation as of July 2, 1988 and June 27, 1987 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 July 2, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Digital Equipment Corporation as of July 2, 1988 and June 27, 1987 and the consolidated results of its operations and consolidated changes in its financial position for each of the three fiscal years in the period ended July 2, 1988 in conformity with generally accepted accounting principles.



Coopers & Lybrand

Boston, Massachusetts
July 27, 1988

Consolidated Statements of Income

(in thousands except per share data)

	Year Ended		
	July 2, 1988	June 27, 1987	June 28, 1986
Revenues *(Notes A and C)*			
Product sales	**$ 7,541,241**	$6,254,187	$5,102,961
Service and other revenues	**3,934,205**	3,135,257	2,487,396
Total operating revenues	**11,475,446**	9,389,444	7,590,357
Costs and expenses *(Notes A and D)*			
Cost of product sales	**3,042,172**	2,532,259	2,675,438
Service expense and cost of other revenues	**2,426,176**	1,981,635	1,606,661
Research and engineering expenses	**1,306,543**	1,010,438	814,138
Selling, general and administrative expenses	**3,065,555**	2,253,105	1,665,411
Operating income	**1,635,000**	1,612,007	828,709
Interest income	**143,665**	122,149	116,899
Interest expense	**37,820**	45,203	88,079
Income before income taxes	**1,740,845**	1,688,953	857,529
Provision for income taxes *(Notes A and E)*	**435,212**	551,518	240,109
Net Income	**$ 1,305,633**	$1,137,435	$ 617,420
Net income per share *(Note B)*	**$ 9.90**	$ 8.53	$ 4.81
Weighted average shares outstanding *(Note B)*	**131,923**	133,305	130,792

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

Consolidated Balance Sheets

(in thousands)	July 2, 1988	June 27, 1987
Assets		
Current Assets		
Cash and temporary cash investments *(Note F)*	$ 2,163,580	$2,118,295
Accounts receivable, net of allowance of $78,148 and $69,280	2,592,160	2,312,188
Inventories *(Note A)*		
Raw materials	392,734	405,111
Work-in-process	651,456	526,483
Finished goods	530,869	521,325
Total inventories	1,575,059	1,452,919
Prepaid expenses	274,160	119,193
Net deferred Federal and foreign income tax charges	324,962	198,465
Total Current Assets	6,929,921	6,201,060
Property, Plant and Equipment, at cost *(Note A)*		
Land	299,157	148,480
Buildings	1,283,048	889,755
Leasehold improvements	458,449	294,630
Machinery and equipment	3,169,792	2,526,457
Total property, plant and equipment, at cost	5,210,446	3,859,322
Less accumulated depreciation	2,115,421	1,732,028
Net property, plant and equipment	3,095,025	2,127,294
Other assets, net *(Note G)*	86,610	79,032
Total Assets	$10,111,556	$8,407,386
Liabilities and Stockholders' Equity		
Current Liabilities		
Bank loans and current portion of long-term debt *(Note H)*	$ 154,670	$ 4,873
Accounts payable	523,173	430,575
Federal, foreign and state income taxes	504,195	328,134
Salaries, wages and related items	257,663	229,623
Deferred revenues and customer advances *(Note A)*	727,984	475,925
Other current liabilities	246,419	355,375
Total Current Liabilities	2,414,104	1,824,505
Net deferred Federal and foreign income tax credits	63,154	20,118
Long-term debt *(Note H)*	123,924	269,292
Total Liabilities	2,601,182	2,113,915
Stockholders' Equity *(Notes I and J)*		
Common stock, $1.00 par value; authorized 450,000,000 shares; issued 130,008,231 shares	130,008	130,008
Additional paid-in capital	2,424,391	2,352,939
Retained earnings	5,463,050	4,410,242
Treasury stock at cost; 3,718,375 shares and 3,821,669 shares	(507,075)	(599,718)
Total Stockholders' Equity	7,510,374	6,293,471
Total Liabilities and Stockholders' Equity	$10,111,556	$8,407,386

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

Consolidated Statements of Changes in Financial Position

(in thousands)	Year Ended		
	July 2, 1988	June 27, 1987	June 28, 1986
Funds from Operations			
Net income	**$1,305,633**	$1,137,435	$ 617,420
Add – expenses not requiring funds in current period:			
Depreciation and amortization *(Notes A and G)*	**527,141**	436,118	384,044
Disposal of property, plant and equipment	**34,341**	53,456	44,112
Restricted stock plans – charge to operations *(Note I)*	**32,008**	20,653	21,155
Change in deferred taxes, net *(Note E)*	**(83,461)**	(158)	(13,936)
Total funds from operations	**1,815,662**	1,647,504	1,052,795
Funds Used to Support Operations			
Increase (decrease) in working capital:			
Accounts receivable	**279,972**	408,901	364,332
Inventories	**122,140**	253,163	(556,411)
Prepaid expenses	**154,967**	33,919	20,705
Accounts payable	**(92,598)**	(171,010)	(74,363)
Federal, foreign and state income taxes	**(176,061)**	(190,576)	130,342
Deferred revenues and customer advances	**(252,059)**	(222,135)	(93,685)
Other current liabilities	**80,916**	(174,573)	(93,685)
	117,277	(62,311)	(302,765)
Additions to property, plant and equipment	**1,517,579**	748,359	564,205
Increase in other assets	**19,212**	80,463	–
Total funds used to support operations	**1,654,068**	766,511	261,440
Net increase in funds from operations	**161,594**	880,993	791,355
Funds Provided (Used) by Financing Sources			
Bank loans and current portion of long-term debt *(Note H)*	**149,797**	(17,324)	8,535
11¾% Notes due 1989	**(150,000)**	–	–
9⅜% Debentures due 2000	**–**	(63,000)	(3,646)
13% Debentures due 2014	**–**	–	(100,000)
8% Conv Sub Debentures due 2009, net	**–**	–	(4,279)
Long-term debt, other *(Note H)*	**4,632**	(863)	(144)
Common stock issued under stock option and purchase plans *(Note I)*	**242,761**	189,346	138,932
Purchase of treasury stock *(Note J)*	**(363,499)**	(781,790)	–
Total funds from financing sources	**(116,309)**	(673,631)	39,398
Net increase in cash and temporary cash investments	**45,285**	207,362	830,753
Cash and temporary cash investments at beginning of year	**2,118,295**	1,910,933	1,080,180
Cash and temporary cash investments at end of year	**$2,163,580**	$2,118,295	$1,910,933

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	Treasury Stock	Total Stock-holders' Equity
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	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)	182,0[illegible]	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	$(599,7[illegible]	$6,293,471
Purchase of 3,000,000 shares of treasury stock *(Note J)*				(363,499)	(363,499)
Shares issued under stock option and purchase plans *(Note I)*			(252,825)	456,1[illegible]	203,317
Restricted stock plans, charge to operations		32,008			32,008
Stock option and purchase plans – excess Federal income tax benefits *(Note I)*		39,444			39,444
Net income – 1988			1,305,633		1,305,633
July 2, 1988	**$130,008**	**$2,424,391**	**$5,463,050**	**$(507,075)**	**$7,510,374**

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. Monetary assets and liabilities of foreign subsidiaries are translated into U.S. dollars at current exchange rates. Nonmonetary assets such as 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 inventories charged to 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, in 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.

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 were treated as reductions of income taxes in the year in which credits arose.

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	3 to 10 years (accelerated methods)

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 years ended July 2, 1988 and June 27, 1987, common share equivalents were attributable to stock options. In the year ended June 28, 1986, 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		
	July 2, 1988	June 27, 1987	ne 28, 1986
Revenues			
United States customers	**$ 5,810,598**	$ 5,016,606	4,472,195
Intercompany	**2,017,928**	1,921,043	1,354,339
	7,828,526	6,937,649	5,826,534
Europe customers	**4,221,631**	3,252,482	2,259,743
Intercompany	**137,669**	114,582	82,649
	4,359,300	3,367,064	2,342,392
Canada, Far East, Americas customers	**1,443,217**	1,120,356	858,419
Intercompany	**912,786**	659,204	577,934
	2,356,003	1,779,560	1,436,353
Eliminations	**(3,068,383)**	(2,694,829)	(2,014,922)
Net revenue	**$11,475,446**	$ 9,389,444	7,590,357
Income			
United States	**$ 512,754**	$ 758,795	342,657
Europe	**770,135**	634,543	405,636
Canada, Far East, Americas	**390,787**	278,359	207,187
Eliminations	**(38,676)**	(59,690)	(126,771)
Operating income	**1,635,000**	1,612,007	828,709
Interest income	**143,665**	122,149	116,899
Interest expense	**37,820**	45,203	88,079
Income before income taxes	**$ 1,740,845**	$ 1,688,953	857,529
Assets			
United States	**$ 5,245,439**	$ 4,627,838	3,911,491
Europe	**3,093,818**	2,246,333	1,817,584
Canada, Far East, Americas	**1,293,906**	843,067	815,067
Corporate assets *(temporary cash investments)*	**2,057,528**	1,979,470	2,035,557
Eliminations	**(1,579,135)**	(1,289,322)	(1,406,373)
Total assets	**$10,111,556**	$ 8,407,386	$ 7,173,326

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 sales subsidiaries, the parent corporation or other 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 the United States, including U.S. export sales, were $5,729,879,000 for the year ended July 2, 1988, $4,412,527,000 for the year ended June 27, 1987, and $3,179,143,000 for the year ended June 28, 1986, which represented 50%, 47%, and 42%, 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 $2,793,239,000 at July 2, 1988, and $2,070,337,000 at June 27, 1987, and $1,473,081,000 at June 28, 1986.

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 $138,308,000 for the year ended July 2, 1988, $110,365,000 for the year ended June 27, 1987 and $111,778,000 for the year ended June 28, 1986. In fiscal 1987, the Company and its principal subsidiaries implemented Statement of Financial Accounting Standards No. 87 – Employers' Accounting for Pensions.

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 years ended July 2, 1988 and June 27, 1987. For the U.S. pension plan, the measurement dates were March 31, 1988 and March 31, 1987, the assumed discount rates in computing the projected benefit obligation were 9.0% and 8.5%, the assumed rates of compensation increase were 7.0% and 6.5%, and the assumed annual rate of return on plan assets was 9.5% and 9.5% for the years ended July 2, 1988 and June 27, 1987, respectively. For the non-U.S. pension plans, the measurement dates ranged from March 31, 1988 to July 2, 1988 and March 31, 1987 to June 27, 1987, the assumed discount rates in computing the projected benefit obligation ranged from 5% to 11.5% and 5% to 9%, the assumed rates of compensation increase ranged from 5.3% to 10.5% and 5.8% to 7.5%, and the assumed annual rates of return on plan assets ranged from 5% to 10% and 5.5% to 10% for the years ended July 2, 1988 and June 27, 1987, respectively.

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 $1,025,000 for the year ended July 2, 1988, $864,000 for the year ended June 27, 1987 and $423,000 for the year ended June 28, 1986. 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)	1988	1987
Actuarial present value of benefit obligations:		
Vested benefit obligation	$ (382,457)	$ (310,590)
Accumulated benefit obligation	$ (448,903)	$ (368,572)
Projected benefit obligation	$(1,375,916)	$(1,054,853)
Plan assets at fair value	1,592,023	1,354,197
Plan assets in excess of projected benefit obligation	216,107	299,344
Contributions made after measurement date but before end of fiscal year	2,874	11,283
Unrecognized net (gain) loss	35,628	(98,373)
Unrecognized prior service cost	27,719	–
Unrecognized transition asset, net	(158,678)	(160,820)
Pension cost recognized on the balance sheet	$ 123,650	$ 51,434

Net periodic pension cost for fiscal 1988 and fiscal 1987 included the following components:

	1988	1987
Service cost-benefits earned during the period	$ 160,225	$ 126,977
Interest cost on projected benefit obligation	90,283	67,695
Actual return on plan assets	590	(187,541)
Net amortization and deferral	(124,714)	93,272
Net periodic pension cost	$ 126,384	$ 100,403
Total net periodic pension cost for all pension plans	$ 138,308	$ 110,365

Note - Income Taxes

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

(in th nds)			*Year Ended*
	July 2, 1988	June 27, 1987	June 28, 1986
Don tic	**$ 773,679**	$ 832,638	$382,708
For n	**967,166**	856,315	474,821
Tot	**$1,740,845**	$1,688,953	$857,529

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

	1988	1987	1986
U.S. Federal statutory tax rate	**34.0%**	46.0%	46.0%
Tax benefit of manufacturing operations in: (a)			
Puerto Rico	**(2.6)**	(3.4)	(3.9)
eland	**(2.4)**	(4.1)	(7.4)
ngapore	**(0.7)**	(1.5)	(1.4)
iwan	**(0.4)**	(0.5)	(0.4)
R earch and engineering credit	**(1.6)**	(1.1)	(0.9)
S te income taxes	**1.9**	1.5	1.1
I estment tax credits	**.1**	.1	(2.8)
(her	**(3.3)**	(4.3)	(2.3)
fective tax rate	**25.0%**	32.7%	28.0%

) The Company's manufacturing subsidiary operating Puerto Rico is subject to tax at a rate of approximately % on its manufacturing earnings through fiscal 1995. The ncome 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. The income from certain products manufactured by the Company's manufacturing subsidiary operating in Taiwan is wholly exempt from Taiwanese taxes through May 1991.

Note I – Stock Plans

Restricted Stock Options □ Under its Restricted Stock Option 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 July 2, 1988 was as follows:

		Options Outstanding	
	Shares Reserved For Future Grants	Shares	Average Price Per Share
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
Options Granted	**(3,244,400)**	**3,244,400**	**152.95**
Options Exercised	–	**(1,302,482)**	**28.67**
Options Cancelled	**182,896**	**(182,896)**	**52.68**
Options Terminated	**(118,075)**	–	–
July 2, 1988	**11,986,051**	**14,762,223**	**$62.25**

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 $32,008,000 in the fiscal year ended July 2, 1988, $20,653,000 in the fiscal year ended June 27, 1987 and $21,155,000 in the fiscal year ended June 28, 1986. 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 2,099,727 shares at July 2, 1988 and 3,937,958 shares at June 27, 1987. There were 1,838,231 shares issued at an average price of $55.25 per share during the year ended July 2, 1988 and 1,437,597 shares at $83.16 per share during the year ended June 27, 1987. 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.

ote J – Treasury Stock

he Company purchased on the open market 3,000,000 ares of its common stock at an aggregate purchase price $363,499,000, or $121.17 per share, during the year ded July 2, 1988 and 5,000,000 shares at an aggregate rchase price of $781,790,000, or $156.36 per share, ring the year ended June 27, 1987. 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.

ote K – Leases

linimum 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)*
1989	$ 275,681
1990	222,634
1991	178,345
1992	129,521
1993	96,252
Later years	381,054
Total minimum lease payments	$1,283,487

Total rental expense for the fiscal years ended July 2, 1988, June 27, 1987 and June 28, 1986 amounted to $406,376,000, $335,518,000 and $257,695,000, respectively.

Quarterly Financial Data (unaudited)

Selected quarterly financial data for the years ended July 2, 1988 and June 27, 1987 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[1]
1988					
First Quarter	**$ 2,529.8**	**$1,333.9**	**$ 369.0**	**$ 269.9**	**$2.03**
Second Quarter	**2,782.2**	**1,459.1**	**429.3**	**329.5**	**2.48**
Third Quarter	**2,824.0**	**1,462.5**	**406.9**	**305.1**	**2.33**
Fourth Quarter	**3,339.4**	**1,751.6**	**534.6**	**401.1**	**3.08**
Total Year	**$11,475.4**	**$6,007.1**	**$1,740.8**	**$1,305.6**	**$9.90**
1987					
First Quarter	$ 2,038.5	$1,011.9	$ 294.6	$ 182.6	$1.37
Second Quarter	2,271.8	1,176.5	423.8	270.0	2.02
Third Quarter	2,410.1	1,260.6	460.2	307.6	2.29
Fourth Quarter	2,669.0	1,426.6	510.4	377.2	2.85
Total Year	$ 9,389.4	$4,875.6	$1,689.0	$1,137.4	$8.53

[1]*Earnings per share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share in 1988 does not equal the total for the year.*

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Corporate Consultant, Advanced VAX Engineering

William D. Strecker
Senior Corporate Consultant, Computer Architecture

Robert M. Supnik
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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 stockholders. Investors' inquiries are welcome, by telephone or letter.

Correspondence may be directed to:

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

Requests for specific information are handled as follows:

Digital Equipment Corporation's Annual Report on Form 10-K for the fiscal year ended July 2, 1988, 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
(508) 351-4401

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

Mark A. Steinkrauss
Director Investor Relations
Digital Equipment Corporation
Investor Relations – ML
111 Powdermill Road (K10)
Maynard, MA 01754-1418
(508) 493-7182

Investor Information (continued)

Inquiries of an administrative nature relating to stockholder 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
(508) 493-5213

Transfer Agent and Registrar
for Common Stock

Morgan Shareholder Services Trust Company is the principal stock transfer agent and registrar, and maintains the stockholder 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. Stockholders 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

Customer Inquiries

Digital Equipment Corporation customers who have questions and/or problems relating to their account should contact the Customer Assistance Department at (508) 493-7161.

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

Paying Agents and Registrars
For 11¾% Guaranteed Notes due 1989
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Digital Equipment Corporation
Maynard, Massachusetts 01754

Digital Equipment Corporation
Annual Report 1989

digital

Initiatives In Enterprise Computing

Corporate Profile

Digital Equipment Corporation is one of the world's leading suppliers of networked computer systems, software, and services, and a leader in systems integration.

An international company, Digital does more than half its business outside the United States, developing and manufacturing products and providing customer services in the Americas, Europe, and the Pacific Rim.

Digital offers a full range of desktop, timesharing, transaction-processing, and scientific systems for research, computation, communications, education, data analysis, industrial control, commercial data processing, electronic publishing, word processing, personal computing, computer-integrated manufacturing, health care, instrumentation, engineering and simulation.

Financial Highlights

Fiscal Year	1989	1988	% Change
Total operating revenues	**$12,741,956,000**	$11,475,446,000	+11
Net income	**$ 1,072,610,000**	$ 1,305,633,000	(18)
Net income per share	**$8.45**	$9.90	(15)
Total stockholders' equity	**$ 8,035,673,000**	$ 7,510,374,000	+7
Number of stockholders	**99,084**	103,162	
Stockholders' equity per share	**$66.12**	$59.47	+11
Return on equity	**13.8%**	18.9%	
Return on assets	**10.3%**	14.1%	

Annual Meeting of Stockholders

The Annual Meeting of Stockholders will be held at 11:00 A.M., Monday, November 6, 1989, at the World Trade Center, Commonwealth Pier, 164 Northern Avenue, Boston, Massachusetts 02210. Stockholders of record on September 8, 1989, will be entitled to vote at this meeting.

Contents

President's Letter

To Our Shareholders,
Employees, and Customers:

Digital is in the business of helping organizations become more productive and more competitive. Our computer systems and networks tie organizations together, facilitating easy, efficient teamwork.

In 1989, Digital's revenue growth came from overseas markets, particularly Europe and Japan, where businesses are strengthening their long-term competitive positions in the global marketplace. Although relatively flat U.S. sales restrained our growth, Digital is among the most profitable companies in America. We have a significant, positive cash flow and a very strong balance sheet.

Our $1.5-billion investment in new product development is among the highest in the world. We are enhancing the network application support services our customers need to integrate systems from disparate manufacturers, so information, data, and ideas can be exchanged freely across the entire enterprise.

We are continuing to invest heavily in VAX and RISC-based systems and VMS and UNIX software. Our VAX/VMS operating system is the most modern and complete computing environment in the world. VAX/VMS is the only operating system with the range and functions needed to support everything from personal workstations to large-scale commercial data processing systems, and to tie practically unlimited numbers of computers into a single enterprise-wide information network.

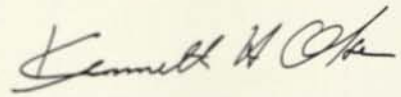
Software written years ago runs unchanged on any VAX system today, and software written today will run on VAX systems in the future. VAX and VMS continue to be central to Digital's strategy. The enormous number and breadth of applications, the ease of use, and the security and robustness of the VMS operating system will not be matched for a long time.

Like VMS, the UNIX operating system has an important place in enterprise computing. UNIX software has been part of Digital's product line for 20 years, for those who wanted a simple operating system. Today, UNIX software often lacks the functionality, security, and robustness necessary for commercial applications. Digital's priority in UNIX systems development is to make UNIX software into a quality commercial system.

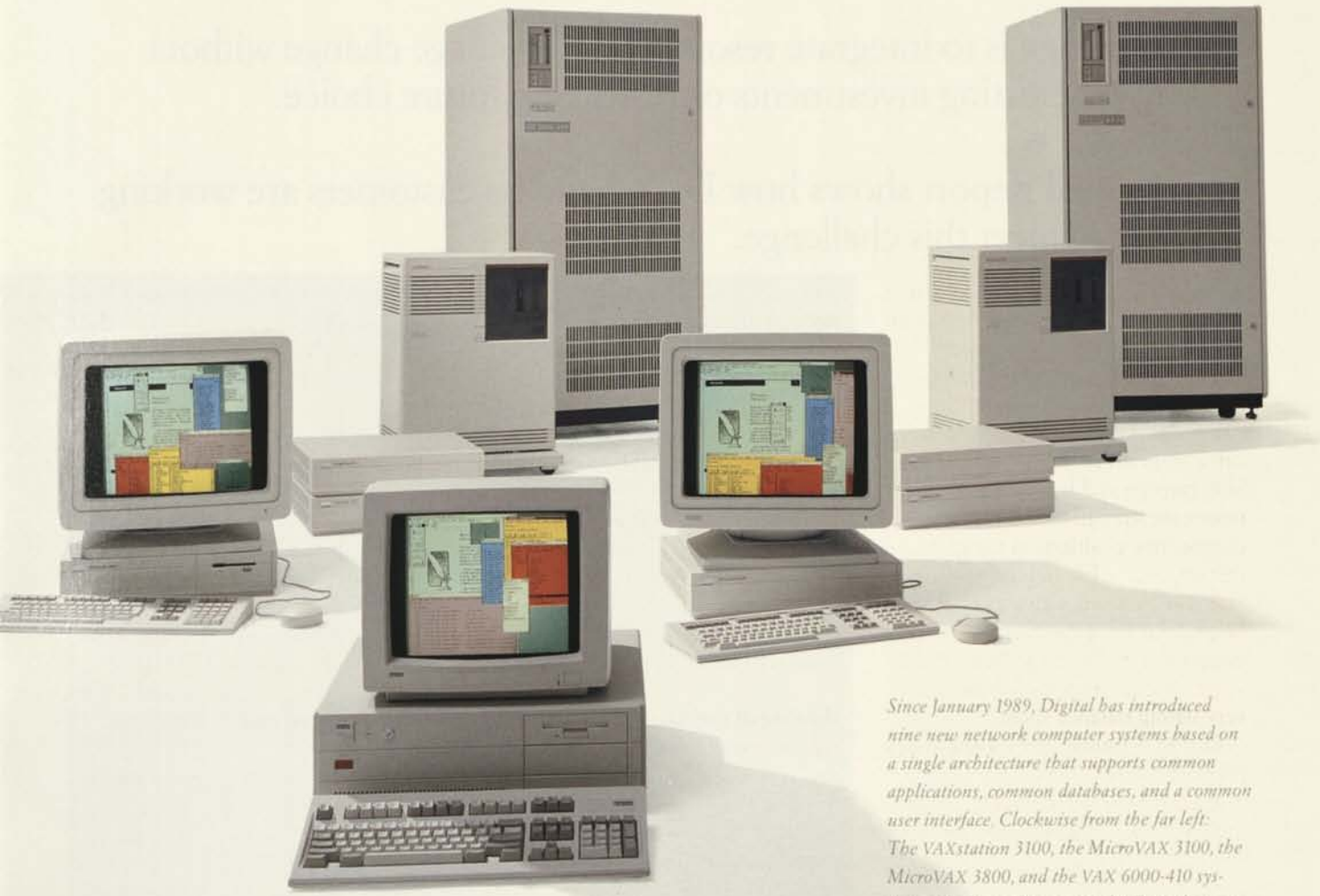
This Annual Re[illegible]t shows how Digital is building [illegible] integrated computing enviro[illegible]nt around the VMS and UNIX so[illegible]re systems. Digital is commit[illegible]o:

- Integrating existi[illegible]sktop computer systems into corp[illegible] networks while increasing our sh[illegible] the terminal, personal compute[illegible]d workstation market.
- Developing distri[illegible]d transaction-processing system[illegible]i applications.
- Becoming a leader [illegible]ntegrating the products of differe[illegible]manufacturers, by building a netwo[illegible]k of alliances with software developers, with other manufacturers, and with systems integrators.

These initiatives require teamwork. Teamwork characterizes the way Digital works with its customers and suppliers. Teamwork is the whole idea behind enterprise computing.



Kenneth H. Olsen, President
September 1, 1989



Since January 1989, Digital has introduced nine new network computer systems based on a single architecture that supports common applications, common databases, and a common user interface. Clockwise from the far left: The VAXstation 3100, the MicroVAX 3100, the MicroVAX 3800, and the VAX 6000-410 systems. Clockwise from top right, Digital's new RISC systems: The DECsystem 5810, the DECsystem 5400, the DECsystem 3100, and the DECstation 3100 computers. Bottom: The DECstation 320 personal computer.

Every enterprise is unique.

Information, automation, and communications networks ha to adapt to the way each organization grows and changes.

The challenge is to integrate resources and manage change w hout writing off existing investments or restricting future choice.

This Annual Report shows how Digital and its customers are working together to meet this challenge.

The Rewards of Working Together

There is a choice. Computers can remain resources for automating discrete functions. Or they can empower the organization so that everyone works together as a single team.

Digital has developed the technology, the systems, the applications, and the support services needed to manage change and integrate a business with its customers and suppliers.

This technology is based on an open systems architecture designed to enhance existing computer investments and provide a single, dynamic computing environment in which systems from different manufacturers can work together.

Within this framework, Digital has undertaken three major initiatives:

- To make terminal, personal-computer, and workstation users more productive – both as individuals and as team members – by giving them access to computer resources throughout the enterprise.
- To distribute transaction-processing and other key applications, making the entire organization more responsive to its customers and to changing business conditions.
- To broaden Digital engineering, systems-integration, and service programs to support multivendor networks by building strategic relationships with customers, software developers, component manufacturers, and other computer companies.

These initiatives let a retailer work with its suppliers, a parts manufacturer with an automobile company, and a money center bank with its correspondents. They enable a telephone operating company to offer new services to its subscribers.

For example, Pacific Bell installed Digital computers in telephone offices to give businesses access to a public computer network. Businesses can now send electronic mail to customers and suppliers. One computer can access information or submit data to another over a public voice/data network.

But this is only one example of how Digital is making it easier for both individuals and businesses to work together.

"You have to start with a definition. 'The Enterprise' encompasses more than just the corporation. Without customers and suppliers there would be no enterprise. Working toward common objectives, computer and telecommunications companies like Digital and Pacific Bell are providing the services and solutions businesses need to communicate with their customers and suppliers."

Lee Camp, Vice President and General Manager, Information Services Group

Pacific Bell

Pacific Telesis Group

The Customer Challenge: Make the Enterprise More Productive

The Digital I tive: Empower the r by Integrating th esktop Into the Netw

Desktop computing focuses on individual productivity. Desktop systems make it easier for individuals to do their work. But desktop systems have to be networked, if they are to make it easier for people to work together.

Networking enhances both personal and organizational productivity. A network environment automates the delivery of reports and memos, as well as their production. The network provides the up-to-the-minute data financial analysts need for their spreadsheets. The network integrates engineering with marketing and manufacturing so that design engineers are not working in a vacuum.

In most large organizations there are hundreds – sometimes thousands – of people using terminals, personal computers, and workstations for different jobs. They work as individual contributors, on project or interdepartmental teams, and as members of the larger team that includes everyone in the enterprise.

The challenge is to improve both individual and team productivity. To have everyone working with the same information. To share ideas across the organization.

This requires a dynamic, multivendor network based on accepted technologies, open standards, and a clear understanding of customer needs. All the pieces have to fit together.

Digital has the technology and support services needed to:

- Network ten to tens of thousands of PCs and other desktop devices.
- Integrate MS-DOS, UNIX, VMS, and Apple Macintosh systems in a single, integrated computing environment.
- Link new and existing local area networks and integrate them with existing wide-area networks.

This step-by-step approach enhances computer investments by providing existing desktop systems with new capabilities. It eliminates the need to standardize on a single operating system. And it does this without creating complications for either the user or MIS.

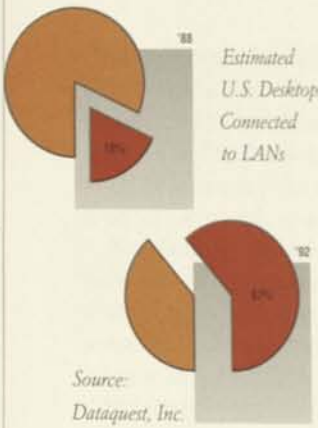
Individuals, departments, and divisions all work together. Both the individual and the enterprise are more productive.

"By pushing industry standards, incorporating them into a clearly defined architecture, and by making formal alliances with other hardware and software companies, Digital is providing the leadership needed to integrate terminals, personal computers, workstations, and applications into the enterprise-wide network."

Ed Esber, Chairman and Chief Executive Officer

Ashton-Tate Inc.

Integrating Ten or Tens of Thousands of Desktop Systems on a Single Network



Estimated U.S. Desktops Connected to LANs

Source: Dataquest, Inc.

In the past year alone, over four million new desktops were added to Ethernet networks. This is the technology Canadian Broadcasting Corporation chose for the datacenter which, together with free-standing PCs in smaller offices, are linked together by DECnet software over CBC's private X.25 data highway. Gateways provide overseas bureaus with access to the network.

Linking industry-standard MS-DOS PCs in a local area network is a good way to enhance computer investments and improve productivity. When desktop systems are networked, users can work together as a team.

The challenge comes when an organization wants to build a company-wide or enterprise-wide network.

This involves a little more than just linking PCs together.

Building a network that will support people in different disciplines and different offices means integrating different desktop systems – Apple Macintosh, IBM, other MS-DOS personal computers, and UNIX workstations.

The key to accessing the enterprise-wide network is the local area network server – the system that keeps a database for the local area network and passes information back and forth among local systems.

Servers are hardware/software systems. They differ widely, not just in power, but in functionality. If a server is to support a variety of desktop devices and act as a gateway to the larger corporate network, it needs sophisticated soft re that is consistent with industry ndards. In addition, a server sho nanage and simplify network ss so that users will not have to r r complex networking comm is. This will reduce support a aining costs.

There is no pra l limit to the number of de p systems that Digital can link to er. Many Digital customers e hundreds or thousands of desk systems from different vendors w king smoothly on a single networ that lets users share information. Digital's own internal network serves over 100,000 users at nearly 500 sites around the world.

Leading desktop computing companies including Apple, COMPAQ, Olivetti, Tandy, and Toshiba, and Ashton-Tate, Lotus, Computer Associates, and Interleaf, have established formal working relationships with Digital. These alliances help ensure that MS-DOS, Apple, UNIX, and VMS desktop systems and applications are able to share files and exchange information.

Everyone can work together as a team.

"Four thousand PCs. Four hundred thousand E-mail messages a month. Canadian Broadcasting Corporation (CBC) is giving a new meaning to networking. CBC built a Digital-based ALL-IN-1 office information and communications system to link users in 35 Canadian cities and its news bureaus in London, Paris, New York, Washington, Tel Aviv, Moscow, and Beijing."

Michael Hughes, Executive Director, MIS

Canadian Broadcasting Corporation

Opening Windows Into Every Corner of the Enterprise

Every PC is a building block. The LEGO Group built its business by developing an easy way to put components together. Digital's new DECwindows software will provide desktop users in large enterprises like The LEGO Group with a single, easy-to-use, intuitive interface to other systems on the network.

As long as different people have different jobs to do, there will be a need for different desktop systems.

This does not have to create needless complexity for either the user or for MIS.

Terminals, personal computers, and workstations can be integrated into a single, uncomplicated computing environment. With DECwindows software, it makes no difference whether the user runs a VMS, UNIX, MS-DOS, or Apple Macintosh application. Everything has the same look and feel.

Unlike stand-alone PC or workstation windowing software that only displays information stored on the local system, DECwindows software can access information and applications anywhere on the network. Realtime links can be established so that, when someone updates data, every system using that data will be automatically updated.

Using a single set of commands, a user can combine text from a PC with graphics generated on an Apple Macintosh, while using a UNIX or VAX system to perform complex calculations. Each application runs in its own window. New windows can be opened as needed, and users can move applications around the screen almost as easily as they move papers around their desks.

At the same time, DECwindows provides software developers with a common application program interface. It is no longer necessary to write separate applications for MS-DOS, UNIX, and VMS systems. A single application can be written for all three environments.

By integrating a complete range of terminals, personal computers, and workstations into a single computing environment, Digital is helping both customers and third-party software developers cut application development, training, and support costs.

Digital's simplified approach to program development has been adopted as a standard by The Open Software Foundation, a consortium of leading hardware and software companies including Digital, IBM, Hewlett-Packard, Bull, and Hitachi. On the strength of this, more than 700 independent software companies are developing DECwindows applications.

"The issue isn't what people do *at* their desks, it is what they can accomplish *from* their desks. It is empowering the user to reach out for data and share information and ideas. Digital has helped us establish a common ground among different computing environments, so our employees can now access all the resources on our worldwide network."

Niels Bonde, Information Technology Manager

LEGO Systems A/S

Building the Worldwide Local Area Network

MicroVAX server systems, such as the PCLAN/Server 3100, link the desktop and the enterprise-wide network. Federal Express has shown how an integrated voice-data network can provide a competitive advantage. Federal Express can track packages from source to destination. Digital systems are a part of the network that makes this possible. This network is one of the reasons businesses call Federal Express when they "absolutely, positively" want overnight delivery just about anywhere in the world.

In a sense, all networks are local networks.

The whole purpose of a computer network is to compress time and distance. So that a toy wholesaler in New York can place an order directly with the factory in Copenhagen. A money trader in London can work hand-in-glove with a colleague in New York. A customer service engineer in Hong Kong can consult with a software specialist in Phoenix.

Speeding the flow of information and ideas is basic to inventory reduction, just-in-time delivery, computer integrated manufacturing, new product introductions, customer service, and other corporate programs.

These programs all require teamwork. They cut across professional, departmental, and organizational lines. They redefine the whole idea of a local area network.

Most local area networks were originally set up by individual workgroups, departments, or facilities. Little thought was given to tying them into a single corporate network, let alone in an enterprise network that could provide direct communication with customers and suppliers.

Fortunately, the pieces can be put together. Working with telephone operating companies and telecommunications equipment suppliers in the Americas, Europe, and the Pacific Rim, Digital can link LANs together in a single worldwide network utilizing Ethernet, fiber-optic, microwave, leased-line, and satellite communications.

An enterprise-wide network makes someone on the next continent as accessible as the person in the next office. It is one of the things that distinguishes the global enterprise of today from yesterday's multinational corporation.

Enterprise-wide networks can provide needed coordination among different companies, different divisions, or different geographies without creating a technological straitjacket. Digital networks are dynamic. They can change and grow with the enterprise.

"When we started to integrate PCs and workstations, we saw that local area networks would only be components in a larger, multivendor, enterprise-wide network. It sounds elementary, but it is all too easy to create islands of automation that are difficult, if not impossible, to integrate into a single, cohesive network."

Thomas Oliver, Vice President, Sales and Customer Service

Federal Express Corporation

The Customer Challenge: Remove the Restraints Surrounding Transaction Processing

The Digit[illegible]tiative: Put Full-F[illegible]on TP on Distribute[illegible]stems to Cut Costs, [illegible]e Time

In the past, airline reservation, currency trading, computer integrated manufacturing, and other large, complex, and critical transaction-processing applications were almost always implemented on mainframe systems.

Only a mainframe could manage corporate databases and provide the automatic backup, audit trails, and other features required for large-scale strategic computing.

But there is a price. Developing mainframe applications is a complex, time-consuming, and expensive business. As a consequence, many companies find themselves with a large backlog of applications.

Fortunately, large-scale transaction processing is no longer limited to datacenter systems. It no longer requires a specialized environment, specialized equipment, or a large and highly specialized support staff. Digital is developing distributed computer systems that will meet today's requirements for transaction-processing speed, security features, and availability.

Distributed transaction processing is particularly attractive to the company looking to speed application development and implementation. New applications can be developed on a small VAX system and replicated on any other VAX system.

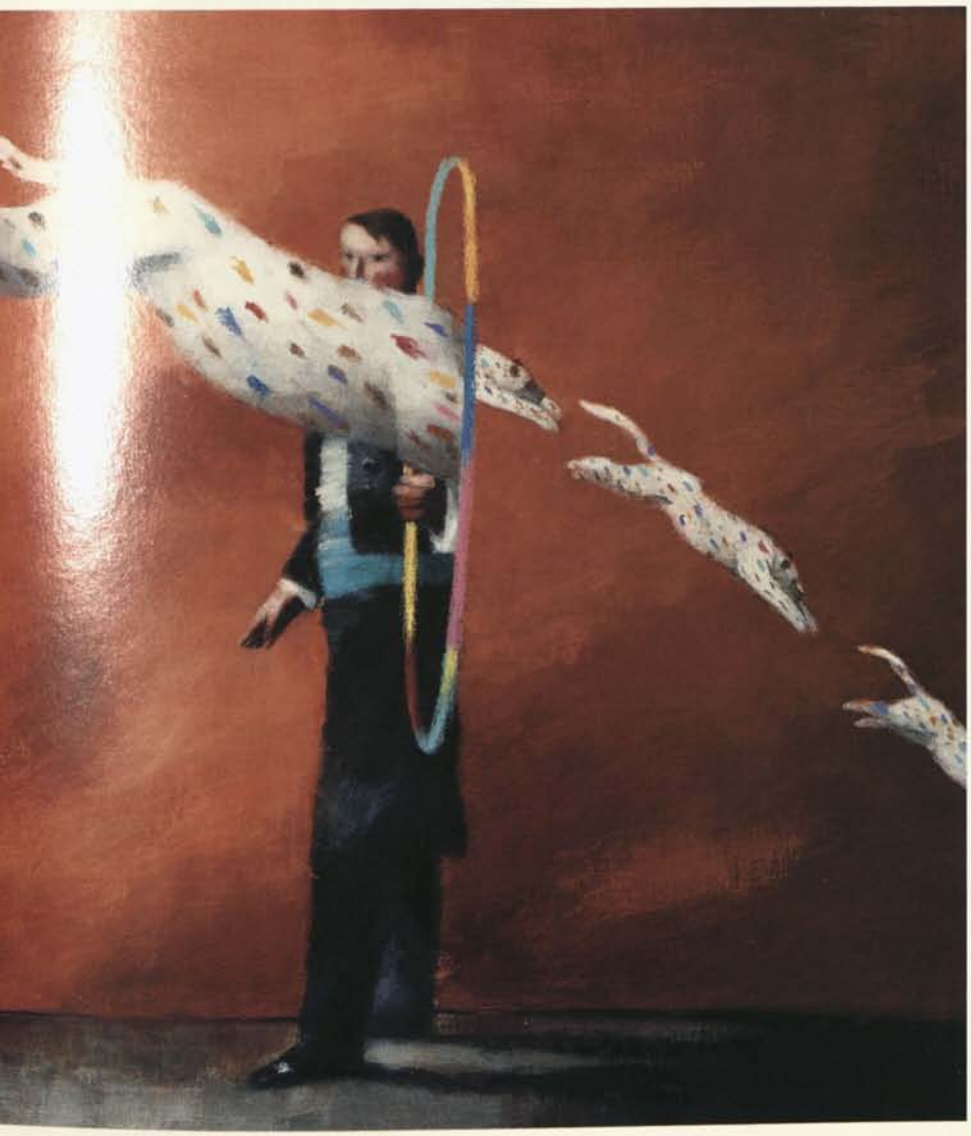
Business needs will now determine how and where transaction-processing applications are implemented. Large transaction-processing and database applications can be centralized on a cluster of VAX systems or distributed over a network of desktop or departmental systems. Small applications can run on small local systems.

Distributed transaction processing can often eliminate the need for dedicated systems. Transaction-processing applications can run concurrently in the same environment as office-automation, decision-support, and scientific and engineering applications. This provides organizational flexibility. Applications can be scaled up and down, be centralized or decentralized, as markets, technologies, and economic conditions change. This flexibility can help bring new products and services to market faster and improve customer service, while cutting the cost of ownership.

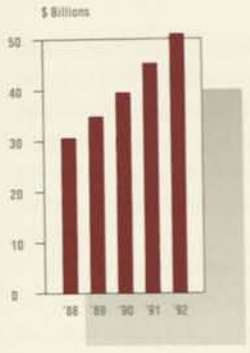
"Transaction processing is not so much an application as it is a style of computing, a way of implementing a manufacturing or commercial application. The functionality associated with TP used to be something that you could only find in a mainframe environment. Bringing TP into a distributed environment cuts costs, shortens time-to-market, and provides organizational flexibility."

Manfred Eicker, Commercial Managing Director

Bayerische Motoren Werke BMW AG



Cutting Time-to-Market While Lowering "Opportunity Cost"



Projected Worldwide Transaction Processing Market

With a worldwide distributed transaction-processing network, The Sumitomo Bank is dramatically reducing the time it takes to get a new investment product to market. Using Digital program development tools, Sumitomo programmers develop new applications on desktop VAX systems. These applications are then replicated or distributed over the entire network. Once an application is developed for one VAX computer, it will run on any other VAX computer. It will run on a larger system, a smaller system, a newer system or an older one—without any reprogramming.

In today's competitive, global economy only one new product in ten is a commercial success.

In many industries, being the first—or certainly one of the first—to market a new product or service often makes the difference between success and failure. But getting to market involves more than simply having a new or better idea. Manufacturing, marketing, and distribution systems have to be developed.

Digital's approach to transaction processing minimizes time-to-market by speeding the development of the support systems needed to test-market new products and services, ramp-up production, refine distribution strategies, and then scale-up operations, if test marketing confirms potential.

Distributed systems provide the ideal environment for software development, freeing programmers from the complexities of mainframe software. In fact, many software companies use VAX computers to develop mainframe applications.

They have a whole library of CASE (Computer Aided Software Engineering) and Artificial Intelligence) tools to work with. And every programmer can have a low-cost VAX development system that has the same functionality as a large VAX computer.

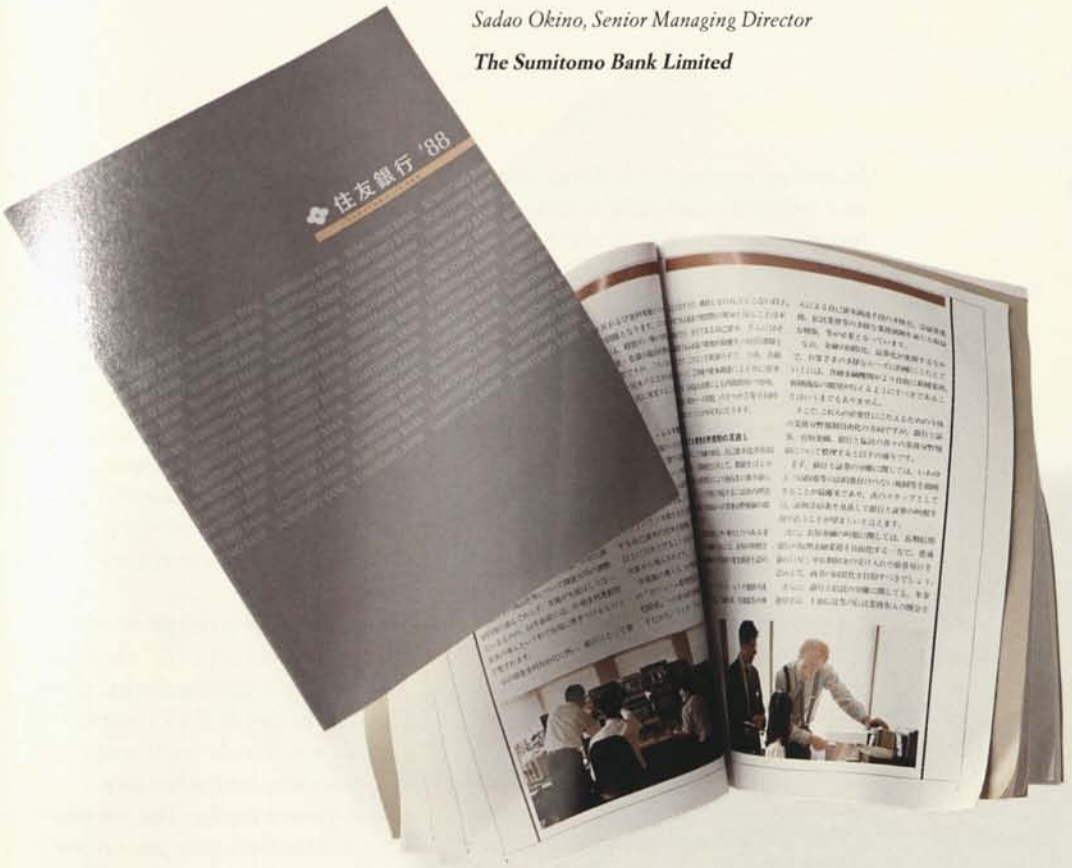
In addition to lower programming costs, distributed transaction processing can reduce operating costs. Studies show that distributed systems cost less per transaction than conventional mainframe systems.

Lower cost per transaction and faster application development are two of the reasons VAX distributed transaction-processing systems are being used to introduce stock options and futures trading in West Germany and Switzerland. And to implement computer-integrated manufacturing programs at BMW and other major manufacturers around the world.

"Developing a new product or service and getting it to market are two very different things. This is particularly true in the financial services industry. We are constantly developing new investment vehicles. Time-to-market is often dependent on the speed with which we can develop the computer applications we need to support those products."

Sadao Okino, Senior Managing Director

The Sumitomo Bank Limited



Making Customer Service a Competitive Advantage in a Service Economy

A network of distributed transaction-processing systems, like the VAX 6000-410 shown here, can match many mainframes in transaction-processing speed and functionality. In The Hartford's Group Operation, a cluster of VAX transaction-processing systems provides up-to-the-minute account information for agents and their customers.

Extended warranties, hotlines, service contracts, and telemarketing are just a few of the ways in which business is using customer service as a marketing tool.

When a retailer shortens the checkout line, when a distributor can tell a buyer exactly what's in stock and when it can be delivered, when an insurance company can provide immediate answers to telephone inquiries, business picks up.

Improving customer service is often dependent on bringing transaction processing closer to the point of sale. Automatic teller machines eliminate rush-hour lines at the bank while providing depositors with up-to-the-minute account balances. Checkout terminals provide immediate credit authorization. Shoppers no longer have to wait for a "blue pencil person" or supervisor to OK their purchases. Distributors can quote immediate delivery from inventory. Travel agents can confirm reservations as they're made.

Distributed computing makes things happ[illegible] It brings transaction processing [illegible]e point of sale. It keeps track [illegible]hange orders in large engineering [illegible]jects. It lets a sales representat[illegible]ce what's in the warehouse or w[illegible] a particular order stands in th[illegible]oduction cycle.

Distribu[illegible]ransaction processing can als[illegible]ed product development. For e[illegible]ple, pharmaceutical manufactur[illegible]se it to collect, analyze, and co[illegible]le the huge volume of data need[illegible] to win approval of a new drug.

Digital transaction-processing systems helped Toys "R" Us shorten checkout lines during the holiday rush. Networks of VAX computers provide worldwide trading systems for Sumitomo and other large money-center banks. The management at Hardee's now has online inventory and sales reports. The Hartford Insurance Group can now provide its agents with prompt answers to their customers' questions about group insurance coverage.

"At The Hartford Insurance Group, we define good service as providing prompt response to customers' questions. Information isn't worth much unless it's available – online – to the people who need it, when they need it."

Lou Abdou, Vice President, Life Systems

The Hartford Insurance Group

Reducing the Cost of Ownership With Distributed Transaction Processing

The MCU—Digital's Multiple Chip Unit—will provide companies like Hardee's with even more power for large-scale distributed transaction-processing applications. The MCU will power high-end VAX processors of the future. This new technology speeds signals by shortening interconnection paths. High-density interconnect technology is used in place of a conventional circuit board, eliminating chip carriers, so integrated circuits can be placed closer together.

Traditional transaction-processing systems were developed for large, stable, and not particularly time-critical applications. Transaction processing was seen as an accounting tool rather than a marketing weapon.

In this environment MIS managers focused on "cost per transaction." This is still a valid measurement. Distributed transaction processing reduces cost per transaction. But this tells only part of the story.

It ignores operating costs.

Studies have shown that distributed systems can cut these costs.

Operating costs include training and personnel costs, the cost of network operations, and, most importantly, the cost of developing new applications and supporting existing programs.

Transaction-processing applications must keep pace with business needs. There are very few applications that run unchanged from year to year. Business is constantly changing as the organization responds to technological change, to competition, and to changing customer demands and expectations.

Change mandates an approach to transaction processing that cuts application development, maintenance, training, and networking costs.

Digital transaction-processing networks can cost up to 50 percent less to operate than comparable networks from other vendors. Distributed systems cost less per unit of processing power than mainframes. Support, training, and programming costs are all lower.

This means that low-cost, full-function transaction processing can now be brought to a wider range of departmental and corporate applications.

"We looked at the total cost of implementing a transaction-processing application – at equipment costs, at the cost of program development and support, as well as cost per transaction. We found that cost of ownership really sets Digital apart. Distributed transaction processing is simply a more cost-effective approach."

William C. Burd, Vice President, Information Services

Hardee's Food Systems, Inc.

Imasco Limited

The Customer Challenge: Be Open – Support Whatever Solution or Technology Is Right for the Job That Has To Be Done

The Di[illegible] Initiative: Broade[illegible]rategic Relatio[illegible]ps to Support Multive[illegible]r Computing

The concept of "The Enterprise" as an organization encompassing a company, its suppliers, its customers, and the community demands an unequivocal commitment to multivendor computing.

No company can go it alone.

To support multivendor computing, Digital is broadening the network of strategic relationships that have enabled it to offer solutions to business problems other computer manufacturers have not addressed.

The idea of interactive computing, and later distributed data processing, came from customers looking for ways to bring computer resources closer to the work that needed to be done. Strategic relationships based on openness and trust are now helping Digital develop multivendor network integration to support the distributed data processing solutions of the 1990s.

In developing new systems, solutions, and services, Digital follows a well-marked path. Digital has a clearly defined, dynamic architecture designed to support a multivendor computing environment. Multivendor computing is the common vision shared by the entire Digital enterprise – customers, suppliers, software developers, channels of distribution, industry standards organizations, and university and industry research organizations.

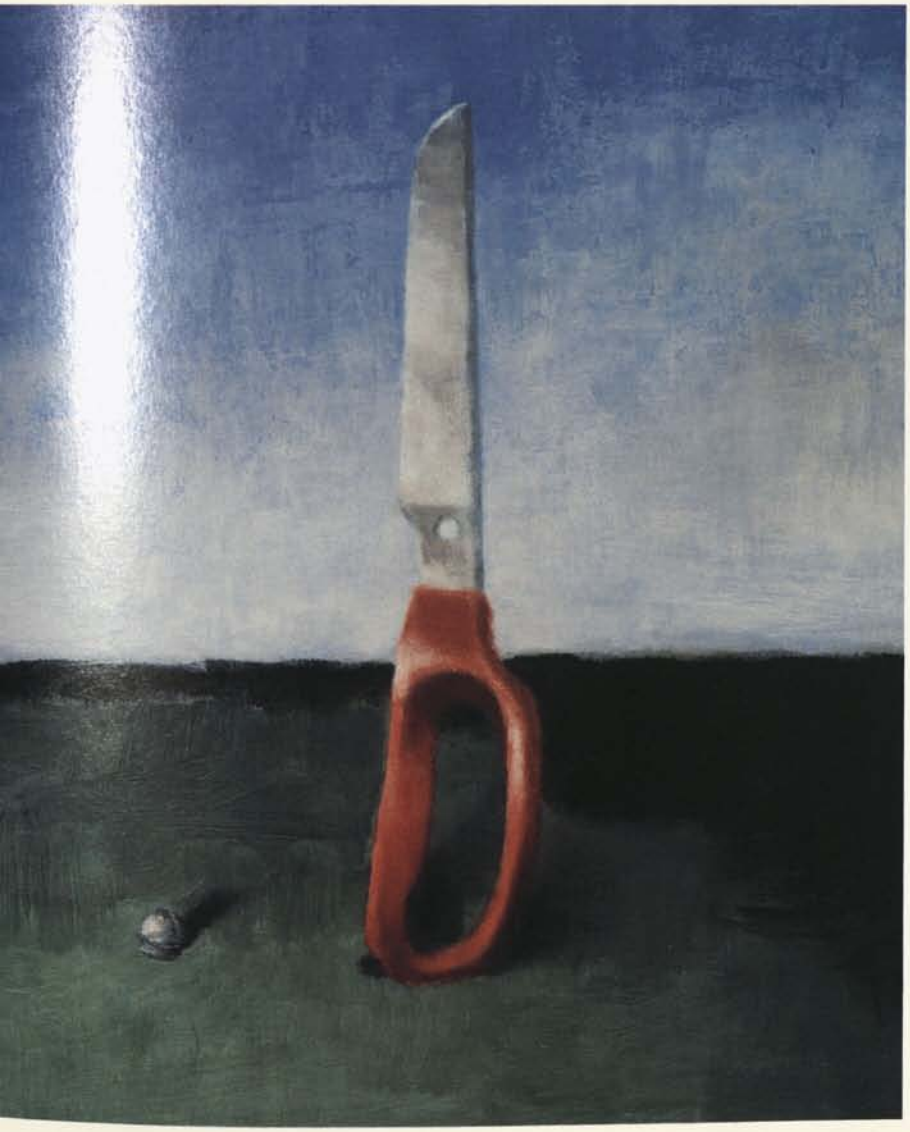
This focus on multivendor computing and the broadening network of relationships with other computer companies, software developers, and consultant organizations has helped to make Digital a major factor in the systems integration market. At the same time, these strategic relationships have enabled Digital to develop a complete range of multivendor support services.

Teamwork is critical in multivendor systems integration. The essence of teamwork is bringing the strengths and talents of different people together to achieve a common goal. This teamwork characterizes the way Digital people work together within the company, with our customers, and in the community.

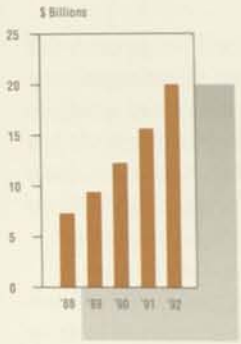
"Many customers are afraid to commit to new technology. They either want to wait until something better comes along or they want to make sure that new technology is fully accepted before they adopt it. You have to take customers into your confidence, show them where technology is going and how you are going to provide them with a continuing support program."

J. Tracy O'Rourke, President and Chief Executive Officer

Allen-Bradley Company



Systems Integration – Leveraging Current and Future Computer Investments



Projected U.S. Systems Integration Market
Source: G2 Research

Systems Integration is one of the fastest-growing segments of Digital's business. When Sweden's Asea and Switzerland's Brown Boveri merged to become the world's largest manufacturer of heavy electrical equipment, they were faced with the problem of integrating 170,000 employees and two different computer networks into a single, responsive organization. Digital was called in to help with systems integration.

Every computer system, every application program has to be justified on its own merits. Management wants to see a return on every investment.

In many cases a new system will pay for itself in less than three years and provide the purchaser with a 20- to 30-percent internal rate of return. But the real payback comes when individual systems are linked together to support the enterprise as a whole, rather than a particular application or department.

Systems integration is the process of building an enterprise network that will leverage current and future computer investments.

In an enterprise network, everything works together. Manufacturing is in step with Sales. Research and Development works with Engineering. Everyone shares information. Everyone works with the same data.

Unfortunately, though, a company can't go out and "buy" an enterprise network. It has to be built, step by step. Integrating computers built by different manufacturers, doing different jobs, a[illegible]orking in different departments [illegible]ires a real understanding of t[illegible]y people and organizations [illegible]k.

Digital ha[illegible] understanding. Digital is not [illegible] a systems integrator, a manufa[illegible]er of computer systems, or a [illegible]ldwide service organization. Digital [illegible] also a multinational laboratory in which new ways to integrate people, technology, and business goals are explored and tested.

There is no substitute for experience. That's why Digital is currently working with several hundred customers on major systems integration programs representing a total investment of nearly $1.3 billion. In manufacturing, Digital is working with companies like ABB Asea Brown Boveri. In government with the U.S. Census Bureau. And in banking with the London office of Bankers Trust, to develop a system for the bank's trading room that will distribute realtime market data and analysis to over 200 dealers simultaneously.

"1992. In just a matter of years, customs barriers that have separated one European nation from the next will come tumbling down. Europe will become one of the world's largest and wealthiest markets. But economic community means economic competition. Business can no longer structure itself along national lines."

Percy Barnevik, President and Chief Executive Officer

ABB Asea Brown Boveri

Enterprise Services – Controlling Operating Costs

The introduction of new products like the VAXstation 3100 system highlights the need for the kind of integrated support services Digital is providing British Gas. Over 360 VAX and VAXstation systems are being used to map a gas distribution system that covers the country. New equipment and applications, like Synercom's INFORMAP III, have to be integrated into existing networks. At British Gas, Digital is helping to plan, design, implement, and manage one of the largest computer mapping programs ever undertaken.

There is much more to service than a technician with a screwdriver. Digital's Enterprise Services support an ongoing, open process that integrates both individual applications and computers from different manufacturers into an enterprise-wide network.

"There has to be a framework around which you can build new applications," according to Robin Laidlaw, British Gas' Director of Information Technology. "This is particularly important to a company like British Gas, with exploration, production, distribution, and business operations spread across an entire country. That's why we chose Digital's ALL-IN-1 office information and communication architecture. New developments in this field will conform to this architecture."

Digital's Enterprise Services simplify implementation of applications and their integration on a multivendor network. When it is time to plan such a network, there's a clear path to follow.

These Digital services include strategic planning and design, implementation and management, and the migration, replication, and distribution of applications across the worldwide enterprise. In addition, Digital provides consulting, training, online preventive maintenance and – when needed – support from hardware and software. These services support the customer with multivendor computing environments. They are not limited to equipment and applications developed by Digital.

Digital provides service and support for more than 4,000 products and systems from over 100 different manufacturers.

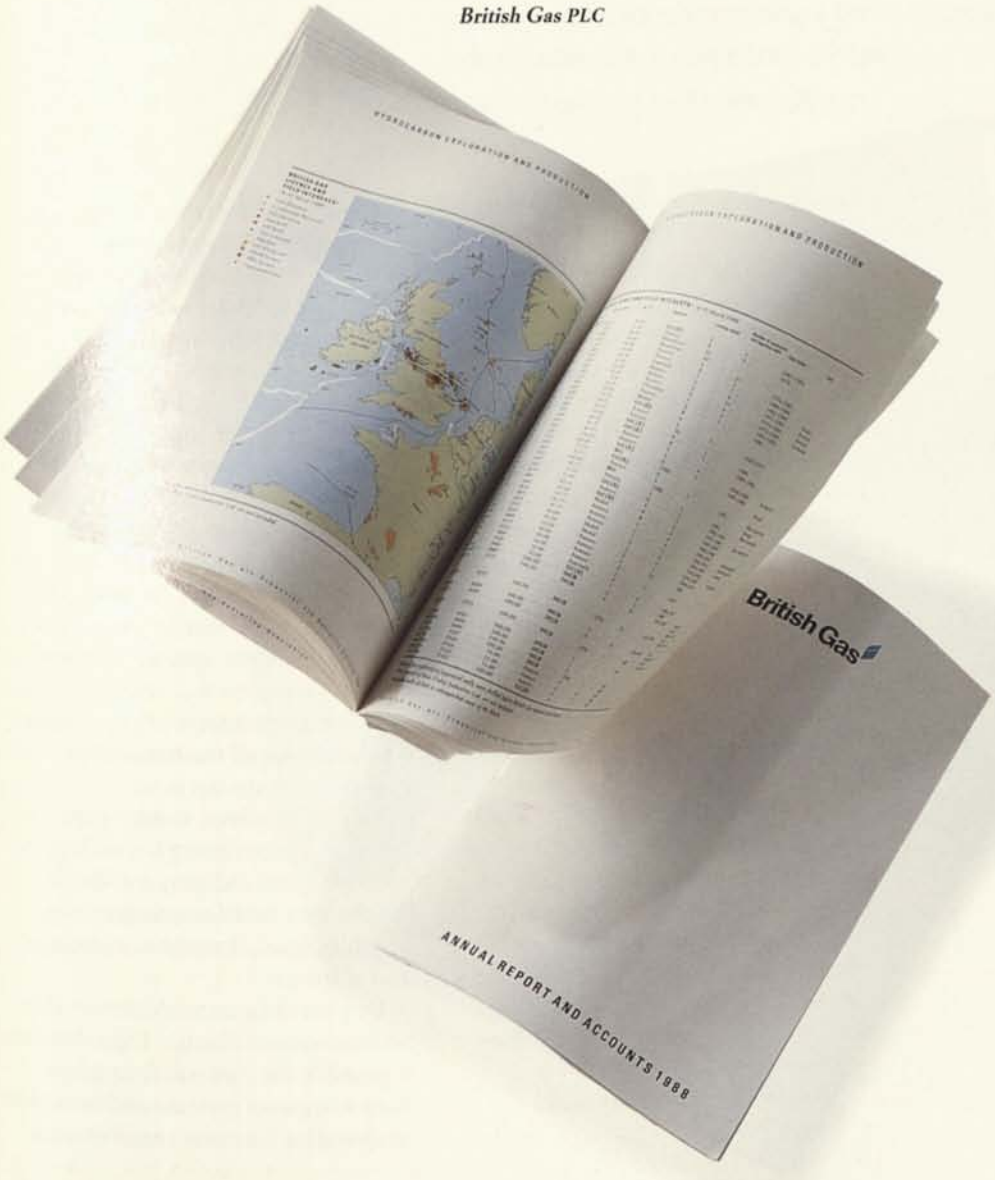
In addition, Digital has built a network of alliances that help assure multivendor interoperability. There are alliances with leading computer manufacturers including Cray Research, Apple, Olivetti, Tandy, and Toshiba. With manufacturers of control systems like Honeywell and Allen-Bradley. With Computer Associates, Ashton-Tate, and other major software developers. In addition, Digital has access to new technologies through alliances with SEMATECH and other research consortia and with key suppliers like MIPS Computer Systems and Motorola.

Digital is also establishing a program to formalize relationships with independent systems integration and service companies. Together this network of alliances enables Digital to provide the broad support needed in a multi-vendor computing environment.

"When we set out to map every gas main in Great Britain, we knew we were tackling an immense job. It's going to take five years to complete. That's why we looked for a systems supplier who could provide us with a continuous, integrated support service."

Mikes Ives, Digital Records Project Manager

British Gas PLC



An Open Architecture – Change Without Obsolescence

Matra Datavision, the world's leading supplier of solid-modeling technology, has ported its EUCLID-IS CAD/CAM/CAE software to Digital's new high-performance RISC workstations. EUCLID-IS integrates and manages design, analysis, and manufacturing applications to allow productive concurrent engineering. Matra Datavision's customers include the U.S. Air Force, Boeing, General Dynamics, Siemens, Digital, Bosch, Thyssen, Audi-Volkswagen, Renault, and CERN.

Computers can do much more than simply automate existing processes. They can provide the flexibility needed to update those processes, scale them up or down, or replicate them in other locations.

When two retail chains merge, when environmental regulations mandate the installation of new automobile emission systems, or when a defense contractor wins a multi-billion-dollar contract, existing computer systems have to adapt to change.

And the key to change without obsolescence, to maintaining future compatibility among past, present, and future hardware and software systems, is an open architecture.

A computer architecture breaks a system into a number of components – the processor, the network, the user interface, the application – and defines the relationships among those components. Most computer architectures are closed in that they are designed to protect proprietary technology.

The ability to support multi-vendor networks requires an open architecture that defines the way *different* hardware, software, and network components work together. The architecture is thought through, individual components can be changed without disturbing the operation of the system or the network as a whole.

For example, an open systems architecture can support a number of different operating systems. Different hardware technologies can support common applications and work together on the same network. And users can have a single, simple way to access all the computing resources on the network.

Digital's systems architecture integrates proprietary technology with accepted industry standards for the user interface, networking, graphics, mail, document exchange, and software.

By providing an architecture that accommodates change, Digital makes it possible for customers to adapt their computer systems and networks to changing business requirements.

"Matra Datavision is committed to building long-term strategic relationships with both customers and suppliers. Everyone talks about this, but Matra has made it a key business strategy. That's why we expect a computer vendor to provide us with technology that meets current standards and anticipates emerging ones. This is a prerequisite to maintaining a technological advantage that gives our customers a competitive edge."

Jean-Luc Lagardere, Chief Executive Officer

Matra

How Digital and Digital People Make Their Communities Better Places to Live and Work

"A long-term relationship between Digital and Boston's Children's Hospital helps children with impaired speech put thoughts into words. With the help of volunteer engineers and a million-dollar Digital grant, we've adapted the DECtalk commercial speech synthesizer to the needs of speech-impaired children. Children's DECtalk is a small, battery-operated unit that can be mounted on a wheelchair or carried to school."

Howard C. Shane, Ph.D., Director, Communication Enhancement Center

The Children's Hospital, Boston

Technology – when focused on the needs of the community – can make a difference.

Digital's relationship with Boston's Children's Hospital is an example. Digital has contributed equipment to the hospital for the development of a speech synthesizer based on Digital's DECtalk technology. Much of the engineering needed to adapt DECtalk technology to the needs of children was done by volunteer engineers from Digital. In addition, the company donated money to establish a loan fund to make DECtalk units available to children who cannot afford them.

This kind of relationship can be found in every country where Digital has major facilities. In Israel, Digital is working closely with The Technion (Israel Institute of Technology), in France with the Technological University of Compiegne, and in Germany with the University of Mannheim. In Italy, Digital is supporting E.N.E.A., a major public research center working to safeguard Venice from high tides and pollution. Digital has also been a long-term supp[illegible]er of the European Communi[illegible]outh Orchestra.

In the U[illegible] Digital underwrites *Evening A[illegible]ps* on over 270 public television [illegible]ons, and *The Infinite Voyage*, a [illegible]s of hour-long specials, broa[illegible]t over both public television [illegible]selected commercial stations t[illegible]ginatively present the latest adv[illegible]s in technology and science. D[illegible]l subsidiaries in Hong Kong, Sin[illegible]ore, and Taiwan are sponsorin[illegible]cal broadcasts of this science se[illegible]. Digital is also underwriting *Mo[illegible]t In The '90s*, a major art exhibition that will open in Boston in February 1990 and tour Chicago and London.

In all, Digital donated more than $35 million in cash and equipment to educational, health-care, civic, cultural, and environmental programs during the fiscal year, while matching $5.5 million in employee contributions to non-profit organizations.

By sharing time, talent, money, and technology, Digital, its employees, and the community reap the rewards of working together.

Financial Contents

Eleven-Year Financial Summary

Operations *(in millions except per share data)*	1989	1988	1987	1986
Revenues				
Product sales	$ 8,190	$ 7,541	$ 6,254	$ 5,103
Service and other revenues	4,552	3,934	3,135	2,487
Total operating revenues	12,742	11,475	9,389	7,590
Costs and Expenses				
Cost of product sales, service and other revenues	6,242	5,468	4,514	4,282
Research and engineering expenses	1,525	1,306	1,010	814
Selling general and administrative expenses	3,639	3,066	2,253	1,665
Operating income	1,336	1,635	1,612	829
Interest income	124	144	122	116
Interest expense	39	38	45	88
Income before income taxes	1,421	1,741	1,689	857
Provision for income taxes	348	435	552	240
Net income	$ 1,073	$ 1,306	$ 1,137	$ 617
Net income per share[1,2]	$ 8.45	$ 9.90	$ 8.53	$ 4.81
Weighted average shares outstanding	127	132	133	131
Financial Position *(in millions except per share data)*				
Inventories	$ 1,638	$ 1,575	$ 1,453	$ 1,200
Accounts receivable, net of allowance	$ 2,965	$ 2,592	$ 2,312	$ 1,903
Property, plant and equipment, at cost	$ 6,249	$ 5,210	$ 3,859	$ 3,263
Total assets	$ 10,668	$ 10,112	$ 8,407	$ 7,173
Long-term debt	$ 136	$ 124	$ 269	$ 333
Stockholders' equity	$ 8,036	$ 7,510	$ 6,294	$ 5,728
Stockholders' equity per share[2]	$ 66.12	$ 59.47	$ 49.87	$ 44.54
General Information and Ratios *(dollars in millions except stock prices)*				
Current ratio	2.9:1	2.9:1	3.4:1	4.9:1
Quick ratio	1.9:1	2.0:1	2.4:1	3.5:1
Working capital	$ 4,501	$ 4,516	$ 4,377	$ 4,223
Additions to property, plant and equipment	$ 1,223	$ 1,518	$ 748	$ 564
Depreciation	$ 659	$ 516	$ 435	$ 384
Debt to debt plus equity ratio	1.7%	1.6%	4.1%	5.5%
Operating income as a percentage of revenues	10.5%	14.2%	17.2%	10.9%
Income before income taxes as a percentage of revenues	11.2%	15.2%	18.0%	11.3%
Effective tax rate	24.5%	25.0%	32.7%	28.0%
Net income as a percentage of revenues	8.4%	11.4%	12.1%	8.1%
Net income as a percentage of average stockholders' equity	13.8%	18.9%	18.9%	12.0%
Net income as a percentage of average total assets	10.3%	14.1%	14.6%	9.1%
Number of days sales of accounts receivable outstanding	76	75	78	79
Inventory turns	3.9	3.6	3.4	2.9
Number of employees at year-end	125,800	121,500	110,500	94,700
Common shares outstanding *(in thousands)*	121,537	126,290	126,187	128,591
Stockholders at year-end	99,084	103,162	99,379	76,860
Common stock yearly high and low sales prices	$ 122-86	$ 199-99	$ 174-82	$ 94-46

1985	1984	1983	1982	1981	1980	1979
$ 4,530	$ 3,804	$ 2,828	$ 2,739	$ 2,313	$ 1,736	$ 1,338
2,156	1,780	1,444	1,142	885	632	466
6,686	5,584	4,272	3,881	3,198	2,368	1,804
4,087	3,379	2,606	2,188	1,779	1,320	1,012
717	631	472	350	251	186	139
1,432	1,179	831	758	632	479	370
450	395	363	585	536	383	283
63	41	61	103	60	54	36
82	35	13	15	29	27	24
431	401	411	673	567	410	295
(16)[1]	72	127	256	224	160	117
$ 447	$ 329	$ 284	$ 417	$ 343	$ 250	$ 178
$ 3.71	$ 2.87	$ 2.50	$ 3.76	$ 3.35	$ 2.73	$ 2.05
124	115	113	111	105	94	90
$ 1,756	$ 1,852	$ 1,354	$ 1,137	$ 1,102	$ 820	$ 514
$ 1,539	$ 1,527	$ 1,125	$ 808	$ 758	$ 629	$ 475
$ 2,828	$ 2,352	$ 1,961	$ 1,605	$ 1,128	$ 772	$ 582
$ 6,369	$ 5,593	$ 4,541	$ 4,024	$ 3,456	$ 2,666	$ 1,863
$ 837	$ 441	$ 93	$ 92	$ 88	$ 490	$ 341
$ 4,555	$ 3,979	$ 3,541	$ 3,165	$ 2,680	$ 1,652	$ 1,120
$ 38.43	$ 34.42	$ 31.42	$ 28.65	$ 24.65	$ 18.12	$ 13.79
4.9:1	3.8:1	3.9:1	4.1:1	4.2:1	4.5:1	3.8:1
2.8:1	1.9:1	2.0:1	2.3:1	2.3:1	2.6:1	2.3:1
$ 3,694	$ 3,001	$ 2,377	$ 2,181	$ 2,030	$ 1,658	$ 1,077
$ 572	$ 452	$ 419	$ 511	$ 399	$ 210	$ 94
$ 315	$ 253	$ 203	$ 153	$ 102	$ 70	$ 58
15.5%	10.0%	2.6%	2.8%	3.2%	22.9%	23.3%
6.7%	7.1%	8.5%	15.1%	16.8%	16.2%	15.7%
6.4%	7.2%	9.6%	17.3%	17.7%	17.3%	16.4%
(3.7%)[1]	18.0%	31.0%	38.0%	39.5%	39.0%	39.5%
6.7%	5.9%	6.6%	10.7%	10.7%	10.6%	9.9%
10.5%	8.7%	8.5%	14.3%	15.9%	18.0%	17.6%
7.5%	6.5%	6.6%	11.2%	11.2%	11.0%	10.6%
75	83	82	73	73	81	82
2.3	2.1	2.1	2.0	1.9	2.0	2.2
89,000	85,600	73,000	67,100	63,000	55,500	44,200
59,253	57,811	56,357	55,227	54,348	45,568	40,606
68,810	44,389	40,903	44,706	39,948	35,144	28,835
$ 63-39	$ 61-33	$ 65-32	$ 55-34	$ 55-29	$ 41-27	$ 29-22

[1] *See Note B of Notes to Consolidated Financial Statements.*
[2] *Per share data adjusted to reflect two-for-one stock split in May 1986.*
[3] *Includes elimination of DISC taxes of $63M accrued prior to 1984.*

Income and Expense Items as a Percentage of Total Operating Revenues				Percentage Changes		
1987	1988	1989	Income and Expense Items	1988-89	1987-88	1986-87
66.6%	65.7%	64.3%	Product sales	9%	21%	23%
33.4%	34.3%	35.7%	Service and other revenues	16%	25%	26%
100.0%	100.0%	100.0%	Total operating revenues	11%	22%	24%
40.5%	40.3%	42.3%	Cost of product sales	14%	20%	(5%)
63.2%	61.7%	60.9%	Service expense and cost of other revenues	14%	22%	23%
48.0%	47.7%	49.0%	Total cost of operating revenues	14%	21%	5%
10.8%	11.4%	12.0%	Research and engineering expenses	17%	29%	24%
24.0%	26.7%	28.5%	Selling, general and administrative expenses	19%	36%	35%
17.2%	14.2%	10.5%	Operating income	(18%)	1%	95%
1.3%	1.3%	1.0%	Interest income	(14%)	18%	5%
0.5%	0.3%	0.3%	Interest expense	4%	(16%)	(49%)
18.0%	15.2%	11.2%	Income before income taxes	(18%)	3%	97%
5.9%	3.8%	2.8%	Provision for income taxes	(20%)	(21%)	130%
12.1%	11.4%	8.4%	Net income	(18%)	15%	84%

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 July 1, 1989 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

In 1989, the Company's operating revenues grew by 11% compared with the prior year. As has been the case for several years, growth overseas exceeded that in the United States. For the year, international revenues accounted for approximately 55% of the Company's total revenues with growth particularly strong in Western Europe and Japan. The Company has invested considerably in its overseas operations in terms of sales, marketing and distribution resources. In recognition of the growing importance of overseas markets, the Company hosted DECWORLD '88 in Cannes, France during its first quarter. DECWORLD '88 was an international demonstration of distributed network computing.

Product sales, which account for nearly two-thirds of operating revenues, increased by 9% in 1989, following increases of 21% in 1988 and 23% in 1987. The Company's VAX architecture and networking products, which allow customers to build enterprise-wide distributed data processing networks, contributed to the improvement in product sales. The reduced rate of growth of product sales reflects the slow pace of business in the U.S. and a change in demand for the industry, favoring mid-range and low-end products. The Company responded to this change in demand by introducing a number of new computer systems for both UNIX and Digital's own VMS operating systems, as well as a variety of software and service products.

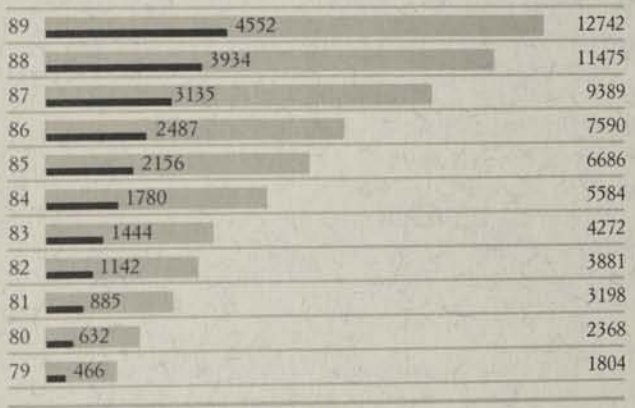
Customer demand during the year was particularly strong for the Company's VAX 6000 computer systems, VAX workstations and peripherals. During the year, the Company shipped approximately 50,000 workstations and over 562,000 terminal products. Two year totals were 80,000 and 1,100,000 units respectively, attesting to the continuing strength of this class of products. A number of other products also contributed to the growth of product sales.

While demand for the Company's mid-range and low-end products was good, sales of the Company's high-end 8000 series computers declined as the year progressed. Shifts in customer demand, the attractiveness of other VAX computer systems and anticipation of the announcement of a more powerful high-end computer system contributed to this decline.

The Company believes it has the technology, products and services needed to integrate a multivendor environment, thereby responding to customer needs and allowing for future growth.

In 1989, service and other revenues, which primarily include maintenance, software support, consulting services, customer training and the sale of replacement parts, grew by $600 million or 16%, following increases of 25% in 1988 and 26% in 1987. Service revenue growth slowed somewhat from the prior two years reflecting the same factors that affected product sales. Service revenues also were affected by changes in the warranty policy in the U.S., the high level of product quality and improvements in product price performance that lead to product replacement instead of maintenance.

Total Operating Revenues **$ Millions**



Non-United States Revenues **$ Millions**

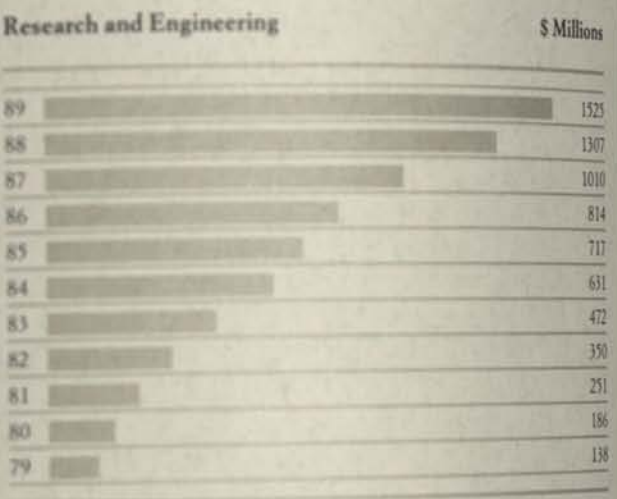
Expenses and Profit Margins

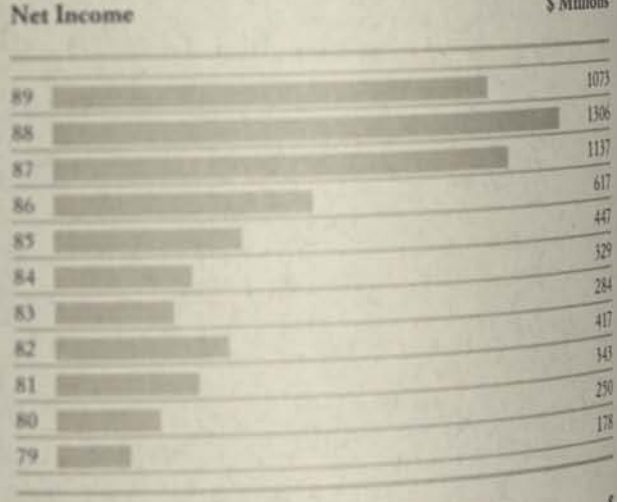
The Company's gross margin declined from the previous year, reflecting primarily competitive pricing pressures and a shift in the Company's mix of product revenues away from larger systems toward smaller desktop systems. This shift reflects a trend evident throughout much of the industry – customers are migrating applications to more of a distributed data processing environment and placing computer resources in the hands of the ultimate user. Service gross margin was slightly higher than the previous year.

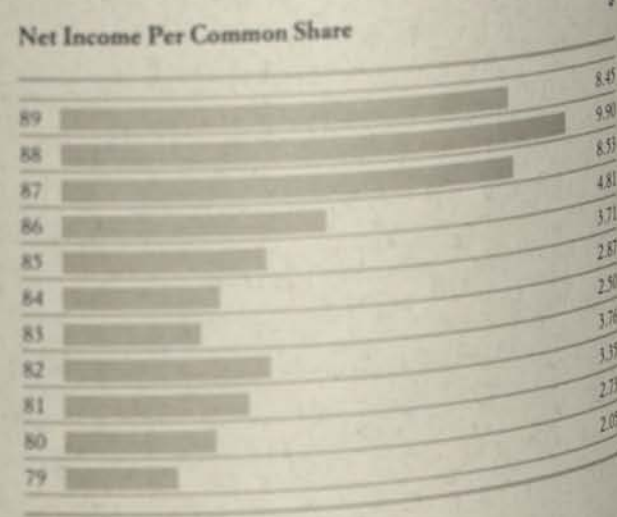
The Company continued to be among the leaders in the industry in its commitment to research and engineering investment. Such investment is critical to maintaining a strong competitive position and ensuring future growth. Research and engineering expenses grew 17% in 1989 and represented 12% of total operating revenues, compared with 11.4% in 1988 and 10.8% in 1987. For the last three years combined, the Company's investment in research and engineering exceeded $3.8 billion. Approximately 8,300 professional employees are involved in a number of research, engineering and programming activities around the world. These activities include developing or enhancing systems and related peripheral equipment and software, expanding product applications, and multivendor systems integration.

During 1989, the Company entered into a comprehensive technology exchange for current and future RISC (reduced instruction set computing) technology and designs developed by MIPS Computer Systems, Inc., of Sunnyvale, California. With the addition of ULTRIX/OSF systems using RISC technology, the Company is able to offer customers more versatility in matching technology to application demands. RISC/ULTRIX and VAX/VMS will be alternative technologies within the Company's system architecture.

The Company announced many new products during the year, the result of its commitment to research and engineering investment. Among the new products were DECtp, allowing for an enhanced transaction processing environment; Digital Enterprise Services, a portfolio of services to aid systems integration; and Digital Enterprise Management Architecture, an open network-management system designed to tie multiple voice and data systems together.







Supporting its desktop initiative, the Company introduced DECstation 210, 316 and 320 systems, a family of industry-standard personal computers; DECstation 3100, a RISC-based desktop workstation; VAXstation 3100, a VAX-based high-performance workstation; and a series of server products that link PC's in work groups and PC's and workstations in local area networks. Also announced as part of the desktop initiative were a number of software, disk and tape drive and imaging products.

The Company expanded its presence in the distributed computing market with the announcement of MicroVAX 3300 and MicroVAX 3400 computer systems, which essentially replace the MicroVAX II line and deliver twice the price performance. Shortly after the close of the second quarter the Company announced VAX 6300 systems, enhancements to the popular VAX 6200 computer; DECsystem 3100, a multiuser, RISC-based system for general purpose computing; and MicroVAX 3800 and 3900 systems with improved performance and storage capacity.

Selling, general and administrative expenses increased 19% over the previous year, and represented 28.5% of total operating revenues compared with 26.7% in 1988 and 24% in 1987. The Company continued to invest in its sales, sales support and marketing efforts to ensure sales growth and to further enhance customer support. Much of the increase in spending represented the addition of personnel added to support growth in overseas markets.

Operating income in 1989 declined 18% from that of the previous two years. Flat year-to-year revenues in the U.S. and a higher level of operating expenses led to the decline.

Interest income in 1989 decreased from 1988 levels, reflecting lower cash balances after the Company repurchased $815 million of its common stock on the open market. Interest expense was essentially unchanged from the previous year.

The Company's effective tax rate for 1989 was 24.5%, down slightly from 25% in 1988.

During December 1987, the Financial Accounting Standards Board issued a new accounting standard for income taxes, SFAS No. 96, which will require the Company to adjust its deferred tax assets and liabilities. The Company must adopt SFAS No. 96 no later than December 29, 1990. Management expects that the adoption of SFAS No. 96 will not have a material impact on the Company's consolidated financial position and results of operations. There will be no cash flow impact from these adjustments.

The total number of employees at year-end was 125,800, an increase of approximately 4,300 over the previous year.

Return on equity, the ratio of net income to average stockholders' equity, was 13.8% in 1989 and 18.9% in both 1988 and 1987.

Employee Population **Thousands**

Availability of Funds to Support Current and Future Operations

Cash to support the Company's operations has historically been met with internally generated cash supplemented with external financing. During 1989, internally generated cash was more than sufficient to support operations.

During the three-year period of 1987-1989, cash generated from operating activities exceeded cash used for investing activities by $1,231 million. In 1989, net cash generated from operations and investments was $189 million, compared with $161 million in 1988 and $881 million in 1987.

The Company repaid at maturity $150 million of 11¾% Guaranteed Notes in March 1989. Total long-term debt, exclusive of current maturities, was $136 million at the end of 1989.

In October 1988, the Board of Directors authorized the repurchase of up to ten million shares of the Company's common stock on the open market. During 1989, the Company purchased 8.25 million shares of common stock at a total cost of $815 million. The shares are being held as treasury stock.

Cash and temporary cash investments were $1,655 million at the end of 1989, compared to $2,164 million at the end of 1988. The decline in cash and temporary investments in 1989 reflects the repurchase of common stock and the repayment of debt. Unused lines of credit at the end of 1989 were $576 million.

The Company's financial performance, together with its substantial reserve debt capacity and high credit rating, leave it well positioned to obtain cash required for future growth.

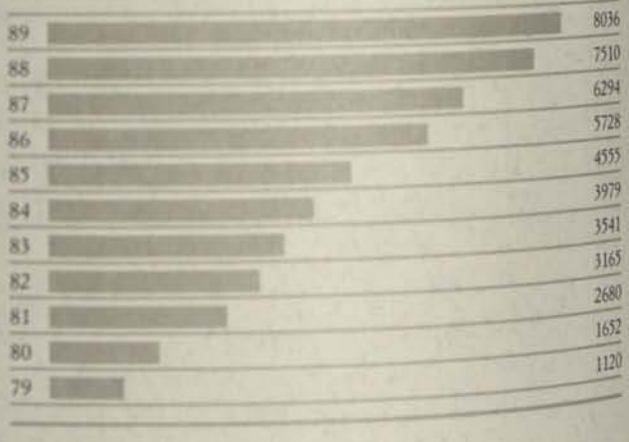
Common Stock Information

The Company's common stock is listed and traded on the Midwest Stock Exchange, New York Stock Exchange, Pacific Stock Exchange and several European stock exchanges. There were 99,084 stockholders of record as of July 1, 1989. The high and low quarterly sales prices for the past two fiscal years are presented below.

		1989
Fiscal Quarter	High	Low
First	$117	$91½
Second	99⅜	86⅜
Third	122⅜	95¼
Fourth	102½	89¼

		1988
Fiscal Quarter	High	Low
First	$198¼	$157½
Second	199½	110
Third	144¾	103¾
Fourth	115⅞	99¼

Total Stockholders' Equity — $ Millions



Spending for Operations

During 1989, the Company continued to make significant investments for the long term, while maintaining a strong financial position.

The Company invested $1,223 million in property, plant and equipment in 1989 compared with $1,518 million in 1988. Of this total, about two-thirds was spent for machinery and equipment primarily related to ensuring continued advances in technology, quality and efficiency in the Company's products and services, and throughout its operations. The balance of the capital spending was for land, buildings and leasehold improvements.

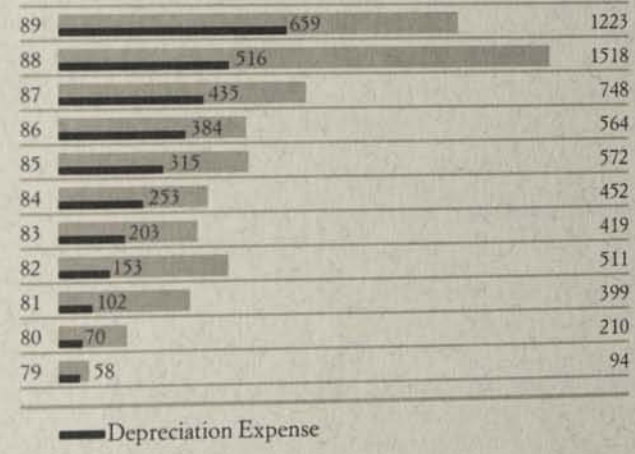
Although revenues increased by 11%, inventories grew only 4% from the prior year. The increase was more than accounted for by higher finished goods inventories as the Company prepared for a number of new product announcements shortly after the close of the fiscal year. Average year inventory turned 3.9 times, an improvement from 3.6 times in 1988 and 3.4 times in 1987. Accounts receivable grew 14% in 1989, slightly greater than the percentage growth in revenues. Days sales in accounts receivable outstanding were 76 days compared with 75 days in the prior year.

Return on assets, the ratio of net income to average total assets, was 10.3% in 1989, 14.1% in 1988 and 14.6% in 1987. The decrease in 1989 reflects a decrease in net income and growth in fixed assets.

The Company added approximately 3.8 million square feet of building space in 1989, bringing the total amount of space to 42.3 million square feet in over 1,100 owned and leased facilities. This compares with 38.5 million square feet in 1988 and 33.6 million square feet in 1987. More than half of the additional space was put in place to support overseas operations, and includes a state-of-the-art semiconductor manufacturing facility in South Queensferry, Scotland.

The Company will continue to invest for the future, and anticipates that its capital spending level in 1990 will be in the same general range as that of 1989. The actual level of spending will be dependent on a variety of factors, including worldwide economic conditions, growth in demand for the Company's products and services and changes in semiconductor and manufacturing process technology.

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



Report of Management

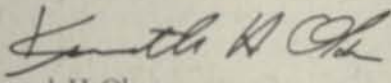
The Company's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of all the financial data included in this Annual Report. In preparing the financial statements, management makes informed judgments 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.

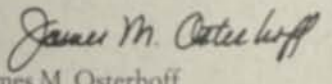
The Board of Directors, through its Audit Committee, is responsible for determining that management fulfills its responsibility with respect to the Company's financial statements and the system of internal accounting controls.

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 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

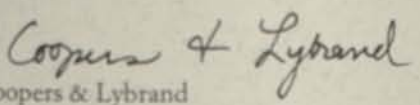
Report of Independent Accountants

To The Stockholders and Directors,
Digital Equipment Corporation

We have audited the accompanying consolidated balance sheets of Digital Equipment Corporation as of July 1, 1989 and July 2, 1988 and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three fiscal years in the period ended July 1, 1989. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Digital Equipment Corporation as of July 1, 1989 and July 2, 1988 and the consolidated results of its operations and cash flows for each of the three fiscal years in the period ended July 1, 1989 in conformity with generally accepted accounting principles.



Coopers & Lybrand

Boston, Massachusetts
July 27, 1989

Consolidated Statements of Income

(in thousands except per share data)	Year Ended		
	July 1, 1989	July 2, 1988	June 27, 1987
Revenues *(Notes A and C)*			
Product sales	**$ 8,190,308**	$ 7,541,241	$6,254,187
Service and other revenues	**4,551,648**	3,934,205	3,135,257
Total operating revenues	**12,741,956**	11,475,446	9,389,444
Costs and Expenses *(Notes A, D and I)*			
Cost of product sales	**3,468,307**	3,042,172	2,532,259
Service expense and cost of other revenues	**2,773,563**	2,426,176	1,981,635
Research and engineering expenses	**1,525,129**	1,306,543	1,010,438
Selling, general and administrative expenses	**3,638,868**	3,065,555	2,253,105
Operating income	**1,336,089**	1,635,000	1,612,007
Interest income	**124,021**	143,665	122,149
Interest expense	**39,435**	37,820	45,203
Income before income taxes	**1,420,675**	1,740,845	1,688,953
Provision for income taxes *(Notes A and E)*	**348,065**	435,212	551,518
Net Income	**$ 1,072,610**	$ 1,305,633	$1,137,435
Net income per share *(Note B)*	**$ 8.45**	$ 9.90	$ 8.53
Weighted average shares outstanding *(Note B)*	**127,008**	131,923	133,305

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

Consolidated Balance Sheets

(in thousands)	July 1, 1989	July 2, 1988
Assets		
Current Assets		
Cash and temporary cash investments *(Note F)*	$ 1,655,264	$ 2,163,580
Accounts receivable, net of allowance of $74,345 and $78,148	2,965,408	2,592,160
Inventories *(Note A)*		
Raw materials	360,135	392,734
Work-in-process	570,064	555,229
Finished goods	707,802	627,096
Total inventories	1,638,001	1,575,059
Prepaid expenses	255,195	274,160
Net deferred Federal and foreign income tax charges	381,140	324,962
Total Current Assets	6,895,008	6,929,921
Property, Plant and Equipment, at cost *(Note A)*		
Land	300,540	299,157
Buildings	1,599,673	1,283,048
Leasehold improvements	530,773	458,449
Machinery and equipment	3,817,587	3,169,792
Total property, plant and equipment, at cost	6,248,573	5,210,446
Less accumulated depreciation	2,602,677	2,115,421
Net property, plant and equipment	3,645,896	3,095,025
Other assets, net *(Note G)*	126,875	86,610
Total Assets	$10,667,779	$10,111,556
Liabilities and Stockholders' Equity		
Current Liabilities		
Bank loans and current portion of long-term debt *(Note H)*	$ 29,755	$ 154,670
Accounts payable	553,818	523,173
Federal, foreign and state income taxes	445,977	504,195
Salaries, wages and related items	300,393	257,663
Deferred revenues and customer advances *(Note A)*	833,831	727,984
Other current liabilities	230,265	246,419
Total Current Liabilities	2,394,039	2,414,104
Net deferred Federal and foreign income tax credits	102,048	63,154
Long-term debt *(Note H)*	136,019	123,924
Total Liabilities	2,632,106	2,601,182
Stockholders' Equity *(Notes I and J)*		
Common stock, $1.00 par value; authorized 450,000,000 shares; issued 130,008,231 shares	130,008	130,008
Additional paid-in capital	2,469,711	2,424,391
Retained earnings	6,366,418	5,463,050
Treasury stock at cost; 8,471,655 shares and 3,718,375 shares	(930,464)	(507,075)
Total Stockholders' Equity	8,035,673	7,510,374
Total Liabilities and Stockholders' Equity	$10,667,779	$10,111,556

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

Consolidated Statements of Cash Flows

(in thousands)	Year Ended		
	July 1, 1989	July 2, 1988	June 27, 1987
Cash Flows from Operating Activities			
Net income	**$1,072,610**	$1,305,633	$1,137,435
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	**686,738**	527,141	436,118
Other adjustments to income	**49,702**	66,349	74,109
(Increase) in accounts receivable	**(373,248)**	(279,972)	(408,901)
(Increase) in inventories	**(62,942)**	(122,140)	(253,163)
(Increase)/decrease in prepaid expenses	**18,965**	(154,967)	(33,919)
Increase in accounts payable	**30,645**	92,598	171,010
Increase/(decrease) in taxes	**(75,502)**	92,600	190,418
Increase in deferred revenues & customer advances	**105,847**	252,059	222,135
Increase/(decrease) in other liabilities	**26,576**	(80,916)	174,573
Total adjustments	**406,781**	392,752	572,380
Net cash flows from operating activities	**1,479,391**	1,698,385	1,709,815
Cash Flows from Investing Activities			
Purchase of plant, property, and equipment	**(1,223,038)**	(1,517,579)	(748,359)
(Increase) in other assets, net	**(67,624)**	(19,212)	(80,463)
Net cash flows from investing activities	**(1,290,662)**	(1,536,791)	(828,822)
Net cash flows from operating and investing activities	**188,729**	161,594	880,993
Cash Flows from Financing Activities:			
Proceeds from issuance of debt	**40,425**	7,283	0
Payments to retire debt	**(153,245)**	(2,854)	(81,187)
Purchase of treasury shares	**(814,958)**	(363,499)	(781,790)
Proceeds from issuance of treasury shares	**230,733**	242,761	189,346
Net cash flows from financing activities	**(697,045)**	(116,309)	(673,631)
Net increase/(decrease) in cash and cash equivalents	**(508,316)**	45,285	207,362
Cash and cash equivalents at the beginning of year	**2,163,580**	2,118,295	1,910,933
Cash and cash equivalents at end of year	**$1,655,264**	$2,163,580	$2,118,295

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	Treasury Stock	Total Stockholders' Equity
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
Tax benefits related to stock option and purchase plans *(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
Purchase of 3,000,000 shares of treasury stock *(Note J)*				(363,499)	(363,499)
Shares issued under stock option and purchase plans *(Note I)*			(252,825)	456,142	203,317
Restricted stock plans, charge to operations		32,008			32,008
Tax benefits related to stock option and purchase plans *(Note I)*		39,444			39,444
Net income – 1988			1,305,633		1,305,633
July 2, 1988	$130,008	$2,424,391	$5,463,050	$(507,075)	$7,510,374
Purchase of 8,247,000 shares of treasury stock *(Note J)*				**(814,958)**	**(814,958)**
Shares issued under stock option and purchase plans *(Note I)*			**(169,242)**	**391,569**	**222,327**
Restricted stock plans, charge to operations		**36,914**			36,914
Tax benefits related to stock option and purchase plans *(Note I)*		**8,406**			8,406
Net income – 1989			**1,072,610**		1,072,610
July 1, 1989	**$130,008**	**$2,469,711**	**$6,366,418**	**$(930,464)**	**$8,035,673**

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. Monetary assets and liabilities of foreign subsidiaries are translated into U.S. dollars at current exchange rates. Nonmonetary assets such as inventories and property, plant and equipment are translated at historical rates. Income and expense items are translated at average exchange rates prevailing during the year, except that inventories charged to 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, in 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.

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.

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	3 to 10 years (accelerated methods)

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 years ended July 1, 1989, July 2, 1988 and June 27, 1987, common share equivalents were attributable to stock options.

Cash dividends have never been paid by the Company.

Note C – International Operations

(in thousands)	Year Ended		
	July 1, 1989	July 2, 1988	June 27, 1987
Revenues			
United States customers	**$ 5,848,975**	$ 5,810,598	$ 5,016,606
Intercompany	**2,103,290**	2,017,928	1,921,043
	7,952,265	7,828,526	6,937,649
Europe customers	**5,130,052**	4,221,631	3,252,482
Intercompany	**113,820**	137,669	114,582
	5,243,872	4,359,300	3,367,064
Canada, Far East, Americas customers	**1,762,929**	1,443,217	1,120,356
Intercompany	**1,065,746**	912,786	659,204
	2,828,675	2,356,003	1,779,560
Eliminations	**(3,282,856)**	(3,068,383)	(2,694,829)
Net revenue	**$12,741,956**	$11,475,446	$ 9,389,444
Income			
United States	**$ 510,364**	$ 512,754	$ 758,795
Europe	**815,655**	770,135	634,543
Canada, Far East, Americas	**411,267**	390,787	278,359
Eliminations	**(401,197)**	(38,676)	(59,690)
Operating income	**1,336,089**	1,635,000	1,612,007
Interest income	**124,021**	143,665	122,149
Interest expense	**39,435**	37,820	45,203
Income before income taxes	**$ 1,420,675**	$ 1,740,845	$ 1,688,953
Assets			
United States	**$ 5,499,763**	$ 5,245,439	$ 4,627,838
Europe	**3,420,247**	3,093,818	2,246,333
Canada, Far East, Americas	**1,298,519**	1,293,906	843,067
Corporate assets *(temporary cash investments)*	**1,469,842**	2,057,528	1,979,470
Eliminations	**(1,020,592)**	(1,579,135)	(1,289,322)
Total assets	**$10,667,779**	$10,111,556	$ 8,407,386

Note C–International Operations (continued)

Industry ☐ The Company's business consists of the design, manufacture, sale and service of network 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 Europe. The products of these manufacturing plants are sold to the Company's sales subsidiaries, the parent corporation or other 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 the United States, including U.S. export sales, were $7,016,952,000, $5,729,879,000 and $4,412,527,000 for the years ended July 1, 1989, July 2, 1988 and June 27, 1987, respectively, which represented 55%, 50%, and 47%, 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 $3,426,975,000, $2,793,239,000 and $2,070,337,000 at July 1, 1989, July 2, 1988 and June 27, 1987, respectively.

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.

It is the Company's policy to make contributions to the plans in accordance with local laws and 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. For the U.S. pension plan, there were no contributions in fiscal 1989 due to the full funding limit of the Omnibus Budget Reconciliation Act of 1987. 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 years ended July 1, 1989, July 2, 1988 and June 27, 1987, respectively. The measurement dates for all plans were within 90 days of year-end.

Net periodic pension cost for fiscal years 1989, 1988 and 1987 included the following components:

(in thousands)	1989	1988	1987
Service cost-benefits earned during the period	$ 188,068	$ 160,225	$ 126,977
Interest cost on projected benefit obligation	111,095	90,283	67,695
Actual return on plan assets	(230,671)	590	(187,541)
Net amortization and deferral	84,129	(124,714)	93,272
Net periodic pension cost	$ 152,621	$ 126,384	$ 100,403
Total net periodic pension cost for all pension plans	$ 166,848	$ 138,308	$ 110,365

Note D – Pension Plans and Other Retirement Benefits (continued)

The significant actuarial assumptions as of the year-end measurement date were as follows:

	1989	1988	1987
U.S. pension plan:			
Discount rate	9.0%	9.0%	8.5%
Expected long-term rate of return on plan assets	9.5%	9.5%	9.5%
Rate of increase in future compensation levels	6.8%	7.0%	6.5%
Non-U.S. pension plans:			
Discount rate	5.0-12.5%	5.0-11.5%	5.0- 9.0%
Expected long-term rate of return on plan assets	5.0-10.0%	5.0-10.0%	5.5-10.0%
Rate of increase in future compensation levels	4.0- 9.5%	5.3-10.5%	5.8- 7.5%

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

(in thousands)	1989	1988
Actuarial present value of benefit obligations:		
Vested benefit obligation	$ (472,004)	$ (382,457)
Accumulated benefit obligation	$ (552,685)	$ (448,903)
Projected benefit obligation	$(1,570,855)	$(1,375,916)
Plan assets at fair value	1,884,146	1,592,023
Plan assets in excess of projected benefit obligation	313,291	216,107
Contributions made after measurement date but before end of fiscal year	3,112	2,874
Unrecognized net (gain) loss	(140,296)	35,628
Unrecognized prior service cost	25,149	27,719
Unrecognized transition asset, net	(147,320)	(158,678)
Pension cost recognized on the balance sheet	$ 53,936	$ 123,650

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 $1,565,000, $1,025,000 and $864,000 for the years ended July 1, 1989, July 2, 1988 and June 27, 1987, 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 E – Income Taxes

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

(in thousands)			*Year Ended*
	July 1, 1989	July 2, 1988	June 27, 1987
Domestic	**$530,298**	$ 773,679	$ 832,638
Foreign	**890,377**	967,166	856,315
Total	**$1,420,675**	$1,740,845	$1,688,953

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

	1989	1988	1987
U.S. Federal statutory tax rate	**34.0%**	34.0%	46.0%
Tax benefit of manufacturing operations in: (a)			
Puerto Rico	**(3.9)**	(2.6)	(3.4)
Ireland	**(3.3)**	(2.4)	(4.1)
Singapore	**(0.4)**	(0.7)	(1.5)
Taiwan	**(0.4)**	(0.4)	(0.5)
Research and engineering credit	**(1.5)**	(1.6)	(1.1)
State income taxes	**0.8**	1.9	1.5
Other	**(0.8)**	(3.2)	(4.2)
Effective tax rate	**24.5%**	25.0%	32.7%

(a) The Company's manufacturing subsidiary operating in Puerto Rico is subject to tax at a rate of approximately 8% on its manufacturing earnings through fiscal year 2003. The income from products manufactured for export by the Company's Irish manufacturing subsidiary is exempt from Irish taxes through April 1990. After that time, the Irish manufacturing operations will be subject to a 10% tax rate through December 1999. The income from certain products manufactured by the Company's Singaporean manufacturing subsidiary is wholly exempt from Singaporean taxes through December 1990 and partially exempt through December 1993. The income from certain products manufactured by the Company's manufacturing subsidiary operating in Taiwan is wholly exempt from Taiwanese taxes through May 1991.

Note E–Income Taxes (continued)

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

(in thousands)	Year Ended		
	July 1, 1989	July 2, 1988	June 27, 1987
U.S. Federal:			
Current	**$136,331**	$175,079	$264,966
Deferred	**(6,775)**	(80,118)	32,118
Total	**$129,556**	$ 94,961	$297,084
Foreign:			
Current	**$211,652**	$259,246	$200,416
Deferred	**(10,861)**	31,483	5,346
Total	**$200,791**	$290,729	$205,762
State income taxes	**$ 17,718**	$ 49,522	$ 48,672
Total income taxes	**$348,065**	$435,212	$551,518

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 July 1, 1989, July 2, 1988 and June 27, 1987, and the tax effect of each were as follows:

(in thousands)	Year Ended		
	July 1, 1989	July 2, 1988	June 27, 1987
Inventory related transactions	**$ (7,390)**	$ 23,417	$ 6,943
Installment sales, principally intercompany, and financing leases	**(1,086)**	(79,317)	38,054
Deferred warranty revenue	**14,687**	(99,510)	(14,303)
Depreciation	**3,670**	12,648	4,957
Capitalized software development costs	**3,375**	33,575	11,265
Other	**(30,892)**	60,552	(9,452)
Total	**$(17,636)**	$(48,635)	$37,464

In connection with its normal examinations of the Company's 1982 and 1983 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 December 1987, the Financial Accounting Standards Board issued a new accounting standard for income taxes, SFAS No. 96, which will require the Company to adjust its deferred tax assets and liabilities. The Company must adopt SFAS No. 96 no later than December 29, 1990. Management does not expect that the adoption of SFAS No. 96 will have a material impact on the Company's consolidated financial position and results of operations. There will be no cash flow impact from these adjustments.

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

Note F – Cash Flow Statement

In 1989, the Company adopted Statement of Financial Accounting Standards No. 95, Statement of Cash Flows. Prior years' Statements of Changes in Financial Position have been restated for comparative purposes.

The Company considers all highly liquid temporary cash investments with low interest rate risk to be cash equivalents. Temporary cash investments are valued at cost plus accrued interest, which approximates market. None of the cash reflected on the balance sheet at July 1, 1989 and July 2, 1988 was required as compensating balances.

Income taxes paid were $451,460,000, $307,785,000 and $323,478,000 during the years ended July 1, 1989, July 2, 1988 and June 27, 1987, respectively.

Interest paid was $40,902,000, $38,182,000 and $45,570,000 during the years ended July 1, 1989, July 2, 1988 and June 27, 1987, respectively.

Note G – Capitalized Computer Software Development Costs

Unamortized computer software development costs which are included in Other assets, net on the balance sheet were $90,395,000, and $65,638,000 at July 1, 1989 and July 2, 1988, respectively. These costs are amortized over three years from the date the products are available for general release. Costs amortized were $27,359,000, $11,634,000 and $1,431,000 for the years ended July 1, 1989, July 2, 1988 and June 27, 1987, respectively.

Note H – Debt

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

(in thousands)	**July 1, 1989**	July 2, 1988
Lease obligations payable 1991-2002 (5.4%-10.95%)(a)	**$ 17,083**	$ 15,185
Notes due 1994 (12⅜%)(b)	**100,000**	100,000
Other debt obligations	**18,936**	8,739
	$136,019	$123,924

Principal payments required during the next five fiscal years are as follows: 1990 – $3,211,000; 1991 – $2,900,000; 1992 – $3,290,000; 1993 – $3,403,000; 1994 – $102,478,000.

(a) Weighted average interest rate at July 1, 1989 and July 2, 1988 of 9.2% and 8.6%, respectively.

(b) 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.

The Company has lines of credit available for short-term financing totaling $602,079,000. Unused lines of credit totaled $575,535,000 at July 1, 1989 and $580,568,000 at July 2, 1988.

Note I – Stock Plans

Restricted Stock Options ☐ Under its Restricted Stock Option 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 years ended July 1, 1989 was as follows:

		Options Outstanding	
	Shares Reserved For Future Grants	Shares	Average Price Per Share
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
Options Granted	(3,244,400)	3,244,400	152.95
Options Exercised	–	(1,302,482)	28.67
Options Cancelled	182,896	(182,896)	52.68
Options Terminated	(118,075)	–	–
July 2, 1988	11,986,051	14,762,223	$62.25
Options Granted	**(3,491,580)**	**3,491,580**	**73.00**
Options Exercised	**–**	**(1,081,871)**	**29.75**
Options Cancelled	**307,370**	**(307,370)**	**66.99**
Options Terminated	**(142,472)**	**–**	**–**
July 1, 1989	**8,659,369**	**16,864,562**	**$66.47**

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 $36,914,000, $32,008,000 and $20,653,000 in the years ended July 1, 1989, July 2, 1988 and June 27, 1987, respectively. The amounts deductible for Federal income taxes may differ from the amounts charged to income for book purposes. The Federal income tax effects of these differences are included in 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. On November 3, 1988, the Company's stockholders approved an increase of 9,000,000 shares of common stock to the 1968 Employee Stock Purchase Plan and 1,000,000 shares to the 1981 International Employee Stock Purchase Plan. Common stock reserved for future grants aggregated 9,682,268 shares at July 1, 1989 and 2,099,727 shares at July 2, 1988. There were 2,417,459 shares issued at an average price of $78.87 per share during the year ended July 1, 1989 and 1,838,231 shares at $93.25 per share during the year ended July 2, 1988. 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.

Note J – Treasury Stock

The Company purchased on the open market 8,247,000 shares of its common stock at an aggregate purchase price of $814,958,000, or $98.82 per share, during the year ended July 1, 1989; 3,000,000 shares at an aggregate purchase price of $363,499,000, or $121.17 per share, during the year ended July 2, 1988 and 5,000,000 shares at an aggregate purchase price of $781,790,000, or $156.36 per share, during the year ended June 27, 1987. All of the acquired shares are held as common stock in treasury, less shares distributed 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 from issuance 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)*
1990	$ 318,205
1991	273,328
1992	208,325
1993	142,637
1994	104,976
Later years	644,513
Total minimum lease payments	$1,691,984

Total rental expense for the years ended July 1, 1989, July 2, 1988 and June 27, 1987 amounted to $452,078,000, $406,376,000 and $335,518,000, respectively.

Supplementary Financial Information

Quarterly Financial Data (unaudited)

Selected quarterly financial data for the years ended July 1, 1989 and July 2, 1988 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[1]
1989					
First Quarter	**$ 2,941.8**	**$1,492.5**	**$ 306.0**	**$ 223.4**	**$1.71**
Second Quarter	**3,179.5**	**1,623.3**	**373.7**	**279.6**	**2.20**
Third Quarter	**3,125.8**	**1,605.3**	**339.6**	**256.4**	**2.05**
Fourth Quarter	**3,494.9**	**1,779.0**	**401.4**	**313.2**	**2.51**
Total Year	**$12,742.0**	**$6,500.1**	**$1,420.7**	**$1,072.6**	**$8.45**
1988					
First Quarter	$ 2,529.8	$1,333.9	$ 369.8	$ 269.9	$2.03
Second Quarter	2,782.2	1,459.1	429.5	329.5	2.48
Third Quarter	2,824.0	1,462.5	406.9	305.1	2.33
Fourth Quarter	3,339.4	1,751.6	534.6	401.1	3.08
Total Year	$11,475.4	$6,007.1	$1,740.8	$1,305.6	$9.90

[1]*Earnings per share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share in 1989 and 1988 does not equal the total for the year.*

Officers

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Butler W. Lampson
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Richard Lary
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Investor Information

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

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

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

Correspondence may be directed to:

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

Requests for specific information are handled as follows:

Digital Equipment Corporation's Annual Report on Form 10-K for the fiscal year ended July 1, 1989, 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 NR02/H3
Northboro, MA 01532-2599
(508) 351-4401

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

Mark A. Steinkrauss
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111 Powdermill Road (K10)
Maynard, MA 01754-1418
(508) 493-7182
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Investor Information (continued)

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

Digital Equipment Corporation
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111 Powdermill Road (L12)
Maynard, MA 01754-1418
(508) 493-5213

Transfer Agent and Registrar
for Common Stock

First Chicago Trust Company of New York is the principal stock transfer agent and registrar, and maintains the stockholder 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 First Chicago Trust Company of New York. Stockholders should state the name in which the stock is registered, account number, as well as the old and new addresses.

First Chicago Trust Company of New York
30 West Broadway
New York, NY 10007

Customer Inquiries

Digital Equipment Corporation customers who have questions and/or problems relating to their account should contact the Customer Assistance Department at 800-332-4636.

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