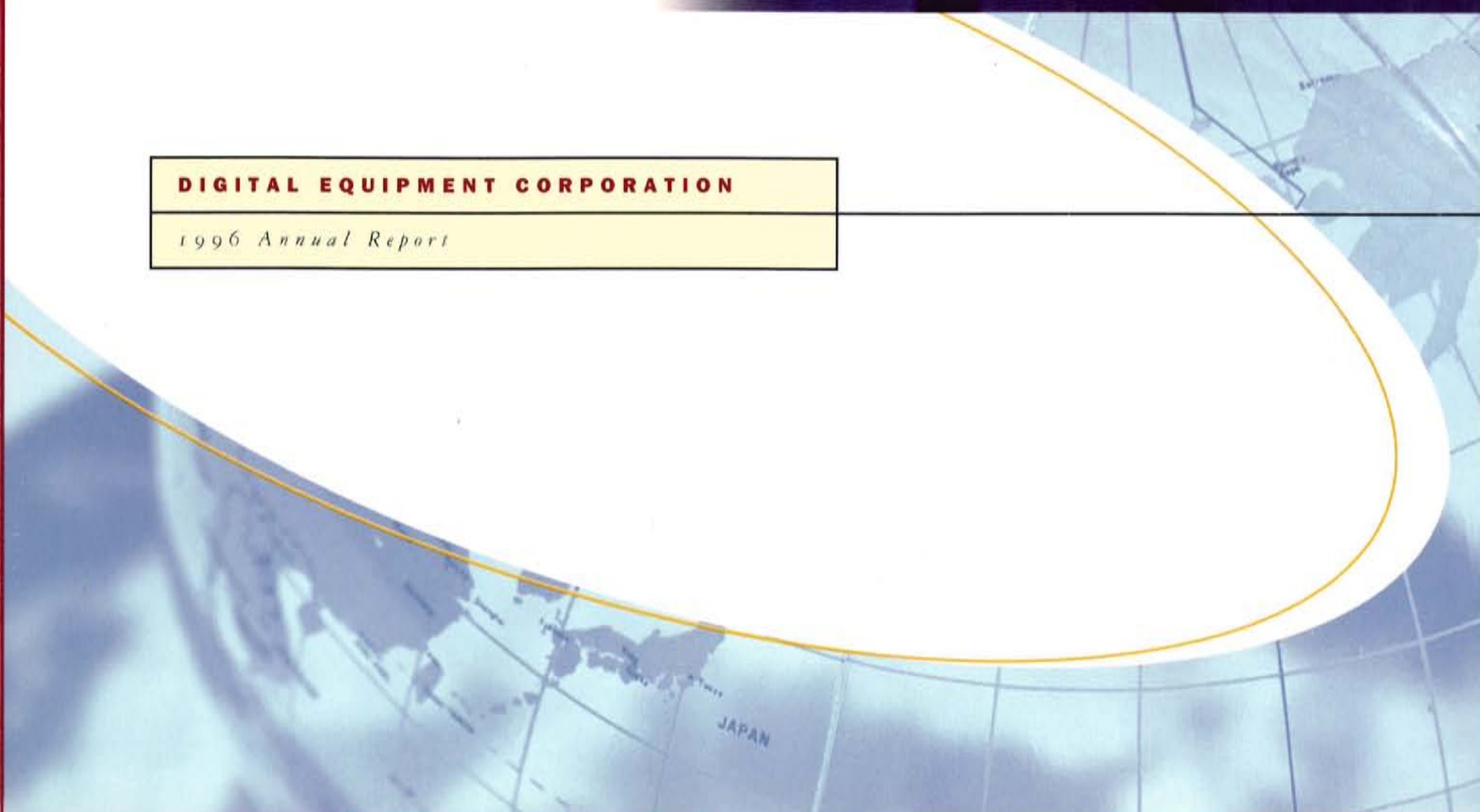
digital

DIGITAL EQUIPMENT CORPORATION

1996 Annual Report



CONNECTIONS

Chairman's letter

TO OUR SHAREHOLDERS, EMPLOYEES, CUSTOMERS AND PARTNERS:

The past year was one of continued progress for DIGITAL. We had significant accomplishments, including the highest level of revenue in DIGITAL's history. As with any turnaround of this magnitude, we also had some disappointments, including a restructuring charge that resulted in a loss for the year. When all is said and done, however, 1996 was a year in which we strengthened the foundation for the company's long-term success.

We introduced a clear and forward-looking corporate strategy in which I have great confidence. It builds on our historic strengths and on opportunities for significant growth. We formed strategic alliances with industry leaders. Including the alliance we established with Oracle the previous year, we now have alliances with the three largest software companies in the world—Microsoft, Oracle and Computer Associates—as well as with one of the leading telecommunications companies, MCI.

And we continued to enhance our products and services—extending our leadership in 64-bit computing; capturing worldwide attention with offerings such as AltaVista, the fastest and most comprehensive search service on the Internet; and building on the considerable advantage we enjoy by having the best-trained and largest group of Microsoft-certified engineers in the industry.

These are important milestones in our drive to industry leadership. We can expect occasional setbacks along the way, but the real test for DIGITAL—for the management team and for employees—is how we respond and adjust, and the actions we take to achieve our objectives.

We have demonstrated over the past two years that DIGITAL has become more responsive to customer needs, more agile in responding to competitive marketplace realities, and more willing to take the sometimes difficult actions necessary to achieve long-term industry leadership.

I particularly want to recognize the contributions of our employees. The progress we continue to make is a direct result of their talent, hard work and determination. I have often said that the position I hold is a privilege—and my greatest privilege is to work with the people of DIGITAL.

OPERATIONAL REVIEW

For fiscal 1996, DIGITAL reported a net loss of $112 million, including a $492 million restructuring charge taken in the fourth quarter. Although we have made significant progress in reducing operating expenses during the last few years, we are not as efficient as our top competitors. The restructuring charge will help DIGITAL achieve a competitive cost structure. It allows us to eliminate 7,000 positions over the year and to reduce 3.5 million square feet of space worldwide.

Excluding restructuring and other one-time charges, DIGITAL's net profit margin improved from a loss of five percent in fiscal 1994 to a profit of three percent in fiscal 1996. Total operating revenues were $14.6 billion, up five percent over fiscal 1995, or nine percent when adjusted for divestments. This was the highest level of revenue in the company's history, despite the fact that we have divested non-strategic businesses during the past two years that had been generating more than $1 billion of annual revenue.

Another positive sign was an improvement of almost five points in product gross margin to 34 percent. This was the first time in eight years that we showed year-over-year improvement. Our continued emphasis on asset management enabled us to improve cash and short-term investments to a year-end balance of $2 billion. This is our strongest position in nearly five years. To enhance shareholder value and to express our confidence in DIGITAL's underlying strength, we announced in July our plan to repurchase up to ten million shares of DIGITAL common stock.

STRATEGIES AND ACCOMPLISHMENTS

Underlying DIGITAL's success is a corporate strategy focused on three major growth opportunities:

- High-performance 64-bit UNIX platforms
- Windows NT across the enterprise
- Internet connectivity within and between enterprises

These are areas of market transformation where there is significant potential for breakthrough growth, and where we intend to achieve market leadership. We have clear evidence that this strategy is working. We see it in the success of our very large memory database technology...in the increasing demand for 64-bit solutions...and in the growing portfolio of 64-bit applications available from our software partners. We have established clear leadership in this area, and we intend to sustain it.

We see it in the market's increasing recognition of DIGITAL as a leader in enterprise solutions for Windows NT...reinforced by our broad relationship with Microsoft.

And we see it in our increasing competitive strength in the Internet market. DIGITAL's AltaVista Internet search service, with more than 17 million queries each day, is one of the most popular sites on the World Wide Web. And our network products business is one of the clear leaders in the market for high-performance switches.

In each of these markets we also are differentiating DIGITAL through our ability to deliver global services and support—services that range from multivendor customer services and operations management to network and systems integration.

Finally, we are delivering significant value to customers by establishing strategic alliances with best-in-class companies. Working closely with Microsoft, for example, we are delivering products and services that integrate Microsoft's Windows NT operating system with DIGITAL's OpenVMS. This allows customers to take advantage of the mission-critical capabilities of OpenVMS and the rapidly growing number of new applications written for Windows NT.

I am confident that we have the right strategy. Our focus now is on achieving excellence in execution. This means sharpening our market focus and implementing an aggressive go-to-market strategy that builds on the major growth opportunities we have identified, and on our core mission—delivering networked business solutions. We are targeting nine market segments—including data warehousing, mail and messaging, and Internet commerce—where DIGITAL has key strengths, and where we have an opportunity to win significant market share.

To improve execution, we are making changes in the way we sell to enterprise accounts, based on our experience during the past two years and feedback from customers and partners. For example, we found that many of our customers want to have direct contact with DIGITAL, even if they purchase most of their DIGITAL products and services through indirect distribution channels. In response, we are expanding the number of customers we cover directly, while increasing business opportunities for our channel partners.

PRIORITIES FOR 1997

One of the most important steps we can take to assure DIGITAL's success is to dramatically improve customer and partner loyalty. We define loyal customers as people who prefer to do business with DIGITAL, and who are proud to recommend us to others.

We are implementing several initiatives that will make it easier and more satisfying for customers and partners to do business with us. From reliable, on-time delivery of products and services, to quick and accurate responses to telephone queries, we are committed to doing whatever it takes to ensure that every customer engagement is a quality, rewarding and memorable experience. To drive home the importance of these initiatives, improvement in customer loyalty is one of the major criteria I will use to measure and reward the management team in fiscal 1997.

We understand that we will not earn customers' loyalty without a worldwide workforce that is fully engaged in the task at hand. DIGITAL will prosper only if each employee understands the company's strategy and direction, and the important role he or she plays in our success. We have a responsibility to recognize the contributions employees make to the company, provide them with the tools and support they need to succeed, and reward excellence. It is our people, not our technology, that have always been the backbone of this company. Our objective this year is to forge a new and stronger partnership between DIGITAL and its employees.

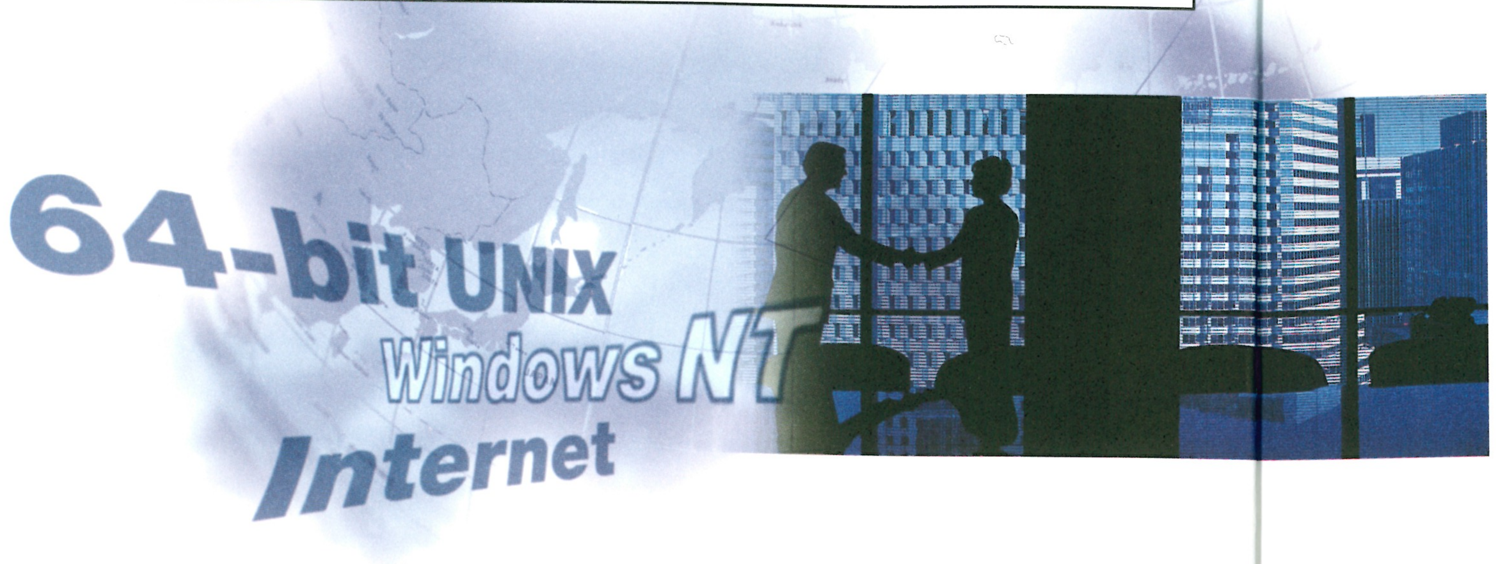
A measurable increase in customer loyalty and employee engagement will accelerate our progress toward improved profitability and growth.

There is much to do, but I am confident that we have the strategy, the products and services, the partnerships and the commitment necessary for continued financial improvement in fiscal 1997. Our objective for the next two years is to achieve a level of financial performance that puts us among the industry leaders. We owe it to our shareholders to achieve and sustain these leadership goals.

DIGITAL has made significant improvements during the last two years, but that has only raised our expectations for the future. We want customers and partners to regard DIGITAL as the information technology vendor of choice. We want employees to see DIGITAL as the most rewarding place to work. And we want shareholders to consider DIGITAL the best long-term investment in the industry. We will settle for no less.

Robert B. Palmer
Chairman of the Board,
President and Chief Executive Officer

Strategy and growth



Finding new ways to bring everyone together to create networked business solutions

The world is rapidly becoming a place where anyone, anywhere, can gain immediate access to information. This is creating new opportunities for businesses to become "networked enterprises" intimately linked with customers and partners. New network and enterprise applications hold the promise of reducing computing and communication costs. They present the opportunity to build cohesive infrastructures to support day-to-day operations. At the same time, these new networked applications can provide our customers with the information needed to manage change and implement corporate initiatives that will deliver greater value to *their* customers and shareholders.

DIGITAL's growth strategy focuses on nine key markets where customers are looking for business solutions that will enable them to create the networked enterprise. These solutions are built on high-performance 64-bit UNIX, the implementation of Windows NT across the enterprise and our expertise in Internet connectivity. The nine markets are:

- Data Warehousing
- Continuous Computing
- Windows NT Integration
- Enterprise Applications
- Visual Computing
- Mail and Messaging
- Intranets
- Internet Commerce
- Internet Service Providers

DIGITAL has the worldwide service organization in place to ensure these solutions work and are fully integrated with customers' existing computer environments.

Global partners *DIGITAL has formal alliances with Microsoft, Oracle, Computer Associates and MCI. We work closely with leading application developers including SAP, SAS, Netscape, Baan and PeopleSoft. And we support the distributors and value-added resellers who provide the solutions our customers need to compete in a changing world.*

HIGH-PERFORMANCE 64-BIT UNIX

High-performance 64-bit UNIX platforms play an important role in the networked enterprise. Billion-instruction-per-second microprocessors are bringing the power of the mainframe to the desktop. Clusters, 64-bit very large memory technology and data warehousing are changing the way data is stored, organized and retrieved to provide customers with more and better information on which to base decisions.

WINDOWS NT ACROSS THE ENTERPRISE

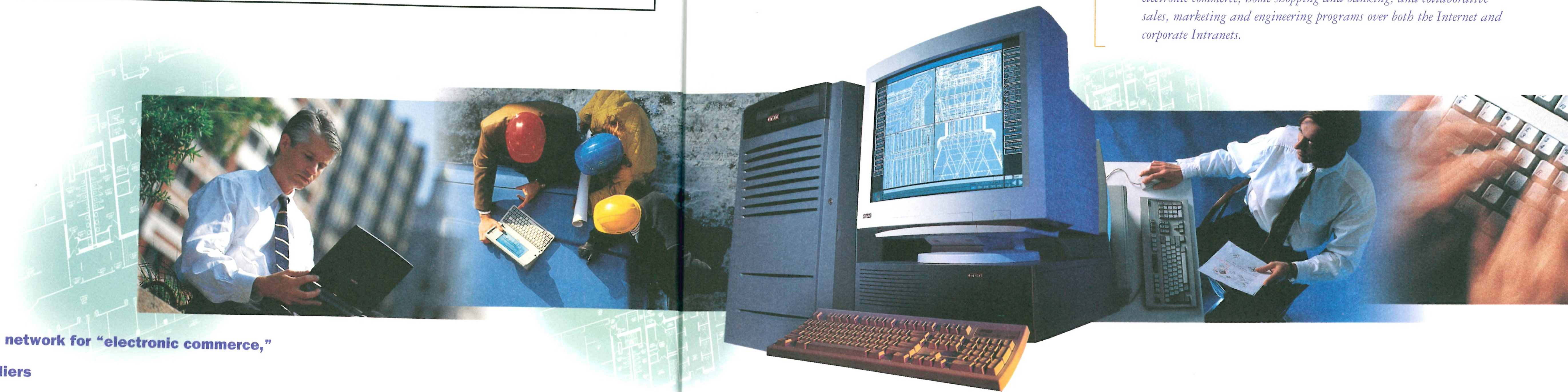
Windows NT is another prerequisite for building the networked enterprise. The growing popularity of Windows NT reflects the natural evolution of Windows-based computing from the desktop across the enterprise. Working with Microsoft, and building on the natural affinity between Windows NT and OpenVMS, we are integrating desktop systems into the enterprise network.

This enables customers to choose the right computing environment for each application—64-bit UNIX for high-performance computing, Windows NT for enterprise client/server applications and 64-bit OpenVMS for high-availability and mission-critical systems—with the knowledge that DIGITAL will provide the services needed to make everything work together.

INTERNET CONNECTIVITY

Internet connectivity plays a key role in many of these solutions. Each business within DIGITAL is developing connectivity products and services to support Internet communications. And, to provide a corporate focus, we created the Internet Software Business Unit to capitalize on these investments in Internet technology and support services.

Internet and Intranet computing



Opening the network for "electronic commerce," with customers and suppliers

The explosive growth of the Internet—combined with the deregulation of the telecommunications industry—is changing the very definition of networking. In the past, a network was easily defined. It covered a specific area. It served specific users. It was usually optimized for specific applications. And it was expensive to build and maintain.

Internet servers
"DIGITAL's TP Internet Server, with its capability to deliver secure transaction processing over the Internet, will provide a new dimension of functionality for corporate Intranet and electronic commerce."
Jim Johnson, Chairman, The Standish Group

The Internet is changing all that. It gives small and medium-sized businesses the same networking capabilities as their larger competitors.

The Internet is the global network that connects people to people, people to information and business to business. It provides an opportunity to reach out to employees, customers and suppliers around the world without having to invest in a dedicated networking infrastructure.

DIGITAL is focusing its resources on Internet business applications and Internet Service Providers. We're helping our customers use the Internet as a business tool to capitalize on both the public and the private side of the network to:

- Expand their market reach
- Vastly increase intracompany productivity
- Securely connect and collaborate as virtual organizations

Electronic commerce *DIGITAL provides the servers, software and services needed to support mobile computing, data access, electronic mail, electronic commerce, home shopping and banking, and collaborative sales, marketing and engineering programs over both the Internet and corporate Intranets.*

THE PUBLIC NETWORK

The public side of the Internet supports electronic commerce, a global electronic mail network and the World Wide Web. Here, companies can publish corporate information, technical data, price lists and multimedia marketing material for everyone to access.

According to the Giga Information Group, U.S. companies already buy $500 billion worth of goods electronically each year. And the volume is growing because electronic commerce does away with much of the paperwork associated with traditional sales channels. It creates an almost friction-free market where business is transacted at electronic speeds.

Internet services
"As our business skyrocketed, the Alpha machines came along at just the right time. Alpha has the power and expandability to keep up with the exponential growth companies like Lycos derive from the Internet."
Robert J. Davis, President and CEO, Lycos, Inc.

DIGITAL was a pioneer in electronic commerce and Internet communications. Twenty years ago, we were the first computer company to be on the ARPANET, the forerunner of the Internet. We were the first computer company to use the Internet as an interactive sales tool. Today, our World Wide Web site contains more than 6,000 pages of product and market information and is accessed by customers and business partners more than 150,000 times a week.

We are putting this experience to work for our customers. For example, DIGITAL is working with Internet Payment Processing Inc. to build the PayPro Network, Canada's first nationwide home banking and shopping system. The new network will enable consumers to shop over the Internet using a card reader and keypad to "charge" their purchases against credit and bank cards. Using DIGITAL network technology, 20 AlphaServer systems will process consumer sales and host retail and financial Web sites and a virtual shopping mall. These systems will support home banking services by giving the consumer access to Canada's nationwide INTERAC banking network.

Election returns
Working with Spain's leading newspaper—*El Mundo*—DIGITAL created a multimedia World Wide Web site to provide complete, up-to-the-minute coverage of the country's national elections. This Internet site averaged more than 20,000 "hits" a day during the campaign and handled more than 150,000 "hits" in three hours on election eve. But this was not an isolated demonstration. Working with the media, DIGITAL has built similar national election Web sites in the U.S., Belgium and Italy.

THE PRIVATE NETWORK

There's also a private side to the Internet—the Intranet, the network within the network. Many companies—including DIGITAL—are building private networks using Internet technology and communications to link their offices and employees together and to create "virtual" networks with customers, partners and suppliers.

DIGITAL provides the products and services needed to make these enterprise networks safe and secure. As part of our new AltaVista family of Internet software, we developed "firewalls" to protect proprietary information and keep intruders from "hacking" into corporate systems.

The AltaVista software family also includes "tunneling" software that encrypts data traveling over the Internet to create secure channels of communication, when, where and as needed. This encryption software is critical in electronic commerce applications where financial transactions may travel across the network.

During the year, we also developed the TP Internet Server, an integrated hardware/software solution for Internet-based transaction processing. Designed for financial services, insurance claims, order processing, inventory control and distribution applications, DIGITAL's TP Internet Server software encrypts and authenticates each transaction. It also ensures that each transaction is completed and confirmed through a "two-phase-commit" process.

Intranet growth
"The Internet revolution has come home—to internal corporate networks. Cheap, flexible 'intranets' are spreading everywhere—and becoming a new management tool."
Business Week, February 26, 1996

In addition to software, DIGITAL builds a complete family of ready-to-run Internet and Web servers. And we provide all the software, services and support customers need to create their own Web sites and link their businesses to remote offices, customers and suppliers.

As part of our Internet service practice, DIGITAL launched a data center for Internet commerce, the DIGITAL Internet Exchange. Here, customers can keep their Web server farms and data at a major Internet hub for instant access and transmission over multiple high-speed telecommunication links. This eliminates the usual charges associated with reaching a network hub and lowers costs through shared support services and high-speed communication links.

Electronic commerce
"DIGITAL has been extremely visible as a leader in Internet computing. This established expertise along with the flexibility and power of the AlphaServer made it apparent that this was the system we needed to build our service upon. The servers are well equipped to handle multiple and multifunction transactions and contain the scalability that will allow us to quickly and easily expand our system as our retail and consumer base increases."
Wayne Simpson, Executive Vice President, Operations, The PayPro Network (Canada)

THE WORLD'S MOST POWERFUL SEARCH ENGINE

To demonstrate the power of our Internet AlphaServer systems and AltaVista software, we introduced a free Internet search service at http://www.altavista.digital.com.

AltaVista is one of the most popular World Wide Web sites—averaging more than 17 million hits a day. This search engine has indexed every word in more than 30 million Web pages and 13,000 newsgroups—more than any other search engine. Powered by DIGITAL's 64-bit AlphaServer system, it can conduct a lightning-fast search to find information about any subject.

We make this technology available to our customers and other Internet service providers. DIGITAL recently announced the first two affiliate partners in the AltaVista network: Telia TeleCom AB of Sweden and Telstra/Yellow Pages of Australia. This worldwide network will be made up of a series of AltaVista "mirror" sites that will provide both high-performance search services in regional areas and local features designed to increase the value of AltaVista services.

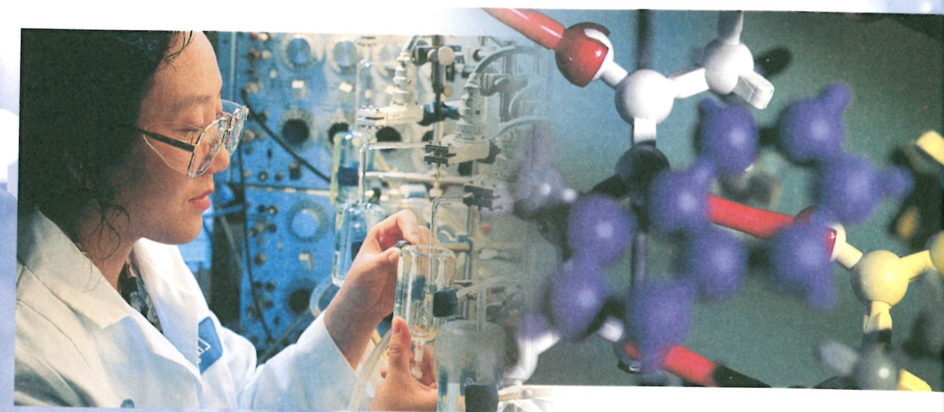
Yahoo!, one of the leading search/indexing services on the Web, is incorporating the AltaVista search service into its Internet guide. Increasingly, DIGITAL customers are using AltaVista search software to index the content of their Intranets. With the AltaVista search engine, their employees can pinpoint information without searching through dozens of separate databases.

DIGITAL, MCI AND MICROSOFT

To help customers capitalize on Internet technology, DIGITAL, MCI and Microsoft have formed a strategic alliance. Together, we're showing customers how to use the Internet to support concurrent engineering programs, home banking services, online catalog sales, EDI (Electronic Data Interchange), videoconferencing and multimedia applications.

The DIGITAL AlphaServer 4100 System is part of DIGITAL's complete family of ready-to-run Internet and Intranet servers. Like all AlphaServer systems, it provides the leadership performance expected of 64-bit systems—high availability, data integrity and flexible scalability.

Systems and enterprise computing



Pinpointing markets *Many pharmaceutical companies, financial institutions and direct marketing companies are capitalizing on Digital's 64-bit Very Large Memory technology to build data warehouses, transforming operational data into intelligent information to spot trends, analyze sales and pinpoint prospects.*

Building alliances to help customers implement networked business applications

Information is an asset. To get the best possible return on that asset you need to manage and disseminate information across the enterprise.

Digital builds a complete range of Alpha and Intel servers for data warehousing, enterprise-wide mail and messaging systems, continuous computing and other enterprise applications. These platforms are designed for network applications where they work together to make information readily available when, where and as needed.

"This (the DIGITAL/Microsoft Alliance for Enterprise Computing) is a renewal of our commitment to Alpha. It is a resounding endorsement of Alpha as a premier platform."
Bill Gates, Chairman and CEO, Microsoft Corporation

Digital has a full complement of IT services to support these platforms. We help customers plan, design, implement and manage complete business solutions. And we integrate these solutions into their IT environments and make sure that everything works together.

We offer a choice of operating systems—Windows, Windows 95, Windows NT, UNIX and OpenVMS—together with the software needed to integrate these systems into a seamless client/server environment. And, through partnerships with Oracle, Sybase, Informix, Software AG and other database software companies, we provide the ability to create and manage massive databases built around 64-bit Very Large Memory technology—VLM64.

Although a number of companies announced 64-bit chips this year, VLM64 technology and 64-bit system performance require a 64-bit operating system and 64-bit applications. Digital has the operating systems and applications needed to take full advantage of 64-bit microprocessor technology—now.

Alpha workstations
Within a three-month period in 1996, DIGITAL's 64-bit Alpha architecture was chosen for three multimillion-dollar U.S. Defense Department contracts. Altogether, the Army Workstations, the Air Force Desktop V and Air Force Workstations awards are worth up to $1.2 billion.

DIGITAL UNIX: THE 64-BIT ADVANTAGE

Digital has the only 64-bit UNIX operating system to receive X-Open branding for UNIX 95. Digital UNIX meets all the standards customers use to define open systems. Standards simplify software development, multivendor systems integration and the porting of applications from one system to the next to protect long-term software investments. Implementing industry standards, our partners have created a full range of 64-bit applications to run under Digital UNIX.

From data warehousing and online transaction processing to visual computing and genetic mapping, 64-bit Digital UNIX is rapidly becoming the operating system of choice. It's ideal for applications that demand a robust, scalable and high-performance operating environment. It offers unsurpassed interoperability with Windows. It supports 64-bit database software and symmetric multiprocessing. And, when coupled with an AlphaServer system, Digital UNIX delivers mainframe performance and reliability at a fraction of mainframe costs.

BREAKING THE LIMITS OF 32-BIT MEMORY

While 32-bit systems—including large mainframes—support only four gigabytes of memory, an enterprise-level AlphaServer running Digital UNIX or OpenVMS will support six gigabytes. A high-end AlphaServer 8400 can support 14 gigabytes. And that's just for starters. Theoretically, a 64-bit system could support 4.5 billion times the memory of a 32-bit system.

Windows NT integration
"DIGITAL has the leadership position in providing NT-based high-performance, price/performance platforms for production, enterprise applications. Aberdeen does not believe that any other major systems supplier will be able to surpass DIGITAL's position within the next several years."
The Aberdeen Group Inc.

DIGITAL's scalable Alpha architecture can support all the memory ever needed for even the most complex database and scientific applications. And those applications will run at blinding speed. For example, with Oracle 64-bit database software, some applications run up to *200 times* faster than they do with the fastest 32-bit system.

Oracle is not alone in developing software to capitalize on VLM64 technology. Almost every major database company—including Sybase, Informix, PeopleSoft, SAP and Red Brick—is working with DIGITAL to utilize 64-bit technology in the implementation of next-generation data warehousing, decision support, online transaction processing and thousands of business and vertical applications.

TruCluster SHARED MEMORY SYSTEMS

This year, we introduced DIGITAL UNIX TruCluster Solutions. In a TruCluster system, an ultrafast memory-to-memory interconnect joins multiple computers so they can work together sharing memory as well as data storage. TruCluster Solutions bring unprecedented levels of performance, availability and affordability for enterprise computing applications.

THE ALLIANCE FOR ENTERPRISE MANAGEMENT

In many cases, business solutions may be deployed around the world. This requires sophisticated software and worldwide support services. DIGITAL and Computer Associates formed The Alliance for Enterprise Management to create a standard, unified enterprise management environment across Windows NT, UNIX, OpenVMS and legacy mainframe systems.

WINDOWS NT: INTEGRATING THE ENTERPRISE

Data warehousing
Rhone-Poulenc Rorer, an international pharmaceutical company, built a data warehouse containing over 400 billion characters of information around AlphaServer systems, DIGITAL's VLM64 technology and Oracle7 software.

While PCs have greatly enhanced the productivity of individual employees, organizational productivity has lagged as most client/server solutions have been limited to local area networks.

This has made it difficult for people in different departments to share information and work together. The answer is to create a single computing environment that integrates personal computers and servers with enterprise databases, legacy systems and global networks.

Microsoft Windows NT provides this environment. It is the "missing ingredient" needed for the full implementation of client/server computing. It reflects the natural evolution of Windows from the desktop to the enterprise. Microsoft Windows is the standard for desktop computing and Windows NT is the emerging standard in client/server computing environments.

Mobile and wireless computing
The Clydesdale Bank in Scotland placed a million pound sterling order for DIGITAL HiNote Ultra notebook computers for its "mobile" branch managers who work with bank customers in remote locations.

Telecommunications
Telia TeleCom AB, Sweden's national telephone carrier, installed a $9 million, Alpha-based message processing system to streamline its customer care system to make it possible to bill any type of service—telephony, mobile services, data communication services, Internet services—on a single bill.

INTEGRATING WINDOWS NT WITH OpenVMS AND UNIX

As part of the DIGITAL/Microsoft Alliance for Enterprise Computing, the two companies are working together to develop the tools and application program interfaces needed to integrate Windows NT with OpenVMS and Windows NT with DIGITAL UNIX. Through this program, we bring the strengths of DIGITAL operating systems—high availability, data integrity, system security and scalability—to Windows NT client/server environments. Microsoft has implemented Windows NT on Alpha platforms and DIGITAL has implemented its proven cluster technology on Windows NT systems. We are also working with Microsoft to develop a 64-bit version of Windows NT. This will be released first on Alpha.

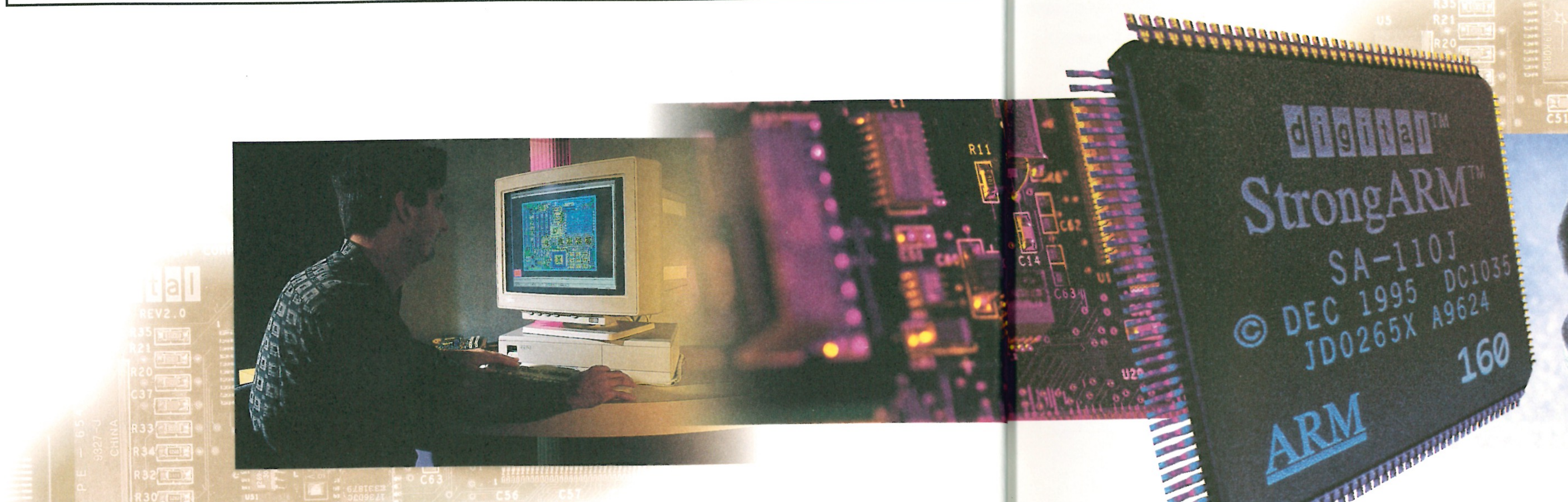
AlphaServer systems and DIGITAL's new Alpha XL personal workstations provide the broadest platform scalability for Windows NT and are priced competitively with Intel-based systems. With the announcement of DIGITAL FX!32 translation and emulation software, a 64-bit AlphaServer system will have the ability to run shrink-wrapped 32-bit Windows or Windows NT applications as fast or faster than an Intel Pentium system.

DIGITAL'S INTEL SERVERS AND PCs

With the growing acceptance of Windows NT as an enterprise operating system, more and more customers are looking for high-performance Intel-based servers, NT workstations, industrial-strength PCs and comprehensive service and support. DIGITAL has a complete family of Pentium-based servers, workstations, and notebook and personal computers optimized for business use. In addition, we have a full line of services to help customers implement network solutions where Windows, Windows 95, Windows NT, DIGITAL UNIX, OpenVMS and other systems work together in a seamless environment.

With VLM64 technology, DIGITAL AlphaServer 8200 and AlphaServer 8400 enterprise systems are ideal for data warehousing, high-performance technical computing, and large business, manufacturing and financial applications.

Technology and new markets



Developing new products *DIGITAL Semiconductor is working with manufacturers of mobile phones, set-top boxes for cable TV and PDAs (Personal Digital Assistants) to create highly intelligent devices built around the StrongARM chip that delivers workstation performance on AA batteries.*

Protecting your investment in enterprise systems, networks and applications

Advances in technology open new markets. DIGITAL minicomputers created a new market when they brought information technology out of the data center and into the world. With the development of Ethernet, we helped create the market for local area networks. Today, new technologies are opening new markets for data warehousing, visual computing, Intranets and other advanced solutions.

DIGITAL is a leader in focusing research and development on customer needs. This past year, we invested more than a billion dollars in research and development. Some of the dividends from this investment are detailed in this annual report. We developed the world's fastest Internet search engine, software that allows 64-bit Alpha systems to run 32-bit personal computer software as fast or faster than Pentium systems, and a new Alpha microprocessor that can process more than two billion instructions per second.

Semiconductors and other advanced components determine the performance of a system or a network and the applications that run on it. DIGITAL has developed the key components needed to build enterprise networks and to provide Alpha systems with superior performance and price/performance to support enterprise applications. And we sell these components to other manufacturers.

IP switching
"The breadth of DIGITAL's network architecture is unrivaled in terms of starting low and moving up to unprecedented IP (Internet Protocol) switching performance at the high end. DIGITAL's reputation of openness, worldwide service and engineering excellence is further corroborated with this announcement (the introduction of the GIGAswitch/IP)."
John Morency, Network Consultant, The Registry, Inc.

ALPHA: THE WORLD'S FASTEST MICROPROCESSOR

DIGITAL has been investing in semiconductor technology since 1974. In 1985 we announced the first 32-bit microprocessor. And in 1992 we introduced the Alpha 64-bit microprocessor.

The 64-bit Alpha chip gave us a two-to-one performance advantage over the fastest 32-bit microprocessor then on the market. And we have maintained this two-to-one performance lead year after year through continuous investment in semiconductor development and process technology. This year, we brought our new, state-of-the-art semiconductor manufacturing facility on line. This new facility combines the latest eight-inch wafer, submicron fabrication processes with proven semiconductor design, development and simulation capabilities.

We continue to push the pace. On July 8th, we strengthened our four-year claim to the world's fastest and highest-performance microprocessors with the announcement of the 500 MHz Alpha 21164 RISC microprocessor. With peak execution rates of up to two billion instructions per second, this chip pushed the performance envelope for visual computing applications including videoconferencing, 3-D modeling, video editing, multimedia authoring, image rendering and animation.

No fewer than 22 computer manufacturers are building high-performance workstations and systems around Alpha microprocessors. Mitsubishi is building Alpha microprocessors under license from DIGITAL to provide a second source for this growing market. This year, Samsung became the second major semiconductor manufacturer to form an alliance with DIGITAL to manufacture and market Alpha microprocessors and to incorporate them into computer products.

WORKSTATION PERFORMANCE ON AA BATTERIES

"Best New Product"
Aspen Systems' Alpha-based Summit Power Server was chosen by *Government Computer News* as "Best New Product, Server Category" at the spring 1996 Federal Office Systems Exposition (FOSE) in Washington, D.C. Aspen is among the growing number of companies—including Raytheon, Deskstation Technology, Polywell Systems and Microway—who are building systems based on DIGITAL's Alpha microprocessor.

DIGITAL is also becoming a growing force in developing and manufacturing low-power microprocessors for mass-market electronic products. These include set-top boxes for cable TV, PDAs (Personal Digital Assistants)—palmtops and digital "organizers"—and handheld computers, electronic games and mobile phones.

In 1995, we formed a strategic relationship with Advanced RISC Machines, Ltd. (ARM), developers of the microprocessor that's at the heart of Apple's Newton MessagePad 130. This alliance brought together DIGITAL's high-speed design and process strengths with ARM's low-power expertise.

The result is DIGITAL's StrongARM chip, introduced this year. This new, low-price microprocessor combines supercomputer performance with low-power dissipation, while processing from 115 MIPS (million instructions per second) to more than 250 MIPS. This is a two-to-one advantage in both absolute performance and price/performance over competing microprocessors. Normal mode power is as little as 150mW (milliwatts) and sleep mode consumes only 50uA (microamps)—enabling the StrongARM chip to run on AA batteries.

ATM (Asynchronous Transfer Mode)
"We want to show the world that ATM is the switching technology of the future, a technology that can handle applications like video-conferencing and realtime data transfer. We are using DIGITAL's GIGAswitch/ATM system to develop those applications."
Bernd Weise, Project Manager, DeTeBerkom GMBH (a subsidiary of Deutsche Telekom)

Low power consumption makes the StrongARM microprocessor ideal for pocket-sized mobile devices and provides the processing power needed to support handwritten and voice input, voice output and advanced peripherals integration. For example, DIGITAL has already ported its DECtalk speech synthesis technology to the ARM architecture to enable PDAs to "speak" with advanced hands-free text-to-speech capabilities.

AN EXPLODING MARKET

The market for PDAs is expected to triple over the next two years as the next generation of palmtop or handheld computers is introduced. The StrongARM architecture already has been selected by Oracle for its new network computer (nc) reference and by Apple for selected models of its next-generation Newton PDA.

In addition to microprocessors, DIGITAL builds a wide range of specialized chips for data communications, multimedia and other computer applications.

HIGH-PERFORMANCE NETWORK COMPONENTS

Internet connectivity
At the Cybersmith store in Boston's historic Faneuil Hall, more than 60 computers are connected to a DEChub Ethernet switch and RouteAbout module for Internet connectivity via T1 lines. According to Cybersmith President Carl Rosendorf, "With the depth and variety of technical experiences offered at Cybersmith, we needed a network with the highest level of flexibility and dependability. DIGITAL has provided an excellent solution for us."

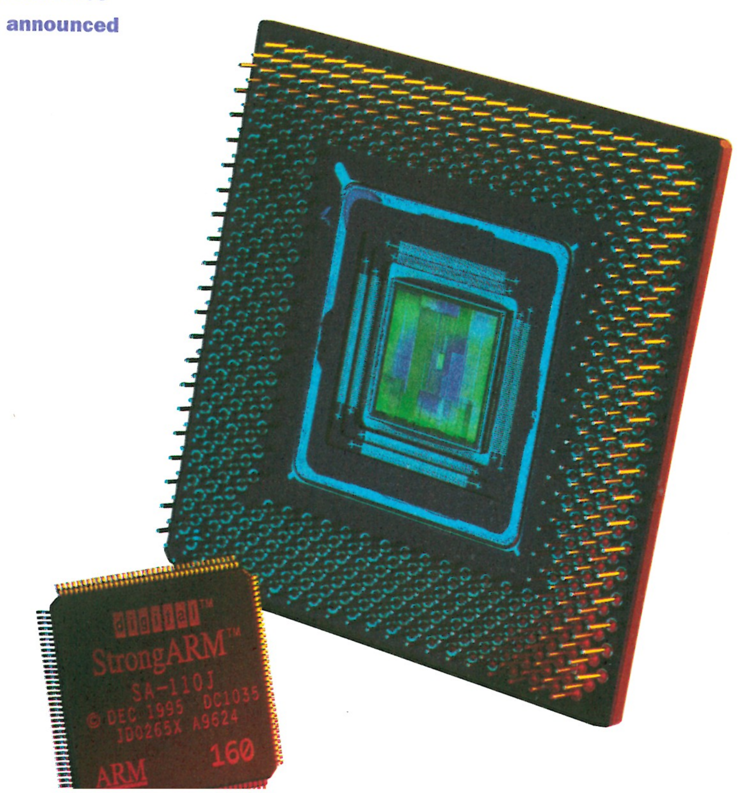
We manufacture a complete line of network adapters, hubs, internetworking products, high-performance digital switches and management software for entry-level and enterprise networks based on a hardware and software architecture that provides the flexibility to create virtual LANs and networks.

According to International Data Corporation, DIGITAL shipped more remote access server ports than any other vendor in 1995. And the Dell'Oro Group ranked DIGITAL first in FDDI switching revenue and ports shipped worldwide in 1995.

DIGITAL's new GIGAswitch/IP, the industry's fastest Internet Protocol (IP) switch, delivers up to 18 million packets per second to provide the best price/performance solution to the bandwidth problems found on many traditional backbone and routed networks. It implements the enVISN (Enterprise Virtual Intelligent Switched Network) architecture, which provides central administration with local control. It enables connections to local and wide area networks, remote users and ATM and other future technologies, to protect customer investments as networks grow to handle increased traffic.

Alpha performance
"DIGITAL's 500 MHz Alpha 21164 should keep Alpha in the performance lead, even as Intel rolls out its 0.28-micron process for Pentium Pro in 1997. Alpha performance has increased by an impressive 70 percent since the Pentium Pro was announced last fall."
Linley Gwennap, MicroDesign Resources

Based on this architecture, DIGITAL developed a complete family of switch products to integrate all major LAN technologies—from desktop to enterprise—into a cost-effective, seamless and flexible multigigabit system. The new VNswitch complements GIGAswitch backbone solutions to address the high-performance, low-latency and low cost-of-ownership needs of today's client/server environments.



Semiconductor Leadership: DIGITAL Alpha and StrongARM microprocessors are setting new performance standards. The new 500MHz Alpha 21164 microprocessor executes up to two billion instructions per second, while DIGITAL's StrongARM microprocessor delivers workstation performance on AA batteries.

CONNECTIONS

Integration, operations management and multivendor services

Managing change *Implementing new applications, integrating new technologies, managing multivendor networks and supporting a growing user base can tax the resources of even the largest enterprise. To assist these customers, DIGITAL's Services Division provides a complete portfolio of integration, operations management and multivendor services.*

Worldwide service partnerships support networked business solutions

More and more businesses are evolving into networked enterprises where employees, customers, business partners and suppliers share ideas and work together. Reducing network support costs and ensuring the availability of network resources 24 hours a day, 365 days a year is becoming a priority.

DIGITAL customers and partners are seeking assistance in three critical areas: the integration of system- and network-based solutions, product service and interoperability support across multivendor environments, and the management of information technology operations.

These challenges cannot be met by a company that works on its own. Almost every successful information technology implementation is a partnership between the customer and the systems integrator, database and application companies, platform developers and service organizations.

By working together, customers and computer companies can support existing computer environments and anticipate future needs. Almost without exception, these environments include hardware and software from different vendors. That's why it is not enough for a computer company to support its own products. It must partner with other computer companies and work with its channel partners to meet the needs of its customers. And it must have the resources to support multivendor computing environments and networks wherever they're found.

Enterprise applications
"We went through an RFP (Request For Proposal) process to select the vendor. A combination of things led us to choosing DIGITAL...but, primarily, we thought they understood how SAP ran on their box better than the competitors did, and we thought they would be there to support us through the implementation process."
Tony Kenzie, Director of Information Services, Borden, Inc.

THE DIGITAL SERVICES DIVISION

Desktop support
Citibank awarded DIGITAL a $500 million, three-year contract to implement, service and support Citicorp desktop and local area networking systems and software throughout the world.

This year, DIGITAL formed a Services Division to focus on networked business solutions for large and medium-sized businesses to expand customer coverage and partner relationships—bringing together all the resources needed to support our customers.

This division operates in more than 100 countries and supports more than 14,000 products from 1,300 vendors. Working with Compaq, MCI, Microsoft, Avnet, Computer Associates and a growing list of partners, the division has the capabilities and resources to plan, design, implement and maintain multivendor computing environments. The focus is on providing enterprise services including:

- The integration of system- and network-based solutions
- Product service and support across multivendor environments
- The management of information technology operations

DIGITAL's portfolio of multivendor services includes our award-winning PC Utility. This unique program provides customers with customized desktop services, including planning, local area network design, multivendor product procurement, staging, installation, training, help desk support and hardware, software and networking upgrades as well as "take back" and asset recovery.

Our Software Utility service provides a flexible approach to managing software from the desktop to the data center. It includes software acquisition, license management and tracking, maintenance and upgrades to help reduce support costs and ensure the smooth implementation and integration of new applications.

THE ALLIANCE FOR ENTERPRISE COMPUTING

Mission-critical computing
"The benefits of DIGITAL's mission-critical support service is really, in my opinion, largely in the proactive work and the personal relationships that develop. We look at DIGITAL as a team to help solve our issues. The bottom line is availability and time to solve problems. Without this structure that would not be possible. DIGITAL has come to understand our unique needs as a customer."
Babak Aghevli, Senior Manager Mid-Range Systems, MCI

Another major service and support initiative grew out of the Alliance for Enterprise Computing formed by DIGITAL and Microsoft to promote the adoption of Windows NT across the enterprise. This comprehensive alliance includes joint activities ranging from engineering and cross-licensing agreements to customer support programs. Together, we are providing complete Windows NT client/server solutions and services for both Alpha and Intel platforms.

With more than 1,000 Microsoft-certified systems engineers and solution developers, DIGITAL has the largest Windows support organization in the world. We provide Windows, Windows 95 and Windows NT on-site and remote support 24 hours a day, 365 days a year. In addition, we have established 29 Microsoft Authorized Support Centers—more than any other Microsoft service provider—to support our customers and resellers.

A DISCIPLINED APPROACH TO OPERATIONS MANAGEMENT

With the growing acceptance of client/server computing, customers are looking for customized operations management and outsourcing services. They want to work with a company that understands both business and technology.

Competitive advantage
"With DIGITAL's help, Integris now has a competitive advantage in technology with added creativity and flexibility when it comes to adding future sites. DIGITAL's expertise and knowledge of multivendor environments play key roles in achieving our corporate business needs and computing goals."
George Conklin, CIO, Integris Health

Outsourcing represents a rapidly growing market for DIGITAL. We are one of the few computer companies with extensive experience in operating and managing multivendor computer and network environments for our customers.

By partnering with DIGITAL, customers can augment their information technology resources with systems analysts, network engineers, project managers, consultants and other computer professionals. These individuals have firsthand experience with both the business and technical aspects of data warehousing, Internet commerce, Enterprise NT Applications, continuous computing and other leading-edge applications.

SYSTEMS AND NETWORK INTEGRATION

PC Utility
"When we launched a statewide project to upgrade all aspects of the desktop information systems used by our representatives, we found out just how much technology had changed and how complex it had become. We also realized that a wrong decision or flawed implementation anywhere in the upgrade process could have a major impact on us for years to come. That's why we selected a PC Utility solution from DIGITAL."
George Meier, Executive Director for the Speaker of the House, State of Florida

This year we combined our systems integration and network service operations into a single business unit within the Services Division. This allows us to manage our systems integration business as a full portfolio of services directed toward network-intensive business solutions.

We work in partnership with the customer—and in many cases with other computer companies, consultants, systems integrators and prime contractors—to deliver complete and integrated business solutions. Together, we are ready to tackle computer migration projects, design and implement IT infrastructures and implement enterprise networks that integrate users with advanced information technology.

LEVERAGING CONNECTIONS

Services play a key role in leveraging the connections between DIGITAL and its business partners. DIGITAL set the standard in the industry for providing service and support to and through our worldwide reseller network. Together we are focusing our resources on supporting our customers as information technology undergoes a paradigm shift to client/server technology.

The Alliance for Enterprise Computing: In addition to providing a complete range of Intel and Alpha systems optimized for Windows NT, DIGITAL has a formal marketing, product development and customer service alliance with Microsoft. And we are the largest Windows training and support vendor in the world.

CONNECTIONS

The community and the environment

Working with customers and the community

Throughout this annual report we have focused on connections. We've talked about the way we're "connecting" with customers and business partners to help create a world where information and ideas can be freely exchanged.

Since the company's inception, DIGITAL has taken an active role in the communities where we have a presence. Adding to the long list of community-related programs we have supported over the years, we continue to make a difference. This year, we became the first national corporate sponsor of Tech Corps, a nonprofit, volunteer organization designed to assist U.S. public schools in integrating technology into educational programs. But our concern for children and their future goes beyond technology.

We have contributed more than $1 million to the National Center for Missing and Exploited Children (NCMEC) since 1985 to help develop, publish and distribute "KIDS AND COMPANY: Together for Safety" throughout the United States. This program provides the knowledge children need to avoid abuse, abduction and physical harm.

In recognition of DIGITAL's long-standing partnership with the National Center for Missing and Exploited Children (NCMEC), The Massachusetts Children's Trust Fund presented DIGITAL with its annual Voice of Children Award for its "outstanding contribution toward making the world a place children can trust."

In Guatemala, India and seven other countries, we're working with Children's International to provide basic life necessities to more than 180,000 children. In addition, we made cash contributions to 91 children's service organizations in 23 countries during the past year.

We want every child to enjoy a healthy environment. We recognize the global nature of environmental, health and safety issues, and our responsibility to our employees, customers and the communities where we live and work. Our efforts are guided by DIGITAL's corporate environment, health and safety (EHS) policy statement: "Earth Vision." It provides a framework for action that ensures wise choices today, sound goals for tomorrow and a standard for measuring our progress. DIGITAL is creating smart solutions for EHS issues through our practices and policies, our collaboration with business partners and research institutions, and our continuing excellence in information technology.

Based on our core values and in support of enhancing our business relationships, we have a formal code of business conduct that governs our actions and business practices. Working together, sharing information and ideas, we are leveraging the connections between DIGITAL and its partners, customers and the community.

Financial statements

Eleven-year financial summary

(dollars in millions except per share data and stock prices)	1996	1995	1994	1993	1992	1991	1990	1989	1988	1987	1986
Statements of operations[1]											
Product sales	$ 8,362	$ 7,616	$ 7,191	$ 7,588	$ 7,696	$ 8,299	$ 8,146	$ 8,190	$ 7,541	$ 6,254	$ 5,103
Service and other revenues	6,200	6,197	6,260	6,783	6,235	5,612	4,797	4,552	3,934	3,135	2,487
Total operating revenues	14,563	13,813	13,451	14,371	13,931	13,911	12,943	12,742	11,475	9,389	7,590
Cost of product sales, service and other revenues	9,756	9,392	8,912	8,631	8,132	7,278	6,795	6,242	5,468	4,514	4,282
Research and engineering expenses	1,062	1,040	1,301	1,530	1,754	1,649	1,614	1,525	1,306	1,010	814
Selling, general and administrative expenses[2]	3,788	3,273	5,234	4,447	6,181	5,572	4,521	3,639	3,066	2,253	1,665
Operating income/(loss)	(44)	108	(1,996)	(237)	(2,136)	(588)	13	1,336	1,635	1,612	829
Net interest income/(expense)	(24)	(33)	(24)	13	57	68	111	85	106	77	28
Income/(loss) before income taxes and cumulative effect of changes in accounting principles	(68)	76	(2,020)	(224)	(2,078)	(520)	124	1,421	1,741	1,689	857
Provision for income taxes	44	18	85	27	232	97	50	348	435	552	240
Net income/(loss)[3]	$ (112)	$ 122	$ (2,156)	$ (251)	$ (2,796)	$ (617)	$ 74	$ 1,073	$ 1,306	$ 1,137	$ 617
Net income/(loss) applicable per common share[3]	$ (.97)	$ .59	$ (15.80)	$ (1.93)	$ (22.39)	$ (5.08)	$ .59	$ 8.45	$ 9.90	$ 8.53	$ 4.81
Weighted average shares outstanding (in millions)	152	146	137	130	125	122	125	127	132	133	131
Financial position											
Inventories	$ 1,821	$ 2,054	$ 2,064	$ 1,755	$ 1,614	$ 1,595	$ 1,538	$ 1,638	$ 1,575	$ 1,453	$ 1,200
Accounts receivable, net of allowances	3,223	3,219	3,319	3,020	3,594	3,317	3,207	2,965	2,592	2,312	1,903
Working capital	3,188	3,026	1,832	2,964	2,015	3,777	4,332	4,501	4,516	4,377	4,223
Net property, plant and equipment	2,223	2,269	3,129	3,178	3,570	3,778	3,868	3,646	3,095	2,127	1,867
Total assets	10,075	9,947	10,580	10,950	11,284	11,875	11,655	10,668	10,112	8,407	7,173
Long-term debt	999	1,013	1,011	1,018	42	150	150	136	124	269	333
Stockholders' equity	3,606	3,528	3,280	4,885	4,931	7,624	8,182	8,036	7,510	6,294	5,728
Stockholders' equity per common share	20.62	20.89	20.24	36.19	38.58	61.18	66.76	66.12	59.47	49.87	44.54
Ratios and other information											
Current ratio	1.8:1	1.7:1	1.4:1	1.8:1	1.4:1	2.0:1	2.3:1	2.9:1	2.9:1	3.4:1	4.9:1
Quick ratio	1.2:1	1.1:1	.9:1	1.2:1	1.0:1	1.4:1	1.6:1	1.9:1	2.0:1	2.4:1	3.5:1
Debt/debt plus equity	22.0%	22.5%	24.1%	17.5%	1.8%	2.2%	2.0%	2.0%	3.6%	4.2%	5.9%
Operating income/(loss) as a percentage of revenues	(.3)%	.8%	(14.8)%	(1.7)%	(15.3)%	(4.2)%	.1%	10.5%	14.2%	17.2%	10.9%
Net income/(loss) as a percentage of revenues	(.8)%	.9%	(16.0)%	(1.7)%	(20.1)%	(4.4)%	.6%	8.4%	11.4%	12.1%	8.1%
Return on equity	(3.1)%	3.6%	(52.8)%	(5.1)%	(44.5)%	(7.8)%	.9%	13.8%	18.9%	18.9%	12.0%
Return on assets	(1.1)%	1.2%	(20.0)%	(2.3)%	(24.1)%	(5.2)%	.7%	10.3%	14.1%	14.6%	9.1%
Non-U.S. revenues as a percentage of total revenues	66%	65%	62%	64%	63%	60%	56%	55%	50%	47%	42%
Days sales outstanding	78	77	76	69	83	76	86	76	75	78	79
Number of employees at year-end	59,100	61,700	77,800	89,900	107,900	115,100	116,900	118,400	113,900	103,000	88,300
Number of shares outstanding at year-end (in millions)	156	150	142	135	130	130	130	130	130	130	129
Common stock yearly high and low sales prices	$ 76–35	$ 49–18	$ 43–18	$ 49–30	$ 72–33	$ 87–45	$103–70	$122–86	$199–99	$174–82	$ 94–46

[1]Amounts may not be additive due to rounding.
[2]Includes restructuring charges of $492M in 1996, $1,206M in 1994, $1,500M in 1992, $1,100M in 1991 and $550M in 1990. Includes reduction in carrying value of intangible assets of $310M in 1994.

[3]The cumulative effect of changes in accounting principles were: a one-time benefit of $65M, or $.44 per share, on net income and net income per share for fiscal 1995; a one-time charge of $71M, or $.51 per share, and a one-time benefit of $20M, or $.14 per share, on net loss and net loss per share for fiscal 1994; and $485M or $3.89 per share on net loss and net loss per share in fiscal 1992.

Revenues

In fiscal 1996, total operating revenues increased $750 million or 5% to $14.6 billion, following an increase of $362 million or 3% in fiscal 1995 and a decrease of $921 million or 6% in fiscal 1994. Non-U.S. revenues accounted for 66% of total operating revenues in fiscal 1996, up from 65% and 62% in fiscal 1995 and 1994, respectively (see Note B).

Revenues (dollars in billions)

Fiscal year	1996	1995	1994
Product sales	$ 8.4	$ 7.6	$ 7.2
% of total revenues	57%	55%	53%
Service and other revenues	$ 6.2	$ 6.2	$ 6.3
% of total revenues	43%	45%	47%
Total revenues	$14.6	$13.8	$13.5

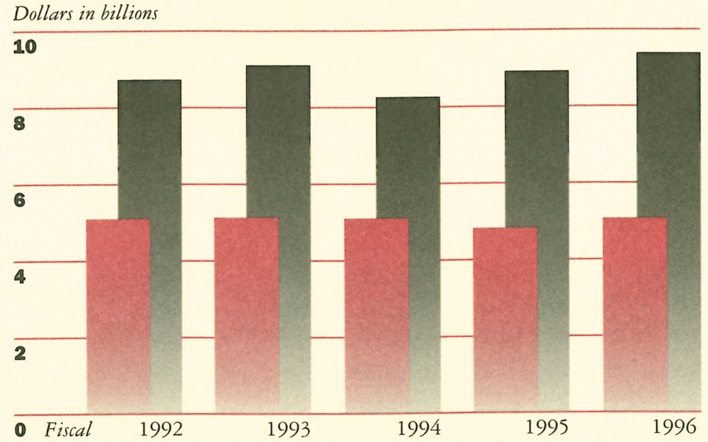
Revenues from product sales for fiscal 1996 were $8.4 billion or 57% of total operating revenues, compared with $7.6 billion or 55% of revenues and $7.2 billion or 53% of revenues in fiscal 1995 and 1994, respectively. Product sales increased in fiscal 1996 due principally to increased revenues from the sale of Alpha-based systems and to a lesser extent Intel-based personal computers, storage subsystems and network products. Adjusted for the effects of divested businesses, product sales increased 16% and 14% in fiscal 1996 and 1995, respectively. Continued increased demand for the Corporation's UNIX-based offerings and increased acceptance of the Corporation's Windows NT-based products contributed to the growth in Alpha-based systems revenues in fiscal 1996.

Alpha-based systems revenues represented 29% of fiscal 1996 product sales, up from 22% and 13% in fiscal 1995 and 1994, respectively. Revenue from Intel-based personal computers represented 26% of fiscal 1996 product sales, unchanged from fiscal 1995 and up from 19% in fiscal 1994. In fiscal 1996, revenues from personal computers grew 11% compared with fiscal 1995. Following strong growth in the first half of the year, personal computer sales declined in the second half of the year reflecting weakened sales of desktop products to commercial customers and competitive pricing pressures. VAX systems revenues represented 5% of fiscal 1996 product sales, down from 10% and 19% in fiscal 1995 and 1994, respectively, as the Corporation completed a major product transition. Revenues from the Corporation's component businesses, including storage subsystems, networks, software and peripheral products, represented 40% of fiscal 1996 product sales, compared with 42% and 49% in fiscal 1995 and 1994, respectively. The decline in revenues from component businesses was attributable to the effects of divested businesses, partially offset by strong growth in storage subsystems and network products revenue.

In fiscal 1996 and 1995, service and other revenues were $6.2 billion, down from $6.3 billion in fiscal 1994. Services and other revenues as a percentage of total operating revenues were 43%, 45% and 47% in fiscal 1996, 1995 and 1994, respectively. Increased revenues from multivendor services and integration services were offset by a decline in revenues from Digital products maintenance business.

During fiscal 1996, the Corporation sold its learning services business and several small businesses. During fiscal 1995, the Corporation sold portions of its storage business, its relational database business, a software distribution subsidiary, a contract manufacturing business and a semiconductor facility. In addition, as part of the Corporation's restructuring actions, the Corporation transferred part of its business in Germany to a new, independent, employee-owned company, effective October 1, 1994. In fiscal 1994, the divested businesses represented 8% of consolidated operating revenues and did not have a material effect on the consolidated net loss from operations (see Note J).

Domestic and non-U.S. revenues



Expenses and profit margins

The Corporation's total gross margin for fiscal 1996 was 33% of total operating revenues, compared with 32% and 34% for fiscal 1995 and 1994, respectively.

Gross margin (dollars in billions)

Fiscal year	1996	1995	1994
Product sales	$2.8	$2.2	$2.2
% of related revenues	34%	29%	31%
Service and other revenues	$2.0	$2.2	$2.3
% of related revenues	32%	36%	37%

The Corporation's gross margin on fiscal 1996 product sales was 34%, compared with 29% and 31% of product sales for fiscal 1995 and 1994, respectively. The increase in product gross margin in fiscal 1996 was due principally to manufacturing cost efficiencies, an increased proportion of higher-margin Alpha-based systems revenues, and the effect of more competitive product offerings. The decline in product gross margin in fiscal 1995 was due to several factors, including a continued shift in the Corporation's product sales toward lower-margin products, as well as greater use of indirect distribution channels, partially offset by the divestment of certain low-margin businesses and increased demand for higher-margin server products.

Gross margin on service revenues was 32% for fiscal 1996, compared with 36% and 37% of service revenues for fiscal 1995 and 1994, respectively. The decline in service gross margin in fiscal 1996 was primarily due to the shift in the mix of maintenance service revenues toward lower-margin multivendor service offerings, and improved product reliability.

Operating expenses (dollars in billions)

Fiscal year	1996	1995	1994
Research & engineering expenses	$1.1	$1.0	$1.3
% of total revenues	7%	8%	10%
Selling, general and administrative expenses	$3.3	$3.3	$4.0
% of total revenues	23%	24%	30%
Restructuring charges	$0.5	—	$1.2
% of total revenues	3%	—	9%

Research and engineering (R&E) spending for fiscal 1996 totaled $1.1 billion, compared with $1.0 billion and $1.3 billion in fiscal 1995 and 1994, respectively. The decrease in R&E expense in fiscal 1995 compared with fiscal 1994 was due principally to the elimination of redundant engineering efforts, more standardized product offerings and divestments. The Corporation believes that its level of R&E spending as a percentage of total operating revenues is appropriate to support current operations and to offer competitive, market-driven products.

Selling, general and administrative (SG&A) expenses totaled $3.3 billion for fiscal 1996, approximately the same level as fiscal 1995 and down from $4.0 billion in fiscal 1994 which included $310 million of non-recurring charges (see Note J). For fiscal 1996, SG&A expenses reflected increased variable costs associated with higher revenue levels, increased salaries and wages and administrative systems investments, partially offset by the favorable effects of restructuring actions taken in the first half of fiscal 1995 and the effects of divestments. Fiscal 1996 SG&A expenses included $72 million of gains from divestments and asset sales (see Note J). The decrease in SG&A expenses in fiscal 1995 compared with fiscal 1994 was due principally to restructuring actions.

In the fourth quarter of fiscal 1996, the Corporation recorded a restructuring charge of $492 million. The restructuring plan is intended to increase sales productivity, further consolidate manufacturing plants and distribution sites, improve service delivery and further reduce overhead in support areas. The charge includes $363 million to pay for termination benefits for approximately 7,000 employees in fiscal 1997, as well as for employee termination benefits incurred in the fourth quarter of fiscal 1996. The remaining $129 million of the charge is for the cost of closing approximately 3.5 million square feet of office and manufacturing space, principally in Europe and the United States. When completed, the actions associated with the fiscal 1996 restructuring charge are expected to result in annualized operating expense savings of approximately $400 million. See Note E for a further description of the Corporation's restructuring actions and related costs.

Total employee population decreased by 2,600 during fiscal 1996 to approximately 59,100. The Corporation had approximately 61,700 and 77,800 employees at the end of fiscal 1995 and 1994, respectively.

The net effect of currency exchange rate movements on revenues was insignificant in fiscal 1996 compared with fiscal 1995 and positive in fiscal 1995 when compared with fiscal 1994. The effect of currency exchange rate movements on revenues was offset substantially by similar effects on non-dollar denominated costs in fiscal 1996 and 1995. See Note I for a further description of the Corporation's use of foreign exchange option and forward contracts.

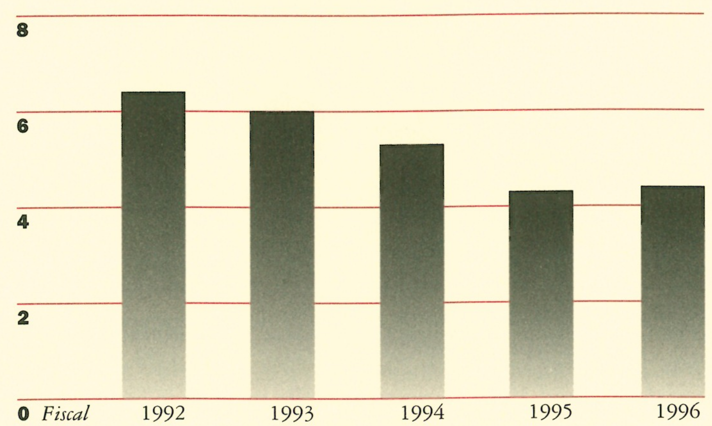
Interest income in fiscal 1996 was $76 million, up from $57 million and $49 million in fiscal 1995 and 1994, respectively, reflecting higher interest rates and significantly higher cash balances. Interest expense increased to $100 million from $90 million and $73 million in fiscal 1995 and 1994, respectively (see Note F). Interest expense related to interest rate swaps was approximately $4 million in fiscal 1996, compared with reductions of interest expense of approximately $1 million and $12 million in fiscal 1995 and 1994, respectively (see Note I).

In fiscal 1996, income tax expense was $44 million on a pre-tax loss of $68 million. Income tax expense reflects several factors, including income taxes provided for profitable operations, benefits taken from net operating loss carryforwards and an inability to recognize currently certain tax benefits from operating losses. Income tax expense was $18 million on pre-tax income of $76 million in fiscal 1995 and $85 million on a pre-tax loss of $2.0 billion in fiscal 1994. Income tax expense for fiscal 1994 included a $70 million reduction in net deferred tax assets associated with non-U.S. operations. See Note C for a further explanation of income tax expense.

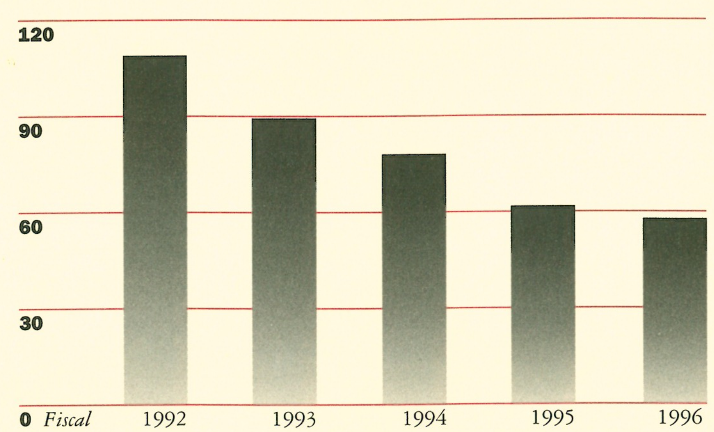
In the fourth quarter of fiscal 1996, the Corporation adopted Statement of Financial Accounting Standard (SFAS) No. 121 – Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. The adoption of SFAS No. 121 did not have a material impact on the results of operations or financial position of the Corporation and there was no cash flow impact associated with the adoption.

In October 1995, the Financial Accounting Standards Board issued SFAS No. 123 – Accounting for Stock-Based Compensation. SFAS No. 123 encourages companies to recognize compensation costs for all stock-based compensation arrangements using a fair value method of accounting. Alternatively, SFAS No. 123 permits a company to continue accounting for these arrangements under Accounting Principles Board Opinion No. 25 – Accounting for Stock Issued to Employees, accompanied by footnote disclosure of the pro forma effects on net income and earnings per share had the new accounting rules been applied. The Corporation will implement the alternative approach in fiscal 1997.

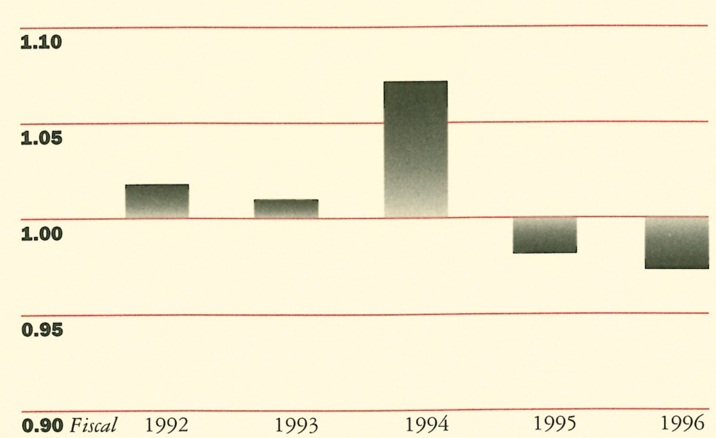
Operating expenses
Dollars in billions, excluding restructuring charges



Employees
Thousands of employees



U.S. dollar relative to major foreign currencies
Fiscal 1991 equals 1.00



Availability of funds to support current and future operations and spending for operations

Cash and short-term investments totaled $2.0 billion, $1.6 billion and $1.2 billion at the end of fiscal 1996, 1995 and 1994, respectively (see Note A).

Cash flows from: (in billions)

Fiscal year	1996	1995	1994
Operating activities	$ 0.6	$(0.3)	$(0.4)
Investing activities	(0.5)	0.6	(0.6)
Operating and investing activities	0.1	0.3	(1.0)
Financing activities	0.2	0.1	0.5
Total cash flows	$ 0.3	$ 0.4	$(0.5)

Net cash generated by operating activities was $602 million in fiscal 1996, compared with net cash used of $348 million and $375 million in fiscal 1995 and 1994, respectively. The $950 million improvement in cash generated from operating activities in fiscal 1996 was primarily due to a $181 million decrease in inventories in fiscal 1996 compared with an increase of $272 million in fiscal 1995, and a lower level of restructuring related expenditures in fiscal 1996 compared with fiscal 1995.

Net cash used for investing activities was $492 million in fiscal 1996, compared with net cash generated (including divestments) of $638 million in fiscal 1995, and net cash used of $637 million in fiscal 1994. Capital spending in fiscal 1996 was $431 million compared with $366 million and $682 million in fiscal 1995 and 1994, respectively. In fiscal 1996, the Corporation sold its learning services business and several small businesses generating proceeds of $156 million. The sale of property, plant and equipment generated an additional $73 million in cash. In fiscal 1995, the Corporation sold all of its shares of Ing. Olivetti & C. S.p.A. common stock, portions of its storage business, its relational database business, a software distribution subsidiary, a contract manufacturing business, a semiconductor facility, property, plant and equipment and other assets generating approximately $1.1 billion in cash proceeds (see Note J). The Corporation increased its short-term investments by $177 million, $31 million and $11 million in fiscal 1996, 1995 and 1994, respectively.

Net cash generated from financing activities was $150 million, $100 million and $538 million in fiscal 1996, 1995 and 1994, respectively. The principal financing activity for fiscal 1996 and 1995 was the issuance of stock under the Corporation's employee stock plans, offset by the payment in each year of approximately $36 million of dividends on preferred stock. In the third quarter of fiscal 1994, the Corporation issued and sold preferred stock generating net proceeds of $387 million. Dividends on preferred stock of approximately $2 million were paid in fiscal 1994.

Long-term debt was approximately $1.0 billion at the end of fiscal 1996, 1995 and 1994. At the end of fiscal 1996, substantially all of the Corporation's available lines of credit and accounts receivable securitization facilities were unused (see Note F).

For fiscal 1996, cash expenditures for restructuring activities were $237 million, net of proceeds of approximately $54 million from the sale of property, plant and equipment. Cash expenditures for restructuring actions are expected to be approximately $500 million in fiscal 1997, and $130 million in fiscal 1998 and beyond related to facilities closures (see Note E).

On July 29, 1996 the Corporation's Board of Directors authorized the repurchase for cash, as conditions warrant, of up to 10 million shares of the Corporation's common stock. As of August 30, 1996 the Corporation had purchased on the open market 447,500 shares of its common stock at an aggregate purchase price of $17,362,000, or $38.80 per share.

On August 27, 1996, the Corporation's wholly-owned subsidiary, AltaVista Internet Software, Inc. filed with the Securities and Exchange Commission a registration statement on Form S-1 under the Securities Act of 1933, as amended, for the registration of shares of its Class A Common Stock in an initial public offering.

The Corporation's need for, cost of and access to funds are dependent on future operating results, as well as conditions external to the Corporation. The Corporation historically has maintained a conservative capital structure, and believes that its current cash position and its sources of and access to capital are adequate to support current and future operations.

Factors that may affect future results

From time to time, information provided by the Corporation or statements made by its employees may contain "forward-looking" information, as that term is defined in the Private Securities Litigation Reform Act of 1995 (the "Act"). The Corporation cautions investors that there can be no assurance that actual results or business conditions will not differ materially from those projected or suggested in such forward-looking statements as a result of various factors, including but not limited to the following:

- The Corporation's future operating results are dependent on its ability to develop, produce and market new and innovative products and services. There are numerous risks inherent in this complex process, including rapid technological change and the requirement that the Corporation bring to market in a timely fashion new products and services which meet customers' changing needs.

- Historically, the Corporation has generated a disproportionate amount of its operating revenues toward the end of each quarter, making precise prediction of revenues and earnings particularly difficult and resulting in risk of variance of actual results from those forecast at any time. In addition, the Corporation's operating results historically have varied from fiscal period to fiscal period; accordingly, the Corporation's financial results in any particular fiscal period are not necessarily indicative of results for future periods.

- The Corporation offers a broad variety of products and services to customers around the world. Changes in the mix of products and services comprising revenues could cause actual operating results to vary from those expected.

- The Corporation's success is partly dependent on its ability to predict demand and adjust production capacity accordingly, which is partly dependent upon the ability of external suppliers to deliver components at reasonable prices and in a timely manner; capacity or supply constraints could adversely affect future operating results.

- The Corporation operates in a highly competitive environment and in a highly competitive industry, which include significant pricing pressures and intense competition for skilled employees. Particular business segments may from time to time experience unanticipated intense competitive pressure, possibly causing operating results to vary from those expected.

- The Corporation offers its products and services directly and through indirect distribution channels. Changes in the financial condition of, or the Corporation's relationship with, distributors and other indirect channel partners could cause actual operating results to vary from those expected.

- As the Corporation continues to implement its strategic plan and respond to external market conditions, there can be no assurance that additional restructuring actions will not be required. With regard to the completion of planned restructuring actions, there can be no assurance that the estimated cost of such actions will not change.

Report of management

The Corporation's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of 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 the Corporation's policies. This system includes policies which require adherence to ethical business standards and compliance with all laws to which the Corporation 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 Corporation's independent accountants annually review the accounting and control systems of the Corporation. Their audit includes a review of the internal control structure to the extent they consider necessary and selective tests of transactions to support their report.

The Board of Directors, through its Audit Committee, which is composed of four Board members who are independent of management, is responsible for determining that management fulfills its responsibility with respect to the Corporation's financial statements and the system of internal accounting controls.

The Audit Committee meets regularly with representatives of management, the independent accountants and the Corporation's internal auditors to review audits, financial reporting and internal control matters, and when appropriate, meets with the Corporation's outside counsel on relevant matters. The independent accountants and the internal auditors have full and free access to the Audit Committee and regularly meet privately with the Audit Committee.

Coopers & Lybrand L.L.P., independent accountants, have been engaged by the Audit Committee of the Board of Directors, with the approval of the stockholders, to audit the Corporation's financial statements. Their report follows.

RB Palmer

Robert B. Palmer
Chairman of the Board,
President and Chief Executive Officer

Vincent J Mullarkey

Vincent J. Mullarkey
Vice President, Finance and Chief Financial Officer

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 June 29, 1996 and July 1, 1995, and the related consolidated statements of operations, cash flows, and stockholders' equity for each of the three fiscal years in the period ended June 29, 1996. These financial statements are the responsibility of the Corporation'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 June 29, 1996 and July 1, 1995, and the consolidated results of its operations and cash flows for each of the three fiscal years in the period ended June 29, 1996, in conformity with generally accepted accounting principles.

As discussed in Note J to the consolidated financial statements, the Corporation changed its method of accounting for certain investments in debt and equity securities in fiscal 1995.

Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P.

Boston, Massachusetts
July 29, 1996

Consolidated statements of operations
Digital Equipment Corporation

(in thousands except per share data)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
Revenues *(Notes A and B)*			
Product sales	$ 8,362,423	$ 7,616,441	$ 7,191,251
Service and other revenues	6,200,352	6,196,621	6,259,539
Total operating revenues	14,562,775	13,813,062	13,450,790
Costs and expenses *(Notes A, D, G, H and K)*			
Cost of product sales	5,541,792	5,397,723	4,968,025
Service expense and cost of other revenues	4,214,412	3,993,970	3,943,612
Research and engineering expenses	1,062,253	1,040,028	1,301,347
Selling, general and administrative expenses *(Note J)*	3,295,865	3,272,913	4,027,869
Restructuring charges *(Note E)*	492,000	–	1,206,000
Operating income/(loss)	(43,547)	108,428	(1,996,063)
Interest income	76,438	57,497	49,422
Interest expense *(Notes F and I)*	100,418	90,268	73,353
Income/(loss) before income taxes and cumulative effect of changes in accounting principles	(67,527)	75,657	(2,019,994)
Provision for income taxes *(Note C)*	44,285	18,342	85,043
Income/(loss) before cumulative effect of changes in accounting principles	(111,812)	57,315	(2,105,037)
(Benefit)/charge due to cumulative effect of changes in accounting principles, net of tax *(Notes C, G and J)*	–	(64,503)	51,026
Net income/(loss)	(111,812)	121,818	(2,156,063)
Dividends on preferred stock *(Note L)*	35,500	35,500	10,650
Net income/(loss) applicable to common stock	$ (147,312)	$ 86,318	$ (2,166,713)
Per common share *(Note A)*			
Income/(loss) applicable before cumulative effect of changes in accounting principles	$ (.97)	$ .15	$ (15.43)
Benefit/(charge) due to cumulative effect of changes in accounting principles	–	.44	(.37)
Net income/(loss) applicable per common share *(Note A)*	$ (.97)	$ .59	$ (15.80)
Weighted average common shares outstanding *(Note A)*	152,052	146,331	137,090

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

Consolidated balance sheets
Digital Equipment Corporation

(dollars in thousands)

	June 29, 1996	July 1, 1995
Assets		
Current assets:		
Cash, cash equivalents and short-term investments *(Note A)*	$ 2,039,158	$ 1,602,148
Accounts receivable, net of allowances of $182,033 and $150,655	3,223,293	3,219,082
Inventories *(Note A)*	1,820,811	2,053,620
Prepaid expenses, deferred income taxes and other current assets *(Note C)*	336,836	397,047
Total current assets	7,420,098	7,271,897
Net property, plant and equipment *(Note A)*	2,222,920	2,268,722
Other assets *(Notes A, C, D and J)*	432,363	406,533
Total assets	$ 10,075,381	$ 9,947,152
Liabilities and stockholders' equity		
Current liabilities:		
Bank loans and current portion of long-term debt *(Note F)*	$ 17,896	$ 14,371
Accounts payable	903,618	1,113,160
Income taxes payable *(Note C)*	79,528	76,757
Salaries, wages and related items	632,413	562,442
Deferred revenues and customer advances *(Note A)*	1,099,328	1,232,050
Accrued restructuring costs *(Note E)*	619,416	492,046
Other current liabilities	879,434	755,482
Total current liabilities	4,231,633	4,246,308
Long-term debt *(Note F)*	999,131	1,012,885
Postretirement and other postemployment benefits *(Note G)*	1,238,411	1,159,679
Total liabilities	6,469,175	6,418,872
Commitments and contingencies *(Note H)*		
Stockholders' equity *(Notes K, L and M)*:		
Preferred stock, $1.00 par value (liquidation preference of $100 per share); authorized 25,000,000 shares; 4,000,000 shares of Series A 8⅞% Cumulative Preferred Stock issued and outstanding	4,000	4,000
Common stock, $1.00 par value; authorized 450,000,000 shares; 155,504,284 shares and 149,777,573 shares issued and outstanding	155,504	149,778
Additional paid-in capital	3,764,224	3,544,712
Retained deficit	(317,522)	(170,210)
Total stockholders' equity	3,606,206	3,528,280
Total liabilities and stockholders' equity	$ 10,075,381	$ 9,947,152

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

Consolidated statements of cash flows

Digital Equipment Corporation

(in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
Cash flows from operating activities			
Net income/(loss)	$ (111,812)	$ 121,818	$(2,156,063)
Adjustments to reconcile net income/(loss) to net cash from operating activities:			
Depreciation	405,859	507,966	573,970
Amortization	74,346	67,624	106,584
(Gain)/loss on disposition and write-down of other assets *(Note J)*	(71,941)	(57,333)	310,000
Other adjustments to income/(loss)	10,708	(34,576)	84,026
(Increase)/decrease in accounts receivable	(4,211)	42,862	(298,602)
(Increase)/decrease in inventories	180,761	(272,037)	(308,838)
(Increase)/decrease in prepaid expenses and other current assets	47,002	(17,862)	82,513
Increase/(decrease) in accounts payable	(209,542)	(49,517)	374,916
Increase in taxes *(Note C)*	23,609	16,813	18,913
Increase in salaries, wages, benefits and related items *(Note G)*	151,370	31,306	163,221
Increase/(decrease) in deferred revenues and customer advances	(123,028)	544	101,469
Increase/(decrease) in accrued restructuring costs *(Note E)*	127,370	(859,029)	612,086
Increase/(decrease) in other current liabilities	101,724	153,911	(39,101)
Total adjustments	714,027	(469,328)	1,781,157
Net cash flows from operating activities	602,215	(347,510)	(374,906)
Cash flows from investing activities			
Investment in property, plant and equipment	(431,307)	(365,551)	(682,100)
Proceeds from the disposition of property, plant and equipment *(Notes E and J)*	73,083	208,505	97,456
Purchases of short-term investments	(340,415)	(117,050)	(108,637)
Maturities of short-term investments	163,310	85,924	97,364
Investment in other assets *(Note J)*	(112,532)	(37,687)	(64,377)
Proceeds from the disposition of other assets *(Note J)*	155,971	863,468	23,516
Net cash flows from investing activities	(491,890)	637,609	(636,778)
Net cash flows from operating and investing activities	110,325	290,099	(1,011,684)
Cash flows from financing activities			
Proceeds from issuance of debt	–	13,253	22,742
Payments to retire debt	(11,241)	(29,336)	(19,451)
Issuance of preferred and common shares, including tax effects	196,321	151,643	536,563
Dividends paid	(35,500)	(35,500)	(1,775)
Net cash flows from financing activities	149,580	100,060	538,079
Net increase/(decrease) in cash and cash equivalents	259,905	390,159	(473,605)
Cash and cash equivalents at beginning of year	1,531,849	1,141,690	1,615,295
Cash and cash equivalents at end of year *(Note A)*	$ 1,791,754	$ 1,531,849	$ 1,141,690

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

Consolidated statements of stockholders' equity

Digital Equipment Corporation

(in thousands)

	Preferred stock	Common stock	Additional paid-in capital	Retained earnings/ (deficit)	Treasury stock	Total stockholders' equity
July 3, 1993	$ –	$135,490	$2,851,960	$1,937,627	$ (39,678)	$4,885,399
Issuance of preferred stock	4,000		382,745			386,745
Shares issued under stock plans		6,797	130,785	(27,442)	39,678	149,818
Restricted stock plans, charge to operations			24,550			24,550
Dividends declared—preferred stock				(10,650)		(10,650)
Net loss—1994				(2,156,063)		(2,156,063)
July 2, 1994	4,000	142,287	3,390,040	(256,528)	–	3,279,799
Shares issued under stock plans		7,491	143,993			151,484
Restricted stock plans, charge to operations			10,679			10,679
Dividends declared—preferred stock				(35,500)		(35,500)
Net income—1995				121,818		121,818
July 1, 1995	4,000	149,778	3,544,712	(170,210)	–	3,528,280
Shares issued under stock plans		5,726	190,595			196,321
Restricted stock plans, charge to operations			28,917			28,917
Dividends declared—preferred stock				(35,500)		(35,500)
Net loss—1996				(111,812)		(111,812)
June 29, 1996	$ 4,000	$155,504	$3,764,224	$ (317,522)	$ –	$3,606,206

See *Notes K, L* and *M* of *Notes to consolidated financial statements.*

Cash dividends on common stock have never been paid by the Corporation. The Corporation commenced paying dividends in fiscal 1994 on preferred stock issued in March 1994.

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 Corporation include the financial statements of the parent and its majority-owned U.S. and non-U.S. subsidiaries. All significant intercompany accounts and profits have been eliminated. Certain prior years' amounts have been reclassified to conform with the current year presentation.

Use of estimates The preparation of the Corporation's financial statements requires management to make estimates and judgements that affect the reported consolidated statements of operations and consolidated balance sheets and related disclosures. Actual results could differ from those estimates.

Fiscal year The fiscal year of the Corporation is the fifty-two/fifty-three week period ending the Saturday nearest the last day of June. The fiscal years ended June 29, 1996, July 1, 1995 and July 2, 1994 included 52 weeks.

Translation of foreign currencies For non-U.S. operations, the U.S. dollar is 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 and depreciation charged to operations are translated at historical rates. Exchange gains and losses arising from translation are included in current income.

Revenue recognition Revenues from product sales are generally recognized at the time the product is shipped. Provisions for product sales returns and allowances are recorded in the same period as the related revenue. Service and other revenues are recognized ratably over the contractual period or as the services are performed.

Warranty Warranty service revenues are recognized ratably over the warranty period; warranty-related costs are recognized as incurred. The Corporation also provides warranty coverage as a product attribute on certain products. Estimated costs to repair such products are accrued as product cost when the product is shipped.

Net income/(loss) applicable per common share
Per common share amounts are calculated based on the weighted average number of common shares and common share equivalents outstanding during periods of net income, after deducting applicable preferred stock dividends. Common share equivalents are attributable to stock options. Per share amounts are calculated based only on the weighted average number of common shares outstanding during periods of net loss, after deducting applicable preferred stock dividends.

Cash, cash equivalents and short-term investments
The Corporation considers all highly liquid temporary cash investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents are valued at cost plus accrued interest, which approximates market. Investments with maturities greater than three months mature within six months of the balance sheet date and are classified as short-term investments. Short-term investments are valued at cost plus accrued interest, which approximates market. The Corporation's practice is to hold these investments to maturity.

(in thousands)	June 29, 1996	July 1, 1995
Cash and cash equivalents	$ 1,791,754	$ 1,531,849
Short-term investments	247,404	70,299
Cash, cash equivalents and short-term investments	$ 2,039,158	$ 1,602,148

Inventories Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories are routinely subject to changes in value, resulting from rapid technological change, intense price competition and changes in customer demand patterns. While the Corporation has provided for estimated declines in market value of inventories, no estimate can be made of a range of amounts of loss that are reasonably possible under various competitive conditions.

(in thousands)	June 29, 1996	July 1, 1995
Raw materials	$ 536,911	$ 595,829
Work-in-process	439,318	434,408
Finished goods	844,582	1,023,383
Total inventories	$ 1,820,811	$ 2,053,620

Note A: Significant accounting policies *(continued)*

Property, plant and equipment Property, plant and equipment are stated at cost, subject to review of impairment for significant assets whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

(in thousands)	June 29, 1996	July 1, 1995
Land	$ 218,659	$ 244,187
Buildings	1,384,819	1,418,636
Leasehold improvements	325,120	355,887
Machinery and equipment	3,191,512	3,457,017
Total property, plant and equipment	5,120,110	5,475,727
Less accumulated depreciation	2,897,190	3,207,005
Net property, plant and equipment	$ 2,222,920	$ 2,268,722

Depreciation expense is computed principally on the following bases:

Classification	*Depreciation lives and methods*
Buildings	10 to 33 years (straight-line)
Leasehold improvements	Life of assets or term of lease, whichever is shorter (straight-line)
Machinery and equipment	2 to 10 years (principally accelerated methods)

When assets are retired, or otherwise disposed of, the assets and related accumulated depreciation are removed from the accounts. Gains or losses resulting from restructuring actions are included in accrued restructuring costs. Other resulting gains and losses are included in income.

Other assets Other assets include long-term investments, capitalized software development costs, goodwill, deferred taxes and other intangible assets.

Software development costs are capitalized at the time that technological feasibility is established. These costs are amortized over no more than three years from the date the products are available for general use and are subject to periodic review of net realizable value.

Goodwill and other intangible assets are amortized using the straight-line method over the estimated useful life of the asset, subject to periodic review of impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Note B: Geographic operations

Industry The Corporation operates in one business segment: the design, manufacture, sale and service of networked computer systems.

Non-U.S. operations Sales and marketing operations outside the United States are conducted primarily through sales subsidiaries throughout the world; by direct sales from the parent corporation; and through various representative distributorship arrangements, value-added resellers and retailers. The Corporation's non-U.S. manufacturing operations include plants in Canada, Europe and Asia-Pacific. The products of these manufacturing plants are sold to the Corporation'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 intended to be representative of unaffiliated party transactions.

Sales to unaffiliated customers outside the United States, including U.S. export sales, were $9.6 billion, $9.0 billion, and $8.3 billion for the fiscal years ended June 29, 1996, July 1, 1995 and July 2, 1994, respectively, which represented 66%, 65% and 62%, respectively, of total operating revenues.

The broad diversity of the Corporation's products, service offerings, customers and geographic operations mitigate significantly the risk that a severe impact will occur in the near term as a result of changes in its customer base, competition, sources of supply or composition of its markets.

Note B: Geographic operations *(continued)*

(in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
Net revenues			
United States:			
Unaffiliated customer sales	$ 5,126,405	$ 4,816,024	$ 5,176,748
Inter-area transfers	1,381,671	1,426,305	1,830,749
	6,508,076	6,242,329	7,007,497
Europe:			
Unaffiliated customer sales	6,137,495	5,973,188	5,832,332
Inter-area transfers	703,289	792,277	373,354
	6,840,784	6,765,465	6,205,686
Canada, Latin America, Asia-Pacific:			
Unaffiliated customer sales	3,298,875	3,023,850	2,441,710
Inter-area transfers	2,138,800	2,081,764	1,707,291
	5,437,675	5,105,614	4,149,001
Eliminations	(4,223,760)	(4,300,346)	(3,911,394)
Net revenue	$ 14,562,775	$ 13,813,062	$ 13,450,790
Income/(loss)			
United States	$ 45,707	$ (231,180)	$ (740,709)
Europe	(137,546)	236,641	(1,109,188)
Canada, Latin America, Asia-Pacific	24,312	70,196	(170,097)
Eliminations	23,980	32,771	23,931
Operating income/(loss)	(43,547)	108,428	(1,996,063)
Interest income	76,438	57,497	49,422
Interest expense	100,418	90,268	73,353
Income/(loss) before income taxes and cumulative effect of changes in accounting principles	$ (67,527)	$ 75,657	$ (2,019,994)
Assets			
United States	$ 3,739,570	$ 3,924,941	$ 4,997,184
Europe	3,174,933	3,321,429	4,098,780
Canada, Latin America, Asia-Pacific	2,002,943	2,335,236	1,945,236
Corporate assets	2,039,158	1,602,148	1,180,863
Eliminations	(881,223)	(1,236,602)	(1,642,292)
Total assets	$ 10,075,381	$ 9,947,152	$ 10,579,771

Note C: Income taxes

Income/(loss) before income taxes and cumulative effect of changes in accounting principles (in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
U.S.	$ 41,204	$ (231,180)	$ (754,844)
Non-U.S.	(108,731)	306,837	(1,265,150)
Total	$ (67,527)	$ 75,657	$(2,019,994)

Reconciliation of U.S. federal statutory rate to actual tax rate

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
U.S. federal statutory tax (benefit) rate	(35.0)%	35.0%	(35.0)%
Tax benefit of manufacturing operations in[1]:			
Ireland	(17.9)	(40.2)	(2.3)
Singapore	(4.9)	(12.6)	(.1)
Tax impact due to net loss carryforward position:			
U.S.	(10.2)	106.9	13.5
Non-U.S.	160.2	(93.2)	41.1
Non-U.S. tax rates	(24.9)	27.3	(12.0)
Other	(1.7)	1.0	(1.0)
Effective tax rate	65.6%	24.2%	4.2%

[1] *The income from products manufactured for export by the Corporation's manufacturing subsidiary in Ireland is subject to a 10% tax rate through December 2010. The income from certain products manufactured by the Corporation's manufacturing subsidiary in Singapore was taxed at 15% through December 1995.*

Components of provisions for (benefits from) U.S. federal and non-U.S. income taxes (in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
U.S. federal:			
Current	$ 6,104	$ –	$ –
Deferred	(1,971)	(7,318)	(14,431)
Total	4,133	(7,318)	(14,431)
Non-U.S.:			
Current	28,636	48,388	5,618
Deferred	9,309	(26,260)	92,989
Total	37,945	22,128	98,607
State income taxes	2,207	3,532	867
Total income taxes	$ 44,285	$ 18,342	$ 85,043

The Corporation adopted Statement of Financial Accounting Standards (SFAS) No. 109 – Accounting for Income Taxes, effective July 4, 1993. The Corporation had previously accounted for income taxes under Accounting Principles Board Opinion No. 11. In the first quarter of fiscal 1994, the Corporation recorded a one-time benefit of $20,000,000 or $.14 per common share, for the recognition of previously unrecognized tax benefits. There was no cash flow impact from the adoption of SFAS No. 109. The standard was adopted on a prospective basis, and amounts presented for prior years were not restated.

Note C: Income taxes *(continued)*

Significant components of deferred tax assets and liabilities (in thousands)

Year ended	June 29, 1996		July 1, 1995	
	Assets	Liabilities	Assets	Liabilities
Inventory-related transactions	$ 113,663	$ 7,761	$ 148,399	$ 12,893
Depreciation	59,276	33,474	65,083	55,314
Deferred warranty revenue	96,943	1,343	101,094	–
Postretirement/postemployment benefits	468,662	12,528	447,948	23,524
Restructuring	296,296	20,680	199,319	–
Tax loss carryforwards	1,426,648	–	1,419,630	–
Tax credit carryforwards	192,928	–	166,526	–
Intangible assets	48,465	14,269	55,447	16,388
Research and engineering	503,826	–	504,382	–
Other	222,217	50,274	164,685	67,209
Gross deferred tax balances	3,428,924	140,329	3,272,513	175,328
Valuation allowance	3,179,283	–	2,967,035	–
Net deferred tax balances	$ 249,641	$ 140,329	$ 305,478	$ 175,328

The gross deferred tax asset from tax loss carryforwards of $1.4 billion represents $3.6 billion of net operating loss carryforwards on a tax return basis which will generally expire as follows: $90,000,000 in 1998, $200,000,000 in 1999, $160,000,000 in 2000, $220,000,000 in 2001, $90,000,000 in 2002, $700,000,000 in 2007, $500,000,000 in 2008, and the remainder thereafter.

Tax credit carryforwards will generally expire as follows: $35,000,000 in 2001, $50,000,000 in 2002, $70,000,000 in 2003, $20,000,000 in 2004, and the remainder thereafter.

Tax benefit arising from previously unrecognized operating loss carryforwards amounted to approximately $190,000,000 and $42,000,000 for fiscal 1996 and 1995, respectively.

The Corporation has recorded net deferred tax assets of approximately $109,000,000 at June 29, 1996, reflecting primarily the benefit of net operating loss carryforwards in certain countries. Realization is dependent on generating sufficient future taxable income to utilize the assets. Although realization is not assured, management believes it is more likely than not that the assets will be realized.

As a result of statutory tax rate changes gross deferred taxes increased by $10,334,000 in fiscal 1995. The increase was fully offset by valuation allowances.

In fiscal 1996, 1995 and 1994, net income taxes paid were approximately $18,452,000, $3,008,000 and $42,419,000, respectively.

In general, the Corporation'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. The accumulated retained earnings for foreign subsidiaries aggregated $1.9 billion at June 29, 1996. Applicable taxes are provided only on amounts planned to be remitted. It is not practicable to estimate the amount of additional tax that might be payable on the foreign earnings.

Note D: Capitalized computer software development costs

Unamortized computer software development costs were $93,408,000 and $100,989,000 at June 29, 1996 and July 1, 1995, respectively. Amortization expense was $48,433,000, $59,335,000 and $67,515,000 for fiscal 1996, 1995 and 1994, respectively. Accumulated amortization was $160,785,000 and $197,419,000 at June 29, 1996 and July 1, 1995, respectively.

Note E: Restructuring actions

Accrued restructuring costs and charges include the cost of involuntary employee termination benefits, facility closures and related costs associated with restructuring actions. Employee termination benefits include severance, wage continuation, notice pay, medical and other benefits. Facility closure and related costs include disposal costs for property, plant and equipment, lease payments and related costs. Restructuring costs were accrued and charged to expense in accordance with approved management plans.

As a result of initiatives to increase sales productivity, further consolidate manufacturing plants and distribution sites, improve service delivery and further reduce overhead in support areas, the Corporation accrued a restructuring charge of $492,000,000 in the fourth quarter of fiscal 1996.

The cost of employee separations associated with the fiscal 1996 charge includes termination benefits for approximately 7,000 employees in fiscal 1997 as well as employee termination benefits incurred in the fourth quarter of fiscal 1996. The majority of the employee separations will come from administrative and overhead functions, located in Europe and the United States. Most other organizations and functions also will be affected by the planned reduction in employees. The fiscal 1996 charge also includes costs associated with the closure of an additional 3.5 million square feet of office and manufacturing space, principally in the United States and Europe.

As the Corporation continues to implement its strategic plan and respond to external market conditions, there can be no assurance that additional restructuring actions will not be required. With regard to the completion of planned restructuring actions, there can be no assurance that the estimated cost of such actions will not change.

During fiscal 1996, restructuring actions resulted in approximately 2,400 employee separations, a portion of which were covered under the fiscal 1994 restructuring plan. The number of involuntary separations was less than originally planned due principally to a higher level of voluntary separations and employees transferred in connection with divesting activities. However, associated cost savings were offset by higher than planned separation costs for certain non-U.S. employees.

The Corporation's experience in property dispositions has been consistent with the restructuring plan provided for in fiscal 1994. In the past two fiscal years, the Corporation has sold 6.2 million square feet of space and reduced space under lease by 4.7 million square feet.

Accrued restructuring costs (in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
Balance, beginning of year	$ 492,046	$1,351,075	$ 738,989
Charges to operations:			
Employee separations	363,000	–	679,000
Facility closures and related costs	129,000	–	527,000
Total charges to operations	492,000	–	1,206,000
Costs incurred:			
Employee separations	153,025	507,816	372,450
Facility closures and related costs	177,593	323,029	212,300
Other	34,012	28,184	9,164
Total costs incurred	364,630	859,029	593,914
Balance, end of year	$ 619,416	$ 492,046	$ 1,351,075
Cash expenditures:			
Employee separations	$ 175,839	$ 562,629	$ 532,000
Facility closures and related costs, net of proceeds	61,000	(38,850)	67,550
Net cash expenditures	$ 236,839	$ 523,779	$ 599,550
Number of employee terminations due to restructuring actions	2,400	7,400	12,000

Note F: Debt

Long-term debt, exclusive of current maturities (in thousands)

	Maturity date (Calendar year)	Interest rate	June 29, 1996	July 1, 1995
Lease obligations	1997–2002	5.88%–10.95%[1]	$ 12,034	$ 16,091
Notes[2]	1997	7%	250,000	250,000
Notes[2]	2002	7 1/8%	250,000	250,000
Debentures[2]	2012	8 3/8%	250,000	250,000
Debentures[2]	2023	7 3/4%	250,000	250,000
Unamortized discount and commissions[2]			(13,138)	(14,150)
Other debt obligations			235	10,944
Total long-term debt, exclusive of current maturities			$ 999,131	$ 1,012,885

[1]*Weighted average interest rate of 7.6% and 8.5% at June 29, 1996 and July 1, 1995, respectively.*

[2]*The Notes and Debentures are not redeemable prior to maturity and are not entitled to any sinking fund. The unamortized discount and commissions relate to these Notes and Debentures.*

Principal payments during the next five fiscal years are as follows: 1997 – $10,335,000; 1998 – $256,564,000; 1999 – $926,000; 2000 – $948,000; 2001 – $2,975,000.

In fiscal 1996, 1995 and 1994, interest paid was $116,214,000, $86,157,000 and $76,203,000, respectively.

The Corporation had available lines of credit totaling $315,434,000 and $308,885,000 as of June 29, 1996 and July 1, 1995, respectively. Substantially all of these lines of credit were unused at the end of fiscal 1996 and 1995. Commitment fees on the unused lines of credit were immaterial.

In June 1994, the Corporation entered into a five-year agreement with a major financial institution (i) providing for the transfer and sale by the Corporation to a wholly-owned subsidiary of the Corporation of a designated pool of domestic trade accounts receivable (the "Receivables"), and (ii) allowing the Corporation to sell to a group of investors an undivided ownership interest in the Receivables for proceeds of up to $600,000,000 (the "Purchase Limit"). The agreement includes annual commitment fees up to a maximum of 0.2% of the Purchase Limit. During the third quarter of fiscal 1995, the Corporation elected to amend the Purchase Limit under the agreement from $600,000,000 to $500,000,000. As of June 29, 1996 and July 1, 1995, no interests in the Receivables had been sold.

In May 1995, Digital Equipment Co. Limited, a wholly-owned subsidiary of the Corporation incorporated in the United Kingdom, entered into a five-year agreement with a major financial institution allowing it to sell an undivided ownership interest in a designated pool of trade accounts receivable (the "UK Receivables") to a group of investors for proceeds of up to approximately $124,000,000 (80,000,000 pounds sterling). Commitment fees under the agreement are immaterial. As of June 29, 1996 and July 1, 1995, no interests in the UK Receivables had been sold.

In October 1995, Digital Equipment France S.A.R.L., a wholly-owned subsidiary of the Corporation incorporated in France, entered into a one-year agreement with a major financial institution allowing it to sell an interest in a designated pool of trade accounts receivable (the "France Receivables") to a group of investors for proceeds of up to approximately $87,000,000 (450,000,000 French francs), of which approximately $69,000,000 was available at June 29, 1996. Commitment fees under the agreement are immaterial. As of June 29, 1996, no interests in the France Receivables had been sold.

Note G: Postretirement and other postemployment benefits

Pension plans The Corporation and its subsidiaries have defined benefit and defined contribution pension plans covering substantially all employees. The benefits are based on years of service and compensation during the employee's career. Pension cost is based on estimated benefit payment formulas.

It is the Corporation's policy to make tax-deductible contributions to the plans in accordance with plan provisions and local laws. For the U.S. pension plan, there were no contributions in fiscal 1996, 1995 or 1994. The assets of the plans include corporate equity and debt securities, government securities and real estate.

In December 1995, the Board of Directors approved an amendment to the Corporation's U.S. pension plan effective March 1, 1996. Pursuant to the amendment to the plan, the defined pension benefit is based on an account balance comprised of a percentage of pay for each year of service and interest credited on the cumulative balance. Prior to March 1, 1996, the benefit plan was calculated based on a percentage of the employee's earnings during service to the Corporation.

As a result of the amendment, the vested and accumulated benefit obligations of the pension plan more closely approximate the projected benefit obligation. The amendment did not have a material effect on the consolidated statement of operations or on the consolidated balance sheet. There was no cash flow impact from the amendment to the U.S. plan.

The decline in pension cost before curtailment and settlement gains since fiscal 1994 reflects the positive effects of restructuring activities and increased returns on invested pension assets.

The net periodic pension cost for defined contribution pension plans was $32,382,000, $6,816,000 and $12,585,000 for the fiscal years ended June 29, 1996, July 1, 1995 and July 2, 1994, respectively. The Corporation initiated contributions to the U.S. 401(k) plan on July 1, 1995 which resulted in increased costs for the Corporation's defined contribution plans in fiscal 1996.

The measurement dates for all plans were within 90 days of year-end.

Note G: Postretirement and other postemployment benefits *(continued)*

Components of net periodic pension cost (in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
Service cost for benefits earned during the period	$ 138,069	$ 156,112	$ 180,694
Interest cost on projected benefit obligations	202,385	182,363	191,525
Actual return on plan assets	(512,244)	(344,486)	(143,465)
Net amortization and deferral	256,324	91,251	(79,567)
Net periodic pension cost before curtailment and settlement gains	84,534	85,240	149,187
Curtailment and settlement gains	(5,159)	–	(272,918)
Net periodic pension cost for defined benefit pension plans	$ 79,375	$ 85,240	$ (123,731)
Total pension cost for all pension plans	$ 112,769	$ 95,249	$ (107,686)

Significant actuarial assumptions for pension plans

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
U.S. pension plan:			
Discount rate	8.0%	7.5%	8.0%
Expected long-term rate of return on plan assets	9.0%	9.0%	9.0%
Rate of increase in future compensation levels	5.0%	5.0%	6.0%
Non-U.S. pension plans:			
Discount rate	4.0– 9.3%	5.0– 9.5%	5.0– 9.5%
Expected long-term rate of return on plan assets	4.0–10.0%	6.0–10.0%	6.0–10.0%
Rate of increase in future compensation levels	2.0– 7.0%	3.0– 7.0%	2.8– 7.2%

Funded status of pension plans as of the year-end measurement date (in thousands)

Year ended	June 29, 1996	July 1, 1995
Actuarial present value of benefit obligations:		
Vested benefit obligation	$(2,433,935)	$(1,725,467)
Accumulated benefit obligation	$(2,566,869)	$(1,891,032)
Projected benefit obligation	$(2,875,815)	$(2,727,920)
Plan assets at fair value	3,305,529	3,073,995
Over funded projected benefit obligation	429,714	346,075
Unrecognized net gain	(858,279)	(544,685)
Unrecognized prior service credit	54,454	(41,623)
Unrecognized net transition asset	(76,232)	(84,091)
Pension liability recognized on the balance sheet	$ (450,343)	$ (324,324)

Postretirement benefits other than pensions The Corporation has defined benefit postretirement plans that provide medical and dental benefits for U.S. retirees and their eligible dependents. Substantially all of the Corporation's U.S. employees may become eligible for postretirement benefits if they reach retirement age while working for the Corporation. The majority of the Corporation's non-U.S. subsidiaries do not offer postretirement benefits other than pensions to retirees.

In fiscal 1996, net periodic postretirement benefits cost before curtailment gains declined when compared to fiscal 1995 and 1994, reflecting the positive effects of restructuring activities and lower U.S. health care cost trends.

The Corporation's postretirement benefit plans other than pensions are funded as costs are incurred.

Components of net periodic postretirement benefits cost (in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
Service cost for benefits earned during the period	$ 10,987	$ 18,455	$ 24,949
Interest cost on accumulated postretirement benefits obligations	30,707	41,279	47,309
Actual return on plan assets	–	–	–
Net amortization and deferral	(16,871)	(9,919)	(9,964)
Net periodic postretirement benefits cost before curtailment gains	24,823	49,815	62,294
Curtailment gains	(2,230)	(20,741)	(37,773)
Net periodic postretirement benefits cost	$ 22,593	$ 29,074	$ 24,521

Significant actuarial assumptions for postretirement benefits plans (dollars in thousands)

Year ended	June 29, 1996	July 1, 1995	July 2, 1994
U.S. plans:			
Discount rate	8.0%	7.5%	8.0%
Health care cost trend rate, current year	5.5%	7.0%	9.3%
Health care cost trend rate, ultimate year	5.0%	5.5%	5.5%
Trend rate decreases to the ultimate rate in the year	2004	2005	2005
Effect of a 1% increase in the trend rate:			
Increase in accumulated postretirement benefits obligation	$ 64,819	$100,617	$ 110,011
Increase in net periodic postretirement benefits cost	$ 7,326	$ 13,645	$ 15,643
Non-U.S. plans:			
Discount rate	5.0– 8.5%	5.0– 8.5%	5.0– 8.5%
Health care cost trend rate, current year	4.0– 12.0%	4.0– 11.0%	4.0– 12.0%
Health care cost trend rate, ultimate year	4.0– 7.0%	4.0– 7.0%	4.0– 7.0%
Trend rates decrease to the ultimate rates in the years	1996–2004	1995–2006	1994–2007
Effect of a 1% increase in the trend rate:			
Increase in accumulated postretirement benefits obligation	$ 2,196	$ 8,072	$ 6,057
Increase in net periodic postretirement benefits cost	$ 407	$ 1,043	$ 909

Funded status of postretirement benefits plans as of the year-end measurement date (in thousands)

Year ended	June 29, 1996	July 1, 1995
Accumulated postretirement benefits obligations:		
Retirees	$ (273,908)	$ (334,578)
Fully eligible plan participants	(6,582)	(15,862)
Other active plan participants	(142,617)	(243,587)
Unfunded accumulated postretirement benefits obligation	(423,107)	(594,027)
Unrecognized net gain	(212,646)	(44,092)
Unrecognized prior service credit	(84,929)	(93,041)
Other postretirement benefits liability recognized on the balance sheet	$ (720,682)	$ (731,160)

Note G: Postretirement and other postemployment benefits *(continued)*

Postemployment benefits In the fourth quarter of fiscal 1994, the Corporation adopted Statement of Financial Accounting Standards (SFAS) No. 112 – Employers' Accounting for Postemployment Benefits, effective as of the beginning of the fiscal year. This standard requires the accrual of benefits provided to former or inactive employees, after employment but before retirement. These benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits and continuation of benefits such as health care and life insurance coverage.

The cumulative effect of adopting this standard resulted in a one-time charge to income of $71,068,000 (the "transition obligation"), or $.51 per common share. This transition obligation represents principally the cost of providing medical, dental and life insurance benefits to individuals in the U.S. currently on long-term disability, during the estimated remaining period in which they will receive disability benefits. The annual expense under the standard, exclusive of the transition obligation, is not significantly different than the annual expense under the Corporation's former practice. There was no cash flow impact from the adoption of SFAS No. 112.

Note H: Commitments and contingencies

Lease commitments 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 year	*(in thousands)*
1997	$ 265,167
1998	261,581
1999	315,875
2000	112,403
2001	92,631
Later years	245,592
Total minimum lease payments	$1,293,249

Total rental expense for the fiscal years ended June 29, 1996, July 1, 1995 and July 2, 1994 was $259,349,000, $282,084,000 and $436,080,000, respectively.

Litigation Several purported class action lawsuits were filed against the Corporation during the fourth quarter of fiscal 1994 alleging violations of the Federal securities laws arising from alleged misrepresentations and omissions in connection with the Corporation's issuance and sale of Series A 8⅞% Cumulative Preferred Stock (the "Series A Preferred Stock") and the Corporation's financial results for the quarter ended April 2, 1994. During fiscal 1995, the lawsuits were consolidated into three cases, which were pending before the United States District Court for the District of Massachusetts. On August 8, 1995, the Massachusetts federal court granted the defendants' motion to dismiss all three cases in their entirety. On September 6, 1995, notices of appeal were filed in two of the cases. On May 7, 1996, the United States Court of Appeals for the First Circuit affirmed in part and reversed in part the dismissal of the two cases, and remanded for further proceedings.

Note I: Financial instruments

Foreign exchange options In the ordinary course of business, the Corporation purchases foreign exchange option contracts for periods consistent with its committed exposures to limit potential losses from adverse exchange rate movements on operations. The contracts relate primarily to European currencies, Australian dollars and Japanese yen and generally have maturities which do not exceed three months. The impact of exchange rate movements on contracts used to hedge revenue and expense transactions is included in income in the period that the related operating revenues and expenses are recognized. Premiums on foreign exchange option contracts are amortized over the life of the contract. Unamortized premiums are included in prepaid assets. The Corporation does not anticipate any material adverse effect due to exchange rate movements over the short-term period covered by these contracts.

Foreign exchange forwards In the ordinary course of business, the Corporation enters into foreign exchange forward contracts for periods consistent with its committed exposures to mitigate the effect of foreign currency movements on the U.S. dollar value of monetary asset and liability positions of non-U.S. subsidiaries. The contracts are primarily in European currencies, Australian dollars and Japanese yen and generally have maturities which do not exceed three months. The impact of exchange rate movements on contracts used to hedge monetary assets and liabilities is included in income in the period in which the exchange rates change.

With respect to foreign exchange option contracts and foreign exchange forward contracts, there were no deferred gains or losses at June 29, 1996. Also, the Corporation does not hold or issue foreign exchange futures contracts or foreign exchange option contracts for trading purposes.

Note I: Financial instruments *(continued)*

Interest rate swaps During the first quarter of fiscal 1994, the Corporation entered into interest rate swap agreements, with maturities of up to 10 years, to manage its exposure to interest rate movements by effectively converting a portion of its long-term debt from fixed to variable rates. The net face amount of interest rate swaps subject to variable rates as of June 29, 1996 and July 1, 1995 was $250,000,000. These agreements involve the exchange of fixed rate payments for variable rate payments without the effect of leverage and without the exchange of the underlying principal amount. Fixed interest rate payments are at rates ranging from 5.72% to 5.75%. Variable rate payments are based on the 6 month U.S. dollar LIBOR. Interest rate differentials paid or received under these swap agreements are recognized over the life of the contracts as adjustments to interest expense. As of June 29, 1996, deferred interest expense on contracts which are no longer subject to variable rate payments totaled $15,404,000. The deferred interest expense is being amortized over the original remaining life of the contracts. Unamortized deferred losses are included in prepaid assets. The Corporation does not hold or issue interest rate swaps for trading purposes.

Fair value The carrying amounts reflected in the consolidated balance sheets for cash, cash equivalents, short-term investments, accounts receivable, bank loans, current portion of long-term debt and accounts payable approximate fair value due to the short maturities of these instruments. The fair values for long-term debt and hedging instruments are based on dealer quotes for those instruments. The fair values represent estimates of possible value which may not be realized in the future.

Fair value of financial instruments (in thousands)

	Face amount	Carrying amount	Fair value
June 29, 1996			
Long-term debt	$1,012,269	$ 999,131	$ 979,892
Hedging instruments:			
Option contracts	691,151	884	494
Forward contracts	886,015	(267)	(1,952)
Interest rate swaps	250,000	15,404	(16,540)
July 1, 1995			
Long-term debt	$1,027,035	$1,012,885	$1,004,043
Hedging instruments:			
Option contracts	611,100	3,983	3,291
Forward contracts	977,008	(283)	1,610
Interest rate swaps	1,250,000	–	(30,978)

The face amount of hedging instruments does not necessarily represent amounts exchanged by the parties and thus is not a direct measure of the exposure of the Corporation through its use of hedging instruments. The amounts exchanged are calculated on the basis of face amounts and other terms of the hedging instruments, which relate to interest rates, exchange rates or other financial indexes.

Concentration of credit risk Financial instruments which potentially subject the Corporation to concentrations of credit risk consist principally of temporary cash and short-term investments, trade receivables and hedging instruments.

The Corporation places its temporary cash and short-term investments with high credit qualified financial institutions and, by policy, limits the amount of credit exposure to any one financial institution.

The Corporation sells a significant portion of its products through third-party resellers and as a result maintains individually significant accounts receivable balances from various major resellers. If the financial condition and operations of these resellers deteriorate, the Corporation's operating results could be adversely affected. Total receivables for the ten largest resellers approximated 10% of total accounts receivable at June 29, 1996.

Concentrations of credit risk with respect to other trade receivables are limited due to the large number of customers comprising the Corporation's customer base, and their dispersion across many different industries and geographies. The Corporation performs ongoing credit evaluations of its customers and generally does not require collateral.

The Corporation is exposed to credit-related losses in the event of nonperformance by counterparties to hedging instruments. The counterparties to these contracts are major financial institutions. The Corporation continually monitors its positions and the credit ratings of its counterparties and limits the amount of contracts it enters into with any one party.

Note J: Investing and divesting activities

During fiscal 1996, the Corporation sold its learning services business and several small businesses. During fiscal 1995, the Corporation sold portions of its storage business, its relational database business, a software distribution subsidiary, a contract manufacturing business and a semiconductor manufacturing facility. Prior to sale and in total the divested businesses represented approximately 8% of fiscal 1994 consolidated operating revenues and did not have a material effect on the consolidated net loss from operations.

At the end of the second quarter of fiscal 1996, the Corporation sold its learning services business to Welsh, Carson, Anderson & Stowe for proceeds of approximately $80,000,000. Approximately 600 employees transferred with this business.

In addition, during fiscal 1996 the Corporation sold several small businesses for net proceeds of approximately $76,000,000.

At the end of the fourth quarter of fiscal 1995, the Corporation sold its South Queensferry, Scotland semiconductor facility and related assets to a subsidiary of Motorola, Inc. for net proceeds of approximately $128,000,000. Assets sold included approximately $8,000,000 of inventory and $127,000,000 of net property, plant and equipment. Approximately 530 employees were transferred to Motorola at the time of sale.

At the end of the third quarter of fiscal 1995, the Corporation sold its contract manufacturing business to SCI Systems, Inc. for net proceeds of approximately $75,000,000. Assets sold included approximately $47,000,000 of inventory and $20,000,000 of net property, plant and equipment, including a manufacturing plant in Augusta, Maine. Approximately 700 employees were transferred to SCI Systems, Inc. at the time of sale.

At the beginning of the second quarter of fiscal 1995, the Corporation sold its magnetic disk drive, tape drive, solid state disk and thin film heads businesses (the "Business") to Quantum Corporation ("Quantum") for an aggregate purchase price of $360,000,000, generating net proceeds of $348,000,000. Assets sold included approximately $180,000,000 of inventory and $154,000,000 of net property, plant and equipment, including facilities in Shrewsbury, Massachusetts and Penang, Malaysia, as well as the Corporation's interest in Rocky Mountain Magnetics, Inc. Quantum is leasing facilities owned by the Corporation in Colorado Springs, Colorado and leased by the Corporation in Batam, Indonesia. Approximately 3,100 employees were transferred to Quantum upon sale of the Business.

Also during the second quarter of fiscal 1995, the Corporation sold its relational database business and related assets to Oracle Corporation for net proceeds of $107,000,000. Approximately 250 employees were transferred to Oracle Corporation at the time of sale.

In June 1992, the Corporation entered into agreements to purchase common stock of Ing. Olivetti & C. S.p.A. ("Olivetti") and to form a strategic alliance with Olivetti. Pursuant to these agreements, as amended, the Corporation purchased a total of 98,533,000 shares of Olivetti common stock in fiscal 1993 for a total investment of approximately $287,800,000. As part of the alliance agreement, as amended, Olivetti agreed to purchase a minimum level of Alpha products from the Corporation over a specified period of time. The Olivetti stock was recorded at $83,800,000. The remainder of the purchase price was recorded as an intangible asset to be amortized over a period not to exceed ten years. While the Corporation expected to generate significant revenues from the sale of Alpha products to Olivetti in the long term, in fiscal 1994, the sale of Alpha products to Olivetti fell significantly short of levels called for in the alliance agreement. In the fourth quarter of fiscal 1994, the Corporation concluded that revenues and profits in the future, although potentially significant, would continue below levels called for in the agreement. Accordingly, in the fourth quarter of fiscal 1994, the Corporation reduced the carrying value of the intangible asset by $116,000,000 to its expected net realizable value and included this amount as a charge to Selling, general and administrative (SG&A) expenses on the *Statement of operations.* The remainder of the intangible asset is being amortized over a period of five years.

The Corporation adopted Statement of Financial Accounting Standards (SFAS) No. 115 – Accounting for Certain Investments in Debt and Equity Securities, effective July 3, 1994. SFAS No. 115 expands the use of fair value accounting for certain debt and equity securities. At the date of adoption, the Corporation recorded a one-time unrealized gain of $64,503,000, or $.44 per common share related to the value of Olivetti common stock. Subsequently, in the first quarter of fiscal 1995, the Corporation sold all of its shares of Olivetti stock for approximately $149,000,000, thereby realizing the gain. The cash flow effect is included in the gain/(loss) on disposition and write-down of other assets in the *Statement of cash flows.*

Revenue and operating results for the Corporation's Digital-Kienzle business, acquired in fiscal 1991, fell significantly short of operating plan for fiscal 1994 and from results of prior years despite restructuring efforts and management changes in fiscal 1994 aimed at improving results. During the fourth quarter of fiscal 1994, plans for further restructuring actions to be taken in fiscal 1995 were finalized.

The Corporation concluded that the discounted cash flow, including restructuring actions associated with the acquired business, would no longer support the carrying value of the unamortized goodwill. Accordingly, the unamortized balance of goodwill related to the acquisition of approximately $194,000,000 was written off as a charge to operations. This was included in SG&A expenses on the *Statement of operations* for the year ended July 2, 1994.

Note K: Stock plans

Stock options and awards Under its Equity Plans, the Corporation has awarded restricted stock to certain officers and key employees. Under such Equity Plans and its Restricted Stock Option Plans, the Corporation has granted options to certain officers and key employees to purchase common stock at a price determined by the Board of Directors. Shares purchased under the plans are either subject to repurchase options and restrictions on sales which lapse over an extended time period not exceeding 10 years, or become exercisable ratably over periods of up to five years. At June 29, 1996, 4,329,477 options to purchase shares were exercisable at prices ranging from $19.25 to $153.00. In fiscal 1992, certain options were granted under such Equity Plans which become exercisable ratably over five years, but only if the common stock achieves certain price performance criteria.

The excess, if any, of the fair market value of shares on the measurement date over the exercise price is charged to operations each year as the restrictions lapse.

In May 1994, the Board of Directors approved a program to offer employees of the Corporation (other than executive officers of the Corporation) the opportunity to exchange their outstanding stock options for new options to purchase a reduced number of shares of common stock at a per share exercise price equal to the fair market value of the common stock on the date the program was approved (the "Regrant Program"). Under the Regrant Program, outstanding options granted between 1985 and 1993 to purchase up to 11,854,084 shares of common stock with an average exercise price of $59.43 per share could be exchanged for new options to purchase up to 4,554,870 shares with an exercise price of $22.88 per share. The new options vest over four years and have a seven-year term. As of July 3, 1994 options to purchase 5,765,914 shares had been exchanged and cancelled for new options to purchase a total of 2,328,910 shares. During fiscal 1995, an additional 4,476,977 shares were exchanged and cancelled for new options to purchase a total of 1,663,430 shares. No further exchanges may occur under this program. No compensation expense was reversed as a result of the Regrant Program. Future expense associated with options cancelled, and not replaced by new options under the Regrant Program, will no longer be recognized, resulting in an expense reduction of approximately $31,000,000 over fiscal years 1995 to 1998.

Stock options and awards

	Shares reserved for future grants	Shares	Average price per share
July 3, 1993	620,891	19,824,551	$ 56.89
Additional shares available for grant	2,032,347	–	–
Options granted	(896,650)	896,650	23.07
Shares awarded	(307,460)	–	–
Options exercised	–	(106,612)	33.78
Options cancelled	2,243,356	(2,243,356)	52.08
Options terminated	(1,248,476)	–	–
Regrant program:			
Cancelled	5,765,914	(5,765,914)	59.10
Terminated	(2,843,639)	–	–
Regrant	(2,328,910)	2,328,910	22.88
July 2, 1994	3,037,373	14,934,229	$ 49.59
Additional shares available for grant	2,134,306	–	–
Options granted	(2,781,930)	2,781,930	25.42
Shares awarded	(897,680)	–	–
Options exercised	–	(677,299)	26.58
Options cancelled	3,278,129	(3,278,129)	35.73
Options terminated	(1,748,323)	–	–
Regrant program:			
Cancelled	4,476,977	(4,476,977)	59.26
Terminated	(2,479,767)	–	–
Regrant	(1,663,430)	1,663,430	22.88
July 1, 1995	3,355,655	10,947,184	$ 41.01
Additional shares available for grant	2,246,664	–	–
Options granted	(3,197,920)	3,197,920	44.11
Shares awarded	(493,635)	–	–
Shares forfeited	86,317	–	–
Options exercised	–	(1,984,600)	29.62
Options cancelled	865,196	(865,196)	41.93
Options terminated	(233,542)	–	–
June 29, 1996	2,628,735	11,295,308	$ 43.81

Employee stock purchase plans Under the Corporation's Employee Stock Purchase Plans, all U.S. and certain non-U.S. employees may be granted the opportunity to purchase

Note K: Stock plans *(continued)*

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 employee purchases aggregated 4,206,544 shares at June 29, 1996. There were 3,341,316 shares issued at an average price of $41.58 per share during the year ended June 29, 1996; 6,085,154 shares issued at an average price of $21.96 per share during the year ended July 1, 1995; and 6,938,772 shares issued at an average price of $23.72 per share during the year ended July 2, 1994. There have been no charges to income in connection with these Plans other than incidental expenses related to the issuance of the shares. Federal income tax benefits relating to such Plans, if any, have been credited to additional paid-in capital.

Stock option plans for non-employee directors The 1990 Non-Employee Directors Plan provided for a one-time grant of an option to purchase 5,000 shares of the Corporation's common stock to non-employee directors. The exercise price of an option is 100% of the fair market value per share of common stock of the Corporation on the date the option is granted. An aggregate of 100,000 shares of common stock are authorized for issuance under the Plan, of which 55,000 have been granted at an average purchase price of $48.23 per share. The options become exercisable at the rate of 20% per year, with credit given for past service. None of these options had been exercised as of June 29, 1996. No additional options may be granted under this plan subsequent to adoption of the 1995 Stock Option Plan for Non-Employee Directors.

The 1995 Stock Option Plan for Non-Employee Directors which was approved on November 9, 1995, provides for annual grants to purchase 2,500 shares of the Corporation's common stock to non-employee directors, who are initially elected to office subsequent to January 1, 1995. The plan provides for annual grants to purchase 1,000 shares of the Corporation's common stock to non-employee directors elected to office prior to January 1, 1995. The exercise price of an option is 100% of the fair market value per share of common stock of the Corporation on the date the option is granted. An aggregate of 95,000 shares of common stock are authorized under the Plan, of which 10,500 have been granted at an average purchase price of $56.81 per share. The options become exercisable ratably over 3 years. None of these options had been exercised as of June 29, 1996.

Note L: Stockholders' equity

On January 21, 1994, the Corporation filed with the Securities and Exchange Commission a shelf registration statement on Form S-3 under the Securities Act of 1933, as amended, covering the registration of debt securities, preferred stock, depositary shares, and warrants to purchase equity and debt securities, in an aggregate amount of $1 billion. In March 1994, the Corporation issued and sold 16,000,000 Depositary Shares under the shelf registration statement, each representing a one-fourth interest in a share of the Corporation's Series A 8⅞% Cumulative Preferred Stock (the "Series A Preferred Stock"), par value $1.00 per share. Dividends on the Series A Preferred Stock accrue at the annual rate of 8⅞%, or $35,500,000 per year. At June 29, 1996, there were declared and unpaid dividends of $8,875,000. These dividends were paid on July 15, 1996. Total dividends of $10,650,000 were declared in fiscal 1994, commencing after issuance in March 1994.

The Series A Preferred Stock was offered to the public at $100 per share ($25 per Depositary Share) for a total of $400,000,000, leaving a balance of $600,000,000 available for future issuance under the shelf registration. The net proceeds of $387,000,000 from the Series A Preferred Stock offering was used for working capital and other general corporate purposes. The Series A Preferred Stock is not convertible into, or exchangeable for, shares of any other class or classes of stock of the Corporation. The Series A Preferred Stock is not redeemable prior to April 1, 1999. On or after April 1, 1999, the Corporation, at its option, may redeem shares of the Series A Preferred Stock, as a whole or in part, for cash at the redemption price per share of $100 ($25 per Depositary Share), plus accrued and unpaid dividends to the redemption date. Upon dissolution, liquidation or the winding up of the affairs of the Corporation, the holders of the Series A Preferred Stock will be entitled to receive $100 per share ($25 per Depositary Share), plus accrued and unpaid dividends, before any distribution to holders of the Corporation's common stock.

The Corporation adopted a Stockholder Rights Plan in December 1989 pursuant to which the Corporation authorized the distribution of one Common Stock Purchase Right ("Right") for each share of outstanding common stock. Under certain conditions, each Right may be exercised for one share of common stock at an exercise price of $400, subject to adjustment. Under circumstances defined in the Plan, the Rights entitle holders to purchase stock having a value of twice the exercise price of the Rights. Until they become exercisable, the Rights are not transferable apart from the common stock. The Rights may be redeemed by the Corporation at any time prior to the occurrence of certain events at $.01 per Right. The Plan will expire on December 21, 1999, unless the Rights are earlier redeemed by the Corporation.

Note M: Subsequent event

In July 1996, the Board of Directors authorized the repurchase, as conditions warrant, of up to 10,000,000 shares of the Corporation's common stock. The shares will be used for employee stock plans.

Supplementary information

Quarterly financial data *(unaudited)*

(in millions except per share data)[1]	Total operating revenues	Gross profit	Income/(loss) before income taxes	Income/(loss) after income taxes[2]	Net income/(loss)	Income/(loss) per common share[3]
For the year ended June 29, 1996						
Fourth quarter	$ 3,719	$ 1,212	$ (432)	$ (433)	$ (433)	$ (2.87)
Third quarter	3,621	1,252	138	124	124	.74
Second quarter	3,951	1,288	170	149	149	.91
First quarter	3,271	1,054	57	48	48	.26
Total year	$ 14,563	$ 4,807	$ (68)	$ (112)	$ (112)	$ (0.97)
For the year ended July 1, 1995						
Fourth quarter	$ 3,750	$ 1,215	$ 165	$ 160	$ 160	$ 1.01
Third quarter	3,467	1,115	79	74	74	.44
Second quarter	3,473	1,148	23	19	19	.07
First quarter	3,122	943	(191)	(195)	(131)	(.98)
Total year	$ 13,813	$ 4,421	$ 76	$ 57	$ 122	$ 0.59

[1] *Amounts may not be additive due to rounding.*
[2] *Before cumulative effect of changes in accounting principles.*
[3] *The sum of the quarters' earnings per share does not equal the year-to-date earnings per share due to changes in the weighted average share calculations.*

Officers and management

*Robert B. Palmer
Chairman of the Board,
President and Chief Executive Officer

R.E. Caldwell
Vice President, Digital Semiconductor

Bobby A. F. Choonavala
Vice President; President, Asia Pacific

*Charles F. Christ
Vice President and General Manager,
Components Division

Bruce L. Claflin
Vice President and General Manager,
Personal Computer Business Unit

*Harold D. Copperman
Vice President and General Manager,
Systems Business Unit

Vincenzo Damiani
Vice President; President, Digital Europe

*Savino R. (Sid) Ferrales
Vice President, Worldwide Human Resources

Richard J. Fishburn
Vice President and Chief Information Officer

Samuel H. Fuller
Vice President and Chief Scientist

Charles B. Holleran
Vice President, Communications

Hans Larsen
Vice President, Controller
and Chief Accounting Officer

Alexis Makris
Vice President and Controller,
Business Operations

Gail S. Mann
Vice President, Assistant General Counsel,
Secretary and Clerk

*Paul J. Milbury
Vice President and Treasurer

*Vincent J. Mullarkey
Vice President, Finance and Chief Financial Officer

*John J. Rando
Vice President and General Manager,
Digital Services Division

Robert J. Rennick
Vice President and General Manager,
Network Product Business Unit

*Thomas C. Siekman
Vice President and General Counsel

*William D. Strecker
Vice President, Corporate Strategy and Technology
and Chief Technical Officer

*"Executive Officer" under the Securities Exchange Act of 1934.

Directors

Robert B. Palmer
Chairman of the Board,
President and Chief Executive Officer,
Digital Equipment Corporation

Vernon R. Alden
Director and Trustee of several organizations,
Former Chairman, The Boston Company, Inc.

Colby H. Chandler
Director of several corporations, Retired Chairman
of the Board and Chief Executive Officer,
Eastman Kodak Company

Arnaud de Vitry
Engineering consultant and Director and
Trustee of several organizations

Frank P. Doyle
Director of several corporations,
Retired Executive Vice President,
General Electric Company

Robert R. Everett*
Retired President of the MITRE Corporation

Kathleen F. Feldstein
President of Economics Studies, Inc.
and Director of several corporations

Thomas P. Gerrity
Dean, Wharton School of the University of Pennsylvania
and Director of several corporations

Thomas L. Phillips
Director of several corporations, Retired Chairman of the
Board and Chief Executive Officer, Raytheon Company

Delbert C. Staley
Director of several corporations, Retired Chairman of the
Board and Chief Executive Officer, NYNEX Corporation

Committees of the Board

Audit Committee
Colby H. Chandler, Chairman
Vernon R. Alden
Frank P. Doyle
Kathleen F. Feldstein

Compensation and Management Development Committee
Thomas L. Phillips, Chairman
Robert R. Everett*
Thomas P. Gerrity
Delbert C. Staley

Nominating Committee
Arnaud de Vitry, Chairman
Vernon R. Alden
Colby H. Chandler
Thomas L. Phillips

Strategic Direction Committee
Robert B. Palmer, Chairman
Frank P. Doyle
Robert R. Everett*
Thomas P. Gerrity
Delbert C. Staley

Board of Directors, Digital Equipment Corporation (left to right):
Vernon R. Alden, Kathleen F. Feldstein, Robert B. Palmer, Colby H. Chandler,
Arnaud de Vitry, Thomas L. Phillips, Delbert C. Staley, Robert R. Everett,
Thomas P. Gerrity, Frank P. Doyle.

*Mr. Everett will retire on November 14, 1996, the date of the 1996 Annual Meeting of Stockholders.

Corporate Consulting Engineers

Daniel W. Dobberpuhl
Senior Corporate Consulting Engineer
Digital Semiconductor

Richard B. Grove
Corporate Consulting Engineer
UNIX Business

Robert J. Hannemann
Corporate Consulting Engineer
General Manager, Printing Systems Business
Components and Peripherals Business

William R. Hawe
Corporate Consulting Engineer
Network Product Business

Richard J. Hollingsworth
Senior Corporate Consulting Engineer
Vice President, Semiconductor
Manufacturing and Technology
Digital Semiconductor

Alan Kotok
Corporate Consulting Engineer
Internet Software Business

William A. Laing
Corporate Consulting Engineer
Internet Software Business

Richard F. Lary
Corporate Consulting Engineer
Systems Business

Jesse Lipcon
Corporate Consulting Engineer
Vice President, Product Management and Development
Systems Business

Maurice P. Marks
Corporate Consulting Engineer
Digital Semiconductor

Alan G. Nemeth
Corporate Consulting Engineer
UNIX Business

Mahendra R. Patel
Corporate Consulting Engineer
Vice President, Systems Engineering
Systems Business

Benn L. Schreiber
Corporate Consulting Engineer
Windows NT

Jeffrey A. Schriesheim
Corporate Consulting Engineer
Director of Advanced Networking Technologies
Network Product Business

Richard L. Sites
Corporate Consulting Engineer
Research and Advanced Development

Robert E. Stewart
Corporate Consulting Engineer
Workstations Business

William D. Strecker
Senior Corporate Consulting Engineer
Vice President, Corporate Strategy and Technology
Chief Technical Officer

Robert M. Supnik
Senior Corporate Consulting Engineer
Vice President, Research and Advanced Development
Corporate Strategy and Technology

Charles P. Thacker
Senior Corporate Consulting Engineer
Research and Advanced Development

Richard T. Witek
Corporate Consulting Engineer
Digital Semiconductor

Investor information

Information on common stock

The Corporation's common stock (*Ticker Symbol "DEC"*) is listed and traded on the:

Chicago Stock Exchange
New York Stock Exchange
Pacific Stock Exchange
Swiss Exchange
German Stock Exchanges of Frankfurt, Munich and Berlin

Common stock price composite:
There were 62,804 shareholders of record as of June 29, 1996. The high and low quarterly sales prices for the past three fiscal years were as follows:

Fiscal quarter	*High*	*Low*
1996		
Fourth	**63¼**	**41½**
Third	**76½**	**50⅛**
Second	**65**	**40¾**
First	**45⅞**	**35⅛**
1995		
Fourth	49½	37⅜
Third	38⅞	31⅛
Second	36⅝	24⅞
First	29¼	18⅜
1994		
Fourth	30⅝	18¼
Third	38⅛	27¾
Second	39⅛	34⅛
First	43⅛	35¼

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. For questions on change of ownership, lost stock certificates, consolidation of accounts and change of address, please contact:

First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, New Jersey 07303-2500
Telephone: (201) 324-0498

For change of address, send a signed and dated note or postcard to First Chicago Trust Company of New York and include the name in which the stock is registered, account number and social security number, as well as the old and new addresses.

Employee investor services:
Digital Equipment Corporation is also a stock transfer agent and registrar, and maintains employee stockholder accounting records. Inquiries of an administrative nature relative to employee stockholder accounting records and employee purchases should be directed to:

Digital Equipment Corporation
111 Powdermill Road MSO1-1/L12
Maynard, Massachusetts 01754
(508) 493-3703, (508) 493-5213

Investor information *(continued)*

Information on preferred stock

The Corporation's Depositary Shares, each representing one-fourth of a share of the Corporation's Series A 8⅞% Cumulative Preferred Stock (the "Preferred Stock") (Ticker Symbol DEC PRA), is listed and traded on the New York Stock Exchange. The Preferred Stock carries an 8⅞% cumulative annual dividend payable quarterly on January 15, April 15, July 15, and October 15 of each year.

Depositary for the Series A 8⅞% Cumulative Preferred Stock:
Citibank N.A.
Address correspondence to:
Citicorp Data Distributor
404 Sette Drive
Paramus, New Jersey 07653
(800) 422-2066

Stockholder communications

The Investor Relations Department is available to assist stockholders. Investor inquiries regarding financial information are welcome by letter, telephone or the Internet. The annual report on Form 10-K for the fiscal year ended June 29, 1996, including schedules thereto, which is filed with the Securities and Exchange Commission, will be sent without charge upon written request to:

Digital Equipment Corporation
Investor Relations Department
111 Powdermill Road MSO2-3/B17
Maynard, Massachusetts 01754
Telephone: (508) 493-7182
Fax: (508) 493-7633

Digital Shareholder Direct:
Financial results, quarterly and annual reports and news on the Corporation's products and services is available via voice, fax or mail by calling 1-800-998-9332 (U.S., Canada and Latin America only).

Digital on the Internet:
Access to Corporate and financial information is also available through the Corporation's home page on the Internet: http://www.digital.com and the Digital Financial News & Investor Information home page at http://www.digital.com/info/finance.

Eliminate duplicate mailings

To maintain more than one account, but eliminate duplicate mailings of annual reports to the same address, send a copy of the label from a Corporate mailing to the Investor Services Department, indicating the names you wish to keep on the mailing list and the names you wish to delete.

Auditors

Coopers & Lybrand L.L.P.
One Post Office Square
Boston, Massachusetts 02109
Telephone: (617) 478-5000

The following was inadvertently omitted from the list of Officers and management on page 54:

Ilene H. Lang
Vice President, Internet Software Business Unit

DIGITAL believes the customer, market and product information in this annual report is accurate as of its publication date. This information is subject to change without notice. DIGITAL is not responsible for any inadvertent errors.

DIGITAL will conduct its business in a manner that conserves the environment. As a company we have a tradition of achievement in protecting the environment and in ensuring the health and safety of our fellow employees. A copy of our Environmental Health and Safety Progress Report is accessible through DIGITAL's EHS homepage: www.digital.com/info/ehs.

The following are trademarks of Digital Equipment Corporation: Alpha XL, AlphaServer, AltaVista, DEChub, DECtalk, DIGITAL, the DIGITAL logo, DIGITAL UNIX, enVISN, FX!32, GIGAswitch, HiNote, HiNote Ultra, NetRider, OpenVMS, PC Utility, RouteAbout, TruCluster, VLM and VNswitch.

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1997 annual report

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- www.**firstquote**.com
- www.**kvaerner**.com
- www.**lmco**.com
- www.**nymex**.com
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- www.**southernco**.com/site/home.asp
- www.**timewarner**.com

Digital Equipment Corporation is a world leader in implementing and supporting networked business solutions. Building on its core competencies in software, systems, networks and services, DIGITAL—working with its business partners—is addressing new market opportunities while supporting its existing customer base. DIGITAL networked business solutions are helping our customers compete and win in today's global marketplace.

These solutions are backed by an established service and support network operating in more than 100 countries with manufacturing and logistics facilities in the Americas, Europe and Asia-Pacific.

CONTENTS

Winning in a networked world

In 1969, a group of U.S. Department of Defense and academic researchers created a new computer network—one that allowed them to share information and provide access to computers at key government facilities and research institutions around the country. Their requirements included speed, reliability and security. Their platform of choice was DIGITAL.

Known as the ARPANET after its sponsor, the Advanced Research Project Agency, this fledgling network and its visionary founders sowed the seeds for the most important information technology paradigm shift of the 1990s–the Internet.

Today, more than a quarter century after the birth of the Internet and 40 years after DIGITAL's own founding, we are more focused than ever on the enormous opportunities the Internet is creating for enterprises around the world.

Our strategy concentrates not only on the Internet, but on the other essential building blocks of the networked enterprise–Windows NT and high-performance computing–and the associated services needed by our customers.

Our goal is very simple: to deliver Internet business solutions that enable our customers and partners to win in the global, networked economy.

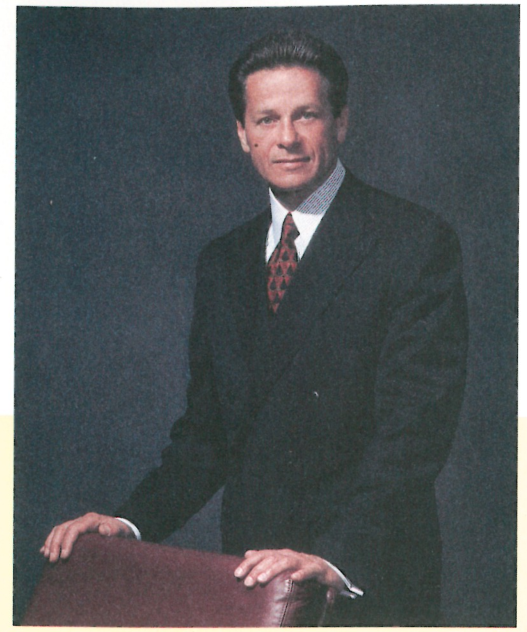
Annual meeting

The annual meeting of stockholders will be held at 11:00 a.m., Thursday, November 13, 1997, at the World Trade Center, Commonwealth Pier, 164 Northern Avenue, Boston, Massachusetts, 02210.

Common stockholders of record on September 15, 1997 will be entitled to vote at this meeting.

Fiscal year	1997	1996
Total operating revenues	$ 13,046,832,000	$ 14,562,775,000
Restructuring charge	$ —	$ 492,000,000
Net income/(loss)	$ 140,875,000	$ (111,812,000)
Net income/(loss) per common share	$ 0.68	$ (0.97)
Total stockholders' equity	$ 3,544,956,000	$ 3,606,206,000
Number of common stockholders	53,911	62,804
Stockholders' equity per common share	$ 20.81	$ 20.62
Number of employees	54,900	59,100

Chairman's letter



To our shareholders, employees, customers and partners Last year was one of transition for DIGITAL–a year that began with a temporary setback and ended with improving results and increasing momentum for our company. It was also a year in which we took several actions that will have a positive impact on DIGITAL's performance going forward.

For fiscal 1997, DIGITAL reported net income of $141 million, or $.68 per common share. Total operating revenue was $13 billion, a 10 percent decline from the previous year. I am certainly not satisfied with that performance because I know that we can–and will–do much better. But I am pleased with the way the company responded after a disappointing loss in our first quarter. We showed continuous improvement in profitability throughout the rest of the year.

For DIGITAL, the key to achieving and sustaining competitive levels of profitability–and to increasing shareholder value–is growth, and that is our top priority. I am confident that we will begin to grow again during the current fiscal year. My confidence is based on the continued progress we made during fiscal 1997 in strengthening our foundation for both growth and profitability. For example:

- We further evolved our corporate strategy, sharpened our focus on targeted growth markets and increased our emphasis on Internet-based solutions.

- We created a single, worldwide sales and marketing organization to improve our marketing, revitalize the DIGITAL brand and generate more demand for our products and services.

- We brought our product businesses together in a new division that provides the increased coordination we need to build on our product leadership and to exploit emerging technologies.

- And we continued to build on our leadership in providing the global service and support that are essential to deliver comprehensive information technology solutions.

Last year was also noteworthy for the action we took to protect DIGITAL's intellectual property. In May, DIGITAL filed an important lawsuit charging Intel Corporation with willful infringement of DIGITAL patents in the development, manufacture and sale of its Pentium, Pentium Pro and Pentium II microprocessor families.

Our decision to file suit was praised by some and questioned by others. But irrespective of the reactions, we believe DIGITAL has an obligation to protect your investments in research and development by enforcing DIGITAL's intellectual property rights.

Throughout the year the one constant was the dedication and determination of DIGITAL employees. Everywhere I go in the DIGITAL world, I am impressed by the talent and the skills of our employees. They are one of the most important reasons for my confidence in our future. Our success is the direct result of their hard work.

Operational review Our performance during the early part of the fiscal year was a reminder that corporate transformations do not move in a straight line. But we are unwavering in our determination to succeed and to achieve competitive levels of growth and profitability. While reaching that goal is a multiyear process, we have set specific financial targets that will help mark our progress.

At the beginning of fiscal 1997, DIGITAL outlined our plan for achieving a competitive financial return.

Our goal for net profit margin is seven percent, and we are making progress in that direction. A key element in achieving that goal is improving gross margins. Total gross margin in the fourth quarter was up a full two points year over year. The increase was even more dramatic in product gross margins, which were up three points year over year and 11 points over the past three years. And we met another important financial objective by stabilizing gross margins in our services business.

Our balance sheet also remained strong. An important factor was continued improvement in all areas of asset management. The cash and short-term investment balance increased to $2.5 billion–an all-time high for the company–even as we repurchased 10 million shares of common stock during the year. Reflecting its strong confidence in our future, the Board of Directors has authorized the company to repurchase up to 15 million additional shares.

One of the highlights of the fiscal year was the return to profitability of our personal computer business. During the previous fiscal year, this business was losing money, and revenue was declining. Since then there has been a remarkable turnaround, driven by new leadership, a more focused strategy and a greater emphasis on business controls. The PC business was profitable for the full fiscal year, and revenues are growing.

DIGITAL also made further progress in controlling expenses, managing assets more effectively and improving the efficiency of our processes and operations. As we grow, we will leverage our improved cost structure to deliver significant improvements in earnings.

Growth strategy As the information technology market and customer needs evolve, we are more confident than ever about the strategic decisions we made two years ago. Those decisions were based on key market trends, including the dramatic expansion of the Internet and its increasing use as a business tool; the rapid acceptance of Windows NT as an enterprise operating system; and continuing strong demand for high-performance, 64-bit computing.

As our growth strategy has developed, we have increased our emphasis on the Internet, particularly the multimedia portion of the Internet known as the World Wide Web. This is reflected in our corporate vision: *DIGITAL will be the undisputed leader in Web-based enterprise computing.*

DIGITAL has more than two decades of experience with the Internet. But what gives us confidence in our vision of leadership are the breadth and depth of what we offer customers today:

- A broad range of integration and operations management services that helps customers design, integrate and deploy Internet business solutions across the enterprise,

- Powerful servers to run the most demanding Web-based applications,

- Innovative software like the AltaVista search engine, the most powerful search and index service on the Internet; security firewalls that protect corporate networks from intruders; and Millicent, a revolutionary microcommerce system that will make Web-based transactions profitable down to a fraction of a cent, and,

- Strategic alliances and partnerships with industry leaders like Microsoft, MCI, British Telecom, Oracle, Computer Associates and SAP, which enable us to deliver comprehensive Internet solutions to customers.

The growing list of companies that have chosen DIGITAL AlphaServer systems to run their critical Web applications reads like a *Who's Who* of Internet pioneers: Netscape, Amazon.com, PointCast, Lycos and Microsoft. In fact, a *Computerworld* survey of the 100 premier Web sites found that nearly three-quarters of them use DIGITAL products.

Our share of key markets is growing. For example, DIGITAL had more than 14 percent of the $1.4 billion Internet Service Provider (ISP) market worldwide at the end of 1997. Our ISP revenues were up 400 percent while that overall market doubled. We expect our market share to increase to 20 percent by the end of fiscal 1998.

The expanding Internet Businesses today are adopting Internet technology at a very rapid pace. They are building internal networks known as "intranets" that help unlock the valuable information stored in corporate databases and make that information available throughout the enterprise. They are establishing virtual networks that link their businesses with customers, partners and suppliers. They are devising new channels to distribute their products directly to customers. And they are creating new forms of electronic commerce, laying the foundation for a truly global, networked economy.

DIGITAL is a leader in the intranet market. We are involved in two of the largest intranet deployments in the world. One is for Kvaerner, a Norwegian multinational that is building a network to link 40,000 of its employees around the world. The other is for the American Red Cross, with the potential to link 1.4 million volunteers and staff members.

Another important trend is the emergence of a wide variety of so-called Internet appliances like network computers, TV set-top boxes, palmtop computers, smart telephones and Web phones. DIGITAL is a pioneer in this new market with our StrongARM microprocessor. This very efficient chip delivers breakthrough performance with very low power consumption and low cost–making it the ideal engine for these new devices. More than 40 companies are already designing Internet appliances around the StrongARM chip, and we expect dramatic growth in this market segment.

In addition to the Internet, we also are focusing on two other major growth opportunities: Microsoft Windows NT and high-performance 64-bit UNIX. Within each of these markets, we are targeting segments where we expect to achieve industry leadership.

During fiscal 1997, for example, DIGITAL established itself as the clear leader in mail and messaging solutions based on Windows NT and Exchange–two of Microsoft's fastest-growing enterprise offerings. Working closely with Microsoft as part of our Alliance for Enterprise Computing, DIGITAL won more than one million Exchange seats worldwide.

We are also integrating Windows NT with other operating environments, like DIGITAL's OpenVMS operating system, which is still unrivaled for mission-critical computing. By integrating OpenVMS and Windows NT, customers can enjoy the reliability and availability of OpenVMS and the broad applications portfolio of Windows NT. DIGITAL will continue to invest in OpenVMS to meet the needs of our customers.

In the UNIX market, we are targeting segments such as data warehousing and high-performance technical computing, both of which benefit from the power and performance of DIGITAL's 64-bit systems and software.

Many companies have selected DIGITAL to provide data warehouse solutions. They include Tele-Communications Inc., one of the nation's largest cable operators, and HFS Incorporated, the nation's largest franchise holding company, with brands like Century 21 and Avis. And we are gaining share in the market for high-performance technical computing with customers like the Los Alamos National Laboratory and Sandia National Laboratories in the U.S., and CERN, a research center in Switzerland. According to International Data Corporation, a market research company, DIGITAL's share of the midrange, high-performance market increased to 28 percent last year from 21 percent the year before.

Across all of these growth markets, one of our most important competitive advantages is our ability to provide service and support worldwide. Enterprise customers are not just looking for a product supplier. They are looking for an information technology partner who can integrate products and applications in a multivendor environment, provide support after the project is complete and, in many cases, take over management of critical IT resources.

The DIGITAL Services Division is widely recognized for leadership in these areas. In fact, DIGITAL was ranked No. 1 in customer satisfaction among systems integrators in *Computerworld* magazine's 1997 user survey.

Executing the strategy One of our continuing objectives is to improve the execution of our strategy. The most important step we took in that direction last year was a major refocusing of DIGITAL's marketing and sales operations.

A single organization is now responsible for all of our marketing efforts worldwide. This has several benefits, but the most important is that DIGITAL will go to market as one company, with a unified marketing strategy and common messages that support our growth strategy and brand. By revitalizing our single brand, we will increase demand for a multitude of DIGITAL solutions.

Part of going to market as one DIGITAL is having a sales force that is empowered to represent the entire company, not just a single business unit or function. To that end, we consolidated our product sales operations into the worldwide sales and marketing organization and increased coordination among our sales and service professionals. This enables us to do business with customers and partners in a more uniform way. By reducing our sales complexity and redundancy, it also makes it easier for customers and partners to do business with DIGITAL.

The other major organizational change we made was the creation of the DIGITAL Products Division. Although we have attained product leadership in some key segments of the market, we are not taking that leadership for granted. By putting all of our product businesses in one division, we will increase cooperation and coordination and leverage our technical excellence across our product lines.

40 years of innovation and customer success On August 23, 1997, DIGITAL celebrated its 40th Anniversary. That milestone was a reminder of just how much has changed since a small group of visionaries started DIGITAL in a 19th-century woolen mill in 1957–and of how much this company has contributed to the growth of the computer industry. We are proud of that heritage of innovation and industry leadership.

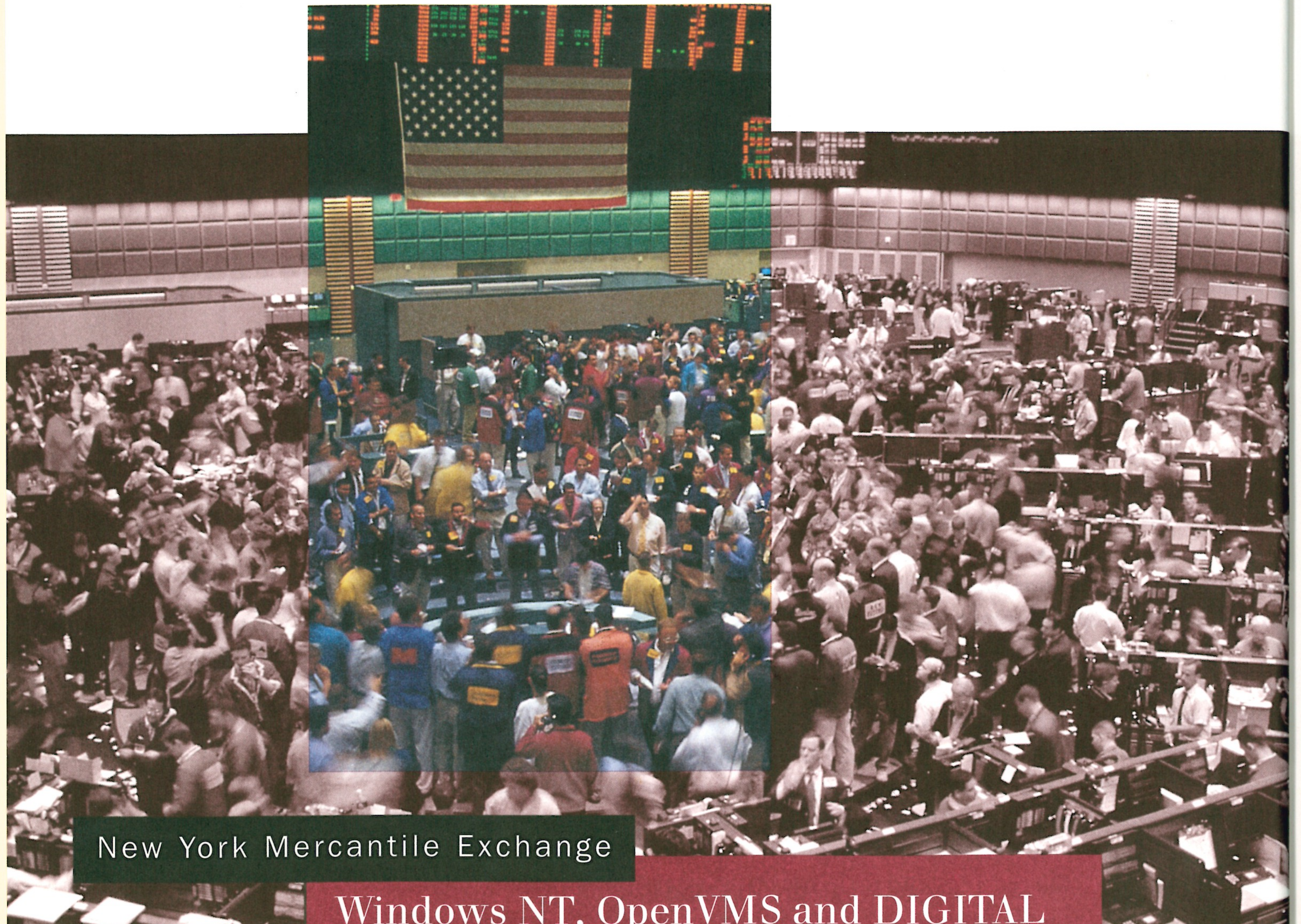
From its inception, our company has been driven by a relentless focus on the future and on developing innovative technologies that will help make our customers more successful. We did these things in the past with the PDP and VAX architectures, the VMS operating system, distributed computing and clustering, to name a few. And we are doing them today with Alpha, StrongARM, DIGITAL UNIX, AltaVista and our HiNote Ultra notebook computers.

But it will take more than leadership services and technology for DIGITAL to succeed. It will take the support of our shareholders, employees, customers and partners. We know that we must continue to earn that support. DIGITAL is committed to increasing value for shareholders, providing an exciting and rewarding workplace for our employees, and offering customers and partners nothing less than the industry's best products, services and solutions.

That is what DIGITAL has enjoyed doing for the last 40 years, and it is why we are looking forward to the next 40.

RB Palmer

Robert B. Palmer
Chairman of the Board,
President and Chief Executive Officer



New York Mercantile Exchange

Windows NT, OpenVMS and DIGITAL UNIX integrated in a disaster-tolerant enterprise solution

www.nymex.com

The world's largest petroleum and precious metals exchange is moving its core trading, settlement and compliance applications from *fault-tolerant* Tandem systems to mirrored *disaster-tolerant* Alpha clusters in separate locations as part of a DIGITAL/Microsoft solution.

Traders will now get realtime trading information rather than having to depend on written reports prepared after the market closes. At the same time, the trading floors and computer rooms in the Exchange's new building will be linked through a high-speed DIGITAL GIGAswitch system and fiberoptic cable to a second building that will serve as a backup center for both the trading floor and back office applications.

This enterprise network will include 1,100 DIGITAL PCs, 50 DIGITAL x86-based servers running Windows NT and ten AlphaServer systems in two different buildings running OpenVMS and DIGITAL UNIX operating systems. The network provides a dramatic demonstration of the interoperability of these three operating systems. Through the DIGITAL Windows NT integration program, Affinity for OpenVMS and AllConnect for UNIX provide the tools to integrate legacy systems with new applications.

Building the networked world

The Internet is not just about the future of technology—*the Internet is now.* It provides the infrastructure needed to acquire, share and publish information. It is the platform where voice, data and video technologies converge. It is the heart of a new global, networked economy.

DIGITAL customers are showing the way. Netscape is operating the busiest site on the Web, handling 140 million requests per day. Best Western's reservation system supports 3,700 hotels in 73 countries. And Lockheed Martin is building a mail system to support 120,000 users. These are just three of thousands of customers who rely on DIGITAL to meet their information technology needs.

These customers recognize DIGITAL as the premier network solutions company. Network solutions were the key to our prosperity in the 1980s. They remain the foundation of our strategy today. The only difference is that now, instead of proprietary solutions, DIGITAL is using Internet technology to deliver some of the most open solutions in the industry.

As we celebrate our 40th Anniversary, we have an opportunity to capitalize on communications paradigm shifts–like the telephone, the radio and television–which can change the way we all live and work. That opportunity is the Internet. We intend to seize this opportunity.

As Internet standards and technology become more robust and pervasive...as issues surrounding bandwidth and security are resolved...and as new kinds of Internet access devices are developed and deployed...the Internet will undoubtedly become the universal computing platform of choice. There are three operating environments where, *today,* DIGITAL is the leader in delivering enterprise-class Internet solutions:

- Windows NT for general-purpose enterprise computing
- 64-bit UNIX for planetary-scale computing
- OpenVMS for very-high-availability computing

But having the right platforms means little unless you have the service and support to apply those platforms to the task at hand. DIGITAL provides integration, product support and operations management services in more than 100 countries through its 23,000-person Services Division.

DIGITAL's two-pronged, go-to-market strategy builds on these technological and service strengths to deliver both infrastructure and industry-focused solutions targeted at nine key markets. These solutions leverage DIGITAL's core competencies–multivendor integration, Internet security, continuous computing, high-availability data and high-performance networked platforms–to clearly differentiate us from our competitors.

Infrastructure solutions As customers incorporate the Internet paradigm into their corporate computing environment, they face infrastructure problems shared by companies in almost every industry. DIGITAL has developed solutions targeted at four key infrastructure markets. We are helping customers plan, design and implement intranets, deploy Internet Commerce solutions, integrate Windows NT into the enterprise, and modernize their mail and messaging systems.

Industry-focused solutions DIGITAL also is focusing on select business solutions customized for specific industries. Four targeted market segments–data warehousing, enterprise applications, high-performance technical computing and visual computing–address specific customer needs in key industries including finance, manufacturing and telecommunications. In these markets, DIGITAL is tightly tying solutions to industry-specific requirements.

For example, we have delivered specific data warehousing solutions customized for different industry needs. Sumitomo Bank of Japan and other money market banks are using DIGITAL solutions to evaluate their credit card and publicly held mortgage-backed securities portfolios. Consumer packaged goods manufacturers and retailers like Schering-Plough have chosen DIGITAL micro-marketing and consumer brand management solutions that help them identify and target their best prospects. Telecommunication companies like Australia's Optus Communications rely on DIGITAL solutions for billing and customer care so they can provide better service to their subscribers.

Internet Service Providers DIGITAL Internet Infrastructure Services play a key role in the ninth target market–Internet Service Providers. Many of these service providers look to DIGITAL for assistance in planning, designing and implementing scalable facilities to keep pace with growing Internet traffic and an expanding customer base.

Partnering to provide total solutions DIGITAL's global alliances with Computer Associates, MCI, Microsoft, Oracle and SAP play an important role in building solution sets for each of our nine targeted market segments. In addition, we have established Centers of Expertise for each market segment and we're integrating the entire value chain–aligning and teaming products, services and business partners–to provide customers with highly reliable, scalable and fully supported solutions tailored to their needs.

1997 Milestones

Forty years ago, DIGITAL opened for business with three employees and 8,500 square feet of production space in an old woolen mill. Today, as DIGITAL celebrates its 40th Anniversary, the company is a leading worldwide supplier of networked computer systems, software and services, developing and manufacturing products and providing customer services in the Americas, Europe and Asia-Pacific.

DIGITAL won the **United States Postal Service** 1997 Quality Service Award. DIGITAL provides information technology solutions to Postal Service locations nationwide, including computer hardware and software, maintenance and support services. Since 1995, DIGITAL has provided the Postal Service with more than 82,000 PCs and servers.

Micron Electronics, Inc. presented DIGITAL Worldwide Services with an Award of Excellence at its 1997 Supplier Conference. DIGITAL provides multivendor desktop, server and notebook service and support for Micron customers worldwide.

DIGITAL's x86-based Prioris servers broke the performance record for Windows NT, processing 8,145 transactions per minute at $48.67 per transaction.

DIGITAL announced that the **StrongARM microprocessor** will support Windows CE, the Microsoft software platform developed for consumer electronic products and Internet appliances such as hand-held personal computers, smart phones and DVD players.

AIM Technology awarded DIGITAL 15 "Hot Iron" awards in the UNIX and Windows NT categories at Networld+Interop.

FX!32, DIGITAL's Windows compatibility software for Alpha systems, was named one of the five best Windows NT software products by *Windows Magazine*. It was also named "Technology of the Year" by *Windows Sources*.

More than 400 companies joined DIGITAL's **Internet Innovators Program** designed to help software companies increase their success throughout the product development cycle.

DIGITAL's semiconductor manufacturing facility was named a **"Top Fab of the Year"** by *Semiconductor International* magazine.

At the 35th Anniversary meeting of DECUS, the **DIGITAL Equipment Computer Users Society**, 3,000 customers were present to see significant expansions to the Windows NT integration program. This is comprised of Affinity for OpenVMS and AllConnect for DIGITAL UNIX and provides the technology, tools, services, systems integration and support needed to integrate Windows NT into the enterprise.

DIGITAL introduced **Enterprise Integration Packages** to extend OpenVMS application and enterprise capabilities to the Windows NT environment.

DIGITAL opened a new **Customer Call Center**. By dialing 1-800-DIGITAL, customers and business partners can speak directly with a highly trained Customer Care representative who will connect them with someone to address their needs.

DIGITAL announced 11 service offerings for enterprises adopting and migrating to Microsoft technology, reinforcing DIGITAL's position as **Microsoft's premier service and support partner**.

Readers of *Data Communications* voted DIGITAL the **"Best Overall Services and Support"** provider in the magazine's annual user survey, prompting the publication to give DIGITAL the top "Users' Choice" award.

For the third consecutive year, *Datamation* magazine readers named DIGITAL's AlphaServer **"Server of the Year."**

"Road Runner" is bringing online news and entertainment to Hawaii

www.timewarner.com

Building on the technological expertise of the DIGITAL/Microsoft Alliance, the Oceanic Division of Time Warner Cable is introducing a new high-speed, online news and entertainment service to the island of Oahu, Hawaii. Named for the famous Warner Bros. Looney Tunes character, Road Runner is super-fast, using fiberoptic cable to provide customers with a unique user-friendly online service and connectivity to the Internet at unparalleled speeds.

Road Runner seamlessly integrates local programming with national and international content. Subscribers will have connectionless, permanent access to a wealth of daily news sources from local media outlets, schools, libraries, government offices, museums, zoos and shopping services. Still photos that would choke a dial-up network will appear instantly over the broadband Internet.

The network is based on Microsoft's Internet Explorer browser and the Microsoft Commercial Internet System (MCIS). DIGITAL is providing planning, design and integration services, as well as DIGITAL x86 Prioris servers and custom code to interface with Oceanic's customer care system. The result is a cost-effective, easily scalable, broadband Internet service that can support an exciting combination of news, entertainment and information.

Oceanic is one of Time Warner Cable's larger operations reaching 332,000 homes. According to Division President, Don Carroll, Oceanic's goal is "...to build real communities, not just ethereal cyber-communities. The day will come when the first thing you see when you go online with Road Runner will be news and information about your own neighborhood. You'll be able to check your children's school calendar, review proceedings of neighborhood board meetings and check for promotions and sales at the stores nearest your home. The possibilities are limitless."

Internet:
changing the very definition of networking

The Internet is changing everything—even the very definition of networking. Many companies claim to be "The Internet Company" or even the inventor of networked computing.

While many of these companies have made significant contributions to Internet technology, DIGITAL was and is the leader in developing Internet solutions. We were the first computer company on the ARPANET, the forerunner of the Internet, and–as one of the original sponsors of Ethernet–we brought the network to the desktop. Today, DIGITAL has all the components–from implementation and integration services to high-capacity, high-performance servers–needed to support large-scale Internet and intranet applications. This leadership can't be challenged: of the *Computerworld* Premier 100 Internet sites, 73 use DIGITAL products.

The experience we've gained in working with companies who have built world-class Internet sites is one reason we can help other customers understand the implications of Internet technology. We're helping them apply this technology to their business needs and build intranets–private networks using Internet technology and communications.

We're helping customers build Web infrastructures with the capacity, reliability and security needed to conduct financial transactions and buy and sell everything from new homes and cars to personalized news reports. And, as new applications fuel the explosive growth of the Internet, we're working closely with Internet Service Providers and telecommunication companies to help them build and maintain the network.

Internet integration, infrastructure and operations management services

As more and more businesses evolve into networked enterprises where employees, customers, business partners and suppliers share ideas and work together over the Internet and intranets, the need to reduce network support costs and ensure round-the-clock, 24x365 availability has become a priority.

DIGITAL Worldwide Services provide Internet Infrastructure Services, Network and Application Integration Services and Internet Operation Management Services to help customers plan, design, implement and manage intranet applications and Internet communications and commerce.

High-performance, high-availability Internet servers No business wants its customers, partners or employees to experience repeated busy signals and "server not available" messages. The need for high-performance, high-availability Windows NT and UNIX servers is particularly critical for Internet Service Providers and companies building intranets or engaged in Internet Commerce.

To demonstrate the power and scalability of our Internet business solutions, DIGITAL established the AltaVista search service (**http://www.altavista.digital.com**). AltaVista has become one of the most popular sites on the World Wide Web. Each day, more than 30 million Internet users rely on AltaVista to quickly and easily find the information they're looking for. Driven by DIGITAL's powerful 64-bit AlphaServer technology, AltaVista gives users access to more than 31 million pages of information. This past year, AltaVista was enhanced with a new user interface that includes simple customization tools and a "refine" function, enabling users to focus their searches and obtain relevant results within seconds. A unique multilingual search feature was also added. Now users can search for Web pages written in any one of 25 languages–from Chinese to Swedish.

The DIGITAL Prioris HX6000 series of x86 servers delivers exceptional value in a "no compromise" package, combining state-of-the-art manageability, availability, performance, scalability and service. Data integrity and reliability are assured with high-availability system design including ECC EDO memory, redundant cooling, optional redundant power, integrated Hot-Swap drives and dual redundant backplane capabilities.

Information access, security and Internet Commerce software Internet applications require specialized software. Without this software, the Internet becomes a tangled web where it is difficult to find the information you're looking for, where transactions can go astray and where hackers and viruses can bring your systems to a halt.

DIGITAL has addressed these issues. Our AltaVista family includes firewall, tunneling, indexing and desktop-to-Web search software for x86 Windows, Windows NT and Sun Solaris desktops and servers as well as Alpha systems running Windows NT and DIGITAL UNIX.

With DIGITAL Internet transaction processing software and the recent introduction of the advanced Millicent technology showcase, DIGITAL has the specialized software and associated services needed to support Internet Commerce. Millicent is the first cyber-commerce program that demonstrates how users can buy and sell information over the World Wide Web at prices as low as a tenth of a cent. It makes "pay-per-click" surfing affordable for the user and opens a profitable new revenue stream for publishers who can now sell news and sports stories, fiction, features, financial reports and other information on a page-by-page basis.

The 64-bit AlphaServer 4000 system is part of DIGITAL's complete family of ready-to-run Alpha and x86 Internet and intranet servers. Designed for round-the-clock, 24x365 operation, AlphaServer systems provide the high availability, data integrity and flexible scalability needed to support growing Internet applications.

To understand the potential of selling products and publishing information over the Internet, you only have to look at Amazon.com and PointCast. Amazon.com, the "electronic bookstore," has been growing 2,000 percent a year. Fortunately, Amazon.com uses AlphaServer systems that have the scalability to handle this growth for another 20 years.

PointCast is the leader in "push" technology, using the Internet to provide customized news and information services to millions of individual users, 24 hours a day. Like Amazon.com, PointCast depends on highly scalable AlphaServer systems to keep pace with its aggressive growth.

Kvaerner

Building an intranet to link 40,000 employees and 400 offices worldwide

www.kvaerner.com

When Kvaerner—a multinational shipping and construction company with its roots in Norway and its international headquarters in London—wanted to link its worldwide subsidiaries, they named DIGITAL and Microsoft as their preferred vendors for Internet/intranet solutions throughout the enterprise.

Service and support were critical issues. Kvaerner wanted to deal with a service organization that had first-hand experience establishing and operating its own enterprise-wide intranet. They looked for a servic organization that could demonstrate its ability to support a global enter prise and a user base comparable in size to their own.

With facilities throughout the world, DIGITAL Worldwide Services i positioned to work with Kvaerner subsidiaries on a one-to-one basis while at the same time providing the coordination necessary to build highly reliable and functional worldwide intranet based on Windows N Microsoft Internet Explorer and high-performance DIGITAL servers.

Virtual Telecom, Inc.

Providing Internet access in Switzerland and realtime financial information services across Europe

www.firstquote.com

Virtual Telecom recognized that its core business is providing value-added services over the Internet. The Swiss company wanted to provide Internet Service Providers instant access to the network through multiple high-speed communications links through a major Internet hub.

Under a multiyear, multimillion-dollar Operations Management Services contract, DIGITAL designed, implemented and is managing the Virtual Telecom network.

In addition to Internet access, Virtual Telecom's FirstSwiss service includes Web hosting, Web development, publishing and online catalog services. Virtual Telecom also provides 1stQuote, a comprehensive range of realtime financial data services over the Internet to banks, investment companies and brokerage houses throughout Europe.

The Virtual Telecom network features DIGITAL AltaVista firewall software at each point of presence to protect against unauthorized access and capitalizes on alliances with Swiss Telecom PTT and British Telecom for high-speed telecommunications services.

Siemens (U.K.)

Building a scalable manufacturing control and management information system

www.siemens.co.uk

Service, support for both Windows NT and UNIX, solutions that are scalable from x86 desktops to Alpha clusters, strategic alliances with key software companies—these are reasons customers give for partnering with DIGITAL.

Siemens is no exception. When they set up a new semiconductor wafer manufacturing plant in the U.K., they needed a manufacturing system to control production processes, improve product quality, lower costs and reduce time-to-market. At the same time, they wanted a scalable mail and messaging system that would initially support up to 1,200 users and link their U.K. plant to other Siemens facilities in both Europe and North America.

In the DIGITAL solution, x86-based Prioris servers and UNIX-based AlphaServer systems work together support CELLworks, Microsoft Exchange and Oracle database software. The DIGITAL solution enables Sieme to track work in progress to control inventories and ensure just-in-time delivery to its customers.

DIGITAL Worldwide Services played a key role in developing and implementing a scalable solution th would allow Siemens to add new users and applications to the network without interrupting work or replaci existing equipment.

Windows NT: delivering enterprise solutions

As customers like the New York Mercantile Exchange, Lockheed Martin and the Southern Company implement client/server applications and build mail and messaging systems to support tens of thousands of users, the challenge is integrating these applications into existing computing environments.

Integration is DIGITAL's strength. In fact, DIGITAL was ranked as the industry's top systems integrator by readers of *Computerworld* in its annual Customer Satisfaction Survey.

It is the need to integrate computing resources around a platform optimized for client/server and network computing that drives the rapid deployment of Windows NT. The trend is accelerating. According to International Data Corporation, the market for Windows NT systems, software and services will be an estimated $20.7 billion in the year 2000. DIGITAL intends to capture a significant share of this growing market.

The Alliance for Enterprise Computing Windows NT was designed for client/server environments. Under the Alliance for Enterprise Computing, DIGITAL and Microsoft are working together to provide products and services to support a single, integrated client/server environment that extends from the desktop, across the enterprise and out over the whole world through Internet communications.

DIGITAL has built the largest Windows NT service and support organization in the world. We now have approximately 1,600 Microsoft certified systems engineers and solution developers–a number that soon will grow to 2,500. We developed software that supports the development of applications that will run across Windows NT, DIGITAL UNIX and OpenVMS systems. We introduced the first Windows NT clusters. And our x86 and AlphaServer systems own the benchmarks for Windows NT performance. In tests conducted by *Pro/E: The Magazine*, a DIGITAL Personal Workstation running Windows NT outperformed all workstations tested, regardless of Central Processing Unit architecture or operating system. In fact, it outperformed a similarly priced Sun system running UNIX by 171 percent.

Microsoft, for its part, is developing a 64-bit version of Windows NT for initial release on Alpha. But the relationship between the two companies extends beyond technology. It includes joint engineering, marketing, sales and service programs. Working in partnership, we've helped customers build user-focused enterprise systems and networks, and we have installed more than 500,000 Microsoft Exchange seats and have another 500,000 under contract.

Winner of PC/Computing *magazine's "Annual Torture Test" and designated the "Best Windows NT Hardware Product of the Year" by* Windows Magazine, *the DIGITAL HiNote VP family of laptop computers features the latest in MMX processor, graphics and removable media technologies.*

"Thin clients"—reducing desktop support costs A whole new class of Internet devices is emerging that will enable people to access the Internet–anywhere, anytime. Collectively called "thin clients," these devices often combine cellular telephone, pager, fax, handwriting recognition and computing functions in a single unit. It would never have been possible to develop many of these new devices without high-performance microprocessors that will run on a battery. DIGITAL is leading the way. Our StrongARM microprocessor operates at speeds up to 250 million instructions per second while running on AA batteries. This is a two-to-one advantage in both absolute performance and price/performance over competing microprocessors.

The concept of the "thin client" also addresses the cost of purchasing and supporting desktop and mobile systems in client/server networks where applications and/or data reside on a central server rather than on the client.

Because data processing controls the server, it can control software used by thin clients throughout select workgroups or the entire enterprise. There is no longer the problem of individual users running different versions of the same application. New software releases no longer have to be installed one desktop at a time. Data is centralized so it can be easily secured and backed up. The potential savings are significant.

Windows NT service and support DIGITAL is the first computer company to offer a comprehensive set of life-cycle services focused on the growing demand for Windows NT and Microsoft Exchange migration, Internet and intranet solutions, and data warehousing using Microsoft SQL Server. In providing these services, DIGITAL intends to help customers decrease implementation time and lower costs.

Lockheed Martin

Helping 120,000 users in 630 locations worldwide get the message

www.lmco.com

When Lockheed and Martin-Marietta merged to become one of America's largest civilian and military aerospace manufacturing and contracting companies, they needed a mail and messaging system with the muscle to support 120,000 users in 630 locations. They selected DIGITAL through a competitive process for an enterprise-wide Windows NT solution that is expected to reduce long-term costs by simplifying their messaging infrastructure and improving productivity.

Working with Microsoft, its partner in the Alliance for Enterprise Comp ing, DIGITAL is implementing the largest Microsoft Exchange network the world. Running under Windows 95 and Windows NT, Micros Exchange provides a complete, highly functional mail and messag system that includes address book, auto signature, remote mail and p lic folder functions. This last provides a forum where authorized memb of a workgroup or product team can share information and ideas.

The DIGITAL/Microsoft solution for Lockheed Martin includes AlphaSe systems with DIGITAL's X.500 directory services software, Micros Windows NT and Exchange software, and DIGITAL program mana ment, network design, implementation and ongoing support services.

DIGITAL's Venturis FX-2 PC client provides breakthrough performance at industry-standard prices with leading-edge features, including x86 MMX technology and DIGITAL ClientWORKS systems management and control software. This software provides powerful desktop management, asset management and configuration utilities.

We provide Internet/intranet enterprise services to help organizations understand the impact the Microsoft Merchant Server and the Microsoft Commercial Internet System will have on their businesses and help them successfully deploy and manage solutions for Internet Commerce.

SQL Data Warehousing As businesses migrate users and applications to client/server environments, they often find themselves with disparate data sources. DIGITAL is addressing this problem with the DIGITAL DataMart. This innovative combination of Microsoft SQL Server with products from Informatica Corporation and Business Objects SA provides the software and services needed to map Microsoft SQL server to industry-standard databases from Oracle, Informix and Sybase.

Windows NT, FX!32 and Alpha Performance and scalability are critical issues in many enterprise networks and applications. DIGITAL supports Windows NT on both its x86 and Alpha platforms to provide the most extensive scalability in the industry. In addition, with DIGITAL FX!32 translation and emulation software, Alpha systems can run the entire library of Windows NT and Windows 95 applications.

Southern Company

America's largest electric utility powers up with Windows NT on DIGITAL server systems

www.southernco.com/site/home.asp

Deregulation is coming to the U.S. electric utility industry. That puts a premium on finding ways to improve customer service and cut costs. The Southern Company is responding to this changing marketplace by standardizing on Windows NT to gain a cost-effective solution.

The Southern Company network currently has more than 17,000 users and 500 NetWare servers from many different vendors. These are being replaced by DIGITAL Alpha and Prioris systems running Windows NT, Microsoft Exchange and SMS in a BackOffice environment.

As in many projects of this size, DIGITAL is working closely with Microsoft and its other business partners. Universal Data Consultants provided systems and network integration services for the Southern Company, while Wyle Electronics, a billion-dollar DIGITAL distribution partner, is delivering the DIGITAL systems on a "just-in-time" schedule.

Optus Communications

Caring for customers across the Australian continent while introducing new wireline, mobile, broadband and satellite services

www.optus.com.au

"Convergence billing"—providing a single bill for local, long distance, mobile and cable-based local-loop telephone service, Internet access and cable TV—is the major customer care issue facing telecommunications companies as they introduce new services.

Using software developed by Kenan Systems, Optus Communications is one of the first telecommunications companies to deploy a UNIX-based billing system to support multiple communications services on an enterprise-wide basis. This high-performance hardware/software solution is capable of supporting 15 million residential subscribers in a production environment.

Running on DIGITAL Alpha systems, Kenan's Arbor/BP software owns the benchmark for online telecommu cations billing and customer care, processing four million call details per hour.

Optus has been a major customer since 1992, when DIGITAL was initially selected as the prime contrac and system integrator for building the Operational Support Systems—the network operating, billing a administrative systems—needed to control and manage the Australia-wide telecommunications network.

DIGITAL UNIX and OpenVMS:

owning the standard for high-performance 64-bit computing

Performance and availability are issues whenever you have large or complex applications, massive amounts of data or a network that supports hundreds or even thousands of users. These are issues that directly affect software developers and systems integrators as well as users. Customers are looking for fully supported hardware/software solutions that deliver the performance, availability and scalability to meet their growing needs.

That's why systems integrators like Ernst & Young and Andersen Consulting and leading application developers like SAS, Platinum and Baan work in partnership with DIGITAL.

These companies recognize the need for 64-bit UNIX systems that can handle massive applications. DIGITAL UNIX systems enabled Schering-Plough's Health Products unit to implement a logistics program that saved the company two million dollars in inventory, transportation and accounts receivable costs. Alpha systems running DIGITAL UNIX and SAP R/3 software enabled Danish Railways to implement a corporate-wide accounting and finance system.

Our partners also recognize the need for systems that deliver the very highest levels of reliability and availability. This is the strength of DIGITAL's OpenVMS operating system.

With 64-bit DIGITAL UNIX and OpenVMS systems, customers have a choice. And they have the opportunity to run their applications on the system that sets the standard for 64-bit computing–DIGITAL's Alpha platform.

Alpha performance: two billion instructions per second High-performance computing starts with high-performance processors. Here DIGITAL has a clear-cut advantage. "AlphaPowered" systems push the envelope for high-performance technical computing, data warehousing, transaction processing and visual computing applications, including videoconferencing, 3-D modeling, video editing, multimedia authoring, image rendering and animation. With patented cache management, branch prediction and superscalar instruction execution technology, high-end Alpha microprocessors run at speeds of more than 600 MHz to execute more than two billion instructions per second.

AlphaServer 8000 systems support up to 14 symmetric multiprocessors, DIGITAL UNIX TruClusters, 28 gigabytes of memory and 39 terabytes of storage to provide better-than-mainframe and supercomputer performance. Business-critical applications include data warehousing, high-performance technical computing, sophisticated telecommunications applications and large-scale database management.

Alpha microprocessors are now available from both DIGITAL and its semiconductor partners. Mitsubishi and Samsung have joined DIGITAL in developing, manufacturing and marketing Alpha microprocessors to deliver performance leadership where performance counts.

DIGITAL UNIX, the high-performance operating system More than 50 percent of all DIGITAL UNIX customers are new customers because this 64-bit operating system–paired with AlphaServer systems–supports large-scale data warehousing, visual computing and other high-performance business, scientific and networking applications that could not be cost-effectively addressed by competitive systems. DIGITAL leads the industry in UNIX cluster performance. The transaction processing benchmark set in April 1996 on a four-node DIGITAL TruCluster system has not been matched by any other four-node cluster on the market.

High-availability OpenVMS clusters for business-critical applications
DIGITAL pioneered the cluster concept in 1983 and continues to set the standard by which clustering and continuous computing solutions are measured. DIGITAL cluster technology provides bulletproof, round-the-clock, 24x365 disaster tolerance. It supports VAX and Alpha systems in mixed clusters, Windows NT clusters, multisite configurations within a 500-mile radius and online backup. In addition, DIGITAL cluster technology allows you to add processors, memory, storage and other devices to a DIGITAL server without interruptin ongoing processes.

In a recent review of cluster computing, an independent research organization, Technolog Business Research, examined various features including scalability, availability, configuration flexibility, connectivity and applications support. The survey concluded that DIGITAL OpenVMS clusters continue to lead over Hewlett-Packard, IBM, NCR and Sun Microsystem clusters.

Very large memory, very large database applications As corporate networks embrace desktop systems throughout the enterprise and link to the worldwide Internet, there is an explosive growth in the forest of data residing within the enterprise. Unfortunately, growth in raw data is not always matched by growth in information. It becomes a case of not being able to see the trees (information) for the forest.

Our business partners are addressing this problem. Oracle, Sybase, Informix, Software AG and other database software companies have developed database solutions that capitalize on DIGITAL 64-bit Very Large Memory (VLM) and Very Large Database (VLDB) technology. These applications run at blinding speed. For example, with Oracle 64-bit database software, some applications will run up to 200 times faster on an AlphaServer system than they can on the fastest 32-bit systems.

Windows NT integration Through the DIGITAL Windows NT integration program, corporate customers and software developers can converge on a source code base, an interoperable middleware base and a single developmental tool set for all DIGITAL UNIX, OpenVMS and Windows NT applications.

Worldwide service and support Planning, designing, implementing, managing and maintaining high-performance enterprise systems and networks can be a daunting task requiring the ability and patience to deal with multiple systems, software and communications vendors.

In many cases, business solutions must be deployed around the world. This requires sophisticated software and worldwide support services. DIGITAL and Computer Associates formed the Alliance for Enterprise Management to create a standard, unified, enterprise management environment across DIGITAL UNIX, OpenVMS, Windows NT and legacy mainframe systems.

DIGITAL and MCI formed a formal alliance to help businesses utilize Internet technology and communications and build corporate intranets.

Like a growing number of customers, our business partners recognize that DIGITAL's strengths in Internet connectivity, Windows NT integration and high-performance computing are key to "Winning in a Networked World."

DIGITAL Personal Workstations offer outstanding performance, a choice of operating systems, leading 3-D graphics and the industry's only CISC-to-RISC upgrade. For Windows NT users, DIGITAL offers the i-Series, which features Intel Pentium Pro processors, or the a-Series, which is built on the super-powerful DIGITAL Alpha processors. For the most demanding UNIX applications, the au-Series features DIGITAL Alpha processors running DIGITAL UNIX.

The Paul Scherrer Institute

Supporting 70 to 80 concurrent research programs that reach beyond the capabilities of a university department

www.psi.ch

Under the auspices of the Board of Swiss Federal Institutes of Technology, the Paul Scherrer Institute in Villigen, Switzerland provides the computer infrastructure to support the research activities of its 1,100-person staff, including 370 scientists plus 500 to 800 guest scientists each year.

Unlike many commercial environments where applications and workloads are constant, research calls for maximum flexibility. Systems are constantly reconfigured and reprogrammed. This places a premium on systems that are modular, scalable and easy to program and configure.

Research also places a premium on high-capacity, flexible data storage. example, the data generated from the Institute's proton therapy facility cancer treatment must be retained and protected for at least a decade one program may open an avenue that spurs further research in a ne ending cycle. Realtime data collection for nuclear physics and material ence investigations conducted on the Institute's particle accelerator produce massive volumes of raw data that require online storage.

The Paul Scherrer Institute's DIGITAL UNIX, OpenVMS Cluster and DIG StorageWorks systems provide the capacity and flexibility needed in a sc tific environment. This type of interoperability, high-availability and raw formance is critical in realtime and large-scale research programs.

Best Western Hotels

Building a reservation system that knows your personal preferences

www.bestwestern.com

Best Western International, Inc. knows how personal service can attract and keep customers. They've built a reservation system that knows your personal preferences and keeps track of every reservation and every one of the nearly 300,000 rooms throughout the Brand. This is a big job. Best Western International, Inc. operates almost 3,700 hotels in 73 countries and territories throughout the world.

The reservation system is based on DIGITAL AlphaServer systems using VLM (Very Large Memory) technology and an Oracle7 database.

With this new system, any desk clerk or travel agent can instantly book and confirm room reservations at any Best Western Hotel.

The system provides business and leisure travelers with the kind of personal service that translates into a higher occupancy rate—and high occupancy means higher revenue. In fact, Best Western International, Inc. expects that their new reservation system will generate $50 million in additional revenue.

Delivering on the promise

the Internet, our children and the environment

As a leader in the development of the Internet, DIGITAL has a responsibility to help create a world where information and ideas can be freely exchanged.

This past year, we took a leadership role in NetDay, an innovative program to provide students and teachers with access to the Internet. We donated servers, PCs and networking packages to schools where DIGITAL volunteers invested their own time and energy wiring and installing systems.

This kind of involvement is not new. As we celebrate our 40th Anniversary, we continue t support innovative programs designed to make this a better world for the next generation. This past year, through our Worldwide Children and Youth Initiative, we awarded cash grants to 70 local children's charities in 27 countries.

But our responsibility goes beyond helping children achieve their potential. We want ever child to enjoy a healthy environment. DIGITAL's corporate Environment, Health and Safety (EHS) policy statement, "Earth Vision," provides the framework for action. For example, w operate Materials Recovery facilities in Contoocook, New Hampshire and Nijmegen, the Netherlands to demanufacture 28 million pounds of discarded electronic equipment every year. Intact parts are removed, tested and stocked as spares. Gold, platinum and silver are extracted and resold. Plastic, glass and other materials are recycled. Less than one-tenth o one percent of the material ends up in landfills. The Contoocook facility is one of the first organizations in the U.S. to win ISO 14001 certification for demanufacturing.

DIGITAL is a national founder of City Year, a service corps that brings young adults from diverse cultural, educational and socioeconomic backgrounds together for full-time community service. During its annual conference held in Boston, DIGITAL employees (in maroon shirts, left to right: Kathy Coyle, Kate Seibert, Lew Karabatsos and Jim Gray) joined City Year corps members to help landscape the grounds of an inner-city school. (Photo credit: Chris Johnson)

Another example of DIGITAL's commitment to the environment was our part in establishi a unique, free-access educational Web site (**http://www.endangeredzone.com**) with high quality images and searchable information about endangered species around the world. Developed in partnership with Oracle and Virage Inc., the Web site incorporates an Oracl database to create dynamic pages so children can build a personalized field journal of information for research reports, study guides or extracurricular projects.

Programs like these demonstrate our belief that we can make a difference; that as individ als and as a company we can use our talents and technology to make this a better world.

Financial statements

Eleven-year financial summary

(dollars in millions except per share data and stock prices)	1997	1996	1995	1994	1993
Statements of operations[1]					
Product sales	$ 7,197	$ 8,362	$ 7,616	$ 7,191	$ 7,588
Service revenues	5,850	6,200	6,197	6,260	6,783
Total operating revenues	13,047	14,563	13,813	13,451	14,371
Cost of product sales and service expense	8,725	9,756	9,392	8,912	8,631
Research and engineering expenses	1,014	1,062	1,040	1,301	1,530
Selling, general and administrative expenses[2]	3,177	3,859	3,266	5,234	4,447
Operating income/(loss)	130	(115)	115	(1,996)	(237)
Other (income)/expense, net[3]	(48)	(48)	40	24	(13)
Income/(loss) before income taxes and cumulative effect of changes in accounting principles	178	(68)	76	(2,020)	(224)
Provision for income taxes	37	44	18	85	27
Net income/(loss)[4]	$ 141	$ (112)	$ 122	$ (2,156)	$ (251)
Net income/(loss) applicable per common share[4]	$ .68	$ (.97)	$ .59	$ (15.80)	$ (1.93)
Weighted average shares outstanding (in millions)	155	152	146	137	130
Financial position					
Inventories	$ 1,503	$ 1,821	$ 2,054	$ 2,064	$ 1,755
Accounts receivable, net of allowances	2,930	3,223	3,219	3,319	3,020
Working capital	3,035	3,188	3,026	1,832	2,964
Net property, plant and equipment	2,104	2,223	2,269	3,129	3,178
Total assets	9,693	10,075	9,947	10,580	10,950
Long-term debt	743	999	1,013	1,011	1,018
Stockholders' equity	3,545	3,606	3,528	3,280	4,885
Stockholders' equity per common share	20.81	20.62	20.89	20.24	36.19
Ratios and other information					
Current ratio	1.7:1	1.8:1	1.7:1	1.4:1	1.8:1
Quick ratio	1.3:1	1.2:1	1.1:1	.9:1	1.2:1
Debt/debt plus equity	22.1%	22.0%	22.5%	24.1%	17.5%
Operating income/(loss) as a percentage of revenues	1.0%	(.3)%	.8%	(14.8)%	(1.7)%
Net income/(loss) as a percentage of revenues	1.1%	(.8)%	.9%	(16.0)%	(1.7)%
Return on equity	3.9%	(3.1)%	3.6%	(52.8)%	(5.1)%
Return on assets	1.4%	(1.1)%	1.2%	(20.0)%	(2.3)%
Non-U.S. revenues as a percentage of total revenues	67%	66%	65%	62%	64%
Days sales outstanding	76	78	77	76	69
Number of employees at year-end	54,900	59,100	61,700	77,800	89,900
Number of shares outstanding at year-end (in millions)	151	156	150	142	135
Common stock yearly high and low sales prices	$ 47–25	$ 76–35	$ 49–18	$ 43–18	$ 49–30

(dollars in millions except per share data and stock prices)	1992	1991	1990	1989	1988	1987
Statements of operations[1]						
Product sales	$ 7,696	$ 8,299	$ 8,146	$ 8,190	$ 7,541	$ 6,254
Service revenues	6,235	5,612	4,797	4,552	3,934	3,135
Total operating revenues	13,931	13,911	12,943	12,742	11,475	9,389
Cost of product sales and service expense	8,132	7,278	6,795	6,242	5,468	4,514
Research and engineering expenses	1,754	1,649	1,614	1,525	1,306	1,010
Selling, general and administrative expenses[2]	6,181	5,572	4,521	3,639	3,066	2,253
Operating income/(loss)	(2,136)	(588)	13	1,336	1,635	1,612
Other (income)/expense, net[3]	(57)	(68)	(111)	(85)	(106)	(77)
Income/(loss) before income taxes and cumulative effect of changes in accounting principles	(2,078)	(520)	124	1,421	1,741	1,689
Provision for income taxes	232	97	50	348	435	552
Net income/(loss)[4]	$ (2,796)	$ (617)	$ 74	$ 1,073	$ 1,306	$ 1,137
Net income/(loss) applicable per common share[4]	$ (22.39)	$ (5.08)	$ .59	$ 8.45	$ 9.90	$ 8.53
Weighted average shares outstanding (in millions)	125	122	125	127	132	133
Financial position						
Inventories	$ 1,614	$ 1,595	$ 1,538	$ 1,638	$ 1,575	$ 1,453
Accounts receivable, net of allowances	3,594	3,317	3,207	2,965	2,592	2,312
Working capital	2,015	3,777	4,332	4,501	4,516	4,377
Net property, plant and equipment	3,570	3,778	3,868	3,646	3,095	2,127
Total assets	11,284	11,875	11,655	10,668	10,112	8,407
Long-term debt	42	150	150	136	124	269
Stockholders' equity	4,931	7,624	8,182	8,036	7,510	6,294
Stockholders' equity per common share	38.58	61.18	66.76	66.12	59.47	49.87
Ratios and other information						
Current ratio	1.4:1	2.0:1	2.3:1	2.9:1	2.9:1	3.4:1
Quick ratio	1.0:1	1.4:1	1.6:1	1.9:1	2.0:1	2.4:1
Debt/debt plus equity	1.8%	2.2%	2.0%	2.0%	3.6%	4.2%
Operating income/(loss) as a percentage of revenues	(15.3)%	(4.2)%	.1%	10.5%	14.2%	17.2%
Net income/(loss) as a percentage of revenues	(20.1)%	(4.4)%	.6%	8.4%	11.4%	12.1%
Return on equity	(44.5)%	(7.8)%	.9%	13.8%	18.9%	18.9%
Return on assets	(24.1)%	(5.2)%	.7%	10.3%	14.1%	14.6%
Non-U.S. revenues as a percentage of total revenues	63%	60%	56%	55%	50%	47%
Days sales outstanding	83	76	86	76	75	78
Number of employees at year-end	107,900	115,100	116,900	118,400	113,900	103,000
Number of shares outstanding at year-end (in millions)	128	125	123	122	126	126
Common stock yearly high and low sales prices	$ 72–33	$ 87–45	$ 103–70	$ 122–86	$ 199–99	$ 174–82

[1] *Amounts may not be additive due to rounding.*
[2] *Includes restructuring charges of $492M in 1996, $1,206M in 1994, $1,500M in 1992, $1,100M in 1991 and $550M in 1990. Includes reduction in carrying value of intangible assets of $310M in 1994.*
[3] *See Note A of Notes to consolidated financial statements.*
[4] *The cumulative effect of changes in accounting principles were: a one-time benefit of $65M, or $.44 per share, on net income and net income per share for fiscal 1995; a one-time charge of $71M, or $.51 per share, and a one-time benefit of $20M, or $.14 per share, on net loss and net loss per share for fiscal 1994; and a one-time charge of $485M or $3.89 per share on net loss and net loss per share in fiscal 1992.*

Revenues

In fiscal 1997, total operating revenues were $13.1 billion, a decrease of $1.5 billion or 10% following an increase of $750 million or 5% and $362 million or 3% in fiscal 1996 and 1995, respectively. Non-U.S. revenues accounted for 67% of total operating revenues in fiscal 1997, up from 66% and 65% in fiscal 1996 and 1995, respectively (see Note B).

Revenues (dollars in billions)

Fiscal year	1997	1996	1995
Product sales	$ 7.2	$ 8.4	$ 7.6
% of total revenues	55%	57%	55%
Service revenues	$ 5.9	$ 6.2	$ 6.2
% of total revenues	45%	43%	45%
Total revenues	$ 13.1	$ 14.6	$ 13.8

Revenues from product sales for fiscal 1997 were $7.2 billion, compared with $8.4 billion and $7.6 billion in fiscal 1996 and 1995, respectively. The decline in product sales in fiscal 1997 reflects the adverse effects of currency rate movements, the discontinuation of the retail personal computer and certain component product lines, as well as an anticipated reduction in inventories in distribution channels.

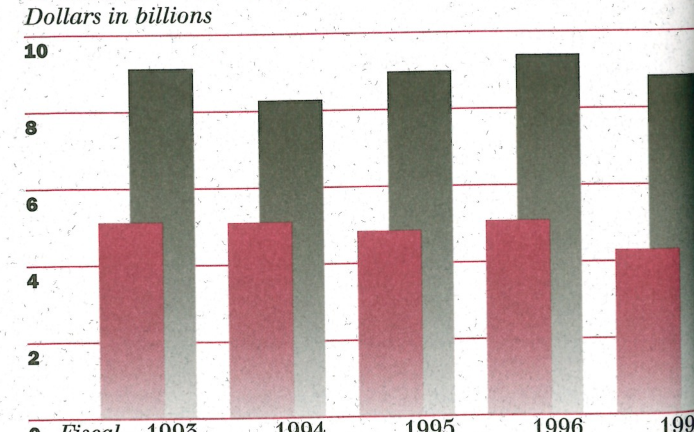
Alpha-based systems revenues represented 32% of fiscal 1997 product sales, up from 29% in fiscal 1996 and 22% in fiscal 1995. For fiscal 1997, Alpha-based systems revenues decreased 4%, compared with an increase of 46% and 76% in fiscal 1996 and 1995, respectively. The decline was due principally to a decrease in desktop product (client) sales, partially offset by an increase in server revenues. Revenue from Intel-based computers represented 28% of fiscal 1997 product sales, up from 26% in both fiscal 1996 and 1995. The increase was due principally to growth in server revenues. The Corporation's other product businesses represented 40%, 45% and 52% of product sales in fiscal 1997, 1996 and 1995, respectively. These revenues continue to represent a smaller portion of product sales, reflecting the withdrawal from certain non-strategic businesses, the transition from VAX systems, and a decline in network products sales in fiscal 1997 compared with fiscal 1996, partially offset by an increase in storage subsystem revenues.

In fiscal 1997, service revenues were $5.9 billion, down from $6.2 billion for both fiscal 1996 and 1995. The decline in service revenues was due principally to the adverse effects of currency rate movements, an anticipated decline in the Digital products maintenance business, as well as the strategic refocusing of the Corporation's systems integration business, partially offset by growth in multivendor services and operations management services.

The Corporation's operating results in fiscal 1997 were adversely impacted by the continued strengthening of the U.S. dollar. Removing the effects of foreign currency exchange rate movements, the decline in revenue for fiscal 1997 would have been 7%, compared with 10% as reported. The net effect of foreign currency exchange rate movements on revenues was insignificant in fiscal 1996 when compared with fiscal 1995.

During fiscal 1997, the Corporation sold certain software products and other assets. The Corporation continues to sell certain of these software products under royalty agreements. Revenues from the software products sold by the Corporation had an immaterial impact on consolidated operating revenues. During fiscal 1996, the Corporation sold its learning services business and several small businesses. During fiscal 1995, the Corporation sold portions of its storage business, its relational database business, a software distribution subsidiary, a contract manufacturing business and a semiconductor facility. In addition, as part of the Corporation's restructuring actions, the Corporation transferred part of its business in Germany to a new, independent, employee-owned company, effective October 1, 1994. In fiscal 1994, the divested businesses represented 8% of consolidated operating revenues and did not have a material effect on the consolidated net loss from operations (see Note J).

Domestic and non-U.S. revenues
Domestic ■ Non-U.S.
Dollars in billions



Expenses and profit margins

The Corporation's total gross margin for fiscal 1997 was 33% of total operating revenues, unchanged from fiscal 1996 and up from 32% in fiscal 1995.

Gross margin (dollars in billions)

Fiscal year	1997	1996	1995
Product sales	$ 2.5	$ 2.8	$ 2.2
% of related revenues	35%	34%	29%
Service revenues	$ 1.8	$ 2.0	$ 2.2
% of related revenues	31%	32%	36%

The Corporation's gross margin on fiscal 1997 product sales was 35%, compared with 34% and 29% of product sales for fiscal 1996 and 1995, respectively. The continued improvement in product gross margin was due principally to manufacturing cost efficiencies and improved cycle times, an increased proportion of higher-margin server revenues, and the effect of more competitive product offerings.

Gross margin on service revenues was 31% in fiscal 1997, compared with 32% and 36% of service revenues for fiscal 1996 and 1995, respectively. The decline in service gross margin in fiscal 1997 and fiscal 1996 compared with the prior year was due principally to improved product reliability, investments in service delivery capabilities and the continued shift in the mix of service revenues toward lower-margin service offerings. During fiscal 1997, service gross margins stabilized for the first time since fiscal 1994.

Operating expenses (dollars in billions)

Fiscal year	1997	1996	1995
Research & engineering expenses	$ 1.0	$ 1.1	$ 1.0
% of total revenues	8%	7%	8%
Selling, general and administrative expenses	$ 3.2	$ 3.4	$ 3.3
% of total revenues	24%	23%	24%
Restructuring charges	–	$ 0.5	–
% of total revenues	–	3%	–

Research and engineering (R&E) spending totaled $1.0 billion for fiscal 1997, compared with $1.1 billion and $1.0 billion in fiscal 1996 and 1995, respectively. The slight decrease in R&E expenses in fiscal 1997 was due principally to the Corporation's withdrawal from certain non-strategic businesses and the elimination of related development costs (see Note J). The Corporation believes that its level of R&E spending is appropriate to support current operations and to offer competitive, market-driven products.

Selling, general and administrative (SG&A) expenses totaled $3.2 billion, down from $3.4 billion in fiscal 1996 and $3.3 billion in fiscal 1995. The decline in fiscal 1997 SG&A expenses reflects reductions in population and facilities expenditures, reduced variable costs and the positive effects of currency rate movements, partially offset by increases in salaries and wages and investment in demand generation activities. The Corporation's efforts to achieve a competitive cost structure and further increase productivity are ongoing. For fiscal 1996, SG&A expenses reflected increased variable costs associated with higher revenue levels, increases in salaries and wages and administrative systems investments, partially offset by the favorable effects of restructuring actions taken in the first half of fiscal 1995.

During fiscal 1997, the Corporation amended its U.S. postretirement medical plan, changing the eligibility requirement, and therefore the period over which benefits are earned and accrued. As a result of the amendment, the Corporation recognized a one-time curtailment gain of $52 million (see Note G). In addition, the shift of employees to managed care and other factors had a significant favorable impact on the Corporation's postretirement medical expense during fiscal 1997. The impact of these items was substantially offset by the write-off of certain intangible assets and other provisions.

At the end of fiscal 1996, the Corporation approved a restructuring plan intended to increase sales productivity, further consolidate manufacturing plants and distribution sites, improve service delivery and further reduce overhead in support areas. The planned employee separations are expected to be substantially complete in fiscal 1998. The number of involuntary separations is expected to be lower than originally planned due principally to a higher than anticipated level of voluntary separations. However, associated restructuring-related cost savings are expected to be offset by an increase in estimated separation costs for certain non-U.S. employees. The total estimated cost of restructuring actions is unchanged. See Note E for a further description of the Corporation's restructuring actions and related costs.

Total employee population decreased by 4,200 during fiscal 1997 to approximately 54,900. The Corporation had approximately 59,100 and 61,700 employees at the end of fiscal 1996 and 1995, respectively.

Expenses and profit margins *(continued)*

Net other income was $48 million for fiscal 1997 and 1996, respectively, compared with net other expense of $40 million in fiscal 1995. Net gains on divestments were $18 million for fiscal 1997, compared with $72 million in fiscal 1996 and a net loss of $7 million in fiscal 1995. The decrease in net gains from divestments in fiscal 1997 was offset by increased interest income resulting from significantly higher cash and short-term investment balances and lower interest expense.

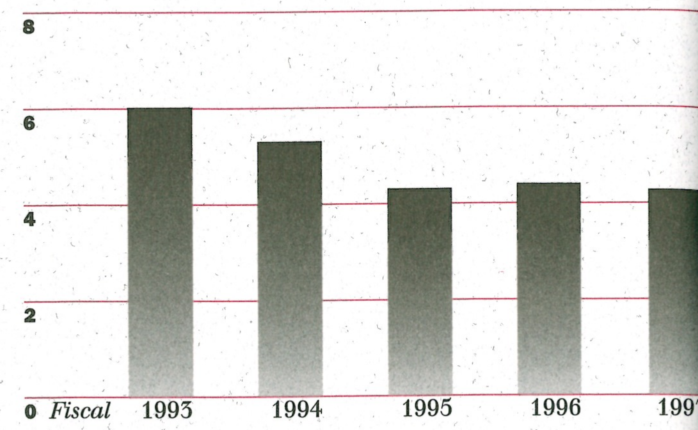
In fiscal 1997, income tax expense was $37 million on pre-tax income of $178 million. Income tax expense reflects several factors, including income taxes for profitable operations, benefits taken from net operating loss carryforwards and an inability to recognize currently certain tax benefits from operating losses. Income tax expense was $44 million on a pre-tax loss of $68 million in fiscal 1996 and $18 million on pre-tax income of $76 million in fiscal 1995. See Note C for a further explanation of income tax expense.

In June 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 130–Reporting Comprehensive Income. SFAS No. 130 requires the reporting and display, in a full set of general-purpose financial statements, of all items that are required to be recognized under accounting standards as components of comprehensive income. SFAS No. 130 is effective for financial statements issued for periods beginning after December 15, 1997 and reclassification of financial statements for earlier periods for comparative purposes is required. The adoption of SFAS No. 130 will have an immaterial impact on the consolidated financial statements.

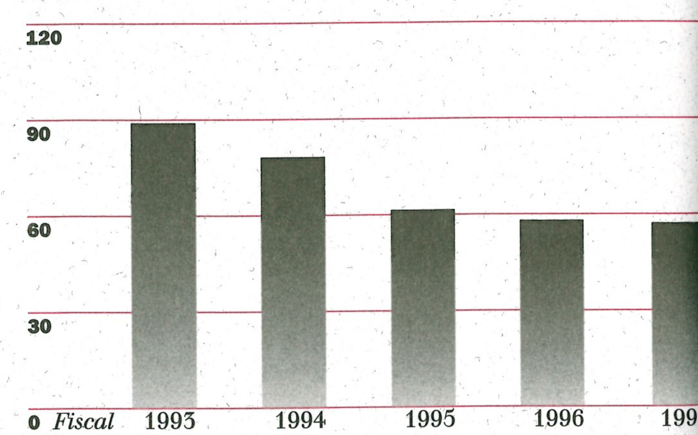
In February 1997, the FASB issued SFAS No. 128–Earnings per Share. SFAS No. 128 establishes standards for computing and presenting earnings per share (EPS) and requires a dual presentation of basic and dilutive EPS. SFAS No. 128 is effective for financial statements issued for periods ending after December 15, 1997 and earlier adoption is not permitted. Neither basic nor dilutive EPS as calculated in accordance with SFAS No. 128 would be materially different from primary EPS as presented in these financial statements.

In January 1997, the Securities and Exchange Commission issued Financial Reporting Release No. 48 which expands disclosure requirements for certain derivative and other financial instruments. The Corporation adopted the sensitivity analysis approach effective in the fourth quarter of fiscal 1997. The sensitivity analysis approach presents the hypothetical change in fair value resulting from hypothetical changes in market rates. See Notes A and I for a description of the Corporation's use of derivative and other financial instruments and the related market risk.

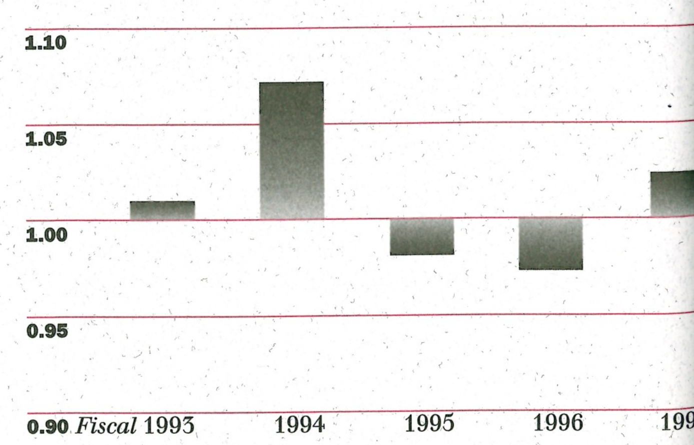
Operating expenses
Dollars in billions, excluding restructuring charges



Employees
Thousands of employees



U.S. dollar relative to major foreign currencies
Fiscal 1991 equals 1.00



Availability of funds to support current and future operations and spending for operations

Cash, cash equivalents and short-term investments totaled $2.5 billion, $2.0 billion and $1.6 billion at the end of fiscal 1997, 1996 and 1995, respectively (see Note A).

Cash flows from (in billions)

Fiscal year	1997	1996	1995
Operating activities	$ 1.0	$ 0.6	$(0.3)
Investing activities	(1.2)	(0.5)	0.6
Operating and investing activities	(0.2)	0.1	0.3
Financing activities	(0.2)	0.2	0.1
Total cash flows	$(0.4)	$ 0.3	$ 0.4

Net cash generated from operating activities was $1.0 billion in fiscal 1997, compared with $602 million in fiscal 1996 and net cash used of $348 million in fiscal 1995. The $424 million improvement in cash generated from operating activities in fiscal 1997 was principally due to a $293 million decrease in accounts receivable in fiscal 1997 compared with an increase of $4 million in fiscal 1996 and a $318 million decrease in inventories in fiscal 1997 compared with a decrease of $181 million in fiscal 1996. The $950 million improvement in cash generated from operating activities in fiscal 1996 was principally due to a $181 million decrease in inventories in fiscal 1996 compared with an increase of $272 million in fiscal 1995, and a lower level of restructuring related expenditures in fiscal 1996 compared with fiscal 1995.

Net cash used for investing activities was $1.2 billion in fiscal 1997, compared with $492 million in fiscal 1996 and net cash generated (including divestments) of $638 million in fiscal 1995. The increase in cash used for investing activities was due principally to short-term investment activities (see Note A). The Corporation increased its short-term investments by $913 million, $177 million and $31 million in fiscal 1997, 1996 and 1995, respectively. In fiscal 1997, the sale of property, plant and equipment and other assets generated proceeds of approximately $120 million. Capital spending in fiscal 1997 was $396 million compared with $431 million and $366 million in fiscal 1996 and 1995, respectively. In fiscal 1996, the Corporation sold its learning services business and several small businesses generating proceeds of $156 million and the sale of property, plant and equipment generated an additional $73 million in cash. In fiscal 1995, the Corporation sold all of its shares of Ing. Olivetti & C. S.p.A. common stock, portions of its storage business, its relational database business, a software distribution subsidiary, a contract manufacturing business, a semiconductor facility, property, plant and equipment and other assets generating approximately $1.1 billion in cash proceeds (see Note J).

Net cash used for financing activities was $254 million in fiscal 1997, compared with net cash generated of $150 million and $100 million in fiscal 1996 and 1995, respectively. The principal financing activity for fiscal 1997 was the open market purchase of 10 million shares of the Corporation's common stock for $354 million and the payment of dividends on preferred stock, partially offset by the issuance of stock under the Corporation's employee stock plans. In July 1997, the Corporation's Board of Directors authorized the repurchase, as conditions warrant, of up to 15 million shares of the Corporation's common stock.

Long-term debt was $743 million at the end of fiscal 1997, compared with approximately $1.0 billion at the end of fiscal 1996 and 1995. During fiscal 1997, $250 million of five-year notes due in November 1997 were reclassified from long-term debt to current portion of long-term debt. At the end of fiscal 1997, substantially all of the Corporation's available lines of credit and accounts receivable securitization facilities were unused (see Note F).

For fiscal 1997, cash expenditures for restructuring activities were $184 million, net of proceeds of $67 million from the sale of properties. Future cash expenditures for currently planned restructuring activities are estimated to be $360 million for fiscal 1998 and beyond, the majority of which will be used in fiscal 1998. While expected total cash expenditures for restructuring actions remain unchanged, actual cash outlays have been delayed due to the timing of certain employee separations, principally in Europe (see Note E).

The Corporation's need for, cost of and access to funds are dependent on future operating results, as well as conditions external to the Corporation. The Corporation historically has maintained a conservative capital structure, and believes that its cash position and its sources of and access to capital markets are adequate to support current operations.

Factors that may affect future results

From time to time, information provided by the Corporation or statements made by its employees may contain "forward-looking" information, as that term is defined in the Private Securities Litigation Reform Act of 1995 (the "Act"). The Corporation cautions investors that there can be no assurance that actual results or business conditions will not differ materially from those projected or suggested in such forward-looking statements as a result of various factors, including but not limited to the following:

- The Corporation's future operating results are dependent on its ability to develop, produce and market new and innovative products and services. There are numerous risks inherent in this complex process, including rapid technological change, the Corporation's ability to access components and related technical information from other companies and the requirement that the Corporation bring to market in a timely fashion new products and services which meet customers' changing needs.

- Historically, the Corporation has generated a disproportionate amount of its operating revenues toward the end of each quarter, making precise prediction of revenues and earnings particularly difficult and resulting in risk of variance of actual results from those forecast at any time. In addition, the Corporation's operating results historically have varied from fiscal period to fiscal period; accordingly, the Corporation's financial results in any particular fiscal period are not necessarily indicative of results for future periods.

- The Corporation offers a broad variety of products and services to customers around the world. Changes in the mix of products and services comprising revenues could cause actual operating results to vary from those expected.

- The Corporation's success is partly dependent on its ability to successfully predict and adjust production capacity to meet demand, which is partly dependent upon the ability of external suppliers to deliver components at reasonable prices and in a timely manner; capacity or supply constraints, or unexpected increases or decreases in the prices of components, could adversely affect future operating results.

- While the Corporation believes that the materials required for its manufacturing operations are presently available in quantities sufficient to meet demand, the failure of a significant supplier to deliver certain components or technical information on a timely basis or in sufficient quantities could adversely affect the Corporation's future results of operations.

- The Corporation operates in a highly competitive environment which includes significant competitive pricing pressures and intense competition for skilled employees. Particular business segments may from time to time experience unanticipated intense competitive pressure, possibly causing operating results to vary from those expected.

- The Corporation offers its products and services directly and through indirect distribution channels. Changes in the financial condition of, or the Corporation's relationship with, distributors and other indirect channel partners, as well as fluctuations in end-user sales by indirect sales channel partners, could cause actual operating results to vary from those expected.

- The Corporation does business worldwide in over 100 countries. Global and/or regional economic factors and potential changes in laws and regulations affecting the Corporation's business, including without limitation, currency fluctuations, changes in monetary policy and tariffs, and federal, state and international laws regulating the environment, could impact the Corporation's financial condition or future results of operations.

- As the Corporation continues to implement its strategic plan and respond to external market conditions, there can be no assurance that additional restructuring actions will not be required. With regard to completion of planned restructuring actions, there can be no assurance that the estimated cost of such actions will not change.

- The market price of the Corporation's securities could be subject to fluctuations in response to quarter to quarter variations in operating results, changes in analysts' earnings estimates, market conditions in the information technology industry, as well as general economic conditions and other factors external to the Corporation.

Report of management

The Corporation's management is responsible for the preparation of the financial statements in accordance with generally accepted accounting principles and for the integrity of 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 the Corporation's policies. This system includes policies which require adherence to ethical business standards and compliance with all laws to which the Corporation 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 Corporation's independent accountants annually review the accounting and control systems of the Corporation. Their audit includes a review of the internal control structure to the extent they consider necessary and selective tests of transactions to support their report.

The Board of Directors, through its Audit Committee, which is composed of four Board members who are independent of management, is responsible for determining that management fulfills its responsibility with respect to the Corporation's financial statements and the system of internal accounting controls.

The Audit Committee meets regularly with representatives of management, the independent accountants and the Corporation's internal auditors to review audits, financial reporting and internal control matters, and when appropriate, meets with the Corporation's outside counsel on relevant matters. The independent accountants and the internal auditors have full and free access to the Audit Committee and regularly meet privately with the Audit Committee.

Coopers & Lybrand L.L.P., independent accountants, have been engaged by the Audit Committee of the Board of Directors, with the approval of the stockholders, to audit the Corporation's financial statements. Their report follows.

RB Palmer

Robert B. Palmer
Chairman of the Board, President and Chief Executive Officer

Vincent J Mullarkey

Vincent J. Mullarkey
Vice President, Finance and Chief Financial Officer

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 June 28, 1997 and June 29, 1996, and the related consolidated statements of operations, cash flows, and stockholders' equity for each of the three fiscal years in the period ended June 28, 1997. These financial statements are the responsibility of the Corporation'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 June 28, 1997 and June 29, 1996, and the consolidated results of its operations and cash flows for each of the three fiscal years in the period ended June 28, 1997, in conformity with generally accepted accounting principles.

As discussed in Note J to the consolidated financial statements, the Corporation changed its method of accounting for certain investments in debt and equity securities in fiscal 1995.

Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P.

Boston, Massachusetts
July 24, 1997

Consolidated statements of operations

(in thousands except per share data)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
Revenues *(Notes A and B)*			
Product sales	$ 7,197,116	$ 8,362,423	$ 7,616,441
Service revenues	5,849,716	6,200,352	6,196,621
Total operating revenues	13,046,832	14,562,775	13,813,062
Costs and expenses *(Notes A, D, G, H and K)*			
Cost of product sales	4,697,438	5,541,792	5,397,723
Service expense	4,027,690	4,214,412	3,993,970
Research and engineering expenses *(Note J)*	1,014,044	1,062,253	1,040,028
Selling, general and administrative expenses *(Note J)*	3,177,428	3,367,806	3,265,743
Restructuring charge *(Note E)*	–	492,000	–
Operating income/(loss)	130,232	(115,488)	115,598
Other (income)/expense, net *(Notes A, F, I and J)*	(47,818)	(47,961)	39,941
Income/(loss) before income taxes and cumulative effect of change in accounting principle	178,050	(67,527)	75,657
Provision for income taxes *(Note C)*	37,175	44,285	18,342
Income/(loss) before cumulative effect of change in accounting principle	140,875	(111,812)	57,315
Benefit due to cumulative effect of change in accounting principle, net of tax *(Note J)*	–	–	(64,503)
Net income/(loss)	140,875	(111,812)	121,818
Dividends on preferred stock *(Note L)*	35,500	35,500	35,500
Net income/(loss) applicable to common stock	$ 105,375	$ (147,312)	$ 86,318
Per common share *(Note A)*			
Income/(loss) applicable before cumulative effect of change in accounting principle	$ .68	$ (.97)	$ .15
Benefit due to cumulative effect of change in accounting principle	–	–	.44
Net income/(loss) applicable per common share *(Note A)*	$ .68	$ (.97)	$ .59
Weighted average common shares outstanding *(Note A)*	155,458	152,052	146,331

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

Consolidated balance sheets

(dollars in thousands)

	June 28, 1997	June 29, 1996
Assets		
Current assets:		
Cash and cash equivalents *(Note A)*	$ 1,358,750	$ 1,791,754
Short-term investments *(Note A)*	1,160,265	247,404
Accounts receivable, net of allowances of $263,763 and $182,033	2,930,014	3,223,293
Inventories *(Note A)*	1,503,145	1,820,811
Prepaid expenses, deferred income taxes and other current assets *(Note C)*	324,122	336,836
Total current assets	7,276,296	7,420,098
Net property, plant and equipment *(Note A)*	2,103,647	2,222,920
Other assets *(Notes A, C, and D)*	312,951	432,363
Total assets	$ 9,692,894	$ 10,075,381
Liabilities and stockholders' equity		
Current liabilities:		
Bank loans and current portion of long-term debt *(Note F)*	$ 262,835	$ 17,896
Accounts payable	871,760	903,618
Income taxes payable *(Note C)*	101,286	79,528
Salaries, wages and related items	637,587	632,413
Deferred revenues and customer advances *(Note A)*	1,079,003	1,099,328
Accrued restructuring costs *(Note E)*	382,559	619,416
Other current liabilities	905,900	879,434
Total current liabilities	4,240,930	4,231,633
Long-term debt *(Note F)*	743,440	999,131
Postretirement and other postemployment benefits *(Note G)*	1,163,568	1,238,411
Total liabilities	6,147,938	6,469,175
Commitments and contingencies *(Note H)*		
Stockholders' equity *(Notes K, L and M)*:		
Preferred stock, $1.00 par value (liquidation preference of $100 per share); authorized 25,000,000 shares; 4,000,000 shares of Series A 8⅞% Cumulative Preferred Stock issued and outstanding	4,000	4,000
Common stock, $1.00 par value; authorized 450,000,000 shares; 157,232,104 shares issued and 155,504,284 shares issued and outstanding	157,232	155,504
Additional paid-in capital	3,835,697	3,764,224
Retained deficit	(234,841)	(317,522)
Treasury stock at cost; 6,132,201 shares and 0 shares	(217,132)	–
Total stockholders' equity	3,544,956	3,606,206
Total liabilities and stockholders' equity	$ 9,692,894	$ 10,075,381

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

Consolidated statements of cash flows

(in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
Cash flows from operating activities			
Net income/(loss)	$ 140,875	$ (111,812)	$ 121,818
Adjustments to reconcile net income/(loss) to net cash from operating activities:			
Depreciation	406,895	405,859	507,966
Amortization	53,828	74,346	67,624
(Gain)/loss on disposition and write-down of other assets *(Notes A and J)*	33,664	(71,941)	(57,333)
Other adjustments to income/(loss)	66,668	10,708	(34,576)
(Increase)/decrease in accounts receivable	293,279	(4,211)	42,862
(Increase)/decrease in inventories	317,666	180,761	(272,037)
(Increase)/decrease in prepaid expenses and other current assets	16,447	47,002	(17,862)
Decrease in accounts payable	(31,858)	(209,542)	(49,517)
Increase in taxes *(Note C)*	15,428	23,609	16,813
Increase/(decrease) in salaries, wages, benefits and related items *(Note G)*	(69,669)	151,370	31,306
Increase/(decrease) in deferred revenues and customer advances	(20,325)	(123,028)	544
Increase/(decrease) in accrued restructuring costs *(Note E)*	(236,857)	127,370	(859,029)
Increase in other current liabilities	40,412	101,724	153,911
Total adjustments	885,578	714,027	(469,328)
Net cash flows from operating activities	1,026,453	602,215	(347,510)
Cash flows from investing activities			
Investment in property, plant and equipment	(395,691)	(431,307)	(365,551)
Proceeds from the disposition of property, plant and equipment *(Notes E and J)*	87,769	73,083	208,505
Purchases of short-term investments	(3,684,299)	(340,415)	(117,050)
Maturities of short-term investments	2,771,438	163,310	85,924
Investment in other assets	(16,913)	(112,532)	(37,687)
Proceeds from the disposition of other assets *(Note J)*	32,222	155,971	863,468
Net cash flows from investing activities	(1,205,474)	(491,890)	637,609
Net cash flows from operating and investing activities	(179,021)	110,325	290,099
Cash flows from financing activities			
Proceeds from issuance of debt	6,240	–	13,253
Payments to retire debt	(18,080)	(11,241)	(29,336)
Purchase of treasury shares	(354,111)	–	–
Issuance of common and treasury shares, including tax effects	147,468	196,321	151,643
Dividends paid	(35,500)	(35,500)	(35,500)
Net cash flows from financing activities	(253,983)	149,580	100,060
Net increase/(decrease) in cash and cash equivalents	(433,004)	259,905	390,159
Cash and cash equivalents at beginning of year	1,791,754	1,531,849	1,141,690
Cash and cash equivalents at end of year *(Note A)*	$ 1,358,750	$ 1,791,754	$ 1,531,849

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

Consolidated statements of stockholders' equity

(dollars in thousands)

	Preferred stock	Common stock	Additional paid-in capital	Retained deficit	Treasury stock	Total stockholders' equity
July 2, 1994	$ 4,000	$ 142,287	$ 3,390,040	$ (256,528)	$ –	$ 3,279,799
Shares issued under stock plans		7,491	143,993			151,484
Restricted stock plans, charge to operations			10,679			10,679
Dividends declared–preferred stock				(35,500)		(35,500)
Net income–1995				121,818		121,818
July 1, 1995	4,000	149,778	3,544,712	(170,210)	–	3,528,280
Shares issued under stock plans		5,726	190,595			196,321
Restricted stock plans, charge to operations			28,917			28,917
Dividends declared–preferred stock				(35,500)		(35,500)
Net loss–1996				(111,812)		(111,812)
June 29, 1996	4,000	155,504	3,764,224	(317,522)	–	3,606,206
Purchase of 10,000,000 shares of treasury stock					(354,111)	(354,111)
Shares issued under stock plans (5,595,619 shares issued, of which 3,867,799 issued from treasury)		1,728	31,455	(22,694)	136,979	147,468
Restricted stock plans, charge to operations			40,018			40,018
Dividends declared–preferred stock				(35,500)		(35,500)
Net income–1997				140,875		140,875
June 28, 1997	$ 4,000	$ 157,232	$ 3,835,697	$ (234,841)	$ (217,132)	$ 3,544,956

See *Notes K, L* and *M* of *Notes to consolidated financial statements.*
Cash dividends on common stock have never been paid by the Corporation.

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 Corporation include the financial statements of the parent and its majority-owned U.S. and non-U.S. subsidiaries. All significant intercompany accounts and profits have been eliminated. Certain prior years' amounts have been reclassified to conform with the current year presentation.

Use of estimates The preparation of the Corporation's financial statements requires management to make estimates and judgments that affect the reported consolidated statements of operations and consolidated balance sheets and related disclosures. Actual results could differ from those estimates.

Fiscal year The fiscal year of the Corporation is the 52/53 week period ending the Saturday nearest the last day of June. The fiscal years ended June 28, 1997, June 29, 1996 and July 1, 1995 included 52 weeks.

Translation of foreign currencies For non-U.S. operations, the U.S. dollar is the functional currency. Monetary assets and liabilities of foreign subsidiaries are translated into U.S. dollars at current exchange rates. Nonmonetary assets and liabilities such as inventories, property, plant and equipment and deferred revenues and customer advances are translated at historical rates. Income and expense items are translated at average exchange rates prevailing during the year, except that inventories and depreciation charged to operations are translated at historical rates. Exchange gains and losses arising from translation are included in current income.

Revenue recognition Revenues from product sales are generally recognized at the time the product is shipped. Provisions for product sales returns and allowances are recorded in the same period as the related revenue. Service revenues are recognized ratably over the contractual period or as the services are performed.

Warranty Warranty service revenues are recognized ratably over the warranty period; warranty-related costs are recognized as incurred. The Corporation also provides warranty coverage as a product attribute on certain products. Estimated costs to repair such products are accrued as product cost when the product is shipped.

Net income/(loss) applicable per common share Per common share amounts are calculated based on the weighted average number of common shares and common share equivalents outstanding during periods of net income, after deducting applicable preferred stock dividends. Common share equivalents are attributable to stock options. Per share amounts are calculated based only on the weighted average number of common shares outstanding during periods of net loss, after deducting applicable preferred stock dividends.

Cash, cash equivalents and short-term investments The Corporation considers all highly liquid temporary cash investments with maturities of three months or less at date of acquisition to be cash equivalents. Cash equivalents are valued at cost plus accrued interest, which approximates market. Investments with maturities greater than three months mature within six months of the balance sheet date and are classified as short-term investments. Short-term investments are valued at cost plus accrued interest, which approximates market. The Corporation's practice is to hold these investments to maturity.

Inventories Inventories are stated at the lower of cost (first-in, first-out) or market. Inventories are routinely subject to changes in value, resulting from rapid technological change, intense price competition and changes in customer demand patterns. While the Corporation has provided for estimated declines in market value of inventories, no estimate can be made of a range of amounts of loss that are reasonably possible under various competitive conditions.

(in thousands)	**June 28, 1997**	June 29, 1996
Raw materials	$ 421,984	$ 536,911
Work-in-process	350,421	439,318
Finished goods	730,740	844,582
Total inventories	$ 1,503,145	$ 1,820,811

Note A: Significant accounting policies *(continued)*

Property, plant and equipment Property, plant and equipment are stated at cost, subject to review of impairment for significant assets whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

(in thousands)	**June 28, 1997**	June 29, 1996
Land	$ 193,722	$ 218,659
Buildings	1,381,568	1,384,819
Leasehold improvements	319,264	325,120
Machinery and equipment	2,973,994	3,191,512
Total property, plant and equipment	4,868,548	5,120,110
Less accumulated depreciation	2,764,901	2,897,190
Net property, plant and equipment	$ 2,103,647	$ 2,222,920

Depreciation expense is computed principally on the following bases:

Classification	*Depreciation lives and methods*
Buildings	10 to 33 years (straight-line)
Leasehold improvements	Life of assets or term of lease, whichever is shorter (straight-line)
Machinery and equipment	2 to 10 years (principally accelerated methods)

When assets are retired, or otherwise disposed of, the assets and related accumulated depreciation are removed from the accounts. Gains or losses resulting from restructuring actions are included in accrued restructuring costs. Other resulting gains and losses are included in income.

Other assets Other assets include long-term investments, capitalized software development costs, goodwill, deferred taxes and other intangible assets.

Software development costs are capitalized at the time that technological feasibility is established. These costs are amortized over no more than three years from the date the products are available for general use and are subject to periodic review of net realizable value.

Goodwill and other intangible assets are amortized using the straight-line method over the estimated useful life of the asset, subject to periodic review of impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Long-term investments are subject to periodic review of impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

Events and circumstances arising during fiscal 1997 indicated that the carrying value of certain intangible and other assets would not be recoverable. Accordingly, unamortized balances of $40.0 million were written off as a charge to operations.

Other (income)/expense, net *(in thousands)*

Year ended	**June 28, 1997**	June 29, 1996	July 1, 1995
Interest income	$ (116,151)	$ (76,438)	$ (57,497)
Interest expense	86,381	100,418	90,268
Net (gain)/loss on divestments and other assets	(18,048)	(71,941)	7,170
Other (income)/expense, net	$ (47,818)	$ (47,961)	$ 39,941

Note B: Geographic operations

Industry The Corporation operates in one business segment: the design, manufacture, sale and service of networked computer systems.

Non-U.S. operations Sales and marketing operations outside the United States are conducted primarily through sales subsidiaries throughout the world; by direct sales from the parent corporation; and through various distributorship

Note B: Geographic operations *(continued)*

arrangements and value-added resellers. The Corporation's non-U.S. manufacturing operations include plants in Canada, Europe and Asia-Pacific. The products of these manufacturing plants are sold to the Corporation'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 intended to be representative of unaffiliated party transactions.

Sales to unaffiliated customers outside the United States, including U.S. export sales, were $8.7 billion, $9.6 billion, and $9.0 billion for fiscal 1997, 1996 and 1995, respectively, which represented 67%, 66% and 65%, respectively, of total operating revenues.

(in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
Net revenues			
United States:			
Unaffiliated customer sales	$ 4,396,636	$ 5,126,405	$ 4,816,024
Inter-area transfers	1,467,175	1,381,671	1,426,305
	5,863,811	6,508,076	6,242,329
Europe:			
Unaffiliated customer sales	5,484,767	6,137,495	5,973,188
Inter-area transfers	315,317	703,289	792,277
	5,800,084	6,840,784	6,765,465
Canada, Latin America, Asia-Pacific:			
Unaffiliated customer sales	3,165,429	3,298,875	3,023,850
Inter-area transfers	1,224,294	2,138,800	2,081,764
	4,389,723	5,437,675	5,105,614
Eliminations	(3,006,786)	(4,223,760)	(4,300,346)
Net revenue	$ 13,046,832	$ 14,562,775	$ 13,813,062
Income/(loss)			
United States	$ 140	$ 45,707	$ (231,180)
Europe	142,280	(137,546)	236,641
Canada, Latin America, Asia-Pacific	35,630	24,312	70,196
Eliminations	(47,818)	(47,961)	39,941
Operating income/(loss)	130,232	(115,488)	115,598
Other (income)/expense, net	(47,818)	(47,961)	39,941
Income/(loss) before income taxes and cumulative effect of change in accounting principle	$ 178,050	$ (67,527)	$ 75,657
Assets			
United States	$ 3,752,689	$ 3,739,570	$ 3,924,941
Europe	2,985,397	3,174,933	3,321,429
Canada, Latin America, Asia-Pacific	2,058,492	2,002,943	2,335,236
Corporate assets	2,519,015	2,039,158	1,602,148
Eliminations	(1,622,699)	(881,223)	(1,236,602)
Total assets	$ 9,692,894	$ 10,075,381	$ 9,947,152

Note C: Income taxes

Income/(loss) before income taxes and cumulative effect of change in accounting principle (in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
U.S.	$ 140	$ 41,204	$ (231,180)
Non-U.S.	177,910	(108,731)	306,837
Total	$ 178,050	$ (67,527)	$ 75,657

Reconciliation of U.S. federal statutory rate to actual tax rate

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
U.S. federal statutory tax (benefit) rate	35.0%	(35.0)%	35.0%
Tax benefit of manufacturing operations in[1]:			
Ireland	(6.6)	(17.9)	(40.2)
Singapore	(9.4)	(4.9)	(12.6)
Tax impact due to net loss carryforward position:			
U.S.	4.8	(10.2)	106.9
Non-U.S.	11.4	160.2	(93.2)
Non-U.S. tax rates	(14.4)	(24.9)	27.3
Other	0.1	(1.7)	1.0
Effective tax rate	20.9%	65.6%	24.2%

[1]The income from products manufactured for export by the Corporation's manufacturing subsidiary in Ireland is subject to a 10% tax rate through December 2010. The income from certain products manufactured by the Corporation's manufacturing subsidiary in Singapore was taxed at 15% through December 1995 and is taxed at 10% from January 1996 through December 1998.

Components of provisions for (benefits from) U.S. federal and non-U.S. income taxes (in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
U.S. federal:			
Current	$ 8,659	$ 6,104	$ –
Deferred	(2,888)	(1,971)	(7,318)
Total	5,771	4,133	(7,318)
Non-U.S.:			
Current	32,477	28,636	48,388
Deferred	(4,144)	9,309	(26,260)
Total	28,333	37,945	22,128
State income taxes	3,071	2,207	3,532
Total income taxes	$ 37,175	$ 44,285	$ 18,342

Note C: Income taxes *(continued)*

Significant components of deferred tax assets and liabilities (in thousands)

Year ended	June 28, 1997		June 29, 1996	
	Assets	Liabilities	Assets	Liabilities
Inventory-related transactions	$ 120,296	$ 5,656	$ 113,663	$ 7,761
Depreciation	60,317	11,038	59,276	33,474
Deferred warranty revenue	93,611	–	96,943	1,343
Postretirement/postemployment benefits	398,757	5,729	468,662	12,528
Restructuring	166,426	31,538	296,296	20,680
Tax loss carryforwards	1,239,826	–	1,426,648	–
Tax credit carryforwards	202,204	–	192,928	–
Intangible assets	40,083	–	48,465	14,269
Research and engineering	659,733	–	503,826	–
Other	224,711	29,936	222,217	50,274
Gross deferred tax balances	3,205,964	83,897	3,428,924	140,329
Valuation allowance	3,006,425	–	3,179,283	–
Net deferred tax balances	$ 199,539	$ 83,897	$ 249,641	$ 140,329

The gross deferred tax asset from tax loss carryforwards of $1.2 billion represents $3.4 billion of net operating loss carryforwards on a tax return basis which will generally expire as follows: $66.5 million in 1998, $162.2 million in 1999, $151.2 million in 2000, $144.3 million in 2001, $92.9 million in 2002, $472.0 million in 2007, $577.0 million in 2008, and the remainder thereafter.

Tax credit carryforwards will generally expire as follows: $20.0 million in 2001, $50.0 million in 2002, $70.0 million in 2003, $20.0 million in 2004, and the remainder thereafter.

The reduction in the valuation allowance of $172.9 million is primarily attributed to the reduction in the gross deferred tax balances.

Tax benefit arising from previously unrecognized operating loss carryforwards amounted to approximately $96.0 million and $190.0 million for fiscal 1997 and 1996, respectively.

The Corporation has recorded net deferred tax assets of approximately $116.0 million at June 28, 1997, reflecting primarily the benefit of net operating loss carryforwards in certain countries. Realization is dependent on generating sufficient future taxable income to utilize the assets. Although realization is not assured, management believes it is more likely than not that the assets will be realized.

In fiscal 1997, 1996 and 1995, net income taxes paid were approximately $32.1 million, $18.5 million and $3.0 million, respectively.

In general, the Corporation'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. The accumulated retained earnings for foreign subsidiaries aggregated $2.0 billion at June 28, 1997. Applicable taxes are provided only on amounts planned to be remitted. It is not practicable to estimate the amount of additional tax that might be payable on the foreign earnings.

Note D: Capitalized computer software development costs

Unamortized computer software development costs were $64.0 million and $93.4 million at June 28, 1997 and June 29, 1996, respectively. Amortization expense was $39.4 million, $48.4 million and $59.3 million for fiscal 1997, 1996 and 1995, respectively. Accumulated amortization was $75.1 million and $160.8 million at June 28, 1997 and June 29, 1996, respectively.

Note E: Restructuring actions

Accrued restructuring costs and charges include the cost of involuntary employee separation benefits, facility closures and related costs associated with restructuring actions. Employee separation benefits include severance, wage continuation, notice pay, medical and other benefits. Facility closure and related costs include disposal costs for property, plant and equipment, lease payments and related costs. Restructuring costs were accrued and charged to expense in accordance with approved management plans.

As a result of initiatives to increase sales productivity, further consolidate manufacturing plants and distribution sites, improve service delivery and further reduce overhead in support areas, the Corporation accrued a restructuring charge of $492.0 million in the fourth quarter of fiscal 1996.

The cost of employee separations associated with the fiscal 1996 charge included separation benefits then estimated for approximately 7,000 employees, as well as employee separation benefits incurred in the fourth quarter of fiscal 1996. The majority of the remaining employee separations will come from administrative and overhead functions, located in Europe and the United States. Most other organizations and functions also will be affected by the planned reduction in employees. The fiscal 1996 charge also included costs associated with the closure of an additional 3.5 million square feet of office and manufacturing space, principally in the United States and Europe.

During fiscal 1997, restructuring actions resulted in approximately 2,100 employee separations. The number of involuntary separations was less than originally planned due principally to a higher level of voluntary separations. However, associated cost savings are expected to be offset by an increase in estimated separation costs for certain non-U.S. employees. The total estimated cost of restructuring actions is unchanged. The planned employee separations are expected to be substantially complete in fiscal 1998.

The Corporation's experience in property dispositions has been consistent with the restructuring plan provided for in fiscal 1996. In the past three fiscal years, the Corporation has sold 7.4 million square feet of space and reduced space under lease by 6.9 million square feet.

As the Corporation continues to implement its strategic plan and respond to external market conditions, there can be no assurance that additional restructuring actions will not be required. With regard to the completion of planned restructuring actions, there can be no assurance that the estimated cost of such actions will not change.

Accrued restructuring costs (in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
Balance, beginning of year	$ 619,416	$ 492,046	$ 1,351,075
Charges to operations:			
Employee separations	–	363,000	–
Facility closures and related costs	–	129,000	–
Total charges to operations	–	492,000	–
Costs incurred:			
Employee separations	119,997	153,025	507,816
Facility closures and related costs	104,683	177,593	323,029
Other	12,177	34,012	28,184
Total costs incurred	236,857	364,630	859,029
Balance, end of year	$ 382,559	$ 619,416	$ 492,046
Cash expenditures:			
Employee separations	$ 135,373	$ 175,839	$ 562,629
Facility closures and related costs, net of proceeds	48,816	61,000	(38,850)
Net cash expenditures	$ 184,189	$ 236,839	$ 523,779
Number of employee separations due to restructuring actions	2,100	2,400	7,400

Note F: Debt

Long-term debt, exclusive of current maturities (in thousands)

	Maturity date (Calendar year)	Interest rate	June 28, 1997	June 29, 1996
Lease obligations	1998–2002	5.31%–10.95%[1]	$ 5,337	$ 12,034
Notes[2]	1997	7%	–	250,000
Notes[2]	2002	7 1/8%	250,000	250,000
Debentures[2]	2012	8 5/8%	250,000	250,000
Debentures[2]	2023	7 3/4%	250,000	250,000
Unamortized discount and commissions[2]			(12,050)	(13,138)
Other debt obligations			153	235
Total long-term debt, exclusive of current maturities			$ 743,440	$ 999,131

[1] *Weighted average interest rate of 7.6% at June 28, 1997 and June 29, 1996.*

[2] *The Notes and Debentures are not redeemable prior to maturity and are not entitled to any sinking fund. The unamortized discount and commissions relate to these Notes and Debentures.*

Principal payments during the next five fiscal years are as follows: 1998 – $255.9 million; 1999 – $0.9 million; 2000 – $0.9 million; 2001 – $2.9 million; 2002 – $0.8 million. During fiscal 1997, $250.0 million of five-year notes due in November 1997 were reclassified from long-term debt to current portion of long-term debt.

In fiscal 1997, 1996 and 1995, interest paid was $85.9 million, $116.2 million and $86.2 million, respectively.

The Corporation had available lines of credit totaling $310.3 million and $315.4 million as of June 28, 1997 and June 29, 1996, respectively. Substantially all of these lines of credit were unused at the end of fiscal 1997 and 1996. Commitment fees on the unused lines of credit were immaterial.

In June 1994, the Corporation entered into a five-year agreement with a major financial institution (i) providing for the transfer and sale by the Corporation to a wholly-owned subsidiary of the Corporation of a designated pool of domestic trade accounts receivable (the "Receivables"), and (ii) allowing the Corporation to sell to a group of investors an undivided ownership interest in the Receivables for proceeds of up to $600.0 million (the "Purchase Limit"). The agreement includes annual commitment fees up to a maximum of 0.2% of the Purchase Limit. During the third quarter of fiscal 1995, the Corporation elected to amend the Purchase Limit under the agreement from $600.0 million to $500.0 million.

As of June 28, 1997 and June 29, 1996, no interests in the Receivables had been sold.

In May 1995, Digital Equipment Co. Limited, a wholly-owned subsidiary of the Corporation incorporated in the United Kingdom, entered into a five-year agreement with a major financial institution allowing it to sell an undivided ownership interest in a designated pool of trade accounts receivable (the "UK Receivables") to a group of investors for proceeds of up to approximately $133.8 million (80 million pounds sterling). Commitment fees under the agreement are immaterial. As of June 28, 1997 and June 29, 1996, no interests in the UK Receivables had been sold.

In October 1996, Digital Equipment France S.A.R.L., a wholly-owned subsidiary of the Corporation incorporated in France, renewed for a second one-year period its agreement with a major financial institution allowing it to sell an interest in a designated pool of trade accounts receivable (the "France Receivables") to a group of investors for proceeds of up to approximately $43.1 million (250 million French francs). Commitment fees under the agreement are immaterial. As of June 28, 1997 and June 29, 1996, no interests in the France Receivables had been sold.

Note G: Postretirement and other postemployment benefits

Pension plans The Corporation and its subsidiaries have defined benefit and defined contribution pension plans covering substantially all employees. The benefits are based on years of service and compensation during the employee's career. Pension cost is based on estimated benefit payment formulas.

It is the Corporation's policy to make tax-deductible contributions to the plans in accordance with plan provisions and local laws. For the U.S. pension plan, there were no contributions in fiscal 1997, 1996 or 1995. The assets of the plans include corporate equity and debt securities, government securities and real estate.

In December 1995, the Board of Directors approved an amendment to the Corporation's U.S. pension plan effective March 1, 1996. Pursuant to the amendment to the plan, the defined pension benefit is based on an account balance comprised of a percentage of pay for each year of service and interest credited on the cumulative balance. Prior to March 1, 1996, the benefit plan was calculated based on a percentage of the employee's earnings during service to the Corporation.

As a result of the amendment, the vested and accumulated benefit obligations of the pension plan more closely approximate the projected benefit obligation. The amendment did not have a material effect on the consolidated statement of operations or on the consolidated balance sheet. There was no cash flow impact from the amendment to the U.S. plan.

The decline in pension cost before curtailment and settlement gains in fiscal 1997 reflects the positive effects of increased returns on invested pension assets and restructuring activities.

The net periodic pension cost for defined contribution pension plans was $33.7 million, $32.4 million and $6.8 million for fiscal 1997, 1996 and 1995, respectively. The Corporation initiated contributions to the U.S. 401(k) plan on July 1, 1995 which resulted in increased costs for the Corporation's defined contribution plans in fiscal 1996.

The measurement dates for all plans were within 90 days of year-end.

Components of net periodic pension cost (in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
Service cost for benefits earned during the period	$ 131,008	$ 138,069	$ 156,112
Interest cost on projected benefit obligations	217,637	202,385	182,363
Actual return on plan assets	(547,331)	(512,244)	(344,486)
Net amortization and deferral	258,166	256,324	91,251
Net periodic pension cost before curtailment and settlement gains	59,480	84,534	85,240
Curtailment and settlement gains	(1,280)	(5,159)	–
Net periodic pension cost for defined benefit pension plans	$ 58,200	$ 79,375	$ 85,240
Total pension cost for all pension plans	$ 92,822	$ 112,769	$ 95,249

Significant actuarial assumptions for pension plans

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
U.S. pension plan:			
Discount rate	7.75%	8.00%	7.50%
Expected long-term rate of return on plan assets	9.50%	9.00%	9.00%
Rate of increase in future compensation levels	5.00%	5.00%	5.00%
Non-U.S. pension plans:			
Discount rate	3.50–8.50%	4.00– 9.30%	5.00– 9.50%
Expected long-term rate of return on plan assets	4.50–9.50%	4.00–10.00%	6.00–10.00%
Rate of increase in future compensation levels	2.00–6.50%	2.00– 7.00%	3.00– 7.00%

Funded status of pension plans as of the year-end measurement date (in thousands)

Year ended	June 28, 1997	June 29, 1996
Actuarial present value of benefit obligations:		
Vested benefit obligation	$ (2,695,564)	$ (2,433,935)
Accumulated benefit obligation	$ (2,867,883)	$ (2,566,869)
Projected benefit obligation	$ (3,109,380)	$ (2,875,815)
Plan assets at fair value	3,637,062	3,305,529
Over-funded projected benefit obligation	527,682	429,714
Unrecognized net gain	(1,006,745)	(858,279)
Unrecognized prior service cost	44,747	54,454
Unrecognized net transition asset	(71,167)	(76,232)
Pension liability recognized on the balance sheet	$ (505,483)	$ (450,343)

Postretirement benefits other than pensions The Corporation has defined benefit postretirement plans that provide medical and dental benefits for U.S. retirees and their eligible dependents. Substantially all of the Corporation's U.S. employees may become eligible for postretirement benefits if they reach retirement age while working for the Corporation. The majority of the Corporation's non-U.S. subsidiaries do not offer postretirement benefits other than pensions to retirees.

The Corporation's postretirement benefit plans other than pensions are funded as costs are incurred.

Unrecognized net gains in excess of the underlying accumulated postretirement benefits obligation have been generated due to a shift to managed care and declining health care cost trends and employee population. Unrecognized gains or losses are amortized over the average expected service period of plan participants, provided that the unrecognized gains or losses do not exceed a certain percentage of the accumulated postretirement benefits obligation, after which the gains and losses are recognized immediately.

During the second quarter of fiscal 1997, the Corporation amended its U.S. postretirement medical plan to provide full retiree medical benefits only to employees working ten years after age 45. As a result of the amendment, the Corporation recognized a one-time curtailment gain of $52.3 million. The change to the plan had an immaterial cash flow impact to the Corporation.

Components of net periodic postretirement benefits cost/(credit) (in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
Service cost for benefits earned during the period	$ 11,593	$ 10,987	$ 18,455
Interest cost on accumulated postretirement benefits obligations	27,397	30,707	41,279
Actual return on plan assets	–	–	–
Net amortization and deferral	(94,274)	(16,871)	(9,919)
Net periodic postretirement benefits cost before curtailment gains	(55,284)	24,823	49,815
Curtailment gains	(52,706)	(2,230)	(20,741)
Net periodic postretirement benefits cost/(credit)	$ (107,990)	$ 22,593	$ 29,074

Significant actuarial assumptions for postretirement benefits plans (dollars in thousands)

Year ended	June 28, 1997	June 29, 1996	July 1, 1995
U.S. plans:			
Discount rate	7.75%	8.00%	7.50%
Health care cost trend rate, current year	5.50%	5.50%	7.00%
Health care cost trend rate, ultimate year	5.00%	5.00%	5.50%
Trend rate decreases to the ultimate rate in the year	2004	2004	2005
Effect of a 1% increase in the trend rate:			
Increase in accumulated postretirement benefits obligation	$ 61,315	$ 64,819	$ 100,617
Increase in net periodic postretirement benefits cost	$ 7,262	$ 7,326	$ 13,645
Non-U.S. plans:			
Discount rate	4.50– 8.50%	5.00– 8.50%	5.00– 8.50%
Health care cost trend rate, current year	0.00–12.00%	4.00–12.00%	4.00–11.00%
Health care cost trend rate, ultimate year	0.00– 7.00%	4.00– 7.00%	4.00– 7.00%
Trend rates decrease to the ultimate rates in the years	2003	1996–2004	1995–2006
Effect of a 1% increase in the trend rate:			
Increase in accumulated postretirement benefits obligation	$ 1,094	$ 2,196	$ 8,072
Increase in net periodic postretirement benefits cost	$ 226	$ 407	$ 1,043

Funded status of postretirement benefits plans as of the year-end measurement date (in thousands)

Year ended	June 28, 1997	June 29, 1996
Accumulated postretirement benefits obligations:		
Retirees	$ (267,939)	$ (273,908)
Fully eligible plan participants	(23,025)	(6,582)
Other active plan participants	(67,152)	(142,617)
Unfunded accumulated postretirement benefits obligation	(358,116)	(423,107)
Unrecognized net gain	(147,972)	(212,646)
Unrecognized prior service credit	(74,558)	(84,929)
Other postretirement benefits liability recognized on the balance sheet	$ (580,646)	$ (720,682)

Note H: Commitments, contingencies and risk factors

Lease commitments 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 year	*(in thousands)*
1998	$ 239,094
1999	268,904
2000	124,968
2001	91,163
2002	71,993
Later years	289,794
Total minimum lease payments	$ 1,085,916

Total rental expense for fiscal 1997, 1996 and 1995 was $199.9 million, $259.3 million and $282.1 million, respectively.

Commitments The Corporation has entered into agreements with another company to provide the Corporation with services in support of its normal operations. The minimum payments for these agreements approximate $96.0 million in fiscal 1998, $88.0 million in fiscal 1999 and $67.0 million per annum in fiscal years 2000 through 2005.

Litigation Several purported class action lawsuits were filed against the Corporation during the fourth quarter of fiscal 1994 alleging violations of the Federal securities laws arising from alleged misrepresentations and omissions in connection with the Corporation's issuance and sale of Series A 8⅞% Cumulative Preferred Stock (the "Series A Preferred Stock") and the Corporation's financial results for the quarter ended April 2, 1994. During fiscal 1995, the lawsuits were consolidated into three cases, which were pending before the United States District Court for the District of Massachusetts. On August 8, 1995, the Massachusetts federal court granted the defendants' motion to dismiss all three cases in their entirety. On May 7, 1996, the United States Court of Appeals for the First Circuit affirmed in part and reversed in part the dismissal of the two cases, and remanded for further proceedings.

The Corporation and Intel Corporation ("Intel") are involved in litigation commenced in the fourth quarter of fiscal 1997 in the U.S. District Courts of Massachusetts and Northern California claiming, respectively, willful infringement by Intel of certain of the Corporation's patents through the manufacture, sale and use of Intel's families of Pentium microprocessors, and breach of contract and various other unfair or unlawful business practices by the Corporation. The two lawsuits are in an early stage, with the parties in the process of answering the respective claims, asserting defenses and filing counterclaims.

Risk factors The broad diversity of the Corporation's products, service offerings, customers and geographic operations mitigate the risk that a severe impact will occur in the near term as a result of changes in its customer base, competition, or composition of its markets.

While the Corporation believes that the materials required for its manufacturing operations are presently available in quantities sufficient to meet demand, the failure of a significant supplier to deliver certain components or technical information on a timely basis or in sufficient quantities could adversely affect the Corporation's future results of operations.

Note I: Financial instruments

Foreign exchange options In the ordinary course of business, the Corporation purchases foreign exchange option contracts to limit potential losses from adverse exchange rate movements on certain anticipated local currency transactions. The contracts are primarily in weighted aggregates of European currencies, Japanese yen and Australian dollars and generally have maturities which do not exceed three months. Premiums to purchase foreign exchange option contracts are amortized over the life of the contract and are included in selling, general and administrative expenses. Unamortized premiums are included in prepaid assets. Gains on option contracts, if any, are included in product and service revenues in the period in which the related local currency revenues are reported.

Foreign exchange forwards In the ordinary course of business, the Corporation enters into foreign exchange forward contracts to mitigate the effect of foreign currency movements on the U.S. dollar value of monetary asset and liability positions of non-U.S. subsidiaries. The contracts are primarily in European currencies, Japanese yen and Australian dollars and generally have maturities which do not exceed three months. Gains and losses on contracts are included in selling, general and administrative expenses in the period in which the exchange rates change.

With respect to foreign exchange option and forward contracts, there were no deferred gains or losses at June 28, 1997. The Corporation does not hold or issue foreign exchange option or forward contracts for trading purposes.

Interest rate swaps During the first quarter of fiscal 1994, the Corporation entered into interest rate swap agreements, with maturities of up to 10 years, to manage its exposure to interest rate movements by effectively converting a portion of its long-term debt from fixed to variable rates. The net face amount of interest rate swaps subject to variable rates as of June 28, 1997 and June 29, 1996 was $250.0 million. These agreements involve the exchange of fixed rate payments for variable rate payments without the effect of leverage and without the exchange of the underlying face amount. Fixed interest rate payments are at a weighted average rate of 5.73%. Variable rate payments are based on six month U.S. dollar LIBOR. Interest rate differentials paid or received under these agreements are recognized over the six month period as adjustments to interest expense. Gains and losses on terminated swap agreements are amortized over the original life of the agreements as adjustments to interest expense. Unamortized deferred losses are included in prepaid assets and totaled $12.9 million as of June 28, 1997. The Corporation does not hold or issue interest rate swap agreements for trading purposes.

Fair value The carrying amounts reflected in the consolidated balance sheets for cash, cash equivalents, short-term investments, accounts receivable, bank loans, current portion of long-term debt and accounts payable approximate fair value due to the short maturities of these instruments. The fair values for long-term debt and hedging instruments are based on dealer quotes for those instruments. The fair values represent estimates of possible value which may not be realized in the future.

The face amount of hedging instruments does not necessarily represent amounts exchanged by the parties and thus is not a direct measure of the exposure of the Corporation through its use of hedging instruments. The amounts exchanged are calculated on the basis of face amounts and other terms of the hedging instruments, which relate to interest rates, foreign exchange rates or other financial indexes.

The fair value of the Corporation's long-term debt and hedging instruments are subject to change as a result of potential changes in market rates and prices. The potential change in fair value for interest rate sensitive instruments is based on a hypothetical immediate 1% point increase in interest rates across all maturities; the potential loss in fair value for foreign exchange rate sensitive instruments are based on a hypothetical immediate 10% increase in U.S. dollar per local currency exchange rates across all maturities. The Corporation's use of this methodology to quantify the market risk of such instruments should not be construed as an endorsement of its accuracy or the accuracy of the related assumptions. The quantitative information about market risk is necessarily limited because it does not take into account operating transactions, anticipated hedging instruments, pensions and other postretirement benefits. The potential loss for purchased foreign exchange option contracts is limited to the premium paid.

Fair value of financial instruments (in thousands)

	Face amount[1]	Carrying amount[1]	Fair value[1]	Hypothetical loss in fair value[1] (Unaudited)
June 28, 1997				
Long-term debt	$ (755,490)	$ (743,440)	$ (717,380)	$ 54,298
Hedging instruments:				
Option contracts	727,645	4,399	425	(297)
Forward contracts	1,322,236	(17,881)	(10,732)	(126,309)
Interest rate swaps	250,000	12,940	(12,285)	(11,313)
June 29, 1996				
Long-term debt	$(1,012,269)	$ (999,131)	$ (979,892)	$ 60,518
Hedging instruments:				
Option contracts	691,151	884	494	(385)
Forward contracts	886,015	(267)	(1,952)	(70,638)
Interest rate swaps	250,000	15,404	(16,540)	(12,509)

[1]*Asset/(liability)*

Concentration of credit risk Financial instruments which potentially subject the Corporation to concentrations of credit risk consist principally of temporary cash and short-term investments, trade receivables and hedging instruments.

Note I: Financial instruments *(continued)*

The Corporation places its temporary cash and short-term investments with high credit qualified financial institutions and, by policy, limits the amount of credit exposure to any one financial institution.

The Corporation sells a significant portion of its products through third-party resellers and as a result maintains individually significant accounts receivable balances from various major resellers. If the financial condition and operations of these resellers were to deteriorate, the Corporation's operating results could be adversely affected. Total receivables for the ten largest resellers approximated 10% of total accounts receivable at June 28, 1997.

Concentrations of credit risk with respect to other trade receivables are limited due to the large number of customers comprising the Corporation's customer base, and their dispersion across many different industries and geographies. The Corporation performs ongoing credit evaluations of its customers and generally does not require collateral.

The Corporation is exposed to credit-related losses in the event of nonperformance by counterparties to hedging instruments. The counterparties to these contracts are major financial institutions. The Corporation continually monitors its positions and the credit ratings of its counterparties and limits the amount of contracts it enters into with any one party.

Note J: Investing and divesting activities

During fiscal 1997, the Corporation sold certain software products and other assets generating $32.2 million of proceeds. The Corporation continues to sell certain of the software products under royalty agreements. Revenue from sales of divested software products represented an immaterial amount of the consolidated operating revenues.

During fiscal 1996, the Corporation sold its learning services business and several small businesses. During fiscal 1995, the Corporation sold portions of its storage business, its relational database business, a software distribution subsidiary, a contract manufacturing business and a semiconductor manufacturing facility. Prior to sale and in total the divested businesses represented approximately 8% of fiscal 1994 consolidated operating revenues and did not have a material effect on the consolidated net loss from operations.

At the end of the second quarter of fiscal 1996, the Corporation sold its learning services business to Welsh, Carson, Anderson & Stowe for proceeds of approximately $80.0 million. Approximately 600 employees transferred with this business.

In addition, during fiscal 1996 the Corporation sold several small businesses for net proceeds of approximately $76.0 million.

At the end of the fourth quarter of fiscal 1995, the Corporation sold its South Queensferry, Scotland semiconductor facility and related assets to a subsidiary of Motorola, Inc. for net proceeds of approximately $128.0 million. Assets sold included approximately $8.0 million of inventory and $127.0 million of net property, plant and equipment. Approximately 530 employees were transferred to Motorola at the time of sale.

At the end of the third quarter of fiscal 1995, the Corporation sold its contract manufacturing business to SCI Systems, Inc. for net proceeds of approximately $75.0 million. Assets sold included approximately $47.0 million of inventory and $20.0 million of net property, plant and equipment, including a manufacturing plant in Augusta, Maine. Approximately 700 employees were transferred to SCI Systems, Inc. at the time of sale.

At the beginning of the second quarter of fiscal 1995, the Corporation sold its magnetic disk drive, tape drive, solid state disk and thin film heads businesses (the "Business") to Quantum Corporation ("Quantum") for an aggregate purchase price of $360.0 million, generating net proceeds of $348.0 million. Assets sold included approximately $180.0 million of inventory and $154.0 million of net property, plant and equipment, including facilities in Shrewsbury, Massachusetts and Penang, Malaysia, as well as the Corporation's interest in Rocky Mountain Magnetics, Inc. Quantum is leasing facilities owned by the Corporation in Colorado Springs, Colorado and leased by the Corporation in Batam, Indonesia. Approximately 3,100 employees were transferred to Quantum upon sale of the Business.

Also during the second quarter of fiscal 1995, the Corporation sold its relational database business and related assets to Oracle Corporation for net proceeds of $107.0 million. Approximately 250 employees were transferred to Oracle Corporation at the time of sale.

The Corporation adopted Statement of Financial Accounting Standards No. 115–Accounting for Certain Investments in Debt and Equity Securities, effective July 3, 1994. In fiscal 1995, the Corporation recorded a one-time unrealized gain of $64.5 million or $.44 per common share related to the value of Ing. Olivetti & C. S.p.A. ("Olivetti") common stock. Subsequently, in the same year, the Corporation sold all of its shares of Olivetti stock for approximately $149.0 million, thereby realizing the gain. The cash flow effect is included in the (gain)/loss on disposition and write-down of other assets in the *Statement of cash flows*.

Note K: Stock plans

Stock options and awards Under its Equity Plans, the Corporation has awarded restricted stock to certain officers and key employees. Under such Equity Plans and its Restricted Stock Option Plans, the Corporation has granted options to certain officers and key employees to purchase common stock at a price determined by the Board of Directors. Shares purchased under the plans are either subject to repurchase options and restrictions on sales which lapse over an extended time period not exceeding 10 years, or become exercisable ratably over periods of up to five years. At June 28, 1997, 5,515,234 options to purchase shares were exercisable at prices ranging from $19.25 to $153.00.

The excess, if any, of the fair market value of shares on the measurement date over the exercise price is charged to operations each year as the restrictions lapse.

In May 1994, the Board of Directors approved a program to offer employees of the Corporation (other than executive officers of the Corporation) the opportunity to exchange their outstanding stock options for new options to purchase a reduced number of shares of common stock at a per share exercise price equal to the fair market value of the common stock on the date the program was approved (the "Regrant Program"). Under the Regrant Program, outstanding options granted between 1985 and 1993 to purchase up to 11,854,084 shares of common stock with an average exercise price of $59.43 per share could be exchanged for new options to purchase up to 4,554,870 shares with an exercise price of $22.88 per share. The new options vest over four years and have a seven-year term. As of July 3, 1994 options to purchase 5,765,914 shares had been exchanged and cancelled for new options to purchase a total of 2,328,910 shares. During fiscal 1995, an additional 4,476,977 shares were exchanged and canceled for new options to purchase a total of 1,663,430 shares. No further exchanges may occur under this program. No compensation expense was reversed as a result of the Regrant Program. Future expense associated with options canceled, and not replaced by new options under the Regrant Program, will no longer be recognized, resulting in an expense reduction of approximately $31.0 million over fiscal years 1995 to 1998.

Employee stock options and awards

	Shares reserved for future grants	Shares	Average price per share
July 2, 1994	3,037,373	14,934,229	$ 49.59
Additional shares available for grant	2,134,306	–	–
Options granted	(2,781,930)	2,781,930	25.42
Shares awarded	(897,680)	–	–
Options exercised	–	(677,299)	26.58
Options canceled	3,278,129	(3,278,129)	35.73
Options terminated	(1,748,323)	–	–
Regrant program:			
Canceled	4,476,977	(4,476,977)	59.26
Terminated	(2,479,767)	–	–
Regrant	(1,663,430)	1,663,430	22.88
July 1, 1995	3,355,655	10,947,184	$ 41.01
Additional shares available for grant	2,246,664	–	–
Options granted	(3,197,920)	3,197,920	44.11
Shares awarded	(493,635)	–	–
Shares forfeited	86,317	–	–
Options exercised	–	(1,984,600)	29.62
Options canceled	865,196	(865,196)	41.93
Options terminated	(233,542)	–	–
June 29, 1996	2,628,735	11,295,308	$ 43.81
Additional shares available for grant	**3,110,086**	**–**	**–**
Options granted	**(3,750,800)**	**3,750,800**	**36.30**
Shares awarded	**(654,105)**	**–**	**–**
Shares forfeited	**151,114**	**–**	**–**
Options exercised	**–**	**(647,222)**	**21.01**
Options canceled	**2,187,519**	**(2,187,519)**	**46.88**
Options terminated	**(767,950)**	**–**	**–**
June 28, 1997	**2,904,599**	**12,211,367**	**$ 42.17**

Employee stock purchase plans Under the Corporation's Employee Stock Purchase Plans (ESPP), all U.S. and certain non-U.S. 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 employee purchases aggregated 7,261,138 shares at June 28, 1997. There were 4,445,406 shares issued at an average price of $30.76 per share during the year ended June 28, 1997; 3,341,316 shares issued at an average price of $41.58 per share during the year ended June 29, 1996; and 6,085,154 shares issued at an average price of $21.96 per share during the year ended July 1, 1995. There have been no charges to income in connection with these Plans other than incidental expenses related to the issuance of the shares. Federal income tax benefits relating to such Plans, if any, have been credited to additional paid-in capital.

Stock option plans for non-employee directors The 1990 Stock Option Plan for Non-Employee Directors provided for a one-time grant of an option to purchase 5,000 shares of the Corporation's common stock to non-employee directors. The exercise price of an option is the fair market value per share of common stock of the Corporation on the date the option is granted. An aggregate of 100,000 shares of common stock were authorized for issuance under the Plan, of which 55,000 are subject to options granted under the plan at an average purchase price of $48.23 per share. The options become exercisable at the rate of 20% per year, with credit given for past service. None of these options had been exercised as of June 28, 1997. No additional options may be granted under this plan subsequent to adoption of the 1995 Stock Option Plan for Non-Employee Directors.

The 1995 Stock Option Plan for Non-Employee Directors, which was approved on November 9, 1995, provides for annual grants to purchase 2,500 shares of the Corporation's common stock to non-employee directors, who are initially elected to office subsequent to January 1, 1995. The plan provides for annual grants to purchase 1,000 shares of the Corporation's common stock to non-employee directors elected to office prior to January 1, 1995. The exercise price of an option is the fair market value per share of common stock of the Corporation on the date the option is granted. An aggregate of 95,000 shares of common stock are authorized for issuance under the Plan, of which 20,000 are subject to options granted under the plan at an average purchase price of $45.14 per share. The options become exercisable ratably over three years. None of these options had been exercised as of June 28, 1997. Effective on the date of the 1997 Annual Meeting of Stockholders, non-employee directors will receive an annual stock option grant to purchase either 6,000 shares or 3,500 shares, depending upon the age of the non-employee director and on the date of commencement of service as a non-employee director.

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123–Accounting for Stock-Based Compensation. SFAS No. 123 encourages, but does not require, companies to recognize compensation costs for all stock-based compensation arrangements using a fair value method of accounting. Alternatively, SFAS No. 123 permits a company to continue accounting for these arrangements under Accounting Principles Board Opinion No. 25–Accounting for Stock Issued to Employees, accompanied by footnote disclosure of the pro forma net income and earnings per share had the new rules been applied. The Corporation adopted the alternative approach under SFAS No. 123 as of the first day of fiscal 1997. Accordingly, no compensation expense has been recognized for the Corporation's stock-based compensation plans other than for restricted stock. If the Corporation had elected to recognize compensation expense based on the fair value of the options at the date of grant for awards granted in fiscal 1997 and 1996 the Corporation's net income/(loss) and earnings/(loss) per common share would have approximated the pro forma amounts indicated below:

(in thousands, except per share data)

Year ended	**June 28, 1997**	June 29, 1996
Pro forma net income/(loss) applicable to common stock	**$ 36,198**	$ (188,040)
Pro forma net income/(loss) applicable per common share	**$ 0.23**	$ (1.24)

The weighted-average fair value of each option granted in fiscal 1997 and 1996 is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Stock Option Plans		Employee Stock Purchase Plans	
Fiscal year	**1997**	1996	**1997**	1996
Risk-free interest rate	**6.3%**	6.2%	**5.3%**	5.4%
Life in years	**3.6**	3.6	**0.5**	0.5
Volatility	**35%**	35%	**35%**	35%
Dividend yield	**0%**	0%	**0%**	0%

The weighted average fair value at date of grant for awards granted in fiscal 1997 and 1996 are as follows:

Fiscal year	**1997**	1996
Stock options	**$ 12.63**	$ 15.37
Stock awards	**$ 39.64**	$ 47.96
ESPP	**$ 9.16**	$ 12.62

The pro forma net income/(loss) for fiscal 1997 and 1996 may not be representative of the pro forma net income/(loss) of future years because the SFAS No. 123 method of accounting for pro forma compensation expense has not been applied to options granted prior to July 2, 1995.

Stock options outstanding at June 28, 1997

	Options outstanding			*Options exercisable*	
Range of exercise prices	Shares outstanding	Weighted average remaining contractual life	Weighted average exercise price	Shares exercisable	Weighted average exercise price
$19.25 to $ 19.99	1,097,657	7.28	$19.65	637,603	$19.62
$20.00 to $ 29.99	2,395,118	5.32	$24.20	1,310,980	$22.91
$30.00 to $ 39.99	3,100,105	9.03	$37.52	108,499	$34.05
$40.00 to $ 49.99	3,230,377	7.70	$43.32	1,520,688	$43.68
$50.00 to $ 59.99	401,454	7.01	$55.90	238,820	$57.21
$60.00 to $ 69.99	33,500	8.61	$62.90	11,055	$62.90
$70.00 to $153.00	2,028,156	2.36	$78.03	1,687,589	$78.28
Total	12,286,367	6.63	$42.21	5,515,234	$46.98

Note L: Stockholders' equity

On January 21, 1994, the Corporation filed with the Securities and Exchange Commission a shelf registration statement on Form S-3 under the Securities Act of 1933, as amended, covering the registration of debt securities, preferred stock, depositary shares, and warrants to purchase equity and debt securities, in an aggregate amount of $1.0 billion. In March 1994, the Corporation issued and sold 16 million Depositary Shares under the shelf registration statement, each representing a one-fourth interest in a share of the Corporation's Series A 8⅞% Cumulative Preferred Stock (the "Series A Preferred Stock"), par value $1.00 per share. Dividends on the Series A Preferred Stock accrue at the annual rate of 8⅞%, or $35.5 million per year. At June 28, 1997, there were declared and unpaid dividends of $8.9 million. These dividends were paid on July 15, 1997.

The Series A Preferred Stock was offered to the public at $100 per share ($25 per Depositary Share) for a total of $400.0 million, leaving a balance of $600.0 million available for future issuance under the shelf registration. The net proceeds of $387.0 million from the Series A Preferred Stock offering was used for working capital and other general corporate purposes. The Series A Preferred Stock is not convertible into, or exchangeable for, shares of any other class or classes of stock of the Corporation. The Series A Preferred Stock is not redeemable prior to April 1, 1999. On or after April 1, 1999, the Corporation, at its option, may redeem shares of the Series A Preferred Stock, as a whole or in part, for cash at the redemption price per share of $100 ($25 per Depositary Share), plus accrued and unpaid dividends to the redemption date. Upon dissolution, liquidation or the winding up of the affairs of the Corporation, the holders of the Series A Preferred Stock will be entitled to receive $100 per share ($25 per Depositary Share), plus accrued and unpaid dividends, before any distribution to holders of the Corporation's common stock.

The Corporation adopted a Stockholder Rights Plan in December 1989 pursuant to which the Corporation authorized the distribution of one Common Stock Purchase Right ("Right") for each share of outstanding common stock. Under certain conditions, each Right may be exercised for one share of common stock at an exercise price of $400, subject to adjustment. Under circumstances defined in the Plan, the Rights entitle holders to purchase stock having a value of twice the exercise price of the Rights. Until they become exercisable, the Rights are not transferable apart from the common stock. The Rights may be redeemed by the Corporation at any time prior to the occurrence of certain events at $.01 per Right. The Plan will expire on December 21, 1999, unless the Rights are earlier redeemed by the Corporation.

The Corporation purchased on the open market 10 million shares of its common stock at an aggregate purchase price of $354.1 million. All of the acquired shares were held as common stock in treasury, of which 3.9 million shares were subsequently issued to employees under stock plans. The difference between the average acquisition cost of the shares and the proceeds from issuance is charged to retained earnings.

Note M: Subsequent event

In July 1997, the Board of Directors authorized the repurchase, as conditions warrant, of up to 15 million shares of the Corporation's common stock.

Supplementary information

Quarterly financial data *(unaudited)*

(in millions except per share data)[1]	Total operating revenues	Gross profit	Income/(loss) before income taxes	Net income/(loss)	Income/(loss) per common share[2]
For the year ended June 28, 1997					
Fourth quarter	$ 3,463	$ 1,199	$ 141	$ 124	$ .75
Third quarter	3,314	1,106	62	51	.27
Second quarter	3,358	1,104	37	32	.15
First quarter	2,912	912	(62)	(66)	(.48)
Total year	$ 13,047	$ 4,322	$ 178	$ 141	$ .68
For the year ended June 29, 1996					
Fourth quarter	$ 3,719	$ 1,212	$ (432)	$ (433)	$ (2.87)
Third quarter	3,621	1,252	138	124	.74
Second quarter	3,951	1,288	170	149	.91
First quarter	3,271	1,054	57	48	.26
Total year	$ 14,563	$ 4,807	$ (68)	$ (112)	$ (.97)

[1] *Amounts may not be additive due to rounding.*
[2] *The sum of the quarters' earnings per share does not equal the year-to-date earnings per share due to changes in the weighted average share calculations.*

Operating Management and Staff Officers

*Robert B. Palmer
Chairman of the Board, President and Chief Executive Officer

*Bruce L. Claflin
Senior Vice President Worldwide Sales and Marketing

Bobby A. F. Choonavala
Vice President; President, Asia-Pacific

Hans W. Dirkmann
Vice President; President, Europe

Michael Gallup
Vice President; President, North America

Graham Long
Vice President, Global Accounts

Luis M. Zuniga
Vice President, Latin America

*Harold D. Copperman
Senior Vice President DIGITAL Products Division

R.E. Caldwell
Vice President and General Manager, DIGITAL Semiconductor

Howard Elias
Vice President and General Manager, NT Systems Business Unit

Donald Z. Harbert
Vice President, Internet Products Business Unit

Ellen J. Lary
Vice President and General Manager, Storage Products Business Unit

Jesse Lipcon
Vice President and General Manager, UNIX and OpenVMS Systems Business Unit

John F. McClelland
Vice President, Manufacturing and Distribution

Mahendra R. Patel
Vice President, Systems Engineering

Robert J. Rennick
Vice President and General Manager, Network Product Business Unit

Richard J. Fishburn
Vice President and Chief Information Officer

Charles B. Holleran
Vice President, Communications

*Ilene B. Jacobs
Vice President, Human Resources

*Vincent J. Mullarkey
Vice President, Finance and Chief Financial Officer

*Alexis Makris
Vice President and Corporate Controller

*Paul J. Milbury
Vice President and Treasurer

*John J. Rando
Senior Vice President DIGITAL Services Division

Timothy M. Leisman
Vice President and General Manager, Operations Management Services

Peter A. Mercury
Vice President and General Manager, Multivendor Customer Services Business Unit

Kannankote S. Srikanth
Vice President and General Manager, Network and Systems Integration Services

*Thomas C. Siekman
Vice President and General Counsel

Gail S. Mann
Vice President, Assistant General Counsel, Secretary and Clerk

*William D. Strecker
Vice President, Corporate Strategy and Technology and Chief Technical Officer

Samuel H. Fuller
Vice President and Chief Scientist

Robert M. Supnik
Vice President, Corporate Research and Advanced Development

*"Executive Officer" under the Securities Exchange Act of 1934.

Directors

Robert B. Palmer
Chairman of the Board,
President and Chief Executive Officer,
Digital Equipment Corporation

Vernon R. Alden
Director and Trustee of several organizations,
Former Chairman, The Boston Company, Inc.

Colby H. Chandler
Director of several corporations, Retired Chairman of the Board and Chief Executive Officer,
Eastman Kodak Company

Arnaud de Vitry
Engineering consultant and Director and Trustee of several organizations

Frank P. Doyle
Director of several corporations,
Retired Executive Vice President,
General Electric Company

Kathleen F. Feldstein
President of Economics Studies, Inc.
and Director of several corporations

Thomas P. Gerrity
Dean, Wharton School of the University of Pennsylvania and Director of several corporations

Thomas L. Phillips
Director of several corporations,
Retired Chairman of the Board
and Chief Executive Officer,
Raytheon Company

Delbert C. Staley
Director of several corporations,
Retired Chairman of the Board
and Chief Executive Officer,
NYNEX Corporation

Committees of the Board

Audit Committee
Colby H. Chandler, *Chairman*
Vernon R. Alden
Frank P. Doyle
Kathleen F. Feldstein

Compensation and Management Development Committee
Thomas L. Phillips, *Chairman*
Thomas P. Gerrity
Delbert C. Staley

Nominating Committee
Arnaud de Vitry, *Chairman*
Vernon R. Alden
Colby H. Chandler
Thomas L. Phillips

Strategic Direction Committee
Robert B. Palmer, *Chairman*
Frank P. Doyle
Thomas P. Gerrity
Delbert C. Staley

Board of Directors, Digital Equipment Corporation (left to right):
Vernon R. Alden, Kathleen F. Feldstein, Robert B. Palmer, Colby H. Chandler, Arnaud de Vitry, Thomas L. Phillips, Delbert C. Staley, Thomas P. Gerrity, Frank P. Doyle.

Corporate Consulting Engineers

Andrew Birrell
Corporate Consulting Engineer
Corporate Research and Advanced Development
Corporate Strategy and Technology

Daniel W. Dobberpuhl
Senior Corporate Consulting Engineer
DIGITAL Semiconductor
DIGITAL Products Division

Richard B. Gillett
Corporate Consulting Engineer
UNIX and OpenVMS Systems
DIGITAL Products Division

Richard B. Grove
Corporate Consulting Engineer
UNIX and OpenVMS Systems
DIGITAL Products Division

Richard J. Hollingsworth
Senior Corporate Consulting Engineer
Vice President, Semiconductor Manufacturing and Technology
DIGITAL Products Division

William A. Laing
Corporate Consulting Engineer
Corporate Research and Advanced Development
Corporate Strategy and Technology

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Systems Architecture and Storage Products
DIGITAL Products Division

Jesse Lipcon
Corporate Consulting Engineer
Vice President and General Manager, UNIX and OpenVMS Systems Business Unit
DIGITAL Products Division

Maurice P. Marks
Senior Corporate Consulting Engineer
Technical Director, DIGITAL Semiconductor
DIGITAL Products Division

Alan G. Nemeth
Corporate Consulting Engineer
UNIX and OpenVMS Systems
DIGITAL Products Division

Mahendra R. Patel
Corporate Consulting Engineer
Vice President, Systems Engineering
DIGITAL Products Division

Jeffrey A. Schriesheim
Corporate Consulting Engineer
Technology Strategy
Corporate Strategy and Technology

Robert E. Stewart
Corporate Consulting Engineer
NT Systems
DIGITAL Products Division

William D. Strecker
Senior Corporate Consulting Engineer
Vice President, Corporate Strategy and Technology
Chief Technical Officer

Robert M. Supnik
Senior Corporate Consulting Engineer
Vice President, Corporate Research and Advanced Development
Corporate Strategy and Technology

Richard T. Witek
Corporate Consulting Engineer
DIGITAL Semiconductor
DIGITAL Products Division

Investor information

Information on common stock

The Corporation's common stock (*Ticker Symbol "DEC"*) is listed and traded on the:

Chicago Stock Exchange
New York Stock Exchange
Pacific Stock Exchange
Swiss Exchange
German Stock Exchanges of Frankfurt, Munich and Berlin

Common stock price composite:
There were 53,911 shareholders of record as of June 28, 1997. The high and low quarterly sales prices for the past three fiscal years were as follows:

Fiscal quarter	*High*	*Low*
1997		
Fourth	**38½**	**25**
Third	**38¾**	**27**
Second	**41½**	**28⅜**
First	**46⅞**	**30½**
1996		
Fourth	63¼	41½
Third	76½	50⅛
Second	65	40¾
First	45⅞	35⅛
1995		
Fourth	49½	37⅜
Third	38⅞	31⅛
Second	36⅝	24⅞
First	29¼	18⅝

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. For questions on change of ownership, lost stock certificates, consolidation of accounts and change of address, please contact:

First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, New Jersey 07303-2500
Telephone: (201) 324-0498
(800) 519-3111

For change of address, send a signed and dated note or postcard to First Chicago Trust Company of New York and include the name in which the stock is registered, account number and social security number, as well as the old and new addresses.

Employee investor services:
Digital Equipment Corporation is also a stock transfer agent and registrar, and maintains employee stockholder accounting records. Inquiries of an administrative nature relative to employee stockholder accounting records and employee purchases should be directed to:

Investor Services
Digital Equipment Corporation
111 Powdermill Road MSO1-1/L12
Maynard, Massachusetts 01754
(978) 493-3703, (978) 493-5213

Eliminate duplicate mailings:
To maintain more than one account, but eliminate duplicate mailings of annual reports to the same address, send a copy of the label from a Corporate mailing to the Investor Services Department (address above), indicating the names you wish to keep on the mailing list and the names you wish to delete.

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DIGITAL Shareholder Direct:
Financial results, quarterly and annual reports and news on the Corporation's products and services is available via voice, fax or mail by calling 1-800-998-9332 (U.S., Canada and Latin America only).

DIGITAL on the Internet:
Access to Corporate and financial information is also available through the Corporation's home page on the Internet: http://www.digital.com and the DIGITAL Financial News & Investor Information home page at http://www.digital.com/info/finance.

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One Post Office Square
Boston, Massachusetts 02109
Telephone: (617) 478-5000

DIGITAL believes the customer, market and product information in this annual report is accurate as of its publication date. This information is subject to change without notice. DIGITAL is not responsible for any inadvertent errors.

DIGITAL will conduct its business in a manner that conserves the environment. As a company we have a tradition of achievement in protecting the environment and in ensuring the health and safety of our fellow employees. A copy of our Environmental Health and Safety Progress Report is accessible through DIGITAL's EHS homepage: www.digital.com/info/ehs.

digital

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Maynard, Massachusetts
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