Digital Equipment Corporation

Third Quarter Report 1984

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

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, Philadelphia Stock Exchange and Luxembourg Stock Exchange.

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

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

On the Cover: Digital's new VAX-11/785 computer, the most powerful single-processor VAX system to date.

To Our Shareholders

Total operating revenues for the third quarter ending March 31, 1984, were $1,430,765,000, up 31 percent from the $1,094,265,000 recorded in the comparable period a year ago. Net income for the quarter totaled $101,852,000 or $1.77 per share, versus $79,797,000 or $1.40 per share last year.

For the nine months ending March 31, 1984, total operating revenues were $3,928,938,000 versus $3,037,469,000 last year. Net income for the nine months was $198,189,000 or $3.46 per share, versus $197,601,000 or $3.50 per share a year ago.

The 31 percent increase in revenues over the comparable quarter a year ago was due to continued firm demand from Digital's OEM (Original Equipment Manufacturer), commercial and technical end-user customers. OEM demand, which consists of technical and commercial OEMs and components customers, was strong both in the United States and overseas. Demand was also strong for our office and information systems, which are built around ALL-IN-1, Digital's comprehensive and powerful office automation software.

Kenneth H. Olsen
President

New High-End VAX System

Soon after the close of the third quarter, Digital introduced the most powerful VAX computer system to date. The VAX-11/785 is the first single-processor system to offer higher performance than the VAX-11/780 computer.

The new VAX-11/785 system features performance equal to 150 to 170 percent of the performance of the popular VAX-11/780. The improved performance of the VAX-11/785 is the result of advanced technology for CPU circuitry and a cache memory that also boosts performance through quick access to larger amounts of frequently used data and instructions.

For the user, greater performance means more rapid execution of scientific tasks, better response for office systems, and support for a larger number of users in educational and commercial environments. The new computer is fully software-compatible with other VAX systems and uses the same architecture, packaging and peripheral equipment as the VAX-11/780.

Current VAX-11/780 users who need the additional performance of the VAX-11/785 can upgrade present systems. Upgrade kits will protect hardware and software investments in existing VAX-11/780 installations.

The VAX-11/785 can help build VAXcluster multiprocessor configurations of immense power. The more powerful the individual processors in a VAXcluster System, the more powerful the overall capabilities. With its high-speed performance and increased system capacity, the VAX-11/785 is an ideal system for use in VAXcluster configurations.

Prices for the VAX-11/785 begin at $195,000 for the basic system building blocks and range up to $399,000 for preconfigured

Digital's VAX systems comprise the industry's most popular family of 32-bit general purpose computers.

systems with a variety of VAXcluster, storage and communications options. Product availability is scheduled for September 1984.

The entire VAX family offers the widest range of compatible systems in the industry – from the MicroVAX I, priced at under $10,000, to million-dollar-plus VAXcluster Systems. The new VAX-11/785 further extends the performance and functionality of the industry's most popular family of 32-bit general purpose computers. It is the latest manifestation of the Digital style of computing that allows for ease of use, local and wide area networking, customer growth and investment protection, and customized user needs.

New VAX Software for Information Management

In conjunction with the introduction of the VAX-11/785 computer, Digital also announced major new VAX software products for information management and distribution.

VAX Rdb/VMS and VAX Rdb/ELN software are the first members of a new family of relational database products designed to simplify the storage, retrieval and updating of information – databases in which both content and relationships of data change frequently. Typical of these are information systems used in manufacturing, offices, schools and clinical laboratories. For users, the key advantages are the ease and flexibility of data retrieval.

Digital's new VAX VTX videotex system is the industry's first videotex product specifically designed to address the needs of companies and institutions to disseminate "live," useful information – about products, policies, activities, directories, customers and competition – to large numbers of computer users. The system is an easy to use, easy to maintain, cost-effective alternative to paper-based information distribution.

VAX VTX runs on all VAX computers and can be incorporated into the ALL-IN-1 office menu system. It requires no special video delivery equipment and supports all VT200 and VT100 video terminals and Digital's family of personal computers.

Deliveries of VAX Rdb/ELN are scheduled to begin in June 1984; VAX Rdb/VMS shipments will follow in August. Development license fees are $7,500 and $9,000, respectively. Full VAX VTX software is licensed at $25,000 and will be available in June 1984.

Digital Continues Support of Higher Education

Digital has implemented a unique program designed to assist universities in developing procedures to integrate personal computers into the academic environment. Fourteen universities throughout the United States are participating in the program, called PACE (Partners for the Advancement of Computers in Education).

PACE was conceived as a research and development partnership to extend the use of personal computers beyond the traditional engineering disciplines to a wider cross-section of academic applications. Through the PACE program, each participating university will acquire up to 100 Professional 350 and Rainbow 100 systems, which can then be connected to a Digital VAX computer for development work.

A major objective of the PACE program, involving over $16 million of computer equipment to support research and instruction, is to foster the development of new instructional

methods and software, while increasing student and faculty productivity.

Digital and the University of Pennsylvania have signed a major multi-million dollar cooperative technical exchange agreement. As part of the agreement, Digital will donate 500 Rainbow and Professional personal computers valued at $2.5 million. The company has also issued a matching grant of $10 million to be used by Penn for the purchase of Digital computer equipment with a value of up to $20 million.

Digital's investments in education are part of a long-term, ongoing commitment to support computing in academic communities. The company contributes to research and academic programs at colleges, universities, secondary schools and technical schools, and participates in a wide range of training programs.

The Digital Electronic Store

A new computer-based sales service allows Digital customers to select, review and purchase products electronically.

The Digital Electronic Store has been introduced at selected Fortune 500 companies and Digital Business Centers. The Store features all Digital software and third-party developed Digital Classified software, educational self-paced instruction products and Digital's Referenced Service products. Throughout the year, the Store will add hardware products, accessories and other Digital products to its current offering.

Customers reach the Store by dialing a toll-free telephone number, with access available 24 hours a day, seven days a week. They can compare product offerings, review product feature descriptions, request software demonstrations and enter their orders for the products that best fit their needs and environments. Customer response at pilot sites has been very enthusiastic.

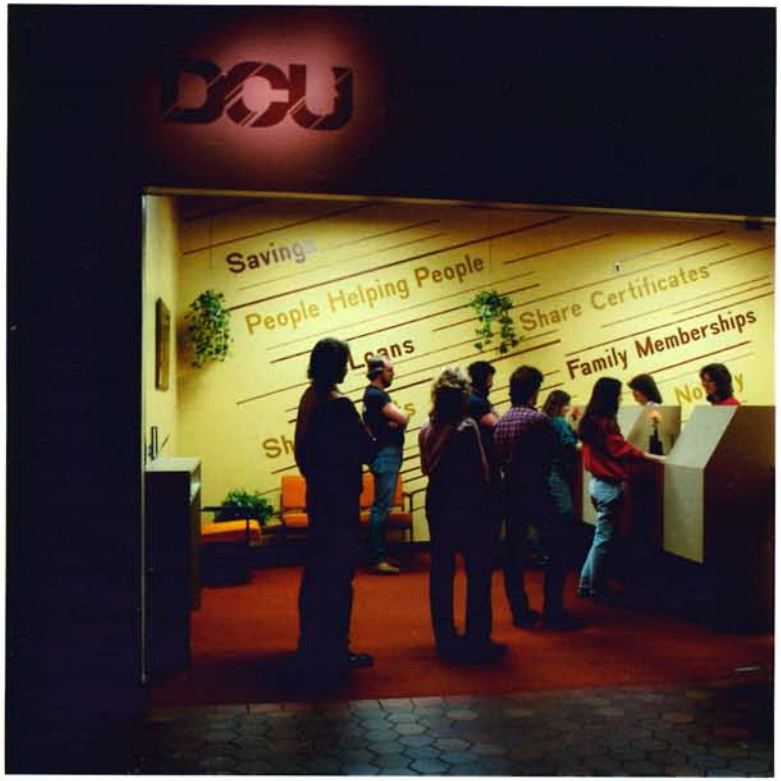
The Electronic Store provides an easy and efficient way for customers to shop for software and other products. Store users can browse for the right product, using friendly, conversational menus that focus on customer needs, or they can directly access the specific products they want.

Steady Growth and Smooth Transitions for DCU

With an eye toward continued growth guaranteed by its past successes, the Digital Employees' Federal Credit Union (DCU) is pursuing a vigorous path of upgrading its computer systems and services to meet demand.

DCU opened the doors of its first two branches in May 1980. Now, only four years later, DCU operates a 20-branch network for 57,000 members. With assets of $140,000,000, DCU ranks among the top 40 of the more than 12,000 federal credit unions in the United States.

DCU provides financial services for Digital employees, members of their families and retirees in the continental United States and Puerto Rico. Because DCU has a centralized computer system, members can now do business in person, through automated tellers or by telephone through an electronic audio response system—even if there are no branches at the members' immediate locations.



Digital Employees' Federal Credit Union currently serves 57,000 members and continues to grow.

Most credit unions serve a much smaller geographical area, and DCU's commitment to upgrading software and hardware is a direct response to the need to maintain and expand existing services. With two PDP-11/70 and two PDP-11/44 minicomputers handling its current branch office work and service load, DCU is leading the development of state-of-the-art software that will increase the office management and accounting capabilities of these systems.

Within the year, DCU will add a VAX-11/780 computer to its equipment bank and migrate the specially-developed software to that system. Eventually, a VAXcluster configuration will provide enough power to handle "unlimited" jobs—and allow for more DCU branches throughout the country.

Digital Computers Bring Automation to Florist Industry

Digital's Rainbow family of personal computers, MICRO/PDP-11 systems and terminals will tie together independent members of the Florists Transworld Delivery Association (FTD*) across the United States.

The Rainbow systems will link members of FTD through a mainframe computer and provide each participating florist with an on-site personal computer to help manage the business. The MICRO/PDP-11 systems will allow florists with multiple locations to communicate with the mainframe computer and with other branch locations in the chain.

*FTD is a registered trademark of Florists Transworld Delivery Association.

The Rainbow personal computer will help members of FTD manage their day-to-day business.

The sales agreement, the largest ever for the Rainbow family and with the potential for approximately $75 million in total equipment sales, was signed between FTD and 3 P.M. Inc. A subsidiary of McKesson Corporation, 3 P.M. Inc. is an Authorized Digital Computer Distributor that provides specialized software, training and service to meet specific customer market needs. Specially designed software from 3 P.M. Inc. will provide the FTD florists with inventory control, itemized billing and other accounting capabilities.

Digital Raises Capital in Europe and U.S.

On March 8, 1984, Digital Equipment Overseas Finance, N.V., a Netherlands Antilles subsidiary of Digital Equipment Corporation, issued $150 million of 11¾ percent guaranteed Notes, due 1989, which were unconditionally guaranteed by Digital.

Offered at 100 percent of the principal amount, the Notes are listed on the Luxembourg Stock Exchange. The proceeds to the issuer from this offering were lent to Digital Equipment Corporation, to be used for general corporate purposes. The offering was made by a group of European financial institutions headed by Lehman Brothers Kuhn Loeb International, Inc. This offering constituted Digital's first financing venture outside the United States.

Soon after the close of the quarter, on April 12, Digital issued $200 million of Senior Debt in the United States in two pieces: $100 million in 10-year 12⅝ percent Notes and $100 million in 30-year 13 percent Sinking Fund Debentures. Lehman Brothers managed the underwriting of both issues, and proceeds will be used for general corporate purposes.

Additional Highlights

- Digital has announced an agreement with General Electric Company for distribution of Digital's printers, terminals and personal computer products. General Electric's Instrumentation and Computer Service Department leases, installs and maintains computing and data communication equipment and networks. The department has service locations throughout the United States.
- During the third quarter Digital reached a major milestone for the Rainbow series of personal computers. There are now over 1,000 software packages available for the Rainbow.
- Digital reached another milestone during the quarter with the sale of its 25,000th VAX computer. Citicorp, New York, will use the VAX-11/780 as part of Citibank's worldwide financial accounting system. The first VAX computer sold by Digital was installed in 1978 at Carnegie-Mellon University.
- A new video monitor enables users to interact with computer systems simply by touching the screen. The DECtouch touch-screen monitor is designed for use in place of the VR241 color monitor in a Professional 350 workstation. It is intended for applications in education, the office, laboratories, computer-aided-design and other areas that can benefit from direct interaction with screen displays.
- The new ULTRIX-32 software is a Digital-developed, Digital-supported implementation of the UNIX* operating system and is based on technology from the University of California at Berkeley's Fourth Berkeley Software Distribution. ULTRIX-32 now joins VMS as a second major operating system for mid-range and high-end VAX computers. Principal markets for the ULTRIX-32 system are expected to be in laboratories for program development, at colleges and universities for computer science research, in added-value system development by technical and commercial OEMs (Original Equipment Manufacturers), in computer-aided design and robotics, and in government-sponsored development of portable application software.
- Digital has announced plans to build a new manufacturing facility in Valbonne, France. The proposed production unit will manufacture Digital's advanced workstations, video and graphic terminals and printers. The facility will complement Digital's four other European manufacturing sites in Clonmel and Galway, Ireland; Ayr, Scotland; and Kaufbeuren, West Germany.
- Bausch & Lomb, Inc., supplier of industrial and scientific instruments, has chosen 500 Professional personal computers to implement its automated color matching system. Maaco Enterprises, Inc., the auto body repair firm with more than 400 franchises throughout the United States, has chosen the Rainbow 100 system as the personal computer it will offer to its outlets.

*UNIX is a trademark of AT&T, Inc.

Consolidated Balance Sheets

(Dollars in thousands)	March 31, 1984	July 2, 1983
Assets		
Current Assets		
Cash and temporary cash investments	$ 548,337	$ 556,209
Accounts receivable, net of allowances	1,346,373	1,125,037
Inventories	1,737,794	1,353,830
Prepaid expenses	57,116	38,484
Deferred income tax charges, net	112,226	127,799
Total Current Assets	3,801,846	3,201,359
Property, plant and equipment, net	1,431,814	1,339,726
Total Assets	$5,233,660	$4,541,085
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable	$ 174,590	$ 14,897
Other current liabilities	918,112	809,470
Total Current Liabilities	1,092,702	824,367
Deferred income tax credits, net	93,650	82,626
Long-term debt	237,528	92,810
Total Liabilities	1,423,880	999,803
Stockholders' Equity		
Common stock, $1 par value	57,158	56,357
Additional paid-in capital	1,572,382	1,509,781
Retained earnings	2,180,240	1,975,144
Total Stockholders' Equity	3,809,780	3,541,282
Total Liabilities and Stockholders' Equity	$5,233,660	$4,541,085

Consolidated Statements of Changes in Financial Position

	Nine Months Ended	
(Dollars in thousands)	March 31, 1984	April 2, 1983
Funds from Operations		
Net income	$198,189	$197,601
Depreciation	178,072	138,202
Other	73,181	13,591
Total from operations	449,442	349,394
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	221,336	141,914
Inventories	383,964	144,769
Prepaid expenses	18,632	2,238
Other current liabilities	(108,642)	(113,161)
	515,290	175,760
Additions to property, plant and equipment	293,586	309,599
Total to support operations	808,876	485,359
Net increase (decrease) in funds from operations	(359,434)	(135,965)
Funds Provided by Financing Sources		
Increase (decrease) in:		
Loans payable	159,693	(6,366)
Long-term debt	144,718	(1,438)
Stock issued under employee option and purchase plans	40,244	31,783
Effect of exchange rate changes on working capital	6,907	0
Total funds from financing sources	351,562	23,979
Net increase (decrease) in cash and temporary cash investments	(7,872)	(111,986)
Cash and temporary cash investments at beginning of year	556,209	764,647
Cash and temporary cash investments at end of period	$548,337	$652,661

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Three Months Ended		Nine Months Ended	
	March 31, 1984	April 2, 1983	March 31, 1984	April 2, 1983
Revenues				
Equipment sales	$ 978,938	$ 732,752	$2,668,522	$2,034,001
Service and other revenues	451,827	361,513	1,260,416	1,003,468
Total Operating Revenues	1,430,765	1,094,265	3,928,938	3,037,469
Costs and Expenses				
Cost of equipment sales, service and other revenues	854,965	666,067	2,389,552	1,854,416
Research and engineering expenses	155,288	118,916	440,752	332,057
Selling, general and administrative expenses	291,398	209,926	833,595	591,332
Operating income	129,114	99,356	265,039	259,664
Interest expense	8,185	3,355	19,825	9,975
Interest income	(10,547)	(13,389)	(30,048)	(49,707)
Income before income taxes	131,476	109,390	275,262	299,396
Income taxes	29,624	29,593	77,073	101,795
Net income	$ 101,852	$ 79,797	$ 198,189	$ 197,601
Net income per share (1)	$ 1.77	$ 1.40	$ 3.46	$ 3.50

(1) Net income per common equivalent share was computed based on a fully diluted calculation of the weighted average of such shares outstanding during the period: 57,354,021 shares and 56,528,596 shares for the nine-month periods ended March 31, 1984 and April 2, 1983, respectively, and 57,493,609 shares and 57,089,037 shares for the three-month periods ended March 31, 1984 and April 2, 1983, respectively.

DIGITAL EQUIPMENT CORPORATION
MAYNARD, MASSACHUSETTS 01754

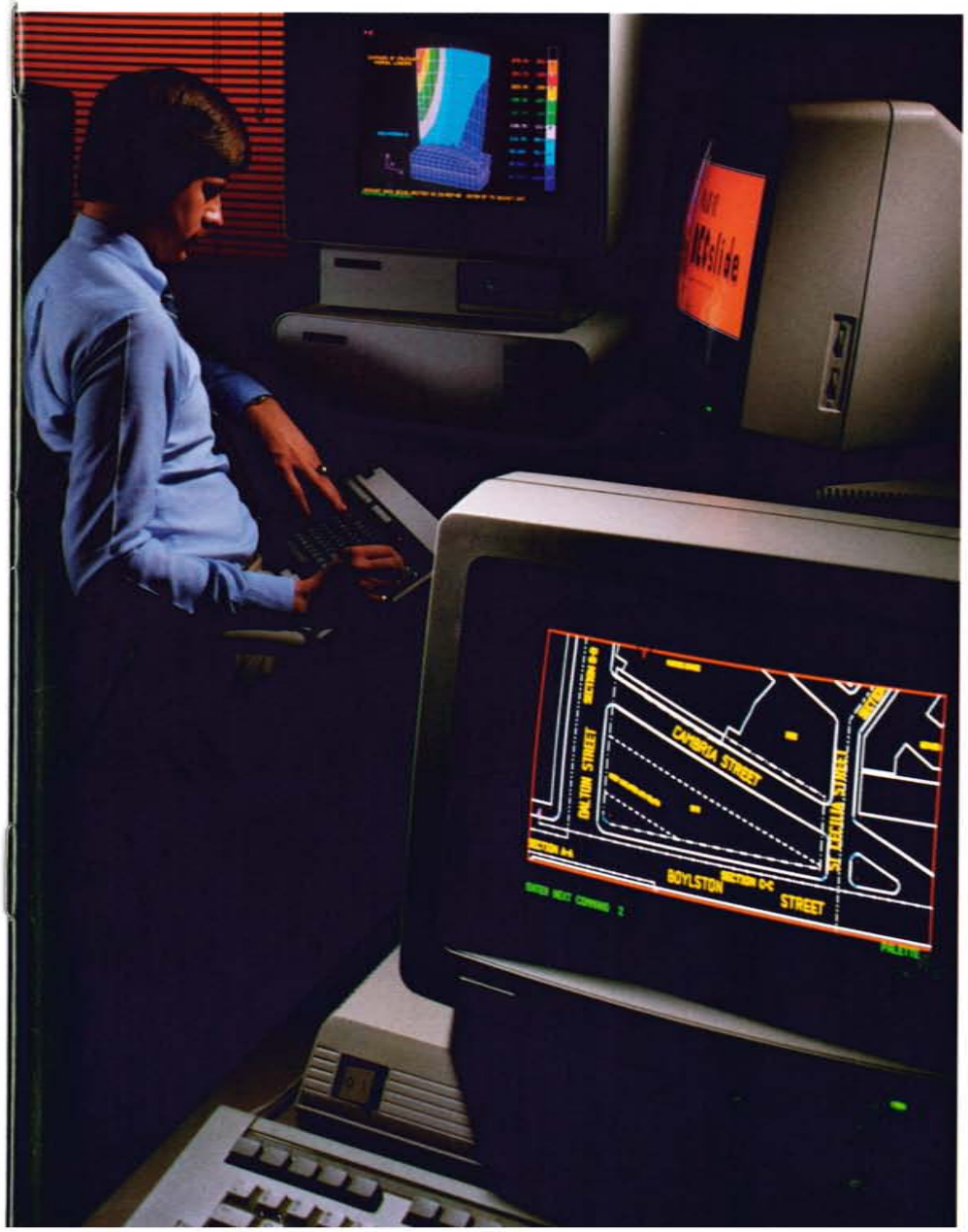
digital

ELIZABETH L CANE &
CLAUDE M CANE JT TEN

MLO 4- 3/A20
632

9104-03-9949

Digital Equipment Corporation
First Quarter Report 1985



On the Cover: Customers keep pace with Digital's latest products and problem-solving techniques in our worldwide CAD/CAM centers.

To Our Shareholders

Total operating revenues for the first quarter ending September 29, 1984, were $1,515,263,000, up 41 percent from the $1,074,327,000 recorded in the comparable period a year ago. Net income for the quarter totaled $144,216,000 or $2.45 per share, versus $15,854,000 or $.28 per share last year. The favorable comparison in earnings per share for the first quarter of fiscal 1985 versus the first quarter of fiscal 1984 was partially due to the positive effect of a $63,250,000 non-recurring benefit from the tax treatment of Domestic International Sales Corporations (DISCs). The $63,250,000 or $1.07 per share, was accumulated over a twelve-year period. DISCs were established by Congress in 1971 to stimulate exports by reducing taxation of their profits.

First quarter revenue growth was due to a continuation of the overall high level of demand for capital equipment and, in particular, for our integrated products. Our original equipment manufacturer (OEM) and office and information system markets were particularly strong as was demand from our overseas markets. Digital's broad product offering, including the most integrated set of hardware products along with a proven and flexible set of computer networking solutions, is increasingly attractive to both existing and potential customers.

Digital Equipment Corporation is one of the world's largest suppliers of computer systems and integrated networks for office, financial and administrative applications, research, engineering, manufacturing, education, personal computing and small business. Digital maintains more than 660 facilities in 48 countries and has more than 87,000 employees worldwide.

Kenneth H. Olsen
President

Important Highlights from the First Quarter

Top-of-the-line Professional workstation debuts ☐ During the first quarter, Digital introduced the Professional 380, a multitasking single-user workstation that provides more than twice the speed, twice the graphics resolution and more circuit board option slots than its high-end predecessor in the Professional 300 series, the Professional 350.

Offering many of the same application programs that run on Digital's family of PDP-11 minicomputers, this new "Personal PDP-11" is compatible with previous Professional 300 series software and hardware options.

It is aimed at technical and commercial users who require high performance applications, superior graphics, full DECnet/Ethernet networking capabilities, and distributed processing with other PDP-11 and VAX systems.

The Professional 380 owes its increased performance capabilities to Digital's J-11 microprocessor chip-set on which it is based.

The Professional 380 computer systems are priced from $8,995. Kits to upgrade the Professional 350 to a 380 system are priced at $4,625 with trade-in.

The new DECmate III features a small size and low price ☐ Just as the quarter closed, Digital introduced a new DECmate family member, the DECmate III Word Processor. It joins the DECmate II Office Workstation to form a fully compatible family of single-user systems designed for people whose work centers on creating and editing text.

Priced at $2,695, the DECmate III is now Digital's lowest-cost system for professional word processing. It is designed for people whose jobs demand a heavy load of text preparation, but who also need full communications and key office applications. The DECmate III can work both as a full-function word processor and as an integrated office terminal.

Taking up less than a square foot of desk space, the DECmate III system unit is also the smallest ever offered by Digital. The entire system weighs only 18 pounds.

The DECmate III is big enough, however, to accommodate a CP/M™-based auxiliary processor unit. This option allows users to run DECspell, Digital's spelling and correction package, along with a variety of CP/M-80 office-support packages such as spreadsheets and database managers.

Full WPS word processing software including communications, List, Sort and Math are included in the $2,695 price of the DECmate III package which is available immediately. Prices are as low as $2,100 each in quantity.

The VAX family of computers is enhanced with new member ☐ Digital also introduced the VAXstation I, the company's first true 32-bit single user workstation system. The new system, which incorporates the MicroVAX I, provides VAX/VMS resources in a desk unit, including high-resolution graphics and multi-windowing capabilities, to scientists, engineers, and other technical users.

Typical applications include laboratory data analysis, schematics capture, process control and software development.

Based on the VAX computer architecture and the VAX/VMS operating system, VAXstation I is able to run a wide range of currently available "worldclass" software, taking advantage of a decade of development languages, productivity tools, information management, networking, and application programs.

New window manager graphics system software have been integrated into the MicroVMS operating system, specifically for the VAXstation I. The new workstation system supports GKS (Graphic Kernel System), the emerging standard for graphics application interface, as its first such language.

The new DECmate III Word Processor can work as a full-function word processor and as an integrated office terminal.

The VAXstation I can be connected to DECnet/Ethernet computer networks, enabling users to access resources of larger VAX computers, VAXclusters, and other VAXstation I workstation systems in the network.

Available in December, the complete VAXstation I hardware and software system is priced from $21,095.

Digital announces the first software "base" for factory automation ☐ Another major product announcement that occurred just as the quarter closed centered on Digital's new BASEWAY software, industry's first software product from a major supplier designed to integrate industrial controllers with manufacturing applications.

BASEWAY software serves as the core of a computerized manufacturing environment and as a framework or "base" for automated factory growth. The BASEWAY product set provides plant managers, engineers, and factory floor personnel with flexible networking and applications sharing capabilities and a common user interface.

The integration of these data sources on the factory floor allows plant managers to: increase productivity through prompt problem identification; improve quality control; expand factory automation capabilities; reduce scrap and rework; and reduce operating costs through more efficient communications.

BASEWAY software is the result of several years of close work between Digital and General Motors. Prototype BASEWAY software has been successfully applied at several General Motors sites in applications such as production monitoring, maintenance management and quality control.

As a foundation for future development, the open design of the BASEWAY software product set allows for the development of customized user applications, as well as the addition of new industrial device support.

Important wins in office automation continue ☐ Digital's strong integrated office and information systems solutions – featuring VAX-PC configurations that run the VAX-based ALL-IN-1 office management system – continue to score important wins in the office automation (OA) arena.

Recent office wins in life insurance, banking, real estate, communications and cosmetics industries underscore Digital's ability to meet complex demands from this diverse sector.

Ease of networking, Digital's product line compatability, ALL-IN-1 integration of office needs and ease of learning and using word processing, were among reasons why one such account chose Digital after it conducted a model study and search that is attracting attention from OA candidates across the country. Another reason was the ability of the VAX minicomputer to communicate with its IBM™ mainframe.

This account, LOMA (Life Office Management Association), is the life insurance industry's home office information and education association.

LOMA serves as an information source for a broad range of issues dealing with finance, human resources, operations and administration, for more than 700 member companies.

Its OA task force, largely composed of people who would be primary users of the system, identified core office needs and was responsible for the final system choice.

LOMA's office needs include functional, efficient access to complex data provided by its member companies, extensive word processing, information networking and intra-office communication.

Chosen over five other major OA vendors, Digital is currently helping LOMA meet its needs with the following products: the ALL-IN-1 system, 38 DECmate II workstations and 18 VT220 terminals all accessing a VAX 11/750 superminicomputer, disk and tape storage products, and a variety of printers.

Newly organized group gears up for small business drive ☐ To better meet the needs of the small business computer market, Digital recently reorganized various groups which shared responsibility for this market sector into one cohesive unit known as the Business Computer Group.

The small business computer market, comprising businesses that generate less than $100 million in annual revenue, is currently an $8 billion market, and industry analysts project it will grow some 25% annually, reaching $20 billion by 1987-1988.

That's largely because small businesses increasingly are graduating from stand-alone computers that serve as productivity tools to computer systems that offer total business solutions.

It is this vastly expanding group of small businesses that Digital's Business Computer Group is targeting. To meet their diverse needs, the group is offering a wide range of compatible Digital products – from all members of its Rainbow, DECmate and Professional 300 series personal computing families to members of the PDP-11 and VAX families of minicomputers and superminicomputers that accommodate varying numbers of multi-users.

The group's software strategy unfolds around Digital's unique integrated multi-user software package known as the A-Z Integrated System. A-Z offers word processing, data inquiry and graphics applications, and can be integrated easily into the software packages of external software developers. The needs of selected industry segments will be met further through software applications developed by

Digital, third party software developers and commercial original equipment manufacturers (COEMs).

Because the breadth of the small business computer market mandates a multi-channel approach, the group will support three major channels in reaching it: COEMs, business computer dealers/distributors, and Digital Business Centers.

Digital and Computervision sign a CAD/CAM-based OEM agreement ☐ Early in the quarter, Digital and Computervision Corporation, Bedford, Mass., signed an original equipment manufacturer (OEM) agreement under which Computervision will market on a worldwide basis Digital's VAX computer systems in conjunction with its newly-announced MEDUSA™ software for computer-aided design and manufacturing (CAD/CAM).

MEDUSA is an integrated software system for two-dimensional design, drafting and dimensioning, and three-dimensional solid modeling. It has been successfully marketed throughout the world since 1977, for mechanical and other applications.

Digital's VAX family of computers are considered an industry standard in the CAD/CAM market.

Digital invests in Scientific Calculations ☐ Digital acquired a minority interest in Scientific Calculations Inc., Fishers, N.Y., a leading developer of sophisticated computer-aided design software for the electronics industry. The investment in SC, a privately-held company, will be used for expansion of ongoing business operations and software development. The two firms have been Cooperative Marketing Partners since 1979, a program in which Digital and qualified suppliers of software for computer-aided design and computer-aided manufacturing (CAD/CAM) undertake joint marketing activities. The move underscores Digital's commitment to this important market.

Additional Highlights

- Digital continued its effort in becoming a leading supplier of artificial intelligence (AI) tools and service with a first quarter announcement that it had reached agreements with a number of leading independent AI software producers to market cooperatively their products on Digital's VAX computer and personal computer systems. These producers include the Carnegie Group, Inc., Pittsburgh, Penn.; Digital Research, Inc., Pacific Grove, Calif.; Gold Hill Computers, Cambridge, Mass; Inference Corp., Los Angeles, Calif.; Prologia, Marseilles, France; and USC Information Sciences Institute, Marina del Ray, Calif.

- Some highlights of Digital's on-going commitment to support computing in academic communities include:
  – A donation to Roxbury Community College, Roxbury, Mass., of $96,000 towards the purchase of a VAX-11/750 computer system. This system will upgrade equipment previously donated by Digital, expand the curriculum in the Computer-Aided Drafting Program, and allow almost 100 more students a year hands-on vocational training with state-of-the-art equipment.
  – Digital was named an industrial affiliate in Rochester Institute of Technology's Microelectronics Engineering Program, which is the only undergraduate degree program in this critical discipline in the United States. The Digital affiliation consists of donations of used process equipment, a cash donation, and a four-year sponsorship of two graduate microelectronics fellowships.

- ULTRIX-32m, a version of the UNIX™ operating system for Digital's compact MicroVAX I computer system, was announced in September as the newest member of Digital's family of ULTRIX products that run on larger VAX and PDP-11 computer systems. The new operating system enables users with larger systems to expand programming operations to the low-cost MicroVAX I. Both single-user and multi-user versions will be available this fall. Prices start at $750 for a single-user license.

Consolidated Balance Sheets

(Dollars in thousands)	September 29, 1984	October 1, 1983
Assets		
Current Assets		
Cash and temporary cash investments	$ 808,770	$ 516,987
Accounts receivable, net of allowances	1,497,716	1,161,474
Inventories	2,017,833	1,481,353
Prepaid expenses	53,285	37,893
Deferred income tax charges, net	174,255	125,104
Total Current Assets	4,551,859	3,322,811
Property, plant and equipment, net	1,566,213	1,365,417
Total Assets	$6,118,072	$4,688,228
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	$ 15,570	$ 112,696
Other current liabilities	1,091,342	819,962
Total Current Liabilities	1,106,912	932,658
Deferred income tax credits, net	32,377	86,007
Long-term debt	841,455	94,301
Total Liabilities	1,980,744	1,112,966
Stockholders' Equity		
Common stock, $1 par value	58,077	56,530
Additional paid-in capital	1,624,205	1,522,406
Retained earnings	2,455,046	1,996,326
Total Stockholders' Equity	4,137,328	3,575,262
Total Liabilities and Stockholders' Equity	$6,118,072	$4,688,228

Consolidated Statements of Changes in Financial Position

	Three Months Ended	
(Dollars in thousands)	September 29, 1984	October 1, 1983
Funds from Operations		
Net income	$144,216	$ 15,854
Depreciation	69,080	53,934
Other	(56,543)	17,708
Total from operations	156,753	87,496
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	(29,541)	36,437
Inventories	165,665	127,523
Prepaid expenses	(3,745)	(591)
Other current liabilities	(23,979)	(10,492)
	108,400	152,877
Additions to property, plant and equipment	125,095	83,345
Total to support operations	233,495	236,222
Net increase (decrease) in funds from operations	(76,742)	(148,726)
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	2,389	97,799
Long-term debt	(262)	1,491
9.375% Debentures due 2000	404	0
8% Debentures due 2009	400,000	0
Stock issued under employee option and purchase plans	6,831	4,886
Effect of exchange rate changes on working capital	0	5,328
	409,362	109,504
Net increase (decrease) in cash and temporary cash investments	336,620	(39,222)
Cash and temporary cash investments at beginning of year	476,150	556,209
Cash and temporary cash investments at end of period	$808,770	$516,987

Consolidated Statements of Income

(Dollars in thousands except per share data)	Three Months Ended September 29, 1984	October 1, 1983
Revenues		
Equipment sales	$1,035,584	$ 696,061
Service and other revenues	479,679	378,266
Total Operating Revenues	1,515,263	1,074,327
Costs and Expenses		
Cost of equipment sales, service and other revenues	917,032	680,348
Research and engineering expenses	165,024	141,777
Selling, general and administrative expenses	323,348	233,926
Operating income	109,859	18,276
Interest expense	17,874	5,293
Interest income	(11,818)	(10,680)
Income before income taxes	103,803	23,663
Income taxes	(40,413)	7,809
Net income	$ 144,216	$ 15,854
Net income per share (1)	$ 2.45	$ .28

(1) Net income per common and common equivalent share was computed based on the weighted average of such shares outstanding during the period: 59,164,197 shares for the three months ended September 29, 1984 and 57,360,421 shares for the three months ended October 1, 1983.

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

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, Philadelphia Stock Exchange and Luxembourg Stock Exchange.

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

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

Digital Equipment Corporation
Maynard, Massachusetts 01754

ELIZABETH L CANE &
CLAUDE M CANE JT TEN

MLO 4- 3/A20
632

9104-03-9949

digital

Digital Equipment Corporation
Second Quarter Report 1985

On the Cover: Avon Products, Inc., leading maker and marketer of cosmetics, uses a VAX-based ALL-IN-1 office system at its Rye, NY, operations. Avon also uses Digital's PDP-11s throughout its nationwide manufacturing network for inventory control, order processing and process control.

To Our Shareholders

Total operating revenues for the second quarter ending December 29, 1984 were $1,628,066,000, up 14 percent from the $1,423,846,000 recorded in the comparable period a year ago. Net income for the quarter was up 37%, totaling $110,331,000 or $1.81 per share, versus $80,483,000 or $1.41 per share last year.

For six months ending December 29, 1984, total operating revenues were $3,143,329,000 versus $2,498,173,000 in the prior year. Net income for the half was $254,547,000 or $4.24 per share, against $96,337,000 or $1.68 per share a year ago.

Demand for Digital's products continued to increase during the quarter, with orders up from the first quarter and from the comparable quarter of a year ago. Demand from our Western European and other overseas markets was particularly strong. Orders for our products from the office and information systems market maintained a strong second-quarter pace, and sales to the computer-aided design and computer-aided manufacturing market exceeded expectations this quarter.

We are closely monitoring general business trends and their potential effect on customer purchasing intentions. Digital remains confident regarding future business prospects, particularly in light of our broad, fully integrated product offerings and well-trained sales and service organization of more than 46,000 people.

During the quarter we introduced our top-of-the-line VAX 8600 that offers customers four times the performance of our pace-setting VAX-11/780 system in the same amount of physical space. The reaction to the product, both in the U.S. and overseas, was very enthusiastic and orders to date also have exceeded expectations. Digital offers an innovative hardware and software

technology for "clustering" VAX computers together to form a powerful system. A VAXcluster acts as a single system sharing a common database, allows for system expansion and data protection, and is designed to be easy to use and manage. When VAX 8600 systems are combined in a VAXcluster, the result actually yields more power and more capabilities than today's mainframe systems.

Digital Equipment Corporation is one of the world's largest manufacturers of computer systems, associated peripheral equipment, networks and communications products, and related software and supplies. The Company is a leading supplier of information management systems and network products for

Innovative technology from Digital allows VAX computers to be "tied" together to form powerful systems known as VAXclusters.

office, government and education, factory and laboratory automation, engineering, personal computing, and small businesses. Digital operates more than 660 sales, service, manufacturing, administrative, and engineering facilities in 48 countries and employs approximately 88,600 people worldwide.

Kenneth H. Olsen
President

Important Highlights from the Second Quarter

DECworld-85 brings executive crowds and computing solutions together ☐ More than 10,000 executives of the world's leading corporations gathered at the Hynes Auditorium in Boston, during December 5-11 to explore Digital's world of computer products that make it all work together.

DECworld-85, the most extensive demonstration of computing solutions ever held exclusively for management by one company, received enthusiastic reviews from the thousands of current and potential customers who attended, and from the press. It also drew the attention of Governor Michael Dukakis, who proclaimed December 5-11 "Digital Equipment Corporation, DECworld-85 Week" in Massachusetts.

Under the theme, "Making It All Work – Together," DECworld-85 brought to life the world of networks, integrated computing, and distributed processing by demonstrating how Digital products can work together today to solve a wide range of business and technical problems.

Attendees explored a vast array of Digital software and hardware products, all interconnected with the company's Ethernet and DECnet networking products. The displays were set in realistic customer environments that covered five strategic solutions areas: industrial, financial, research, education, and technology.

Among the new Digital products featured at DECworld-85 were four of the widely acclaimed VAX 8600 computers, tied together using Digital's state-of-the-art VAXcluster technology to form the most powerful VAXcluster system ever created.

Others included the MicroPDP-11/73 team computer; the LN03, Digital's entry in the desktop laser printer market; the latest release of the VAX/VMS operating system, Version 4.0;

DECworld-85 showed thousands of corporate executives how Digital makes it all work together.

VAX/VTX, a leading-edge videotex product; BASEWAY software, a flexible, expandable software product set for the manufacturing industry; and ALL-IN-1 Version 2.0, an updated and enhanced version of Digital's integrated office automation system.

A coast-to-coast network brings DECUS and DECworld-85 together ☐ Running concurrently with DECworld-85 was the Fall '84 Symposium of the Digital Equipment Computer Users Society, U.S. Chapter (DECUS). Held in Anaheim, California, this symposium was the largest and most successful to date, with close to 6,500 Digital equipment users attending.

Participants at the two big events were able to interact across the country through the linking of networks at each site via a satellite communications system that demonstrated Digital's ability to create powerful, far-reaching networks capable of serving thousands of users simultaneously.

A working PDP-6, Digital's first 36-bit system, was also on hand at the DECUS symposium as part of a 20th anniversary salute to Digital's 36-bit systems. Digital's latest products, including the VAX 8600, were featured as well.

More than 70,000 members of DECUS worldwide exchange knowledge and information through numerous ongoing activities including involvement in symposia, special users groups meetings, newsletters, and a program library.

Digital introduces new software interconnections to IBM SNA networks ☐ Digital kicked off the second quarter by announcing several new software interconnection products – and a joint development agreement with Cullinet Software, Inc. – that expand the company's leadership position in multivendor environments.

The new products provide more extensive links between Digital's DECnet local- and wide-area networks and IBM* SNA networks than were previously available, and run on the full range of Digital's VAX computer systems. They include:

- The first implementation of an interface to IBM's Distributed Office Support System (DISOSS*) by a computer vendor. Known as a DISOSS Document Exchange Facility, this product allows users on a DECnet network to participate in an IBM office systems network.

- The Distributed Host Command Facility that allows users with IBM 3270 terminals, in an SNA environment, to use those terminals in a distributed VAX network and to realize the benefits of Digital's electronic mail and VAX-based VMS operating system.

- The VMS Printer Emulator that allows users to print information from an IBM mainframe on a high-speed printer connected to a VAX system.

- New MicroVMS operating system versions that include 3270 terminal emulation and gateway network management. These functions enable users to configure DECnet networks that communicate with SNA networks and incorporate the low-cost MicroVAX microcomputer.

Under the announced joint development agreement, Digital and Cullinet Software, Inc., will cooperate to develop new products to give VAX computer users easy access to IBM mainframe systems through Cullinet's Information DataBase (IDB*).

Cullinet Software, based in Westwood, Massachusetts, is an industry leader in database management, applications and decision support software for IBM mainframes. The agreement will fortify Digital's strengths in distributed processing and Cullinet's strengths in data access to provide users with excellent interfaces to information stored on IBM mainframes.

The new offerings are aimed towards corporations and other users who require both the central database facilities of an IBM SNA network and the distributed computing power of a DECnet computer network. Typical users include large corporations, government agencies, research facilities, and colleges and universities.

Digital first entered the computer networking business in 1975. Today the company is a recognized leader in both local- and wide-area networking. These second quarter announcements reflect Digital's ongoing pursuit of its goal to provide the greatest number of applications over the widest range of communications technologies.

Strong growth seen on Digital's CAD/CAM front ☐ The demand for Digital's products in the manufacturing and engineering market has continued to expand. Sales of computer equipment and software for computer-aided design and computer-aided manufacturing (CAD/CAM) is a primary international growth market for Digital, and performance in this segment exceeded expectations during the second quarter.

Digital's Computer-Aided Engineering and Manufacturing (CAEM) marketing group also continued making inroads in the oil and exploration market, a strong Digital market for some time now. Digital computers currently are installed in every major petroleum corporation in the world. Of importance to these companies is Digital's style of computing that enables them to combine a range of systems in networks to meet their complex computing requirements.

One such account, DuPont's Conoco, recently added a VAX-11/780 computer system to three others that are used to perform petroleum base-mapping activities and geologic analysis. Conoco uses INFORMAP* II software from Synercom Technology, Inc., one of Digital's Cooperative Marketing Partners.

Digital also opened two new CAD/CAM centers this quarter, bringing its worldwide total to 19. The new centers are located in Irvine, California, and Calgary, Canada. The Irvine facility, serving as Digital's technical and educational center for the Southwest, focuses on electronic and mechanical applications. It also houses Digital's first Application Center for Technology. The Calgary center focuses on applications for the oil industry of Western Canada.

Major enhancements of ALL-IN-1, Digital's OIS offering, are announced

☐ One day before DECworld-85 opened, Digital announced a new version of its ALL-IN-1 Office and Information System that features several significant enhancements and sets new standards for integrated office systems.

Enhancements of the new ALL-IN-1 Version 2.0 Office and Information System include:

- A new, integrated, ALL-IN-1 word processing system.
- A first-of-its-kind voice system, fully integrated into ALL-IN-1.
- New capabilities that make ALL-IN-1 easier to learn and use.
- And the further integration of Digital's networking system with mail and calendar enhancements.

According to Henry Ancona, product group manager for Digital's Office and Information Systems Group, these new products, "combined with Digital's unique distributed processing approach, result in the most useable and useful office system on the market."

He adds, "Never before have voice, word processing, graphics, and data been so elegantly combined in such a simple-to-use, comprehensive office system."

The new ALL-IN-1 word processing system known as WPS-PLUS is a full-featured, DECmate-style word processing system that includes a complete scientific/technical character set and equation editing.

Also available for Digital's VAX/VMS operating system, WPS-PLUS can be the word processing solution for clerical, business management, and technical/scientific users.

DECtalk Mail Access and Voice Messaging Support are the cornerstones of Digital's new industry-leading integrated voice capabilities.

With DECtalk Mail Access, Touch-Tone* telephones become ALL-IN-1 terminals and can access electronic mail and other ALL-IN-1 documents. ALL-IN-1 Voice Messaging Support notifies users that a voice message has been received by sending a short electronic mail message to the ALL-IN-1 "inbox."

New ALL-IN-1 ease-of-use features include a single set of consistent menus covering the different ALL-IN-1 applications; a new "interrupt" capability that lets users move easily from one job to another and back again; and fully integrated computer-based instruction or help for all major functions, including word processing, electronic mail, and calendar management.

Networkwide calendaring is one of several new features of the ALL-IN-1 system that moves Digital's communications capability even further ahead of other vendors' systems. This feature enables meetings to be set with any users, on any computer, in the ALL-IN-1 network and allows a side-by-side format for easier scheduling.

ALL-IN-1 mail enhancements include a four-level priority delivery system, and a message transport system – based on the National Bureau of Standards guidelines – that finds the best ways to make connections and move information.

Slated to become available this spring, these new products represent the first phase of a series of integrated office product introductions planned in the coming months.

RC25 disk subsystems attract new customers and shipments take off ☐ Shipments of Digital's RC25 removable storage subsystems have increased strongly this fiscal year. This trend is expected to continue as they are extended to more of Digital's PDP-11 and VAX computer systems.

The highest density eight-inch removable cartridge in the industry, the RC25 offers users high performance, high capacity and both fixed and removable storage capabilities – all in one compact package. Targeted markets include office automation, commercial, government, engineering, CAD/CAM, and automatic test equipment.

The RC25's benefits have been cited as important factors in swaying new accounts to Digital, such as the Societe Generale de Banque (S.G.B.) The S.G.B. is the largest bank in Belgium, with some 1,200 branches or agencies across the Belgian landscape.

Moving to automate these offices in 1982, the S.G.B. chose Digital, citing its overall style of computing, service, growth, and networking strengths. Its search for a cost-effective, high-performance, and compact system led the influential bank to choose Digital's PDP-11/23-PLUS system teamed with the RC25. Today, more than 800 of the systems have been installed in S.G.B. offices.

The RC25 was designed and developed by Digital's Eastern Technology Center in Shrewsbury, Massachusetts, one of two Digital facilities devoted to storage systems development. The other is located in Colorado Springs, Colorado. Plans to expand both sites were recently announced, in keeping with Digital's goal of being a leader in disk technology.

Digital adds a LAN alternative: Ethernet on broadband ☐ In another networking development announced this quarter, Digital became the first computer manufacturer to extend the Ethernet approach for local area networks (LANs) from the baseband to the broadband environment.

The announcement featured two new products: a new Broadband Ethernet Transceiver that is fully compatible with Digital's Ethernet hardware and software products, and an associated Broadband Ethernet Frequency Translator that provides connection to broadband cabling.

The broadband environment can be used to distribute other services, such as data, video, and voice. This shared-cable capability can be a cost-effective networking solution for universities, hospitals, manufacturing complexes, and research parks with large, dispersed user populations.

Closely following the company's formal entry into the broadband LAN market, Digital and Sytek, Inc., of Mountain View, California, announced an agreement for cooperative marketing of broadband LANs.

The agreement calls for the two firms to cooperate in developing proposals for broadband networks incorporating their respective network products to customers, when appropriate. It also enables customers to operate Sytek's LocalNet 20* products and Digital's broadband Ethernet products simultaneously without conflict on the same broadband LAN.

When its plans unfold, M.I.T.'s campus networking system will include VAX systems and IBM mainframes.

M.I.T. will acquire three more VAX systems for administrative use ☐ The Massachusetts Institute of Technology is acquiring three more VAX computer systems from Digital, at a cost of $1 million, that will expand the scope of administrative functions performed by a uniform system of desktop terminals linked to compatible computers.

The systems include: a VAX-11/780 (to be upgraded to a VAX-11/785 this spring) that will support purchasing and accounts payable; a VAX-11/785 that will support budgeting, accounting, and general ledger operations; and a VAX-11/750 that will be used for applications development.

According to Professor James D. Bruce, Director of Information Systems at M.I.T., the university some time ago began developing software for use with a VAX-11/780 to carry out purchasing and accounts payable operations. The decision to add more VAX systems came after this VAX began experiencing very heavy usage, since it was shared with students engaged in course work and research.

"Prior existence of the purchasing and accounts payable software was paramount" in M.I.T.'s decision, according to Professor Bruce. "But we were also encouraged by what we anticipate in the way of distributed processing capabilities of the VAX systems, by the potential ease of VAX operations, and by the prospects for incremental growth within the VAX family."

Future plans call for connecting some of the VAX systems together through M.I.T.'s campus networking system that will include the university's administrative IBM mainframes.

New PDP-11 minicomputer debuts ☐ The PDP-11/84, a high-end member of Digital's celebrated PDP-11 minicomputer family targeted for original equipment manufacturers (OEMs) and large end-user customers, debuted during this quarter.

The new minicomputer features PDP-11/70-class performance and total hardware and software compatibility with the entire UNIBUS PDP-11 line at less than one-third the price of a PDP-11/70. It is available in two variations: a rack-mount processor and a kernel subsystem for freestanding configurations.

Based on Digital's powerful J-11 microprocessor chip set, the new PDP-11/84 effectively couples today's technology with an industry-standard computer family. The most powerful, yet cost-effective, UNIBUS PDP-11 computer ever designed, the new minicomputer provides its users with solid investment protection.

Highlights from Europe □

Computer-integrated manufacturing (CIM) occupied a special place in Digital's European operations during the second quarter. As part of its new, worldwide Application Center for Technology (ACT) program, Digital announced the opening of a CIM center in Turin, Italy – headquarters of Fiat, an important Digital customer – to specialize in projects and application products for the automobile industry.

Meanwhile, in the United Kingdom, Digital supplied a large CIM system to Westland Helicopters Ltd., for use in small-parts manufacture. The sale represented the first purchase from Digital of a complete system capable of controlling all stages of production, from design through assembly.

On another note, Digital announced in October the first corporate product designed and manufactured entirely in Europe. The communications component is an asynchronous multiplexer known as the DHZ11, in which more than 100 chips have been consolidated using gate-array technology to offer a reduction in board size, power requirements, and production cost.

Additional Highlights

- The National Football League (NFL) recently signed a $1.1 million contract with Digital to improve electronic communications between headquarters and the NFL's 28 teams.

  The league has purchased two VAX computer systems with Digital's ALL-IN-1 integrated software for offices and information systems. The NFL's ability to add the larger VAX systems – without replacing its current PDP-11 – was one of the criteria it used when deciding to expand its computer network. The new systems are slated to be up and running in time for the spring '85 draft.

- Prices for Digital's Rainbow 100 and Rainbow 100 + personal computers, related memory options, and operating system software were reduced during the second quarter.

  A typically configured Rainbow 100 system, including 256 Kbytes of memory, keyboard, monitor, and choice of operating systems, has been reduced by roughly eight percent, as has a comparably equipped Rainbow 100 + .

  Coupled with ongoing product development, the price adjustments reflect Digital's continued commitment to remain competitive in the market for high-performance personal computers that can be integrated easily with larger systems.

- Digital teamed up with AT&T Communications as a participant in AT&T's "Opportunity Calling for Business" program. Under the agreement, AT&T will offer Digital's DECmate II word processor and small-business system and a selection of Digital's office computer accessories to its vast number of small business customers.

  "Opportunity Calling for Business" offers participating customers one dollar in merchandise credit for every dollar they spend in long distance telephone charges between $15 and $300 per month.

Consolidated Balance Sheets

(Dollars in thousands)	December 29, 1984	June 30, 1984
Assets		
Current Assets		
Cash and temporary cash investments	$ 840,935	$ 476,150
Accounts receivable, net of allowances	1,423,001	1,527,257
Inventories	2,069,005	1,852,168
Prepaid expenses	70,117	57,030
Deferred income tax charges, net	178,300	169,308
Total Current Assets	4,581,358	4,081,913
Property, plant and equipment, net	1,618,523	1,511,340
Total Assets	$6,199,881	$5,593,253
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	$ 15,923	$ 13,181
Other current liabilities	1,014,377	1,067,363
Total Current Liabilities	1,030,300	1,080,544
Deferred income tax credits, net	34,400	92,180
Long-term debt	841,853	441,313
Total Liabilities	1,906,553	1,614,037
Stockholders' Equity		
Common stock, $1 par value	58,589	57,811
Additional paid-in capital	1,669,362	1,610,575
Retained earnings	2,565,377	2,310,830
Total Stockholders' Equity	4,293,328	3,979,216
Total Liabilities and Stockholders' Equity	$6,199,881	$5,593,253

Consolidated Statements of Changes in Financial Position

	Six Months Ended	
(Dollars in thousands)	December 29, 1984	December 31, 1983
Funds from Operations		
Net income	$254,547	$ 96,337
Depreciation	140,294	111,955
Other	(41,811)	55,192
Total from operations	353,030	263,484
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	(104,256)	231,756
Inventories	216,837	211,466
Prepaid expenses	13,087	(4,205)
Other current liabilities	52,986	(54,436)
	178,654	384,581
Additions to property, plant and equipment	257,857	184,123
Total to support operations	436,511	568,704
Net increase (decrease) in funds from operations	(83,481)	(305,220)
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	2,742	195,783
Long-term debt	540	(2,835)
8% Debentures due 2009	400,000	0
Stock issued under employee option and purchase plans	44,984	35,867
	448,266	228,815
Net increase (decrease) in cash and temporary cash investments	364,785	(76,405)
Cash and temporary cash investments at beginning of year	476,150	556,209
Cash and temporary cash investments at end of period	$840,935	$479,804

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Three Months Ended		Six Months Ended	
	December 29, 1984	December 31, 1983	**December 29, 1984**	December 31, 1983
Revenues				
Equipment sales	**$1,109,562**	$ 993,523	**$2,145,146**	$1,689,584
Service and other revenues	**518,504**	430,323	**998,183**	808,589
Total Operating Revenues	**1,628,066**	1,423,846	**3,143,329**	2,498,173
Costs and Expenses				
Cost of equipment sales, service and other revenues	**974,280**	854,239	**1,891,312**	1,534,587
Research and engineering expenses	**169,648**	143,687	**334,672**	285,464
Selling, general and administrative expenses	**344,700**	308,271	**668,048**	542,197
Operating income	**139,438**	117,649	**249,297**	135,925
Interest expense	**21,232**	6,347	**39,106**	11,640
Interest income	**(16,737)**	(8,821)	**(28,555)**	(19,501)
Income before income taxes	**134,943**	120,123	**238,746**	143,786
Income taxes	**24,612**	39,640	**(15,801)**	47,449
Net income	**$ 110,331**	$ 80,483	**$ 254,547**	$ 96,337
Net income per share (1)	**$ 1.81**	$ 1.41	**$ 4.24**	$ 1.68

(1) Net income per common equivalent share was computed based on a fully diluted calculation of the weighted average of such shares outstanding during the period: 61,255,463 shares and 57,284,228 shares for the six-month periods ended December 29, 1984 and December 31, 1983, respectively, and 63,346,728 shares and 57,208,034 shares for the three-month periods ended December 29, 1984 and December 31, 1983, respectively.

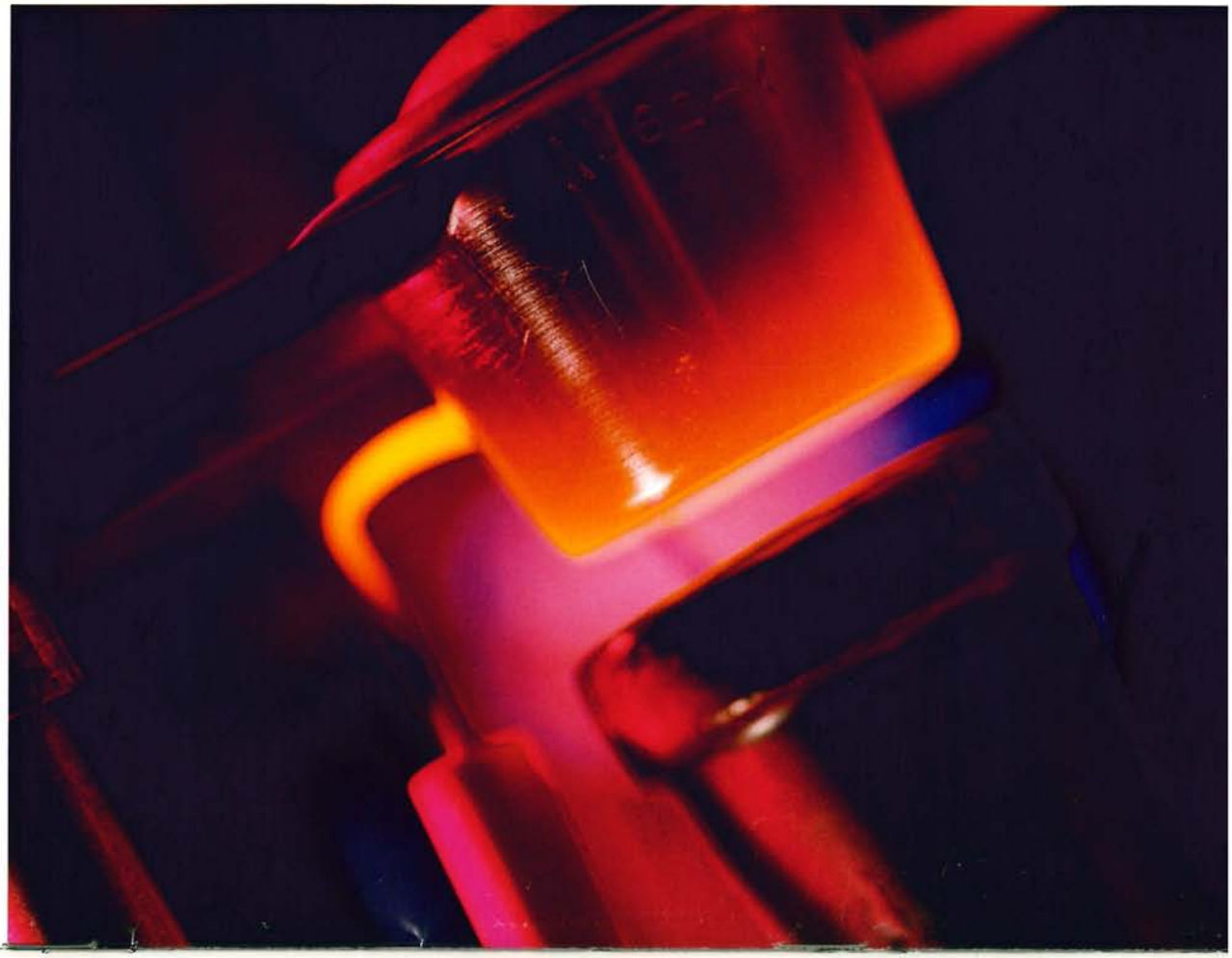
Digital's common stock is traded on the New York Stock Exchange and Pacific Stock Exchange (Ticker Symbol "*DEC*").

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, Philadelphia Stock Exchange, and Luxembourg Stock Exchange.

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

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

Digital Equipment Corporation
Third Quarter Report 1985



Digital Equipment Corporation
Maynard, Massachusetts 01754

Bulk Rate
US Postage
PAID
Permit No. 129
Northboro, MA
01532

ELIZABETH L CANE

MLO 4- 3/A20
632

9004-03-9949

digital

On the Cover: Alcoa, a world leader in aluminum, uses a variety of Digital's computer systems to manage a broad range of activities, including this ore fusion apparatus for x-ray flourescence analysis at its Technical Center near Pittsburgh.

To Our Shareholders

Total operating revenues for the third quarter ending March 30, 1985 were $1,691,127,000, up 18 percent from the $1,430,765,000 recorded in the comparable period a year ago. Net income for the quarter totaled $91,688,000 or $1.52 per share, versus $101,852,000 or $1.77 per share last year.

For the nine months ending March 30, 1985, total operating revenues were $4,834,456,000, up 23 percent from $3,928,938,000 a year ago. Net income for the nine months was $346,235,000 or $5.77 per share, compared with $198,189,000 or $3.46 per share in the prior year.

Digital's third quarter revenue growth of 18 percent over a year ago exceeded the results posted by most other companies in our industry. Sales in the United States reflected cutbacks in capital spending in many industries. However, business from customers in Western Europe and Japan, and from the government and communication sectors in the United States continued strong.

Orders for our established VAX computers were slowed because of enthusiastic response to our new giant VAX 8600 computer and by anticipation of powerful new MicroVAX and VAXstation products slated for introduction this spring. We have cautioned that we may not be able to ship our new products fast enough over the next several months to replace demand for our older products. This may have a short-term effect on revenues.

Shipments of our VAX 8600 computer began earlier than the promised April 1 date, and 140 systems were shipped this quarter. More than half are being used in our unique cluster arrangement that permits the building of large-scale computing systems to serve large numbers of users who share a single database.

Kenneth H. Olsen
President

Important Highlights from the Third Quarter

Several factors drive Digital's continuing strength in CAD/CAM ☐ Sales in engineering and manufacturing areas continued strong this quarter, especially in Europe and other overseas markets. Overall economic expansion and the continued success of the joint efforts of Digital and its Cooperative Marketing Partners (CMPs) were key factors. New products and our progress in providing integrated solutions for customers were other major contributors.

Among our key computer-aided design/computer-aided manufacturing (CAD/CAM) markets that continue to expand are aerospace, automotive, and government. Mill-wide control in the paper industry, and pipeline monitoring and control in the petroleum industry are particularly strong. These industries are attracted to Digital's VAX family of

computers, including our VAX workstations, innovative VAXcluster technology, and networking products.

General Electric Company, one of Digital's largest corporate accounts, received two of the first VAX 8600 computers that Digital has shipped. They are being used for engineering and manufacturing applications. One system runs ANSYS™ finite element analysis software from Swanson Analysis Systems, Inc., one of Digital's CMPs.

Sanders Associates, a major defense contractor, selected our VAXstation line of workstations to serve as its standard workstation for electronic design. Sanders' initial application is schematic entry and simulation using software from Silvar-Lisco, also a CMP. The VAXstations add to Sanders' large installation of VAX computers, which are linked together with DECnet – Digital's own networking system – and used for engineering and software development.

BASEWAY shipments will spur computer-aided manufacturing ☐ Shipments of BASEWAY began this quarter. BASEWAY is the first software package that integrates various industrial controllers and minicomputer-based application software. Integration is a key requirement for the use of computers in manufacturing and BASEWAY provides a strong foundation.

A proven success with customers in the automotive and aerospace industries, BASEWAY and its predecessors have been in use at a number of General Motors plants for about three years. It is a key component in the highly automated Pratt & Whitney plant in Columbus, Georgia, which produces parts for the company's jet engines. Strong interest recently has been shown by companies in such other industries as steel, electronics, chemical, and paper.

In addition to our BASEWAY offering, Digital is dedicated to supporting industry-standard networks such as the MAP (Manufacturing Automation Protocol) specification for factory networking.

Highlights from Europe ☐ Digital made significant investments in Germany and Italy in the field of computer-integrated manufacturing (CIM), and plans to invest more through participation in the European Community's (EC) billion-dollar ESPRIT (European Strategic Program for Research in Information) project.

In cooperation with Italy's COMAU (the industrial automation arm of the FIAT group) and Renault Automation of France (specialists in advanced

automation and robotics), Digital will invest nearly $4 million over the next five years to design, develop and test an advanced production-control system. The project represents a total investment of over $10 million, a quarter of which is funded by the EC, and over 90 man-years of work. Only four American corporations have been chosen to participate in the 104 separate ESPRIT projects announced to date.

The third quarter also saw the company's inauguration of two new European Competence Centers, in Munich, West Germany, and in Turin, Italy, bringing the European total to five. Each center will employ over 30 experts in the field of CIM. The Turin center's work will concentrate on the automotive industry. The Munich center, which also houses one of the first two CIMLABs Digital opened this quarter, will be the focal point of Digital's participation in ESPRIT.

The corporation's business performance in Europe during the quarter remained very strong. A typical example was the purchase of ALL-IN-1, Digital's comprehensive office and information system, by the municipal government of Vienna, Austria. The city of Vienna employs more than 60,000 people, and ALL-IN-1 will handle its administration of a broad range of municipal services, from transportation to medical care.

Meanwhile, Digital's European Headquarters in Geneva inaugurated Europe's first private use of a fiber-optic cable that carries both voice and data – demonstrating the company's leadership in the growing field of telematics. Operating between the two headquarters buildings over a distance of more than a mile, the network is Switzerland's first installation of a large digital telephone exchange and the first European application of a new Digital-developed fiber-optic remote repeater for data transmission.

Office customers choose Digital for solutions to varied needs ☐ Digital provides comprehensive solutions in the office automation marketplace, qualities that often make us the vendor of choice.

Customers cite the flexibility and expandability of Digital systems that allow for individual solutions to problems and continued growth in office automation processes. They also point to versatility – the ability to do much more, for example, than word processing or spreadsheet analysis. Others are sold on the compatibility and connectability of Digital products to each other and to other systems.

For an educational system, whether college or university, elementary or high school, compatibility of components and systems is high among criteria. "It was essential that we have true compatibility among workstations, or standalones, or whatever was chosen," says Dr. Eugene Rathswohl, associate professor in the business school at the University of San Diego. "That decision as much as anything else shaped our decision to go with Digital."

Expandability was an important consideration at Aluminum Company of America in Pittsburgh. Says Jim Yates, manager of ALCOA's systems group, engineering division, "Part of our system design criteria was to go with a vendor who built products that would not become obsolete as the system grew." Its engineering information network, powered by a VAX-11/780 computer, provides communication across time zones via electronic mail and makes powerful engineering tools and databases available online anywhere. More VAX-11/780 computers are on order and VAX-11/785 upgrades are planned.

While many brokerage firms are merging into large corporations, Nashville's J.C. Bradford & Co., with

46 offices concentrated in the southeastern United States, is reaffirming its commitment to provide full-scale personal investment services. Digital's computers are helping them to meet that commitment. "We knew that with Digital we would have compatibility between and within systems—from the smallest computer to the new VAX 8600," says Brad Phelan, vice-president of finance. "We knew that when we were ready to grow, we could simply cluster VAX systems, rather than change to a whole new system."

Office automation is more than word processing or spreadsheet analysis at the Federal Land Bank of Wichita, Kansas. Along with 37 affiliated Land Bank Associations it serves farmers and ranchers in Kansas, Oklahoma, Colorado, and New Mexico. "ALL-IN-1 is the glue we use to hold everything together, to make it all happen," says David Personne, assistant vice-president for data resources. "Our goal is to put in place tools that will help people to be more creative and efficient in doing their jobs. That's really what it is all about."

"And," says Larry Wergin, senior vice-president, data center, "Digital provides the flexibility to keep pace with our ever-changing workplace." Mike Bone, vice-president of the bank adds, "We wanted a vendor with staying power. We wanted to know who would be around in the next 10 to 20 years producing information-processing equipment."

Addition announced for storage systems site in Shrewsbury ☐ Plans to construct a 110,000 square foot addition to Digital's Storage Systems Technology Center in Shrewsbury, Mass. were announced in April.

The facility, which will house operations for thin film magnetic head engineering and manufacturing, represents an important step in Digital's plan to continue its leadership position in disk storage technology. Moving in this direction four years ago, we now have a skilled engineering and process development group, along with a pilot manufacturing group. This permanent manufacturing capability completes the plan.

Digital markets magnetic disk drives, which it develops and manufactures, as part of the company's VAX and PDP-11 computer families, cluster systems, and networked systems. Thin film heads are used in these magnetic disk drives.

The new facility, which will be highly specialized in order to fabricate thin-film structures similar to those used in semiconductor manufacturing, is expected to be completed by next July. It will employ approximately 200 people.

Brazilian firm licensed to manufacture VAX computers ☐ Digital announced the signing of a long-term agreement with Elebra Computadores, São Paulo, Brazil, to license the manufacture of VAX-11/750 computers in Brazil. Elebra Computadores is a private Brazilian company, wholly owned by Companhia Docas de Santos, Banco Brasileiro de Descontos S.A. (BRADESCO), and Medidata Informatica e Tecnologia, S.A.

Elebra initially will assemble and test VAX-11/750 systems from subassemblies imported from Digital's Burlington, Vermont, facility. It plans to produce modules for this mid-range member of the VAX family and develop applications software. In addition to assisting Elebra's manufacturing startup operations, Digital will train Elebra's sales and service staff, license software, and provide a wide range of peripherals, parts, and components.

Brazil ranks among the 10 largest computer markets in the world. Digital's Brazilian subsidiary, Digital Equipment Comercio e Industria, Ltda., has been in operation for 11

years, and will work closely with Elebra to maximize their combined presence in the country. Brazilian computer users now will be able to purchase medium-sized systems from Elebra and large VAX systems such as the VAX 8600 from Digital's Brazilian subsidiary.

Digital taps small business market with its DECtap System ☐ One product that's helping Digital make inroads into the rapidly expanding small business computer arena is the DECtap System, which provides multiuser solutions for a variety of businesses in this developing market.

The DECtap System features 14 application packages from which small businesses can choose to meet their general accounting, build-to-order manufacturing, and wholesale distribution needs. It runs on Digital's PDP-11 family of general purpose minicomputers.

Although it can be used as delivered, DECtap has been designed so that our customers can modify it easily – without the aid of programmers – to meet their unique needs.

Tangent Tool and Stamping is a typical DECtap customer. The company, based in Laconia, N.H., manufactures metal parts used by a variety of industries in the United States and overseas.

According to David St. Gelais, vice-president of engineering, Tangent's DECtap system serves as a complete solution to the firm's financial, manufacturing, and distribution needs. It runs on a low-cost high-performance PDP-11/73 that is connected to six VT220 terminals and two printers.

DECtap came along just as Tangent was looking to replace some stand-alone personal computers with a more comprehensive system that its users could share. St. Gelais says he found other multiuser systems that could handle Tangent's office needs, but DECtap was the only system he found that could affordably handle its needs on the factory floor as well.

Since it's been in operation, the DECtap System has proven to be a time saver and productivity booster, St. Gelais says. It's also contributing to the company's competitive edge. "Using DECtap," he says, "we have a better handle on inventory control, we're more accurate on customer delivery dates, we have a better handle on our lead-time requirements, and we can keep a close eye on costs."

AT&T Network Systems grants $7 million contract to Digital ☐ Digital was awarded a two-year, $7-million contract from AT&T Network Systems, Morristown, N.J., for specialized computer equipment that links AT&T's DATAKIT™ VCS local-area network to Digital computers.

Digital will manufacture specially designed interface boards that will provide a high-speed link between AT&T's DATAKIT Virtual Circuit Switches (VCS) and Digital's VAX and PDP-11 computers.

Initially, the equipment will be used for telephone companies' internal business functions. Designed and sold by AT&T, the KMS11-K interface board will be manufactured by Digital's facility in Hudson, N. H.

Digital wins $3 million contract from Lawrence Berkeley Laboratory ☐ Digital signed a $3 million computer system contract with the Computing Division of the Lawrence Berkeley Laboratory (LBL), Berkeley, Calif.

The contract, won on a competitive bid, calls for Digital to supply a VAXcluster system of five VAX 8600 computers, DECnet/Ethernet communications capabilities, 20 Gbytes of disk storage, and systems and software support to LBL's scientific computing center.

Digital's VAXcluster system will replace a large 10-year-old mainframe that has served as the principal computer in LBL's Central Facility. The system will be funded through a Department of Energy contract with the University of California.

Chase Manhattan selects Digital systems for Spectrum service ☐ Digital and Chase Manhattan Bank have announced that Digital's systems will be the backbone of Chase Manhattan's Spectrum℠ home banking and information system. The Spectrum service uses Digital's VAX VTX videotex information delivery system for bill payment, portfolio management, and other banking services.

Spectrum is the only home banking and information system in the New York market that allows customers to trade securities directly through an investment brokerage house. Spectrum's investment service also provides up-to-date prices for NYSE, AMEX, and OTC securities and leading market indicators.

The initial $2 million contract calls for several VAX computers, including two VAX 8600 systems in the form of a VAXcluster. Spectrum interacts with other computer systems in Chase Manhattan's account management network, including the bank's IBM™ mainframes.

BellSouth and Digital join forces in S.E. office systems market ☐ Under an agreement reached during the quarter, BellSouth Advanced Systems, Inc., will market a number of Digital office systems products as it enters the office systems equipment market in the southeastern United States this spring.

A subsidiary of BellSouth Corporation, BellSouth Advanced Systems, Inc., will market Digital's ALL-IN-1 Office and Information System for large users, and Digital's A-to-Z Integrated System for small users. It will also market Digital's personal computers, DECmate word processors, peripherals, and supplies supporting both systems.

These Digital products will complement a number of voice and data communications products from a variety of manufacturers that BellSouth Advanced Systems, Inc. currently markets – providing southeastern businesses a single source for a total-solutions package of office systems equipment.

Computer-integrated manufacturing gets a boost with CIMLAB openings ☐ Digital furthered its commitment to provide integrated CAD/CAM solutions with the opening of its first two CIMLABs, which are part of its developing computer-integrated manufacturing (CIM) program. The new R&D centers, located in Shrewsbury, Massachusetts, and Munich, West Germany, are Digital's first laboratories designed to build and test CIM systems. They will focus on mechanical design and discrete manufacturing.

The CIMLABS and CIM program signify Digital's dedication to helping its customers automate and integrate their engineering, manufacturing, and office operations. Digital is a leading worldwide supplier of CIM solutions.

Digital is one of the largest suppliers of computer equipment for the factory floor and its VAX computers have set the standard for distributed engineering computing. Digital also has a strong set of products for business and office automation applications, such as ALL-IN-1, its office and information system integration tool. The CIMLABs will use these and other products to help Digital's customers develop their own CIM systems designed to keep them competitive in worldwide markets.

Digital names two new authorized distributors ☐ Two companies came on board as authorized distributors for Digital during the quarter. ASK Computer Systems Inc., which has been affiliated with Digital for more than four years as a commercial original equipment manufacturer, was named an Authorized Digital Computer Distributor. A pioneer in providing management information systems, ASK is the leading independent supplier of minicomputer-based manufacturing and financial planning and control software.

Morse Typewriter of New England became an Authorized Distributor of Digital's DECmate III word processing systems and associated equipment. It will remarket these products in New England and upstate New York.

Consolidated Balance Sheets

(Dollars in thousands)	March 30, 1985	June 30, 1984
Assets		
Current Assets		
Cash and temporary cash investments	$ 898,851	$ 476,150
Accounts receivable, net of allowances	1,484,694	1,527,257
Inventories	2,017,754	1,852,168
Prepaid expenses	71,062	57,030
Deferred income tax charges, net	182,300	169,308
Total Current Assets	4,654,661	4,081,913
Property, plant and equipment, net	1,678,468	1,511,340
Total Assets	$6,333,129	$5,593,253
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	$ 15,872	$ 13,181
Other current liabilities	1,044,984	1,067,363
Total Current Liabilities	1,060,856	1,080,544
Deferred income tax credits, net	36,400	92,180
Long-term debt	837,341	441,313
Total Liabilities	1,934,597	1,614,037
Stockholders' Equity		
Common stock, $1 par value	58,711	57,811
Additional paid-in capital	1,682,756	1,610,575
Retained earnings	2,657,065	2,310,830
Total Stockholders' Equity	4,398,532	3,979,216
Total Liabilities and Stockholders' Equity	$6,333,129	$5,593,253

Consolidated Statements of Changes in Financial Position

	Nine Months Ended	
(Dollars in thousands)	March 30, 1985	March 31, 1984
Funds from Operations		
Net income	$346,235	$198,189
Depreciation	219,053	178,072
Other	(34,626)	73,181
Total from operations	530,662	449,442
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	(42,563)	221,336
Inventories	165,586	383,964
Prepaid expenses	14,032	18,632
Other current liabilities	22,379	(108,642)
	159,434	515,290
Additions to property, plant and equipment	406,443	293,586
Total to support operations	565,877	808,876
Net increase (decrease) in funds from operations	(35,215)	(359,434)
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	2,691	159,693
Long-term debt	(3,972)	144,718
8% Debentures due 2009	400,000	0
Stock issued under employee option and purchase plans	59,197	40,244
Effect of exchange rate changes on working capital	0	6,907
	457,916	351,562
Net increase (decrease) in cash and temporary cash investments	422,701	(7,872)
Cash and temporary cash investments at beginning of year	476,150	556,209
Cash and temporary cash investments at end of period	$898,851	$548,337

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Three Months Ended		Nine Months Ended	
	March 30, 1985	March 31, 1984	March 30, 1985	March 31, 1984
Revenues				
Equipment sales	$1,142,823	$ 978,938	$3,287,969	$2,668,522
Service and other revenues	548,304	451,827	1,546,487	1,260,416
Total Operating Revenues	1,691,127	1,430,765	4,834,456	3,928,938
Costs and Expenses				
Cost of equipment sales, service and other revenues	1,032,224	854,965	2,923,536	2,389,552
Research and engineering expenses	173,067	155,288	507,739	440,752
Selling, general and administrative expenses	382,304	291,398	1,050,352	833,595
Operating income	103,532	129,114	352,829	265,039
Interest expense	20,964	8,185	60,070	19,825
Interest income	(15,974)	(10,547)	(44,529)	(30,048)
Income before income taxes	98,542	131,476	337,288	275,262
Income taxes	6,854	29,624	(8,947)	77,073
Net income	$ 91,688	$ 101,852	$ 346,235	$ 198,189
Net income per share (1)	$ 1.52	$ 1.77	$ 5.77	$ 3.46

(1) Net income per common equivalent share was computed based on a fully diluted calculation of the weighted average of such shares outstanding during the period: 61,677,882 shares and 57,354,021 shares for the nine-month periods ended March 30, 1985 and March 31, 1984, respectively, and 63,160,924 shares and 57,493,609 shares for the three-month periods ended March 30, 1985 and March 31, 1984, respectively.

Additional Highlights

- Digital increased its strength in the manufacturing management market by entering into a cooperative marketing agreement with GSI Transcomm of Pittsburgh. When used with Digital's VAX computers, GSI Transcomm's TOLAS™ software provides manufacturers or wholesale distributors with a complete solution for distribution and financial management applications. One such customer, Pioneer-Standard Electronics, Inc., a major electronics distributor, uses TOLAS on its six-unit VAXcluster system. The system manages Pioneer-Standard's shipping, receiving, ordering, and billing operations in 27 distribution locations.

- The opening of a new CAD/CAM center in Detroit this quarter brought Digital's worldwide total to 20. The new operation complements Digital's Detroit Field Application Center, one of 14 such centers we operate worldwide to help our customers implement total solutions to their business problems. All Digital Centers are part of our evolving Application Centers for Technology (ACT) program. ACT provides total customer support for many application areas and for all phases of a project, including system selection, decision making, and implementation.

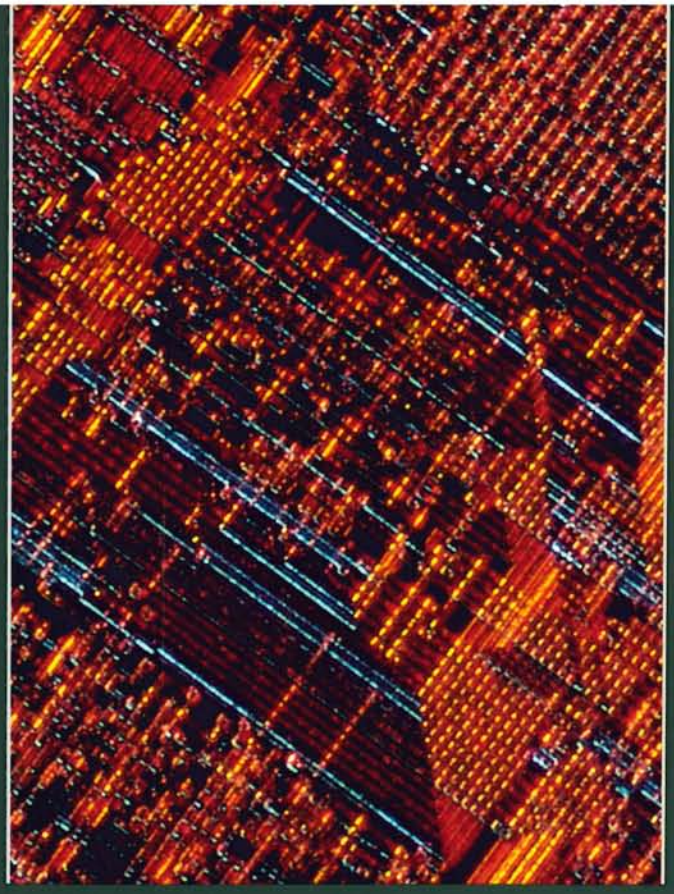
- Digital began shipping DECalc Version 2.1, an enhanced version of the popular spreadsheet program. This version enables people who work with numbers to increase their productivity significantly. DECalc, the fastest-selling application program for Digital's VAX computers, is the first spreadsheet program that was specifically designed for systems with more than one user. DECalc Version 2.1 interacts directly with other Digital office automation software products, such as ALL-IN-1, VAX DECgraph, and VAX DATATRIEVE, allowing users to transfer data between programs without tedious retyping.

Digital's common stock is traded on the New York Stock Exchange and Pacific Stock Exchange (Ticker Symbol "DEC").

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, and Philadelphia Stock Exchange.

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

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



DIGITAL EQUIPMENT CORPORATION
FIRST QUARTER REPORT 1986

Digital Equipment Corporation
Maynard, Massachusetts 01754

digital

On the Cover: Implementation of VAX architecture on a single chip, enlarged here 10,000 times, brings full VAX functionality and networking capabilities to Digital's desktop MicroVAX II and VAXstation II computer systems.

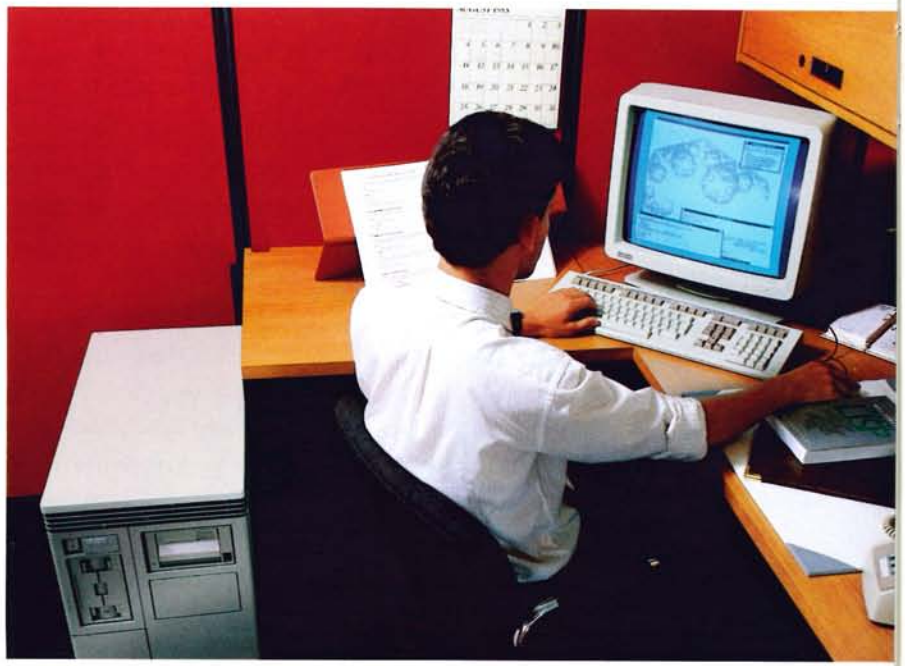
To Our Shareholders

Total operating revenues for the first quarter ended September 28, 1985 were $1,623,927,000, compared to $1,515,263,000 a year ago. Net income for the quarter was $72,325,000 or $1.20 per share, compared to $80,966,000 or $1.38 per share a year ago. Last year's first quarter results also included $63,250,000 or $1.07 per share as a one-time benefit from the tax treatment of Domestic International Sales Corporations (DISCs). Total net income for the first quarter of a year ago was $144,216,000.

We appear to be faring better than most during the protracted slump in the computer industry because of our ability to deliver the high-speed networking solutions that businesses want and need most. Digital integrates local networks into single, company-wide systems that allow all sizes of computers to communicate, to share workload, and to share common databases. For 15 years we've built our entire product strategy around networking. We provide a complete range of large and mid-size computers, workstations, and personal computers that can be tied together easily and economically through local and global communications, and connect to competitive machines.

Business outside the United States remained strong this quarter, particularly in Europe, but our United States business continued to reflect the cautious spending of some of our major customers. We continued to show improved productivity in our operations, with inventories down more than $100,000,000 from the previous quarter. Receivables were also lower.

Kenneth H. Olsen
President



Industry's first fully integrated workstation for artificial intelligence, the AI VAXstation combines the performance of the MicroVAX II with multitasking, multiwindowing capabilities and large-screen, high-resolution graphics.

NEW PRODUCTS ENHANCE DIGITAL'S INTEGRATED NETWORKING STRATEGY

Several important new products were introduced during the quarter, each an implementation of the integrated networking strategy on which Digital has been building for many years and each designed to address a specific information management need.

Of the most significance is the LAN Bridge 100, which dramatically extends the ability to build and connect Ethernet local area networks (LANs). Previously, local networks were usually limited to the confines of a single room or a small building. Digital's new bridge makes it possible to interconnect several local networks and effectively removes limitations on the size of the network. It permits the building of a single, virtually seamless network capable of supporting thousands of computers, workstations, printers and other devices.

The bridge also directs message traffic dynamically within a local network or between networks to ensure optimum utilization. Intradepartment messages are kept within the local segment, and those messages intended for other departments are passed along to other segments of the network. The extended network moves information at the same speed as a single local network. The LAN Bridge will be available in January.

The LAN Bridge adds an important new dimension to Digital's local area networking capability. Our Ethernet-based strategy has been very successful and we continue to be encouraged by the growing number of users who see our implementation of local networks as the best solution available today.

Other new products introduced within the context of our overall strategy include:

- A high-capacity MicroVAX II system that greatly increases the amount of data that can be stored in a single system and increases from 21 to 33 the number of users who can be connected to the system. The increased storage capacity makes this new system particularly cost effective for data-intensive applications such as computer-aided design and seismic analysis. Its ability to support many more simultaneous users makes the new system ideally suited to timesharing applications in commercial as well as technical and scientific organizations. The new high-capacity MicroVAX II is available for immediate delivery.

- Slated for December delivery is a new MicroVAX-based system for artificial intelligence (AI) applications. Called the AI VAXstation, it is the industry's first fully integrated workstation and is priced under $50,000. It provides a practical and inexpensive development tool in the fast-growing "knowledge engineering" field, offering such features as multitasking, multiwindowing and high resolution graphics on a large, easy-to-read screen. We expect this new AI workstation to be popular in a wide variety of commercial, technical and industrial markets, including aerospace, petrochemicals, government, finance and education. Applications developed on this new system will run on any other computer in the VAX family, from entry-level MicroVAX IIs to the largest VAXcluster systems.

Digital offers a wide range of artificial intelligence software tools, all of which run on any VAX computer. They include VAX LISP, Digital's version of the emerging standard language of AI; ADA;* an AI language

widely used in government projects; and VAX OPS5, a language used by customers with expertise in knowledge engineering.

The AI VAXstation is the latest evidence of Digital's commitment to maintain its leadership in the burgeoning artificial intelligence market. We continue to invest in new software products, programming environments and workstations to meet problem-solving needs in such areas as fault-diagnosis, image analysis, factory scheduling, process control and financial planning.

- Three additional high-end VAXstation 500 systems were also introduced which combine high resolution, high performance color graphics with full VAX power and functionality for applications in the electronics, laboratory, petroleum and government markets. Deliveries will start in December.

New Digital Plants for Mexico, Scotland

The company has announced that it will develop two new manufacturing facilities outside the United States. A 50,000-square-foot plant at Chihuahua, Mexico, for the assembly and testing of MicroVAX II systems will begin operations early in 1986. The new facility meets Mexican government requirements for foreign investments and will give Digital access to the important Mexican computer market, which is expected to reach $500 million by 1988. In addition to its Chihuahua plant production, the company will also be allowed to import computer systems to serve customers in Mexico, and will export locally produced systems to Latin America.

The company will also expand its manufacturing operations in Scotland with a 200,000-square-foot semiconductor facility on an 86-acre site at South Queensferry, near Edinburgh. Construction begins in 1986; completion is scheduled for early 1988. Digital also has a plant at Ayr, near Glasgow. The new facility will supply growing European production requirements and significantly increase the company's production of proprietary custom integrated circuits, which are currently produced at Digital's Semiconductor Technology Center in Hudson, Massachusetts.

New Software Forges Direct Link to IBM Environment

A new, low-cost software product will be available in December that links Digital's MicroVAX-based systems directly to computing environments using the IBM* Systems Network Architecture (SNA). The new software, called VMS/SNA, builds on the compatibility inherent in Digital's VAX/VMS architecture and allows users to distribute VAX power and functionality throughout their organization while still being able to access large IBM databases. It does not require a gateway between the SNA and the Digital Network Architecture (DNA).

VMS/SNA is intended for traditional MIS and data processing centers that need to distribute computing resources to other departments, divisions or remote branches. Local teams of users can use a MicroVAX or VAXstation as their primary computer and still gain direct access to an SNA environment. This new capability provides a practical, economical solution in applications areas such as sales or banking that demand reliable, high-speed local computing but that also require an occasional connection to an SNA environment.

Digital Shows Networking Strengths in Europe

More than 7,500 executives representing customers from 17 countries gathered at Cannes, France, in mid-September to view DECville '85, the largest one-company trade show in the history of the European information technology industry. Patterned after the succesful DECworld expositions in the United States, DECville '85 showcased the company's leadership in integrated computer networks and vividly demonstrated our problem-solving strengths across a vast range of commercial, technical and industrial applications areas.

The show assembled $30 million of hardware, software, and communications products under one roof, all linked by Digital's Ethernet into a single, integrated network. Products from Digital's European original equipment manufacturers, third-party software suppliers and participants in Digital's Cooperative Marketing Program were important elements in many exhibits.

Among the highlights of the exposition was the most extensive computer-integrated manufacturing (CIM) exhibit ever assembled. It demonstrated how the various functions of a manufacturing company–product design, parts production, inventory control, order entry–can be linked into a single, fully integrated system. The CIM exhibit featured BASEWAY, Digital's integration application for factory automation. Other demonstrations of CIM applications included electronic and mechanical engineering, manufacturing and resource planning and distribution management.

Other demonstrations, and a program of management presentations, explained Digital's strategies and strengths in the office, finance,

research, science, education and technology markets. Another showcase of Digital's capabilities is being planned for the United States early in 1986.

The 21st annual European symposium of DECUS, the Digital Equipment Computer Users Society, was also held at Cannes. Approximately 1,800 members from 33 countries attended the forum that explored the issues of how integrated computer networks can be used to solve business problems. The next symposium for DECUS members in the United States will be held in California in December.

Major Vendors Join Expanded Cooperative Marketing Program

Four major suppliers of computer-aided design (CAD) systems for mechanical engineering have joined Digital's new Systems Cooperative Marketing Program, an expansion of our successful Cooperative Marketing Program. The new program is the company's latest effort to promote compatibility and interconnectibility among major suppliers to the computer-integrated manufacturing (CIM) market.

The four new participants are Applicon, a Schlumberger, Ltd. company; CIS/Computervision Corporation; MATRA DATAVISION, Inc. and McDonnell Douglas Manufacturing Industry Systems.

One recent SCMP-related purchase involves The Stop & Shop Companies, Inc., a major Northeast supermarket and retail department store chain, which recently purchased a number of MicroVAX II systems through McDonnell Douglas. These systems are equipped with design

and layout software developed by McDonnell Douglas and will be used to develop prototypes of planned "superstores."

Two software vendors also became new participants in Digital's long-standing Cooperative Marketing Program. Computer Data Information Systems, Inc., of West Lake Village, California, a vendor of distribution and financial management programs; and Exploration Computer Services, Inc., of Dallas, Texas, which markets mine-planning software for VAX computers.

MicroVAX Links International Banking Network

The Society for Worldwide International Financial Telecommunications, (S.W.I.F.T.), has chosen Digital's MicroVAX II systems to connect member banks to its new international financial processing network. The value of the agreement to Digital could reach $30 million over the next several years.

A cooperative, nonprofit society registered under Belgian law and headquartered near Brussels, S.W.I.F.T. services 1,600 member banks in 40 countries. Through a wholly owned subsidiary, S.W.I.F.T. Terminal Services (STS), the society will market the ST400 turnkey system, which combines the MicroVAX II system with applications software that will enable member banks to connect to the SWIFT II network. The ST400 system will be available with the introduction of the network in mid-1986. Daily traffic on the network will exceed 650,000 transactions.

The software used on the ST400 system can be used with any VAX computer and will be available to bankers worldwide both as a decision support tool and as a means of delivering their services more efficiently. All of the software programs created for the VAX computer family will also run on the ST400 system.

Important New Document Processing Products

Digital made significant additions to its document processing capabilities, introducing a new generation of WPS-PLUS software packages with industry-leading linguistic capabilities that run on all VAX computers. The new software offers a fully integrated document processing environment that includes Digital's DECmate word processors, Rainbow personal computers, and Professional desktop minicomputers, as well as IBM PCs and PC/XT*s. It allows the user to create and edit documents on any of these workstations using the same keystrokes and commands. Documents can then be transferred to a VAX-based ALL-IN-1 Office and Information System for electronic review, distribution and printing on high-quality laser printers. These new document processing packages will be available by December. European language versions will be available in February.

Digital Wins Major Contracts

- Digital was chosen by Electronic Data Systems Corporation (EDS) to provide computer systems for use by EDS to automate manufacturing operations at five facilities of the General Motors Truck and Bus Division in the United States and Canada as part of an historic project known as GMT 400, for which EDS has been designated the systems

integrator by GM. Under the terms of a five-year, multimillion-dollar contract with EDS, Digital will supply clustered VAX 8600 systems to each plant, together with PDP-11/24s and MicroVAX systems running Digital's BASEWAY factory integration application. Digital will also supply field-maintenance and software-support training.

- Digital was granted a $5 million contract to establish a training center at the Royal Hong Kong Jockey Club. Staffed by Digital instructors, the center will provide hardware maintenance, software operations, applications and office automation training for the club's 4,000 full-time and 8,000 part-time employees. The Jockey Club is a nonprofit organization that uses revenues from its operation of two race tracks to support many community projects and charitable organizations in Hong Kong.

- The District of Burnaby, British Columbia, purchased a large VAX-cluster system for use in its municipal administration and base mapping operations. The system runs INFORMAP* II and EMIS* mapping software from Synercom Technology, Inc., a participant in Digital's Cooperative Marketing Program. It also runs Digital's ALL-IN-1 Office and Information System. All of Burnaby's statistical and geobased data are being integrated into a single database. Officials there estimate that the time required to maintain their base maps has been reduced from 340 person-days per year under a manual system to 40 days with the new system, and operating costs have dropped from approximately $60,000 a year to under $1,000.

- Daisy Systems Corporation, Mountain View, California, and Digital signed an original equipment manufacturer (OEM) agreement whose value is expected to exceed $50 million in the first two years. A leading supplier to the computer-aided engineering (CAE) market, Daisy Systems will sell a series of MicroVAX II-based workstations with its extensive offering of CAE tools. The first product in the series, the LOGICIAN VX* system, will be available in early 1986.

- Another OEM, General Electric's CALMA Company subsidiary, a major supplier of computer-aided manufacturing and design systems, recently ordered 400 MicroVAX II systems which it will market in combination with GE/CALMA mechanical computer-aided design software.

- The CAE Systems Division of Tektronix, Inc., will market MicroVAX and VAXstation systems with its computer-aided engineering design software. And Tektronix's Software Development Products Division will market its microprocessor Digital's software for use on workstations.

Other First-Quarter Highlights

- Digital signed a cooperative marketing agreement with Mead Data Central, Inc. to market products that interface with Mead's information services which include full-text legal, business, medical, and general news and information databases, all of which now will work with any of Digital's computer systems employing emulation mode for VT100 or VT200 terminals.

- Additional new products introduced by Digital during the quarter included a faster-throughput controller that increases disk performance for all MicroVAX II systems; a new version of VAX-11 RSX software that permits users of applications software developed on PDP-11 computers to run those programs on MicroVAX II systems; and a new 20-Mbyte Winchester technology disk drive that offers twice the storage capacity and faster data access than earlier models, and will become a standard component in Rainbow personal workstations.

- The President's Citation Program for Private Sector Initiatives honored Digital for its support of Project 50/50, a regional computer based education program jointly sponsored by the French River Education Center, the Oxford, Massachusetts public schools and Digital. The company was also cited by the Business Committee for the Arts for having "one of the finest art support programs in America." The award recognized Digital's long-term comprehensive support of cultural institutions and its major contributions to public television through program underwriting and support of fund-raising auctions conducted by public broadcasting stations nationwide. The Business in the Arts Program is co-sponsored by Forbes Magazine.

*LOGICIAN VX is a trademark of Daisy Systems Corporation.

Consolidated Balance Sheets

(Dollars in thousands)	**September 28, 1985**	June 29, 1985
Assets		
Current Assets		
Cash and temporary cash investments	**$1,360,778**	$1,080,180
Accounts receivable, net of allowances	**1,510,130**	1,538,955
Inventories	**1,653,367**	1,756,167
Prepaid expenses	**90,950**	64,569
Deferred income tax charges, net	**201,902**	197,957
Total Current Assets	**4,817,127**	4,637,828
Property, plant and equipment, net	**1,754,112**	1,731,029
Total Assets	**$6,571,239**	$6,368,857
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	**$ 20,948**	$ 12,251
Other current liabilities	**1,033,792**	931,358
Total Current Liabilities	**1,054,740**	943,609
Deferred income tax credits, net	**38,204**	33,704
Long-term debt	**837,189**	836,945
Total Liabilities	**1,930,133**	1,814,258
Stockholders' Equity		
Common Stock, $1 par value	**59,478**	59,253
Additional paid-in capital	**1,751,791**	1,737,834
Retained earnings	**2,829,837**	2,757,512
Total Stockholders' Equity	**4,641,106**	4,554,599
Total Liabilities and Stockholders' Equity	**$6,571,239**	$6,368,857

Consolidated Statements of Changes in Financial Position

	Three Months Ended	
(Dollars in thousands)	**September 28, 1985**	September 29, 1984
Funds from Operations		
Net income	**$ 72,325**	$144,216
Depreciation	**83,407**	69,080
Other	**11,766**	(56,543)
Total from operations	**167,498**	156,753
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	**(28,825)**	(29,541)
Inventories	**(102,800)**	165,665
Prepaid expenses	**26,381**	(3,745)
Other current liabilities	**(102,434)**	(23,979)
	(207,678)	108,400
Additions to property, plant and equipment	**114,523**	125,095
Total to support operations	**(93,155)**	233,495
Net increase (decrease) in funds from operations	**260,653**	(76,742)
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	**8,697**	2,389
Long-term debt	**244**	142
8% Debentures due 2009	**–**	400,000
Stock issued under employee option and purchase plans	**11,004**	6,831
	19,945	409,362
Net increase (decrease) in cash and temporary cash investments	**280,598**	332,620
Cash and temporary cash investments at beginning of year	**1,080,180**	476,150
Cash and temporary cash investments at end of period	**$1,360,778**	$808,770

Consolidated Statements of Income

(Dollars in thousands except per share data)	Three Months Ended **September 28, 1985**	September 29, 1984
Revenues		
Equipment sales	**$1,055,621**	$1,035,584
Service and other revenues	**568,306**	479,679
Total operating revenues	**1,623,927**	1,515,263
Costs and Expenses		
Cost of equipment sales, service and other revenues	**964,401**	917,032
Research and engineering expenses	**187,837**	165,024
Selling, general and administrative expenses	**373,189**	323,348
Operating income	**98,500**	109,859
Interest expense	**21,134**	17,874
Interest income	**(20,370)**	(11,818)
Income before income taxes	**97,736**	103,803
Income taxes	**25,411**	(40,413)
Net income	**$ 72,325**	$ 144,216
Net income per share *(1)*	**$1.20**	$2.45

(1) Net income per common equivalent share was computed based on a fully diluted calculation of the weighted average of such shares outstanding during the period: 63,874,102 shares and 59,164,197 shares for the three month periods ended Sept. 28, 1985 and Sept. 29, 1984, respectively.

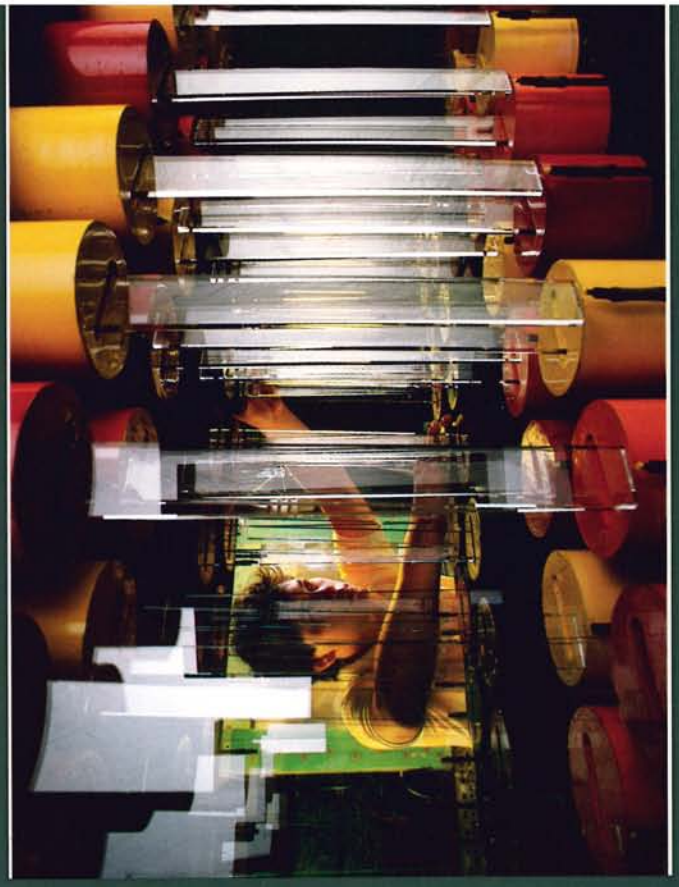
Digital's common stock is listed and traded on the New York Stock Exchange and Pacific Stock Exchange (Ticker Symbol "DEC").

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, Philadelphia Stock Exchange, and Luxembourg Stock Exchange.

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

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

Photo on cover taken by Phillip A. Harrington/ Fran Heyl Associates.



DIGITAL EQUIPMENT CORPORATION
SECOND QUARTER REPORT 1986
REPORT OF THE 1985 ANNUAL MEETING

Digital Equipment Corporation
Maynard, Massachusetts 01754

Bulk Rate
US Postage
PAID
Permit No. 129
Northboro, MA
01532

digital

On the Cover: Lawrence Berkeley Laboratory in California employs a wide range of sophisticated instruments to support research. Data is collected, transported, and analyzed by a network of Digital computers including five VAX 8600 systems.

To Our Shareholders

Total operating revenues for the second quarter ended December 28, 1985 were $1,862,493,000, up more than 14 percent from the $1,628,066,000 recorded in the comparable period one year ago. Net income for the quarter was $136,114,000 or $2.17 per share, compared to $110,331,000 or $1.81 per share last year.

For six months ending December 28, 1985, total operating revenues were $3,486,420,000, compared to $3,143,329,000 in the prior year. Net income for the half was $208,439,000 or $3.36 per share versus $254,547,000 or $4.24 per share last year. Last year's first half results included $63,250,000 or $1.07 per share as a one-time benefit from the tax treatment of Domestic International Sales Corporation (DISCs).

Demand increased in the quarter, particularly in the United States. This was due in part to the introduction and immediate availability of several significant products over the last twelve months. Our MicroVAX II and VAXstation II systems are doing extremely well after nine months, with more than 12,000 shipped to date. Customer reaction to the new VAX 8650, our biggest and most powerful system, has been very enthusiastic. The new high-speed technical workstation introduced in mid-January also is being very well received. Called the VAXstation II/GPX system, it is very fast and provides a number of advanced capabilities, including high-performance color.

Kenneth H. Olsen
President

Highlights from the Annual Meeting of Shareholders 1985

The annual meeting was held Friday, November 8, 1985, in Boston, Massachusetts. Mr. Kenneth H. Olsen, President, presided.

Approximately 72 percent, or 43 million, of the common shares were represented at the meeting in person or by proxy. The four items listed in the Proxy Statement were voted upon at the meeting and received a majority of the votes cast:

- To fix the number of directors at seven and to elect the Board of Directors for the ensuing year.

- To approve an amendment to the 1968 Employee Stock Purchase Plan to increase the number of shares subject to the plan.

- To approve the Digital Equipment Corporation 1985 Restricted Stock Option Plan.

- To ratify and approve the selection of the firm of Coopers & Lybrand as auditors for the fiscal year ending June 28, 1986.

Highlights from Kenneth H. Olsen's Presentation

Today, and for a number of years, our goal as a company has been to sell computers that can be linked together in networks. Networking is a concept we developed very early on. A project we developed at MIT before founding Digital involved very large, extensive networks. One of the things we did from the very start was to tie computers together. We also had to tie, or network, our computers to IBM* computers.

Then, about 15 years ago, we set out with a very formal, very disciplined, and very organized set of goals and strategies to make networking the theme of all our products. At that time we laid out a protocol that was designed to last forever. We call that protocol DECnet. Today it is the most commonly used networking protocol and it's the basis of all we have to offer.

We also laid out a computer architecture that would lend itself to a consistent networking strategy and that would also last forever. We call it the VAX Information Architecture. At the same time we laid out a software strategy to work on VAX systems. That software is called VMS (Virtual Memory System.) The heart of VMS software has been the integration of all the parts into a network.

In the late '70s, we chose a vehicle upon which to carry out our networking, called Ethernet. Proposed by Xerox Corporation, Ethernet was a concept that we, Xerox, and several other companies strove to make the industry standard. Today it is probably the most commonly accepted vehicle for networking.

So, the confidence we have in the future of the company arises from this strategy – and, in many ways, from the extreme discipline it took to carry out. Today we can offer networking that I think is commonly agreed to be the only complete set of networking that truly works across a whole organization...

We are doing it [networking] better all the time; we are investing heavily in it. This is where we feel the next big change, big improvement in computing, and the next big contribution to industry is going to be. It is in this kind of networking where the whole organization can work together.

We have the advantage of starting early, of laying out a strategy where everything fits together. This gives us an enormous advantage over those who do not have the resources and the background to make software, or those who have many different types of computers, many different types of software, and many different types of activities which never were designed to fit together.

New Products Heighten System Performance for Large-Scale Applications

During the first week of December, several important products were announced, each designed to bring an added dimension of VAX power and performance to large-scale computing and capitalize on Digital's existing strengths in networking and VAXcluster technology. The VAXcluster technique permits the tying together of large numbers of VAX computers with one database to create a single, very large system.

Perhaps the most significant is the introduction of the VAX 8650, a powerful addition to the VAX family that combines fast throughput, system availability, and operating economy. Such systems were once thought to be the exclusive domain of large, expensive mainframe computers. The VAX 8650 system is 44 percent more powerful than the VAX 8600 and up to six times more powerful than the VAX-11/780, the industry standard for 32-bit computers.

Based on the enthusiastic response to the VAX 8600 introduced last year, this new system is expected to accelerate Digital's penetration into office automation, computer-integrated manufacturing, and management information systems, as well as to provide a more powerful system for other markets that Digital has served for years – science, engineering, and research.

In environments with many users, the VAX 8650 greatly improves user response time across the organization. It connects to Digital's local- and wide-area networks, enabling communication with other Digital systems worldwide. The VAX 8650 also can communicate with systems of other manufacturers, such as IBM. Other associated announcements by Digital this quarter include:

- Main memory capacity of both the new VAX 8650 and the VAX 8600 has been more than doubled from that of the previous VAX 8600.

- New versions of Digital's VMS database management and relational database management software enable users to distribute their applications to VAXclusters, local-area networks, wide-area networks, and to combinations of these networks and VAXclusters.

- The assembly of two comprehensive collections of programming tools for large- and small-scale software development. VAXset features five sophisticated development tools for the implementation, testing, and maintenance of system software and application programs that operate in the VAX/VMS environment. VNXset is a collection of software engineering products that provide programmers with a simulated UNIX* environment for the VAX/VMS operating system.

Highlights from Europe

Digital expanded its cooperative strategy in Europe during the quarter. Through this strategy, Digital enters into non-exclusive agreements with major European companies in joint projects, sharing technology to develop and – where appropriate – to market complementary products.

For example, Digital's Italian subsidiary and COMAU, a subsidiary of FIAT, agreed to establish a joint venture company called SESAM. SESAM will develop manufacturing automation products targeted to the fast-growing market for computer-integrated manufacturing (CIM) solutions. This Digital-COMAU venture culminates ten years of growing cooperation between the two companies.

In other news, Digital recently delivered three VAX 8600 computer systems to Intasun Travel, one of Britain's largest travel agencies, and received an order for a fourth such system. When combined with Intasun's existing Digital computers, the new systems will comprise one of the largest commercial VAXclusters in Europe.

Meanwhile, Digital will supply four VAX 8600 computer systems to the Italian Institute for Nuclear Physics (INFN). These systems will be connected to the sophisticated INFN-net communications network linking the physics departments of the Italian universitites of Milan, Padua and Rome, the INFN national laboratories in Frascati, Catania, and Legnaro, and the CERN laboratory in Geneva, Switzerland – all of which already use one or more VAX computer systems. The installation of the new VAX 8600 will significantly boost the computing power available to researchers while guaranteeing complete compatibility with their existing systems.

Digital also officially opened an Application Center for Technology (ACT) in Turin, Italy. The new center augments similar centers in the United Kingdom, West Germany and France and features CIM solutions with a particular emphasis on the automotive industry.

Key Customers Select VAX 8600 to Enhance Product Development and Manufacturing

Digital's VAX 8600 system was pivotal to several key sales within the engineering and manufacturing industries this quarter. More than 1,000 systems have been shipped over the last 12 months to both new and existing customers. For example:

- Cincinnati Milacron, Inc., a leading manufacturer of machines, robots, and other products and systems for the metal-working and plastic-processing industries, purchased the VAX 8600 for its software engineering and development capabilities.

- The Electronics Control & Distribution Divison of Westinghouse Canada, Inc., selected the VAX 8600 because of its performance capabilities and Digital's overall networking and computer-integrated manufacturing capabilities. The company also cited the ability of VAX systems to run MRP II (manufacturing resource planning) software from Cincom Systems, Inc., which has a cooperative marketing agreement with Digital. Westinghouse's new system also uses Digital's comprehensive ALL-IN-1 Integrated Office and Information System.

- A joint venture of Parsons, Brinckerhoff, Centec, Inc. and De Leuw, Cather & Company, engineering consultants, recently purchased VAX 8600 and MicroVAX II computers for use in the Dallas Area Rapid Transit (DART) project. The DART project, which consists of more than 147 miles of light rail, will use VAX-based integrated structural and civil design, analysis, and drafting applications developed and sold by McDonnell Douglas. The project is expected to take 25 years, with completion of the first segment due in 1988. Initially, 13 graphics design stations and 20 engineering workstations from Digital will be used, with additional purchases expected as the project continues.

Additionally, the Aluminum Company of America (Alcoa) replaced the computer equipment at its aluminum smelting plant in Rockdale, Texas with a new Digital system. The system includes PDP-11/84 computers to control cell lines. Via Digital's DECnet network, the PDP-11/84 computers are linked to a VAX-11/750 computer, which performs critical data management functions during the smelting process. Digital's DECnet/SNA gateway links the plant's operations with Alcoa's corporate IBM host computer.

Digital Named the Official Computer Vendor of the National Football League

During the second quarter, the National Football League (NFL*) named Digital the Official Computer Vendor of the NFL. Under terms of the exclusive, four-year agreement, each of the NFL's 28 member teams received a MicroVAX II computer or equivalent credit towards a larger VAX computer system. The MicroVAX II systems can be used as stand-alone computers or to support the individual teams' needs for multi-user systems.

The NFL plans to use Digital's ALL-IN-1 Integrated Office and Information System software on the system. Each team's VAX computer will be linked via Digital's DECnet/Ethernet network to a powerful VAXcluster at NFL headquarters in New York.

"This agreement caps more than two years of study by the league to expand its computer capacity by creating a common office and information system and a communications network between member clubs and league headquarters," said John Schoemer, NFL Treasurer.

"With the installation of a MicroVAX II or larger VAX computer and ALL-IN-1 software at each club, we are applying the modern tools of business to professional football," Schoemer added. "With common electronic mail- and word-processing software at all sites, we have gone beyond the scope of our original concept for our network expansion. This is only the first step toward a complete, totally compatible, and flexible communications system."

Top-of-the-line PDP-11 Computer Protects Hardware, Software Investments

Another significant product introduced this quarter is a top-of-the-line PDP-11 computer designed for customers with an investment in PDP-11 architecture and software. The MicroPDP-11/83 computer provides both original equipment manufacturers (OEMs) and end users with greater performance and storage capacity than previously available. As many as 33 users can share the resources of this new computer.

Introduced in the 15th anniversary year of the PDP-11 computer, the MicroPDP-11/83 is fully compatible with all members of the PDP-11 computer family. It is targeted to technical and commercial markets, including offices and small businesses, as well as manufacturing facilities and laboratories.

Digital's Presence in U.S. Education Markets Continues to Grow

Digital's strong performance last year in the education market is expected to continue this year. Some highlights:

- Digital's networking architecture has been widely accepted among U.S. universities. More than 80 percent of them have at least one Ethernet or DECnet network.

- VAX-based workstations also have been popular among universities. The University of California at Berkeley and the Massachusetts Institute of Technology, for example, have very large installations.

Higher education customers also have ordered more than 100 VAX 8600 computer systems in the past year.

- Digital had particularly strong growth in sales to electrical engineering and computer science departments across the country.

- A recent survey by the University of California at Los Angeles found the VAX computer to be the leading computer in business school departments of higher education in the United States.

On the secondary education market front, Digital announced a $3.5 million sale of VAX computer equipment to an Ohio school district consortia to upgrade the organization's data processing network. Under terms of the agreement, Digital will provide the Ohio Education Computer Network (OECN) with six VAX-11/785, three VAX-11/750, and two PDP-11/84 computer systems.

The OECN, based in Columbus, provides cost-effective data processing for school districts throughout the state. Last year, the OECN purchased more than 400 Rainbow personal computer systems for academic and administrative use throughout the network.

"The formation of the OECN has provided a cost-effective approach to computer services and equipment," says Dr. John Parsons, Executive Secretary of the Management Council of the OECN. "Member school districts have saved over $125,000 in maintenance costs and over $500,000 in equipment purchases during the current school year."

Digital Launches New Advertising Campaign

Late in the quarter, Digital launched a new advertising campaign that builds on its "one company, one strategy, one message" philosophy and highlights the integrated solutions the company offers now for a wide range of customers and applications.

Using the theme, "Digital has it now," the ads are directed primarily to a management audience and will be placed in major U.S. business publications, such as BusinessWeek, Forbes, and Fortune. Some of the ads take the form of customer testimonials. Others feature product benefit messages. And some may take the form of "advertorials" which outline business solutions that Digital has now.

In other promotional news, preparations are well along for Digital's third annual DECworld Exposition, which will take place in Boston February 24-28, 1986. This invitation-only trade show is the largest single-vendor presentation in the computer industry and is expected to attract more than 10,000 customers.

National Association of Realtors Chooses Digital's Videotex System

The National Association of Realtors (NAR) has selected Digital's VAX VTX distributed videotex system for dispersing information. The NAR will resell Digital's videotex systems to its 1,900 member boards located throughout the country for keeping track of internal information, such as price lists and catalogs, as well as for delivering information to real estate conventions and trade shows.

Digital's flexible videotex system distributes information in the most common form of computer output, text, and graphics. Even people unfamiliar with computers can obtain information quickly and easily. NAR members can combine Digital's VAX VTX with word and document processing, electronic mail, and other office-related functions running under Digital's ALL-IN-1 Integrated Office and Information System.

New Cooperative Marketing Agreements Boost Digital's Integrated CAD/CAM Solutions

A number of major developers of computer-aided design/computer-aided manufacturing (CAD/CAM) software entered into cooperative marketing agreements with Digital this quarter.

Agreements were signed with Teradyne, Inc. and ECAD, Inc., both of which market software for electronics engineering; the Software Development Product Division of Tektronix, Inc. (TEK/SA), which provides state-of-the-art solutions for software engineers; and Structural Dynamics Research Corporation (SDRC) which markets mechanical design software that runs on Digital's VAX computers.

Pritzker & Associates was selected for its manufacturing simulation software that is available on all VAX computers. And Biles & Associates provides a low-cost system solution for supervisory control in the process manufacturing industry.

Digital's strength in earth resource engineering markets was enhanced by the signing of cooperative marketing agreements with Exploration

Consultants Ltd. (ECL) and Engineering Computer Services, Inc. (ECS). ECL provides state-of-the-art application software for the petroleum industry. ECS markets mine-planning software that runs on VAX computers.

Office Solutions Centers Boost OIS Sales

Demonstrating its commitment to the office and information systems (OIS) market, Digital has recently opened 12 Office Solutions Centers in the United States and Canada. Because of their success, the company is proceeding with plans to add others throughout the world this year.

The Office Solutions Center Program aims to bring marketing expertise closer to Digital's customers. The centers are designed to show customers realistically how Digital's OIS solutions can work. They are staffed by Digital office experts who give presentations, demonstrate the company's latest office products, evaluate customer business requirements, and provide customized solutions to business problems.

The full range of Digital's VAX family of computer systems – all of which run on Digital's ALL-IN-1 Integrated Office and Information System – as well as the company's personal computers, are featured at the centers.

The Office Solutions Centers are part of Digital's Application Center for Technology (ACT) program, a worldwide effort to bring expertise and customer visit centers closer to our customers. So far, Office Solutions Centers have opened in New York City (at Wall Street and Penn Plaza); San Francisco, Santa Clara, and Irvine, California; Detroit; Denver; Marlboro, Massachusetts; Chicago; Seattle; Rochester, New York; and Ottawa, Canada.

Digital's Depth in Computer-Integrated Manufacturing Is Seen at Autofact '85

At AUTOFACT '85, the largest trade show of the computer-aided design/computer-aided manufacturing (CAD/CAM) industry, Digital demonstrated the depth of its ongoing commitment to provide customers with integrated solutions.

As evidence of this strategy, a major software product, designed to manage and control engineering data, was announced at the show. The product, VAX EDCS (Engineering Data Control System), tracks, organizes and manages data files for engineers and managers in CAD/CAM environments.

Digital demonstrated a wide range of networked, integrated applications that featured software and hardware from Digital, and from 11 software applications suppliers in the company's Cooperative Marketing Program.

Additionally, Digital coordinated a multi-vendor OSI-on-Ethernet demonstration. OSI (Open System Interconnect) is the international framework for networking different types of computers from various manufacturers. Digital is one of the first companies to announce its commitment to OSI.

Digital also displayed its MAP (Manufacturing Automation Protocol) networking capabilities by participating in General Motors' MAP exhibit, which linked equipment from 25 different computer and manufacturing vendors in an interactive environment.

Corporate Contributions Highlights

Some recent highlights of Digital's continuing commitment to the communities in which our employees live and work:

- Various Massachusetts-based organizations which shelter the homeless have received more than $67,000 in technical assistance, cash, and equipment grants. Recipients to date include Our Father's House in Fitchburg, Lazarus House in Lawrence, and The Governor's Fund for the Homeless.

- Furthering its support of programs that provide educational and employment opportunities for the physically and mentally impaired, Digital announced the DECtalk Grant Program. Some 2,000 organizations across the U.S. and Canada have been given the opportunity to apply for grants towards the purchase of as many as five DECtalk systems. These systems convert computer text into high quality speech. Up to $1.8 million has been allocated for the program.

- Over the holidays, Digital hosted more than 400 underprivileged and special needs children from across Massachusetts for an afternoon with the Boston Pops and Vienna Choir Boys.

Consolidated Balance Sheets

(Dollars in thousands)	December 28, 1985	June 29, 1985
Assets		
Current Assets		
Cash and temporary cash investments	**$1,694,028**	$1,080,180
Accounts receivable, net of allowances	**1,641,678**	1,538,955
Inventories	**1,478,272**	1,756,167
Prepaid expenses	**99,965**	64,569
Deferred income tax charges, net	**207,439**	197,957
Total Current Assets	**5,121,382**	4,637,828
Property, plant and equipment, net	**1,792,139**	1,731,029
Total Assets	**$6,913,521**	$6,368,857
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	**$ 31,015**	$ 12,251
Other current liabilities	**1,168,217**	931,358
Total Current Liabilities	**1,199,232**	943,609
Deferred income tax credits, net	**42,704**	33,704
Long-term debt	**837,340**	836,945
Total Liabilities	**2,079,276**	1,814,258
Stockholders' Equity		
Common Stock, $1 par value	**60,051**	59,253
Additional paid-in capital	**1,808,243**	1,737,834
Retained earnings	**2,965,951**	2,757,512
Total Stockholders' Equity	**4,834,245**	4,554,599
Total Liabilities and Stockholders' Equity	**$6,913,521**	$6,368,857

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Three Months Ended		Six Months Ended	
	December 28, 1985	December 29, 1984	**December 28, 1985**	December 29, 1984
Revenues				
Equipment sales	**$1,232,300**	$1,109,562	**$2,287,921**	$2,145,146
Service and other revenues	**630,193**	518,504	**1,198,499**	998,183
Total operating revenues	**1,862,493**	1,628,066	**3,486,420**	3,143,329
Costs and Expenses				
Cost of equipment sales, service and other revenues	**1,088,699**	974,280	**2,053,100**	1,891,312
Research and engineering expenses	**199,135**	169,648	**386,972**	334,672
Selling, general and administrative expenses	**394,310**	344,700	**767,499**	668,048
Operating income	**180,349**	139,438	**278,849**	249,297
Interest expense	**21,789**	21,232	**42,923**	39,106
Interest income	**(25,378)**	(16,737)	**(45,748)**	(28,555)
Income before income taxes	**183,938**	134,943	**281,674**	238,746
Income taxes	**47,824**	24,612	**73,235**	(15,801)
Net income	**$ 136,114**	$ 110,331	**$ 208,439**	$ 254,547
Net income per share *(1)*	**$2.17**	$1.81	**$3.36**	$4.24

(1) Net income per common equivalent share was computed based on a fully diluted calculation of the weighted average of such shares outstanding during the period: 64,563,577 shares and 61,255,463 shares for the six-month periods ended December 28, 1985 and December 29, 1984, respectively, and 64,712,698 shares and 63,346,728 shares for the three-month periods ended December 28, 1985 and December 29, 1984, respectively.

Consolidated Statements of Changes in Financial Position

(Dollars in thousands)	Six Months Ended December 28, 1985	Six Months Ended December 29, 1984
Funds from Operations		
Net income	$ **208,439**	$254,547
Depreciation	**179,330**	140,294
Other	**31,869**	(41,811)
Total from operations	**419,638**	353,030
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	**102,723**	(104,256)
Inventories	**(277,895)**	216,837
Prepaid expenses	**35,396**	13,087
Other current liabilities	**(236,859)**	52,986
	(376,635)	178,654
Additions to property, plant and equipment	**263,642**	257,857
Total to support operations	**(112,993)**	436,511
Net increase (decrease) in funds from operations	**532,631**	(83,481)
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	**18,764**	2,742
Long-term debt	**395**	540
8% Convertible Debentures due 2009	**0**	400,000
Stock issued under employee option and purchase plans	**62,058**	44,984
	81,217	448,266
Net increase (decrease) in cash and temporary cash investments	**613,848**	364,785
Cash and temporary cash investments at beginning of year	**1,080,180**	476,150
Cash and temporary cash investments at end of period	**$1,694,028**	$840,935

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

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, Philadelphia Stock Exchange, and Luxembourg Stock Exchange.

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

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

Digital Equipment Corporation
Third Quarter Report 1986

Digital Equipment Corporation
Maynard, Massachusetts 01754

digital

On the Cover: The highest performance VAX computer system ever built, the VAX 8800 is one of four VAX systems that have debuted since January– enabling Digital to provide a complete range of second-generation VAX systems.

To Our Shareholders

Total operating revenues for the third quarter ended March 29, 1986, were $1,928,287,000, up 14 percent from the $1,691,127,000 recorded in the comparable period one year ago. Net income for the quarter was $170,348,000 or $1.32 per share, up 86 percent from the $91,688,000 or $.76 per share recorded in this quarter last year. (Our references to per share computations reflect the impact of a one hundred percent stock dividend.)

For nine months ending March 29, 1986, total operating revenues were $5,414,707,000, compared to $4,834,456,000 in the prior year. Net income for the nine months was $378,787,000 or $3.00 per share versus $346,235,000 or $2.88 per share last year.

We are encouraged with our performance in a relatively weak market. Digital is benefiting from being able to deliver today the kind of high-speed, integrated networking solutions that customers need. We have also extended the range of compatible systems we offer with several new computer systems announced earlier this year and described in a subsequent page of this report. These factors helped produce solid revenue growth for the quarter and an increase in profit margins.

Kenneth H. Olsen
President

DECWORLD '86 Demonstrates the Integrated Solutions That Digital Can Deliver Now

Nearly 18,000 business executives and senior managers from more than 7,500 companies around the world gathered in Boston for a week in February to attend DECWORLD '86 – the largest exposition ever staged by a single computer company.

More than 400 exhibits at DECWORLD '86 demonstrated the complete range of integrated computer solutions that Digital can deliver now to all types of businesses, industries, and organizations.

Digital employees installed the vast array of computers and peripherals shown in three hotels and two exhibition spaces, in only 96 hours. They created one of the largest local area networks and linked it to Digital's own internal network, the largest private data network in the world.

DECWORLD visitors touring the Solutions Center saw hundreds of integrated solutions for such varied fields as banking, manufacturing, government, information systems, financial services, and telecommunications – all displayed in realistic business settings. In the Technology Center, attendees viewed demonstrations of the company's VAX family strategy, networking systems and architectures, and product development capabilities.

A majority of the products on display at DECWORLD '86 were new, either introduced last year or making their debut. Among the products unveiled at the show were DECconnect software, a complete solution for improved communications and connections among the many different pieces that make up an integrated office environment. Also introduced were a series of networking "packages" to simplify network planning, installation, and maintenance; several VAX information management products; and a variety of other products, systems, and services in the networking, storage, and voice technology areas.

Four New VAX Offerings Expand Digital's Family of Second-Generation VAX Systems

Three new VAX computer systems were introduced in January and a fourth in April. Digital now provides customers with a complete range of second-generation VAX systems, featuring higher performance and higher reliability at lower cost.

The newest additions, the VAX 8200, VAX 8300, VAX 8500, and VAX 8800 computer systems, follow the MicroVAX II, VAX 8600, and VAX 8650 – all of which have been introduced within an 18-month period.

The VAX 8800, the highest performance VAX system ever built, is designed to solve the most demanding compute-intensive problems in such areas as seismic analysis, image processing, artificial intelligence, and high-energy physics.

The VAX 8200, VAX 8300, and VAX 8500 computers complete the second generation's midrange offerings for office, manufacturing, commercial, technical, and scientific use.

DIGITAL'S NETWORKED COMPUTER SYSTEMS SPUR SALES IN MANY MARKETS

Digital saw increased sales in a variety of markets during the quarter. The underlying cause of this success is the company's ability to deliver the networked computer systems that share critical information throughout our customers' organizations, thereby maintaining their competitive edge. Some highlights:

- Simmonds Precision Instrument Systems Division, a subsidiary of Hercules Incorporated, recently purchased a VAX 8600 system with terminal servers and peripherals. The system will be used by 40 electronic engineers to design aircraft fuel gauges and to improve general engineering productivity.

- Allegheny International, Inc., the world's largest manufacturer and marketer of small home appliances with brand names that include Sunbeam and Oster, is installing large-disk MicroVAX II systems, running McDonnell Douglas's UNIGRAPHICS* computer-aided design/computer-aided manufacturing (CAD/CAM) software in its worldwide operations. McDonnell Douglas, Inc., is a participant in Digital's System Cooperative Marketing Program.

- Allegheny also is evaluating Digital for its "preferred office system vendor," and MAXCIM* software for its companywide manufacturing and financial applications. MAXCIM software is a product of NCA Corporation, which has a Cooperative Marketing Agreement with Digital.

- The Factory Automation Products Division of the General Electric Company develops and manufactures numerical controls and programmable logic controls used in factory automation. Recently, the division purchased six MicroVAX II-based multiuser engineering workstations that will be connected by an Ethernet local area network to an existing cluster of VAX-11/785 systems. The workstations will run Silvar-Lisco's schematic capture and integrated circuit design software. Silvar-Lisco has a Cooperative Marketing Agreement with Digital.

- At a time when the petroleum industry faces major challenges in staying productive and profitable, Digital's computing technology is helping oil companies increase their efficiency and effectiveness in the exploration and production processes. One such company, Marathon Oil, recently purchased an upgraded VAX 8600 for seismic and geophysical modeling.

The company had previously purchased critically needed application software from several of Digital's Cooperative Marketing Program suppliers, such as Zycor's software for mapping applications, Energy Systems's software for well log analysis, and Sierra Geophysics' seismic modeling software.

- T. J. Lipton, Inc., a leading manufacturer and distributor of food and beverage products, will be adding several MicroVAX II systems to its existing network of Digital VAX-11/750 and VAX-11/730 systems in several of its U.S. manufacturing facilities. The MicroVAX II systems will be

used for maintenance management applications provided by CHAMPS* software. CHAMPS is marketed by SCI, Inc., which recently signed a Cooperative Marketing Agreement with Digital.

Lipton also plans to purchase additional MicroVAX II systems for software development of manufacturing applications, such as manufacturing and quality control, and analysis applications.

▪ Ellwood City Forge, of Ellwood City, Pennsylvania, recently selected Digital to help the company retain its leadership in the open-die forging industry by computerizing some of its manufacturing operations. From ingots, Ellwood manufactures work pieces that are assembled as components in heavy equipment, such as mining and printing equipment, and in ships.

The company purchased a MicroVAX II computer with four RA81 storage disks to monitor and track work-in-progress and inventory operations at its forging and melting plants in western Pennsylvania. Running NCA Corporation's MAXCIM software, the MicroVAX II also monitors the forge's resource planning activities.

Digital Announces Two-For-One Stock Split

A two-for-one stock split in the form of a 100 percent stock dividend was announced by Digital in March. Dividend shares were distributed on May 9, 1986, to stockholders of record at the close of business on April 18, 1986.

Certificates representing the additional shares will be mailed to stockholders by Digital's Transfer Agent, Morgan Guaranty Trust Company of New York.

The last Digital stock split, on a three-for-one basis, occurred in October, 1976.

Some of Europe's largest finance and banking concerns are choosing Digital because of its ability to deliver networked computer systems today. As a result, Digital reported increasing success in this major market.

Recent orders, valued at some $100 million over the next few years, have been placed in the United Kingdom by the London Stock Exchange and Reuters, in France by the French domestic interbank clearing system (GSIT), and in Brussels by the Society for Worldwide Interbank Financial Telecommunications (SWIFT).

Meanwhile, Digital has won a major contract from the German PTT to produce the Yellow Pages for German Videotex subscribers. The electronic phone book will include information on 25 million telephone customers who will increase their advertising impact because they will be able to advertise using pictures as well as words.

During the quarter, Digital's common stock was listed on the Swiss stock exchanges of Zurich, Geneva, and Basel, and the German stock exchanges of Frankfurt, Munich, and Berlin. The listings are expected to generate local interest in Digital stock and to expand the base of Swiss and German ownership in the company.

In other news, Digital recently opened a Research and Development Center in Reading, England. Nearly 450 specialists there are working toward the development of Open Systems Interconnect (OSI) standards, designed to enable computers made by different companies to communicate easily with each other.

Psychologists in the center's Human Factors Laboratory are studying how to make office automation systems easier to use. The center also is developing computers that communicate in many different languages.

DIGITAL ANNOUNCES OPEN SYSTEMS INTERCONNECT (OSI) SOFTWARE FOR INTEGRATED, MULTIVENDOR COMPUTER NETWORKS

During the quarter, Digital announced the VAX OSI Transport Service (VOTS) software, the industry's first compatible software developed by a leading computer manufacturer to Open Systems Interconnect (OSI) standards.

The OSI model is the basis for an emerging set of international standards supported by the International Standards Organization (ISO) based in Geneva. The ISO's major objective is to create software standards that allow any vendor's computer system, connected to any network, to share data freely with any other computer system on the network or on another attached network.

VOTS underscores Digital's continued support for compliance with international standards. It enables users to communicate between programs running under VAX/VMS and other vendors' OSI-based programs.

Digital and Evans & Sutherland Form Joint Development Relationship

In March, Digital and Evans & Sutherland Corporation announced a joint plan for developing workstation products. Evans & Sutherland, based in Salt Lake City, Utah, manufactures special-purpose computers and software products for a variety of industrial, military, and scientific applications.

The joint venture will bring to the potentially lucrative workstation market products that combine Digital's leadership in computing and information networking and Evans & Sutherland's strengths in high-performance graphics processors.

Corporate Contributions Highlights

Some recent highlights of Digital's continuing commitment to the communities in which its employees live and work:

- The Springfield Public School System, Springfield, Massachusetts, received a grant worth $500,000 toward the purchase of $1.5 million worth of Digital equipment to create a networked computer system in its high school. The system will feature VAX-11/780 computers, DECmate III word processors, and hundreds of terminals, all of which will be linked together via an Ethernet local area network. As part of the school's far-reaching goals for the system, each department has developed plans for its use by students in such areas as creative writing, special and bilingual education, and laboratory experiments.

- Furthering the company's goal to encourage the technological advancement of women, Digital awarded a major equipment grant toward the purchase of a VAX-11/780 computer system and associated terminals, printers, and software to the American Association of University Women in Washington, D.C. The association is the oldest and largest national organization for the educational advancement of women.

- Digital's United Way Campaign recently raised $3.28 million in employee and company-matched funds which will benefit 307 United Way community agency offices across the United States.

Consolidated Balance Sheets

(Dollars in thousands)	March 29, 1986	June 29, 1985
Assets		
Current Assets		
Cash and temporary cash investments	**$1,961,891**	$1,080,180
Accounts receivable, net of allowances	**1,713,886**	1,538,955
Inventories	**1,374,695**	1,756,167
Prepaid expenses	**88,246**	64,569
Deferred income tax charges, net	**214,675**	197,957
Total Current Assets	**5,353,393**	4,637,828
Property, plant and equipment, net	**1,817,760**	1,731,029
Total Assets	**$7,171,153**	$6,368,857
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	**$ 14,400**	$ 12,251
Other current liabilities	**1,255,828**	931,358
Total Current Liabilities	**1,270,228**	943,609
Deferred income tax credits, net	**49,704**	33,704
Long-term debt *(1)*	**434,849**	836,945
Total Liabilities	**1,754,781**	1,814,258
Stockholders' Equity		
Common Stock, $1 par value	**127,389**	59,253
Additional paid-in capital	**2,152,684**	1,737,834
Retained earnings	**3,136,299**	2,757,512
Total Stockholders' Equity	**5,416,372**	4,554,599
Total Liabilities and Stockholders' Equity	**$7,171,153**	$6,368,857

(1) Substantially all of the Company's $400 million of the 8% Convertible Subordinated Debentures due in the year 2009 were converted into shares of the Company's common stock. The Balance Sheet as of March 29, 1986, reflects the subsequent conversion of the outstanding Debentures.

Consolidated Statements of Changes in Financial Position

	Nine Months Ended	
(Dollars in thousands)	**March 29, 1986**	March 30, 1985
Funds from Operations		
Net income	**$ 378,787**	$346,235
Depreciation	**278,290**	219,053
Other	**35,670**	(34,626)
Total from operations	**692,747**	530,662
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	**174,931**	(42,563)
Inventories	**(381,472)**	165,586
Prepaid expenses	**23,677**	14,032
Other current liabilities	**(324,470)**	22,379
	(507,334)	159,434
Additions to property, plant and equipment	**387,323**	406,443
Total to support operations	**(120,011)**	565,877
Net increase (decrease) in funds from operations	**812,758**	(35,215)
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	**2,149**	2,691
Long-term debt	**(2,096)**	(3,972)
8% Debentures due 2009	**(400,000)**	400,000
Conversion of Debentures to common stock	**395,721**	0
Stock issued under employee option and purchase plans	**73,179**	59,197
	68,953	457,916
Net increase (decrease) in cash and temporary cash investments	**881,711**	422,701
Cash and temporary cash investments at beginning of year	**1,080,180**	476,150
Cash and temporary cash investments at end of period	**$1,961,891**	$898,851

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Three Months Ended		Nine Months Ended	
	March 29, 1986	March 30, 1985	**March 29, 1986**	March 30, 1985
Revenues				
Equipment sales	**$1,269,135**	$1,142,823	**$3,557,056**	$3,287,969
Service and other revenues	**659,152**	548,304	**1,857,651**	1,546,487
Total Operating Revenues	**1,928,287**	1,691,127	**5,414,707**	4,834,456
Costs and Expenses				
Cost of equipment sales, service and other revenues	**1,077,061**	1,032,224	**3,130,161**	2,923,536
Research and engineering expenses	**204,143**	173,067	**591,115**	507,739
Selling, general and administrative expenses	**424,356**	382,304	**1,191,855**	1,050,352
Operating income	**222,727**	103,532	**501,576**	352,829
Interest expense	**19,935**	20,964	**62,858**	60,070
Interest income	**(34,420)**	(15,974)	**(80,168)**	(44,529)
Income before income taxes	**237,212**	98,542	**518,886**	337,288
Income taxes *(2)*	**66,864**	6,854	**140,099**	(8,947)
Net income	**$ 170,348**	$ 91,688	**$ 378,787**	$ 346,235
Net income per share *(3)*	**$1.32**	$.76	**$3.00**	$2.88

(2) As a result of the Deficit Reduction Act of 1984, the Company's income tax expense for the nine months ended March 30, 1985 was reduced by $63 million, or $.51 per share (all of which was recorded in the first quarter of fiscal 1985), reflecting elimination of the taxes provided for DISC earnings in years prior to 1984.

(3) Net income per common equivalent share was computed based on a fully diluted calculation of the weighted average of such shares outstanding during the period: 130,166,014 shares and 123,355,764 shares for the nine-month periods ended March 29, 1986 and March 30, 1985, respectively, and 130,966,690 shares and 126,321,848 shares for the three-month periods ended March 29, 1986 and March 30, 1985, respectively. All per share data have been adjusted to reflect a 100% stock dividend, distributed on May 9, 1986, to stockholders of record on April 18, 1986.

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

Unlisted trading privileges have been granted in the United States by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, and Philadelphia Stock Exchange. In Europe, unlisted trading privileges have been granted by the Luxembourg Stock Exchange; the Swiss stock exchanges of Zurich, Geneva, and Basel; and the German stock exchanges of Frankfurt, Munich, and Berlin.

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

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

DIGITAL EQUIPMENT CORPORATION
FIRST QUARTER REPORT 1987

Digital Equipment Corporation
Maynard, Massachusetts 01754

digital

Printed in U.S.A. EA W0271-86/86 05 23 60.0

On the Cover • *"Boys and Kitten," an 1873 Winslow Homer work, is among the watercolors in the exhibit, "American Traditions in Watercolor: The Worcester Art Museum Collection," being underwritten by Digital. Slated to open in Worcester, Massachusetts in March, the exhibit later will travel to the National Museum of American Art/ Smithsonian, Washington, D.C., and the Minneapolis Institute of Arts, Minneapolis.*

Photo courtesy of the Worcester Art Museum.

To Our Shareholders

Total operating revenues for the first quarter ended September 27, 1986, were $2,038,467,000, up 26 percent from the $1,623,927,000 in the comparable period one year ago. Net income for the quarter was $182,628,000, up 153 percent from last year's first quarter net income of $72,325,000. Quarterly earnings per share were $1.37 versus $.60 last year, up 128 percent.

Continued strong performance in the first quarter reflected the broad market acceptance of our networked systems solutions. In this year's first quarter, we maintained the flow of product introductions from the latest VAX computers to networking products and services that let organizations manage information from desktop personal computers to data center computer systems.

Our performance also reflects Digital's long-standing strategy to work closely with our customers. In the quarter we further evolved our industry marketing initiative by continuing to target and align our products, applications, and sales training to key industries. Our industry focus is showing good results, particularly in financial services where we have won significant new business.

Digital again experienced a high level of demand from European customers. Reflecting our continued success there, some 15,000 European customers attended Digital's conference and exposition, "DECville," held in September in Cannes, France.

Kenneth H. Olsen
President

String of Major VAX Announcements Continues

During the quarter, Digital announced five new products that further strengthen its lead in providing solutions and strategies that address people's computing needs. The announcements include:

PC ALL-IN-1 ▪ An easy-to-use and manage MicroVAX II-based system that allows up to 30 previously isolated personal computers to be part of an integrated office system, thereby bringing the personal computer into the mainstream of an organization.

VAX/VMS Services for MS*-DOS ▪ A software product that combines the resources of VAX/VMS and MS-DOS into one fully networked environment by allowing VAX and MicroVAX computers to act as information servers, thereby integrating personal and organizational computing.

VAXmate ▪ A networked personal computer that is specifically designed to support network group systems, such as PC ALL-IN-1 and VAX/VMS Services for MS-DOS.

VAX 8550 and VAX 8700 ▪ Two additional second-generation, high-performance VAX systems, these systems bring to six the number of computers using the new VAXBI (VAX Bus Interconnect) architecture introduced by Digital since January. The VAXBI is Digital's internal architecture for the interconnect that links the computer's central processing unit and peripheral devices such as printers, terminals, disks, and tape drives. It provides substantial gains in data transmission speed within the system while simplifying design efforts for developers of peripheral devices and OEMs who are incorporating the new VAX computers in their products.

New Enhancements ▪ Also announced this quarter were new configurations for the VAX 8200 and VAX 8300 computers, based solely on the VAXBI architecture. And the DECserver 200, a new compact 8-line terminal server that allows users to connect a wide range of terminals into high-speed Ethernet local area networks easily and inexpensively.

New Cooperative Marketing Agreements Enhance Solutions for Several Markets

Digital has boosted its commitment to several key markets with the announcement of many new participants in our Cooperative Marketing Program (CMP) and System Cooperative Marketing Program (SCMP). The two programs allow both parties to offer more comprehensive solutions to the Digital marketplace, while strengthening their leadership positions through cooperative marketing activities. Agreements were signed with the following companies in:

Electronic Publishing ▪ Datalogics, Inc., which provides VAX-based computer-aided publishing systems for engineering documentation, technical, financial, and legal publishing departments. Interleaf, Inc., developer of Technical Publishing System* (TPS), which automates the production of compound documents for reliable and accurate information processing tasks. Vidar Systems, developer of large format document scanners that convert reams of paper documents into an electronic format, allowing easier manipulation, transfer, and printing of documents.

Financial Services ▪ Computer Aided Decisions, Inc., Boston, Massachusetts, a software development, sales, and support company with expertise in portfolio management systems. Joint marketing activities will center on solutions for the investment management industry.

Personnel/Payroll Management ▪ Cyborg Systems, Inc., a software development, sales, and support company with expertise in payroll and human resource management systems, to jointly market systems for personnel and payroll departments.

Office Automation ▪ Applix, Inc., Westboro, Massachusetts, which will market its ULTRIX-based Alis* office automation software for Digital's family of VAX workstations.

Computer-Aided Design/Engineering/Manufacturing ▪ CADCentre Ltd., of Cambridge, England will market its process flow planning and 3-D modeling software packages for the process industry. And Autotrol Technology Corporation will market integrated software solutions for computer-aided design, drafting, and manufacturing applications. In the electronics market: Valid Logic, Inc. will market its REALCHIP* hardware modeling and REALMODEL* simulation software for computer-aided engineering applications. Nastec Corporation will market its DesignAid* computer-aided design software for electronics applications. And CASE Technology, Inc. will market its Vanguard CAE Design System Software* which offers a comprehensive set of electronic design applications for schematic capture, timing verification, and printed circuit board layout.

Earth Resource Engineering ▪ Radian Corporation will market three advanced contouring and subsurface modeling software packages for earth resource engineering applications. And J.S. Nolen & Associates will market several geotechnical software tools used to simulate production of petroleum reserves.

Computer-Integrated Manufacturing ▪ Control Systems Specialists will market its ABC Systems, a software and color graphics package that provides supervisory control for realtime data collection in the monitoring and control of batch manufacturing operations.

Health Care ▪ Six major suppliers of computerized medical and hospital information systems, including: Cerner Corporation, Kansas City, Missouri; Interpretive Data Systems, Inc., Boston, Massachusetts; McDonnell Douglas Health Information Systems Company, St. Louis, Missouri; Pentamation Enterprises, Inc., Sparks, Maryland; SMS Inc., Malvern, Pennsylvania; and Sunquest Information Systems, Inc., Tucson, Arizona.

Robert R. Everett Elected to Digital's Board of Directors

Robert Rivers Everett became the eighth member of Digital's Board of Directors upon his election this quarter.

In announcing the election, Kenneth H. Olsen, President, said, "We are extremely pleased to have as distinguished a person as Mr. Everett join Digital's Board of Directors, and are confident that with his technical skills and managerial experience, he will make significant contributions to Digital."

Mr. Everett retired as the President and Chief Executive Officer of The MITRE Corporation on July 1. MITRE was formed from part of the Lincoln Laboratory of the Massachusetts Institute of Technology in 1958, at which time Mr. Everett joined as Technical Director. In 1969, he was made President.

Mr. Everett is a trustee of The MITRE Corporation, a member of the United States Air Force Scientific Advisory Board, and a member of the Science Advisory Group of the Defense Communications Agency. He is also a member of the National Academy of Engineering, the American Association for the Advancement of Science, and a Fellow of the Institute of Electronics and Electrical Engineers (IEEE).

Digital Advances the Standard for Integrated Office Systems

During the quarter, Digital introduced a new version of its industry-leading ALL-IN-1 Office and Information System which offers significant new features on a wider range of computer systems. Also announced were expanded customer support services for All-IN-1 users. Enhanced features include document processing capabilities and the industry's most open electronic mail system.

The new ALL-IN-1 office system runs on a broad range of systems, including the desktop VAXstation II, the MicroVAX II system, and a full range of VAX computers including mainframe-class VAX 8800 systems and VAXcluster configurations. And the Digital Software Information Network (DSIN), an on-line customer support system, is now available to all ALL-IN-1 users.

MCI Communications and Digital Announce VAX MAILGATE for MCI Mail

MCI Communications Corporation and Digital announced a new software product that combines the strengths of Digital's industry-leading ALL-IN-1 Office and Information Systems with MCI's worldwide public electronic mail service.

VAX MAILGATE For MCI Mail* is specifically designed to allow Digital ALL-IN-1 electronic mail users to access MCI Mail delivery options, including telex delivery to more than 1.6 million telex subscribers worldwide. Both systems appear as a single, integrated mail system so information can be quickly and easily exchanged and accessed.

Highlights of Recent Customer Wins

International Telephone & Telegraph's (ITT) Avionics Division purchased 19 VAXstation II workstations running Interleaf, Inc.'s Interleaf Workstation Publishing Software,* providing ITT's engineers with the company's first in-house engineering and technical publishing capability. The workstations are connected by DECnet–Digital's protocol for integrating similar or different computers in a network–to an existing VAX 8600 system. By year's end, Avionics will add 50 more VAXstation II workstations to its engineering department.

Pacific Chloride, Inc., a leading manufacturer and supplier of batteries to the automotive industry, purchased a VAX 8500 running MANMAN* software from ASK Computer Systems, Inc. for all of its battery manufacturing plants. ASK, Inc. has recently become a Digital Systems Cooperative Marketing Program (SCMP) supplier. The new system, used for inventory control and manufacturing planning, will also serve as an online electronic ordering system, communicating with the company's extensive customer base. Pacific Chloride, Inc. reports that it has already seen dramatic savings in its computer maintenance and data processing labor costs.

Indiana Bell Telephone Company, a subsidiary of Ameritech, a regional Bell holding company, will use the advanced technology of two networked VAX 8300 systems to develop a computerized mapping information system. This project, known as the Mechanized Outside Plant Records System (MOPR) project, will use Synercom Technology Inc.'s INFORMAP* II and OPIS* software to perform land-based mapping of all of its poles, lines, and supporting equipment. Synercom is an active Digital Cooperative Marketing Program (CMP) supplier in the field of Mapping Information Management Systems. Indiana Bell provides telephone service to some 500,000 customers in its 1100 square mile area in metropolitan Indianapolis. Prior to its decision to automate, Indiana Bell required 13,000 map sheets to locate and manage its outside plant facilities for this same area.

The Microelectronics Center of North Carolina (MCNC) purchased 28 VAXstation II/GPX workstations running Digital's ULTRIX software for its six Participating Institutions and Central Laboratory located in North Carolina's Research Triangle Park. The high resolution, color graphics workstations will be used not only in semiconductor research, but also for an advanced workstation project (Project Omega) to design next-generation integrated circuit technology. This project represents a continuation of cooperative research and educational programs that have existed between Digital and MCNC during the past five years.

Intermetrics, a leading software engineering company with expertise in the ADA programming language, recently made a $1.4 million purchase of Digital systems to develop state-of-the-art software for the defense department and for other major government subcontractors, such as Boeing and Grumman Aircraft. The sale consisted of a VAX 8600 and two upgraded VAX-11/785 systems. Additionally, Intermetrics purchased eight MicroVAX II computers for ADA software development at its U.S. sites. The MicroVAX II systems will be linked to the company's corporate headquarters–creating a wide-area network.

Admiral Grace Hopper Joins Digital

Dr. Grace Murray Hopper, a rear admiral, United States Navy, who recently retired as the oldest officer on active duty, has begun a new career at age 79 as a senior consultant with Digital.

Working out of Digital's Washington, D.C. office, Dr. Hopper will represent Digital at industry forums and symposia, make speeches that focus on government issues and ADP environments, serve as a representative on computer industry committees and at engineering forums, write and publish computer systems/engineering papers on selected subjects, and participate in Digital's liaison programs with educational institutions.

At the time of her retirement from the Navy, Dr. Hopper was assigned to the Naval Data Automation Command in Washington, D.C. Much of her military service has been devoted to keeping the Navy on the leading edge of computer technology.

Digital's Corporate Contributions Program Exceeds $13 Million in Fiscal Year '86

Just as the quarter opened, Digital announced that its Corporate Contributions Program exceeded $13 million in cash and equipment donations for the fiscal year ended June 30, 1986. The program concentrates its support in four program areas: education, culture, health/handicapped, and civic/environmental affairs. It also includes Matching Gift, United Way, and Scholarship programs.

Digital views its contributions as not only a corporate responsibility but also an investment in the future of both the company and the community-at-large. Through diverse funding programs, Digital supports issues and organizations that address the day-to-day, and often critical, needs of the company, our employees, and the communities in which they live and work.

Among contributions made this quarter, Digital announced a commitment to sponsor the creation of an artificial intelligence and robotics exhibition at the Boston Museum of Science. The exhibition will premiere at the museum in January, 1987, and will then go on a national tour to member institutions of the Science Museum Exhibit Collaborative.

For the fourth consecutive year, Digital has participated in the Annual ACT-SO (Afro-Academic, Cultural, Technological and Scientific Olympics) Competition. Designed to recognize and reward the academic excellence and achievements of black high school students around the country, ACT-SO has been supported through employee resources and cash and equipment donations. Sponsored by the National Association for the Advancement of Colored People, ACT-SO provides Digital with an opportunity to meet dual corporate educational objectives – increasing opportunities for youth in science and technology, and encouraging and strengthening educational programs for minority youth. This year, Digital-supported recipients included students from Boston; Jackson, Mississippi; Atlanta; and Los Angeles.

Consolidated Balance Sheets

(Dollars in thousands)	**September 27,1986**	June 28,1986
Assets		
Current Assets		
Cash and temporary cash investments	**$2,042,728**	$1,910,933
Accounts receivable, net of allowances	**1,954,611**	1,903,287
Inventories	**1,221,160**	1,199,756
Prepaid expenses	**126,824**	85,274
Deferred income tax charges, net	**225,200**	206,998
Total Current Assets	**5,570,523**	5,306,248
Property, plant and equipment, net	**1,888,923**	1,867,078
Other assets, net	**6,026**	
Total Assets	**7,465,472**	$7,173,326
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	**12,217**	$ 18,697
Other current liabilities	**1,156,987**	1,064,838
Total Current Liabilities	**1,169,204**	1,083,535
Deferred income tax credits, net	**33,300**	28,809
Long-term debt	**333,772**	333,155
Total Liabilities	**1,536,276**	1,445,499
Stockholders' Equity		
Common Stock, $1 par value	**128,975**	128,591
Additional paid-in capital	**2,242,661**	2,224,304
Retained earnings	**3,557,560**	3,374,932
Total Stockholders' Equity	**5,929,196**	5,727,827
Total Liabilities and Stockholders' Equity	**$7,465,472**	$7,173,326

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

Consolidated Statements of Changes in Financial Position

	Three Months Ended	
(Dollars in thousands)	**September 27,1986**	September 28,1985
Funds from Operations		
Net income	**$ 182,628**	$ 72,325
Depreciation	**95,303**	83,407
Other	**(4,035)**	11,766
Total from operations	**273,896**	167,498
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	**51,324**	(28,825)
Inventories	**21,404**	(102,800)
Prepaid expenses	**41,550**	26,381
Other current liabilities	**(92,149)**	(102,434)
	22,129	(207,678)
Additions to property, plant and equipment	**122,155**	114,523
Increase in other assets	**6,126**	
Total to support operations	**150,410**	(93,155)
Net increase (decrease) in funds from operations	**123,486**	260,653
Funds Provided by		
Increase (decrease) in:		
Loans payable to banks	**(6,480)**	8,697
Long-term debt	**617**	244
Stock issued under employee option and purchase plans	**14,172**	11,004
	8,309	19,945
Net increase (decrease) in cash and temporary cash investments	**131,795**	280,598
Cash and temporary cash investments at beginning of year	**1,910,933**	1,080,180
Cash and temporary cash investments at end of period	**$2,042,728**	$1,360,778

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

Consolidated Statements of Income

(Dollars in thousands except per share data)	Three Months Ended September 27,1986	September 28,1985
Revenues		
Equipment sales	**$1,390,625**	$1,119,321
Service and other revenues	**647,842**	504,606
Total operating revenues	**2,038,467**	1,623,927
Costs and Expenses		
Cost of equipment sales, service and other revenues	**1,026,612**	964,401
Research and engineering expenses	**237,752**	187,837
Selling, general and administrative expenses	**497,950**	373,189
Operating income	**276,153**	98,500
Interest expense	**10,931**	21,134
Interest income	**(29,339)**	(20,370)
Income before income taxes	**294,561**	97,736
Income taxes	**111,933**	25,411
Net income	**$ 182,628**	$ 72,325
Net income per share	**$ 1.37**	$ .60

Certain accounts for the period ended September 28, 1985, have been reclassified to conform with the September 27, 1986 presentation. The accompanying notes are an integral part of these financial statements.

Notes to Consolidated Financial Statements

Capitalized Computer Software Costs

The consolidated financial statements for September 27, 1986 reflect the initial application of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed."

Reclassifications

Certain accounts for the period ended September 28, 1985, have been reclassified to conform with the September 27, 1986 presentation.

Earnings Per Share

Net income per share is based on the weighted average number of common shares and common share equivalents outstanding during each period; 133,005,213 shares for the three months ended September 27, 1986, and 127,748,204 shares for the three months ended September 28, 1985. All share and per-share data have been adjusted to reflect a two-for-one stock split in the form of a 100% stock dividend, distributed on May 9, 1986, to stockholders of record on April 18, 1986.

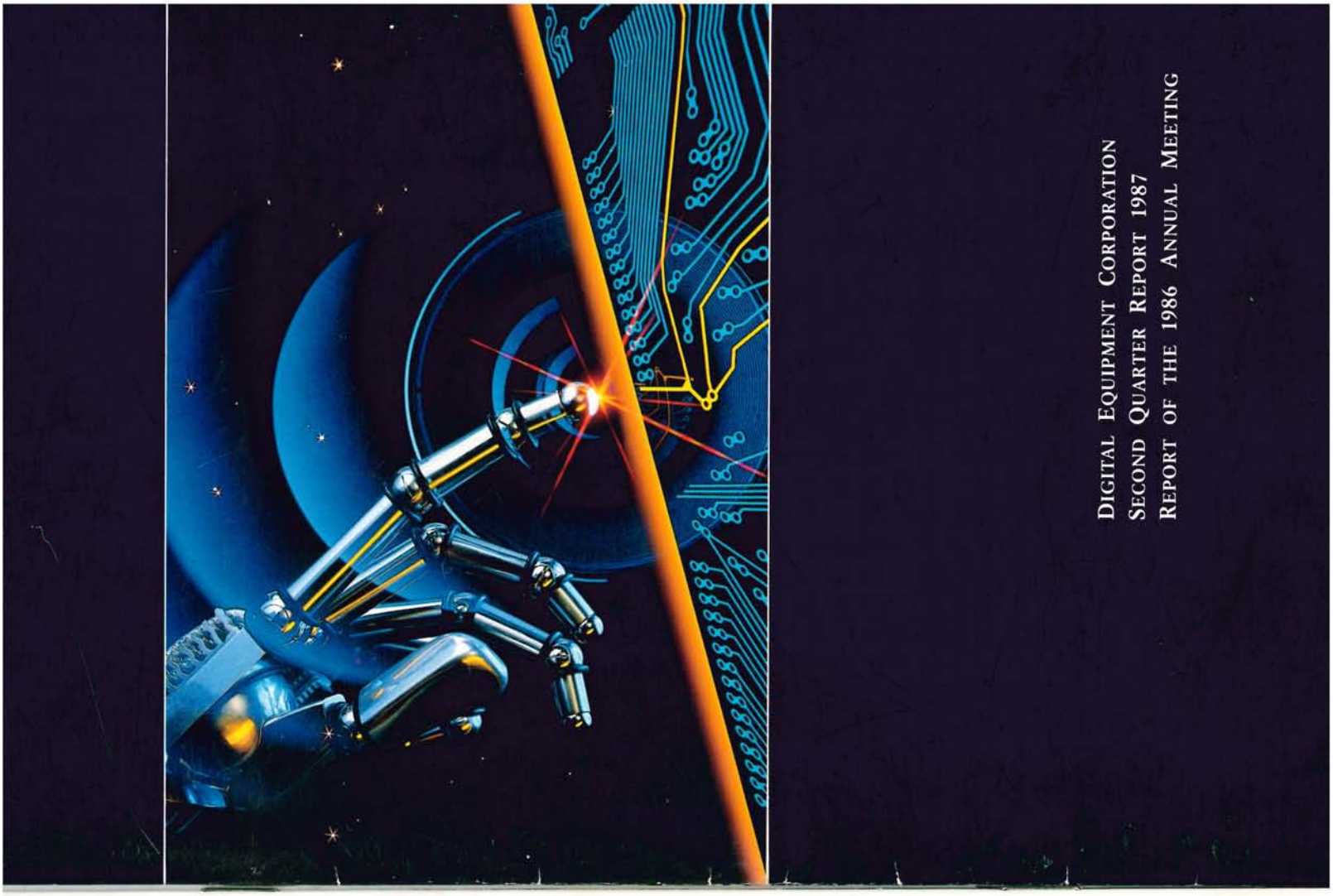
Digital's common stock is listed and traded on the New York Stock Exchange and Pacific Stock Exchange (Ticker Symbol "DEC").

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

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, and Philadelphia Stock Exchange. In Europe: Luxembourg Stock Exchange.

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

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



Digital Equipment Corporation
Second Quarter Report 1987
Report of the 1986 Annual Meeting

Digital Equipment Corporation
Maynard, Massachusetts 01754

digital

On the Cover ▪ A detail of the poster for ROBOTS AND BEYOND: THE AGE OF INTELLIGENT MACHINES, an exhibit sponsored by Digital Equipment Corporation in association with The Kurzweil Foundation. Created and produced by the Boston Museum of Science, this is the first major exhibit to address popular questions and misconceptions about the futuristic field of artificial intelligence and robotics. Slated to open at the museum in late January, the exhibit will travel across the United States over the next three years to science museums in Charlotte, North Carolina; Chicago; Columbus, Ohio; Forth Worth, Texas; Los Angeles; Philadelphia; and St. Paul, Minnesota.

To Our Shareholders

Total operating revenues for the second quarter ended December 27, 1986, were $2,271,842,000, up 22 percent from the $1,862,493,000 of the comparable period one year ago. Net income for the quarter was $269,960,000, up 98 percent from last year's second quarter net income of $136,114,000. Quarterly earnings per share were $2.02 versus $1.08 last year, up 85 percent.

For the six months ending December 27, 1986, total operating revenues were $4,310,309,000, up 24 percent from the $3,486,420,000 of the comparable period a year ago. Net income for the half was $452,588,000, up 117 percent from last year's first half results of $208,439,000.

Strong operating results for the quarter represent continued market recognition that Digital delivers the software solutions to solve today's critical business problems. Customers are seeking the ability to spontaneously access, share, and use information on computers—wherever they are located in an organization worldwide. We will continue to be aggressive in introducing significant solutions-oriented products during the coming months.

During the quarter, Digital experienced a high level of demand from both international and U.S. customers. Midrange and larger VAX computers did particularly well. In addition, Digital has continued to gain market share in computer-intensive markets such as financial services and telecommunications.

Our strong sales momentum plus improvements in gross margins and asset productivity over the past several quarters have permitted us to increase our investments in new product development and in resources necessary both to expand and better service our customer base. All of these factors combined are improving the returns for our investors.

Kenneth H. Olsen
President

Highlights from the Annual Meeting of Shareholders 1986

Digital's annual meeting was held Thursday, November 6, 1986, in Boston, Massachusetts. Mr. Kenneth H. Olsen, President, presided.

Approximately 72 percent, or 93 million, of the common shares were represented at the meeting in person or by proxy. The items of business listed in the Proxy Statement were voted upon at the meeting and received a majority of the votes cast.

At the Board of Directors meeting following the annual meeting, the Board approved the repurchase of up to 5 million shares of Digital stock on the open market over the next 18 months, as market conditions warrant. These shares will be used for Digital's employee stock plans.

Highlights from Kenneth H. Olsen's Presentation

The question is often asked, "What sets Digital apart?" I like to answer this question by stating our company goal: We want to make computing easy, useful, and productive. And we want it to be satisfying, exciting, and fun.

When we started out 29 years ago, we focused on hardware. We kept making better–yet different–hardware. Over the years, our concentration turned to software. It was the software that would define how easy, exciting, and motivating for people computing could be.

To make that happen, we formally set out to design our computer architecture. We standardized on one computer architecture that we call the VAX. Then we turned to our most critical goal–the software. Using the same discipline we used in creating the VAX, we developed one software system, known as VMS.

Our protocol for networking was based on ARPANET, a U.S. government network started in the 1960s. We called our protocol DECNET. It is probably the most widely used protocol today.

In choosing a vehicle for local area networking, we again decided against creating our own. We decided that Ethernet, the system that Xerox had developed and invented, was the best. Today we ship thousands of units of Ethernet each month.

We also developed a system we call clustering. The hardware for clustering is very complex. But the software is very elegant, enabling a large number of powerful computers to share one database, at very high speed.

Much of our software is involved in networking. Networking is something we talk a lot about. We use it. We have a passion for it. Networking has changed our organization. With networking we can foster:

- Communications between computers;
- Timesharing, or what we now call distributed applications;
- Worksharing, or work group computing.

This morning we announced something called Local Area VAXcluster systems, which foster work group computing. Using both local area and Ethernet networks, we can tie a group of computers together to allow a group of people who need to work together to do so easily. Each group within a company can have their own Local Area VAXcluster system and each can then be tied into the corporate network.

This work group concept is being woven into Digital's strategy, becoming a part of the way we work. We can test it ourselves and find it succeeds. With the corporate network, each group is separate, yet they are all one. There is no seam, no break between them. Anyone, anywhere, can tie into

the system. And yet, one group can work together and have one computer. One person can supervise all of their files and all of their work. And yet, everyone in the corporation is tied together as an open unit. This allows for truly easy, satisfying, fun, exciting computing. This network also has the delightful capability of expanding and growing without any strain.

When we look ahead, we see the future as being more of the same. In many ways, we've only just begun. We're making bigger and smaller VAX systems. We're making better, more elegant components for Ethernet. And we're just starting to accomplish our software goals. But, above all, we believe that we're taking part in changing the way organizations work.

From our point of view, the companies that will survive are going to move from an environment of management control to one that allows a large number of people, all using their creative ability, their education, and their motivation, to take part.

This means that companies' management will have to be more competent and tougher. It's easy to be arbitrary and control everything. It's hard to set goals, rules, standards, so that people and organizations can work together.

Now, this change won't be easy. But it has to come. And we're convinced that computer networking will be at the heart of these changes: providing people with an excuse to consider these things and to work them out, and being the vehicle through which these changes are carried out.

Duff & Phelps Boosts Digital's Credit Rating to Highest Level

Duff & Phelps recently raised the rating of Digital's senior debt to D&P-1 (AAA), its highest rating, from D&P-2 (high double A). According to the Chicago-based financial analysis and consulting firm, the new rating reflects Digital's many qualitative strengths including excellent management and a widely recognized trade position.

Duff & Phelps also cited Digital's strong product line which reflects a consistent effort over many years and includes all aspects of computer systems, including not only processors but also software, distributed processing/network emphasis, and terminals. All of these factors, noted Duff & Phelps, combined with the fact that Digital is now a sizable enterprise, mitigate the principal risk for any high-technology company–product obsolescence.

Local Area VAXcluster Systems for Work Group Computing Debut

During the annual meeting, Digital announced Local Area VAXcluster systems that extend powerful VAXcluster capabilities to the work group by integrating MicroVAX II and VAXstation II systems, using Ethernet, into a single computing environment.

Local Area VAXcluster system software allows customers to link, via Ethernet, up to 13 VAXstation II or MicroVAX II systems to a central MicroVAX or VAX server that manages the system software, all software applications, and a shared common file system. Each participating microcomputer acts as a single system–equally sharing resources such as disks, tapes, and printers and using a single, distributed file system.

Among the benefits of Local Area VAXcluster systems: Users have faster access to information, client system management tasks are eliminated, information flow is improved throughout the organization, and overall productivity is boosted.

Customer Win Highlights

Office Information Systems ▪ With the recent naming of Digital as the "Official Computer Vendor to the National Basketball Association," Digital is cornering the professional sports market. The NBA plans to use a VAX 8200 system and the ALL-IN-1 Integrated Office and Information System to create a nationwide network of all 23 league teams. In 1985, Digital was selected as the "Official Computer Vendor to the National Football League."

Digital will cable part of the 1 World Trade Center tower and link it with four metropolitan New York airports, as part of a $12.2 million, 18-month agreement with the Port Authority of New York and New Jersey. The Port Authority chose Digital over several other vendors to automate its 17 departments. The sale includes VAX 8200 clusters, more than 70 MicroVAX II systems, nearly 1,000 workstations, and local- and wide-area networks.

Electronic Markets ▪ Cypress Semiconductor, Inc., a California-based semiconductor manufacturer, recently purchased a VAX 8800 system. The system will run Dracula* integrated circuit design verification software from ECAD, Inc., a new participant in Digital's System Cooperative Marketing Program (SCMP). Cypress Semiconductor also purchased DECnet/Ethernet products to electronically link two of its San Jose facilities.

Mechanical/Civil/Engineering ▪ Albert Trostel Packings Ltd. recently purchased a large MicroVAX II system connected to three Tektronix workstations that runs CIS, Inc.'s MEDUSA* computer-aided design software package. CIS, Inc. is a Digital SCMP supplier. Albert Trostel Packings Ltd. will use this system for computer-aided design projects and also will utilize Digital's expertise in implementing its long-term CIM (Computer Integrated Manufacturing) strategies.

Manufacturing Planning and Control Systems ▪ Organon Teknika, the U.S. subsidiary of Akzo, a Dutch-owned corporation, recently purchased a VAX 8500 system that runs MANMAN* manufacturing software from ASK Computer Systems, Inc. Organon Teknika first will automate the accounting and manufacturing operations at its Durham, North Carolina headquarters. Next it will add other ASK MANMAN software modules, such as quality control and decision support to its new Durham facility.

Distribution ▪ A new information network based on Digital's MicroVAX II computers is being implemented to help in the distribution of up to 78 percent of food products used by the Hardee's Restaurant chain of more than 2,500 restaurants in 38 states. Developed for Fast Food Merchandisers, Inc. (FFM), a sister corporation of Hardee's Food Systems, the networked multiuser computer systems will be located in the company's 10 distribution centers and three manufacturing plants.

Highlights from Europe

Digital continues to experience a high level of demand from its European customers. Some recent highlights of our activities there include:

▪ Digital and Ericsson Information Systems AB, the Swedish information supplier, announced a cooperative agreement aimed at increasing the two companies' combined share of the high-growth banking information systems market in Europe and in the U.S. Digital and Ericsson will integrate Digital's VAX computer systems and the Ericcson family of banking products into common systems for the retail banking market. A joint research and development facility to support the integration of these products and software will be established in Sweden.

- The Digital facility in Conmel, Ireland, which designs and manufactures power supplies and communications products, is the first manufacturing plant in that country to achieve MRP II class "A" status under the internationally accepted criteria for Manufacturing Resource Planning as ratified by the American Production and Inventory Control Society. MRP II, which is widely used by manufacturing industries around the world, uses computer systems to make the most efficient use of a company's total resources.

- The VTX20, Digital's first base product wholly developed, engineered, and manufactured in Europe, was introduced during the quarter. Slated for manufacture in Digital's Valbonne, France manufacturing facility, the VTX20 is a high-quality combined data processing and videotex terminal for intensive professional use. It offers wide-ranging productivity benefits for applications in banking, insurance, international services, distribution, and accounting businesses where access is required to both VAX computer resources and remote or internal videotex databases via a single terminal. The VTX20, fully compatible with Digital's popular VT220 video terminals, can access the three major European videotex standards: Antiope, CEPT, and Prestel.

VAX DEC/MAP Networking Products for Automated Manufacturing Are Introduced

During the Autofact '86 tradeshow in Detroit, Digital introduced an integrated set of networking products, known as VAX DEC/MAP, which are based on the latest Manufacturing Automation Protocol (MAP) specification.

VAX DEC/MAP enables all 13 models of Digital's VAX-11/700 and VAX 8000 series computer systems to communicate with computer systems and automation equipment from other vendors that also support the MAP specification – which is based on the International Standards Organization/Open Systems Interconnect reference model.

Principal markets for VAX DEC/MAP include large-scale manufacturers in the transportation, aerospace, heavy equipment, metal processing, food processing, and chemical industries.

DECVILLE '86 Scores Top Marks as Plans Move Ahead for DECWORLD '87

DECVILLE '86, Europe's largest single-vendor information systems symposium and exhibition, scored top marks with the more than 15,000 visitors who attended the two-week show in Cannes, France, last fall. According to early returns from a visitor satisfaction survey, DECVILLE received very good overall ratings in usefulness of products displayed, information distributed, and business solutions demonstrated. Attendees also said that Digital rates high in understanding its customers.

Meanwhile, plans are well underway for DECWORLD '87, Digital's invitation-only management symposium and exposition which is expected to draw a worldwide audience when it takes place in the United States this fall. Under the theme, "The Network at Work," DECWORLD '87 will present an industry-oriented perspective on integrated solutions in corporate automation through seminars, round-table discussions, and automated solutions exhibits.

VAXcluster Helps Digital Credit Union Offer Expanded Services

The six-year-old Digital Credit Union (DCU) recently replaced two PDP-11/70 systems with a VAXcluster made up of two VAX 8650 computer systems.

The VAXcluster has enabled the DCU to increase its ability to add terminals to branches, build new branches, and expand its automated teller machine network. Processing time for member transactions and back office reports has been dramatically reduced. Clustering and disk shadowing between the two VAX computers eliminates the fear of data loss due to a hardware failure which would result in time-consuming reentry of work.

With assets of a quarter billion dollars, the DCU provides consumer financial services for 65,000 Digital employees and maintains a 25-branch network throughout the United States and Puerto Rico.

System Cooperative Marketing Program Continues to Expand

During the quarter, Digital announced System Cooperative Marketing Program (SCMP) agreements with three major suppliers of computerized energy management control systems. The companies, considered among the electrical utilities industry's leading control systems suppliers, are: ESCA Corporation, Bellevue, Washington; Landis & Gyr, San Jose, California; and Systems Control, Palo Alto, California.

Digital's SCMP is designed to align leading application solution suppliers with Digital's marketing and sales activities in selected markets. The program currently encompasses manufacturing resource planning, mechanical computer-aided design, electronic computer-aided engineering, health care, energy management, and corporate electronic publishing.

Corporate Contributions Highlights

Some recent highlights of Digital's continuing commitment to the communities in which our employees live and work:

- The National Association for the Advancement of Colored People (NAACP) received an equipment grant toward the installation of a VAX 8600 system, the ALL-IN-1 Office and Information System, and networking products for its new national headquarters in Baltimore. Initially, the system will handle all of the NAACP headquarters administrative computing needs. Eventually, it will serve as a host system, networking the NAACP's major regional offices into the national headquarters.

- The New England Aquarium, Boston, received cash and equipment grants to support two upcoming exhibits and its Edgerton Research Lab, which is devoted to basic and applied aquatic research and services. Scheduled to open in the spring of 1987, the Boston Harbor Exhibit will use a MicroVAX II to teach the public about pollution and explore solutions to harbor problems. The "Thinking Gallery," slated to open the following spring, will feature interactive computers that invite visitors to explore the nature of scientific inquiry and guide creative thinking along conceptual themes related to biology.

- Stanford University's Medical Center and Department of Electrical Engineering received an equipment grant to enhance the graphic and memory capabilities of a MicroVAX II used to support their joint Auditory Prosthesis Program. This collaborative research effort will produce an artificial implantable ear that will enable speech comprehension by means of electrical stimulation.

Consolidated Statements of Income

(Dollars in thousands except per share data)

	Three Months Ended		Six Months Ended	
	December 27, 1986	December 28, 1985	**December 27, 1986**	December 28, 1985
Revenues				
Product sales	**$1,535,760**	$1,320,100	**$2,926,385**	$2,439,421
Service and other revenues	**736,082**	542,393	**1,383,924**	1,046,999
Total operating revenues	**2,271,842**	1,862,493	**4,310,309**	3,486,420
Costs and Expenses				
Cost of product sales, service and other revenues	**1,095,337**	1,088,699	**2,121,949**	2,053,100
Research and engineering expenses	**233,388**	199,135	**471,140**	386,972
Selling, general and administrative expenses	**538,930**	394,310	**1,036,880**	767,499
Operating income	**404,187**	180,349	**680,340**	278,849
Interest expense	**11,069**	21,789	**22,000**	42,923
Interest income	**(30,715)**	(25,378)	**(60,054)**	(45,748)
Income before income taxes	**423,833**	183,938	**718,394**	281,674
Income taxes	**153,873**	47,824	**265,806**	73,235
Net income	**269,960**	136,114	**452,588**	208,439
Net income per share	**$2.02**	$1.08	**$3.39**	$1.68

Certain accounts for the periods ended December 28, 1985 have been reclassified to conform with the December 27, 1986 presentations. The accompanying notes are an integral part of these financial statements.

Consolidated Balance Sheets

(Dollars in thousands)	December 27, 1986	June 28, 1986
Assets		
Current Assets		
Cash and temporary cash investments	**$2,357,300**	$1,910,933
Accounts receivable, net of allowances	**2,026,454**	1,903,287
Inventories	**1,269,756**	1,199,756
Prepaid expenses	**118,854**	85,274
Deferred income tax charges, net	**243,500**	206,998
Total Current Assets	**6,015,864**	5,306,248
Property, plant and equipment, net	**1,934,884**	1,867,078
Other assets, net	**15,073**	
Total Assets	**$7,965,821**	$7,173,326
Liabilities and Stockholders' Equity		
Current Liabilities		
Loans payable to banks	**$ 8,500**	$ 18,697
Other current liabilities	**1,327,495**	1,064,838
Total Current Liabilities	**1,335,995**	1,083,535
Deferred income tax credits, net	**37,500**	28,809
Long-term debt	**329,353**	333,155
Total Liabilities	**1,702,848**	1,445,499
Stockholders' Equity		
Common Stock, $1 par value	**129,920**	128,591
Additional paid-in capital	**2,311,075**	2,224,304
Retained earnings	**3,827,520**	3,374,932
Treasury stock at cost	**(5,542)**	
Total Stockholders' Equity	**6,262,973**	5,727,827
Total Liabilities and Stockholders' Equity	**$7,965,821**	$7,173,326

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

Consolidated Statements of Changes in Financial Position

	Six Months Ended	
(Dollars in thousands)	December 27, 1986	December 28, 1985
Funds from Operations		
Net income	**$ 452,588**	$ 208,439
Depreciation	**196,648**	179,330
Other	**(587)**	31,869
Total from operations	**648,649**	419,638
Funds to Support Operations		
Increase (decrease) in working capital:		
Accounts receivable	**123,167**	102,723
Inventories	**70,000**	(277,895)
Prepaid expenses	**33,580**	35,396
Other current liabilities	**(262,657)**	(236,859)
	(35,910)	(376,635)
Additions to property, plant and equipment	**277,690**	263,642
Increase in other assets	**15,224**	
Total to support operations	**257,004**	(112,993)
Net increase (decrease) in funds from operations	**391,645**	532,631
Funds Provided (Used) by		
Increase (decrease) in:		
Loans payable to banks	**(10,197)**	18,764
Long-term debt	**(3,802)**	395
Stock issued under employee option and purchase plans	**74,263**	62,058
Purchase of treasury stock	**(5,542)**	
	54,722	81,217
Net increase (decrease) in cash and temporary cash investments	**446,367**	613,848
Cash and temporary cash investments at beginning of year	**1,910,933**	1,080,180
Cash and temporary cash investments at end of period	**$2,357,300**	$1,694,028

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

Capitalized Computer Software Costs

The consolidated financial statements for December 27, 1986 include the capitalization of computer software costs in accordance with recent pronouncements of the Financial Accounting Standards Board.

Reclassifications

Certain accounts for the periods ended December 28, 1985, have been reclassified to conform with the December 27, 1986 presentations.

Earnings Per Share

Net income per share is based on the weighted average number of common shares and common share equivalents outstanding during each period; 133,294,664 shares and 129,127,154 shares for the six month periods ended December 27, 1986 and December 28, 1985, respectively, and 133,584,116 shares and 129,425,396 shares for the three month periods ended December 27, 1986 and December 28, 1985, respectively. All share and per-share data have been adjusted to reflect a two-for-one stock split in the form of a 100% stock dividend, distributed May 9, 1986, to stockholders of record on April 18, 1986.

Treasury Stock

The Company acquired shares of its common stock which is included in treasury stock at cost.

Taxes

The Tax Reform Act of 1986, including the retroactive provisions, did not have a material impact on the financial results of the Company for the period ending December 27, 1986.

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

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

Unlisted trading privileges have been granted by the Boston Stock Exchange, Cincinnati Stock Exchange, Midwest Stock Exchange, and Philadelphia Stock Exchange. In Europe: Luxembourg Stock Exchange.

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

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

Cover photo concept and design by Impact Marketing & Communications, photography by Steve Grohe, Boston.

Digital Equipment Corporation
Maynard, Massachusetts 01754

digital