X 5582.2010 Tandem Computers, Inc. Annual Reports

1980 ANNUAL REPORT

BUSINESS
REVIEW

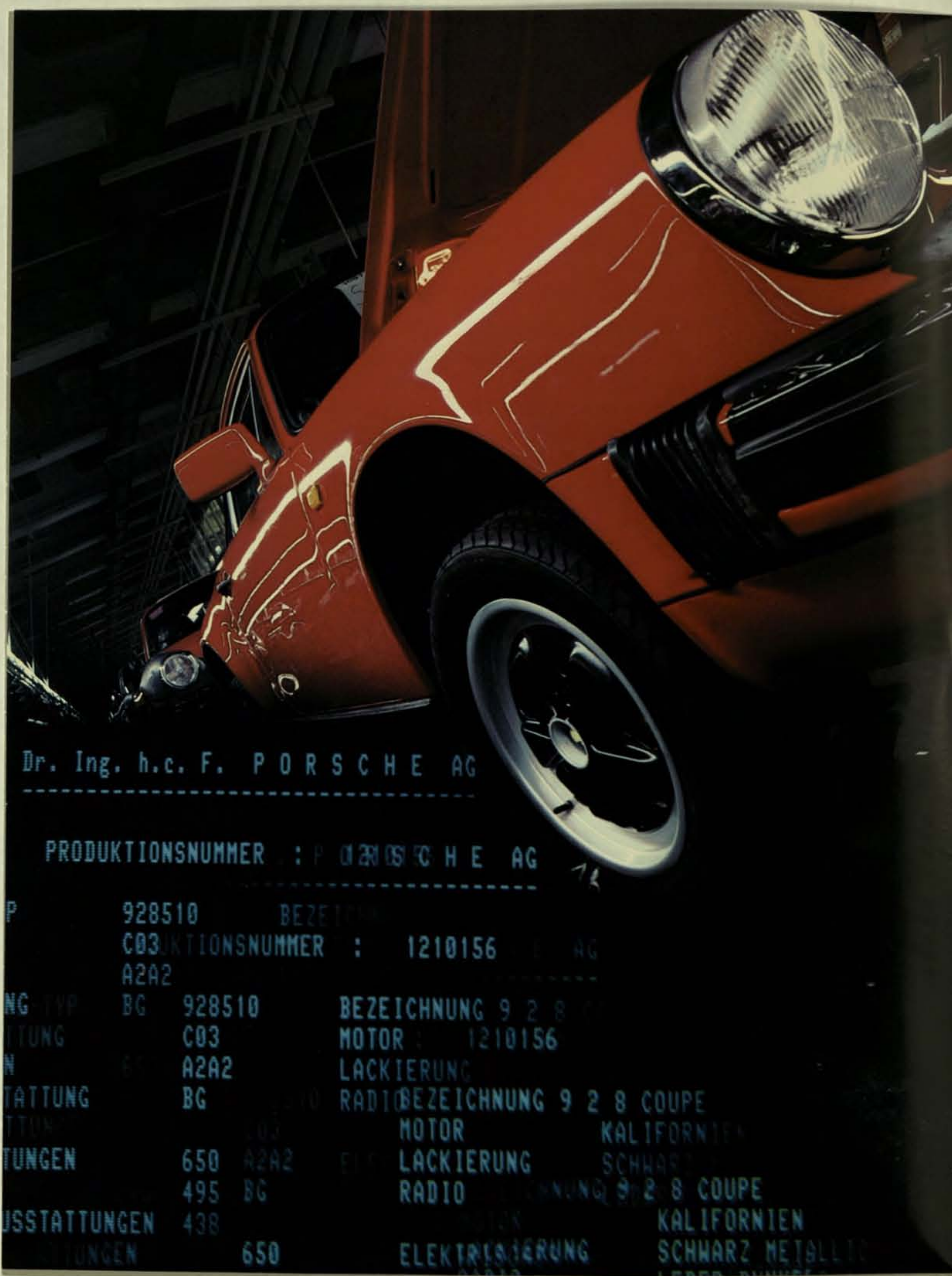
TANDEM

Tandem Computers Incorporated designs, develops, manufactures, markets and supports a unique computer system for the on-line transaction processing marketplace. Called the Tandem NonStop system, its innovative architecture virtually eliminates the risk of system failures and protects the customers' data bases from damage caused by electronic malfunctions. It is also the only computer system that can be expanded modularly from a mid-size to a large-scale system—or expanded into a distributed data processing network of up to 255 geographically dispersed systems—without hardware or software conversions.

Today, Tandem has manufacturing operations in two locations in the United States and one in Germany, and supports customers' systems in 11 countries throughout North America, Europe and Asia from over 60 offices.

In mid-1980, Tandem shipped its 1,000th processor, and ended the year with 290 customers. Fiscal 1980 earnings rose 117% on a 95% increase in revenues over the preceding year, while stockholders' equity grew 123%.

The fundamental advantages behind Tandem's success are summarized over the following pages.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◀ At Porsche, a business renowned for hand-craftsmanship and limited production, automation may at first seem improbable.

Porsche has, however, acquired two Tandem systems to take advantage of automation opportunities that will enhance efficiencies, increase productivity, provide better customer service and improve profitability.

Porsche produces just 135 handcrafted automobiles daily. But, there are some 1,000 work stations in the factory requiring some 13,000 different parts located in 25,000 different locations in the production parts warehouse in Stuttgart. The first Tandem system installed at Stuttgart will simplify the task of parts distribution and quality control.

The second Tandem system will produce production orders and shipping papers, a complicated task because of the number of variables and options associated with each automobile.

Managing spare parts inventories is another task assigned to the Tandem systems. From the Stuttgart warehouse, 50,000 items are shipped worldwide monthly. The warehouse has 70,000 different items located in 140,000 different bins.

A Tandem system will also be used as a management planning tool to project parts requirements well in advance of need to assure components availability for the production line.

The Tandem computers at Porsche will not alter the company's traditional methods, but will help Porsche maintain its time-honored standards of excellence as demand for its products rises.

Large organizations are converting vital aspects of their daily operations to on-line transaction processing to improve customer service, to increase productivity, and to gain a competitive edge.

Tandem was founded on an unfulfilled marketplace need and remains the only computer manufacturer with sole dedication to on-line transaction processing. The company brings to the marketplace a unique computer system designed from scratch specifically to meet the critical requirements of on-line transaction processing and distributed data processing networks.

This marketplace, characterized by its fundamental need for and use of *instantaneously updated information*, is a multi-billion dollar segment of the computer industry that is rapidly expanding at a rate exceeding that of the high-growth industry itself.

SPANS ALL INDUSTRIES

The need for the instantaneous information benefits of on-line transaction processing spans all industries and represents the application of computers to countless tasks that are essential to better management and control of large businesses. The need is especially strong in organizations, both commercial and governmental, that have multiple locations and recognize the control, cost-efficiency and customer service advantages of having a distributed data base.

Tandem NonStop systems are already at work in over 25 industries at such diverse tasks as international banking, hospital patient care, tour reservations, interstate electric power monitoring, railroad yard management, emergency vehicle dispatch, and even parimutuel wagering—to mention just a few.

COMPELLING NEEDS

This is a large marketplace because the advantages of converting to on-line transaction processing are compelling. Banks, for instance, are offering their customers on-line, automated teller machines and on-line teller stations to provide better service and to increase market share. Manufacturers are going on-line with materials ordering, work flow monitoring, customer

Worldwide, the number of Tandem educational centers (such as at Frankfurt, above, one of three in the Federal Republic of Germany) nearly tripled during fiscal 1980. Over 2,800 representatives from new or prospective customer organizations underwent Tandem training during the year.

orders, inventory control, and shipping functions to provide faster deliveries while increasing productivity and profitability. Large department store chains are introducing on-line terminals to their management to track sales instantly to assure availability of fast-moving merchandise and control costs of carrying slow-moving items.

RAPIDLY EXPANDING

It is a rapidly expanding marketplace, not only because of the imperatives of customer service, productivity and profitability, but also because the demand is self-generating. When one bank in a market offers its customers automated teller machines for 24-hour banking, for example, others must follow to maintain their competitive positions. And, once an organization has developed a data base to be used in a primary application, the benefits of additional applications to be used elsewhere in the business—drawing on the same data base—become quickly apparent.

UNIQUE USER NEEDS

Conventional computers fall short of meeting the well-defined requirements of on-line transaction processing. They are prone to periodic failure, can lose the users' vital files of information, and are costly and difficult to expand at a single site and even more so in a network of geographically dispersed systems.

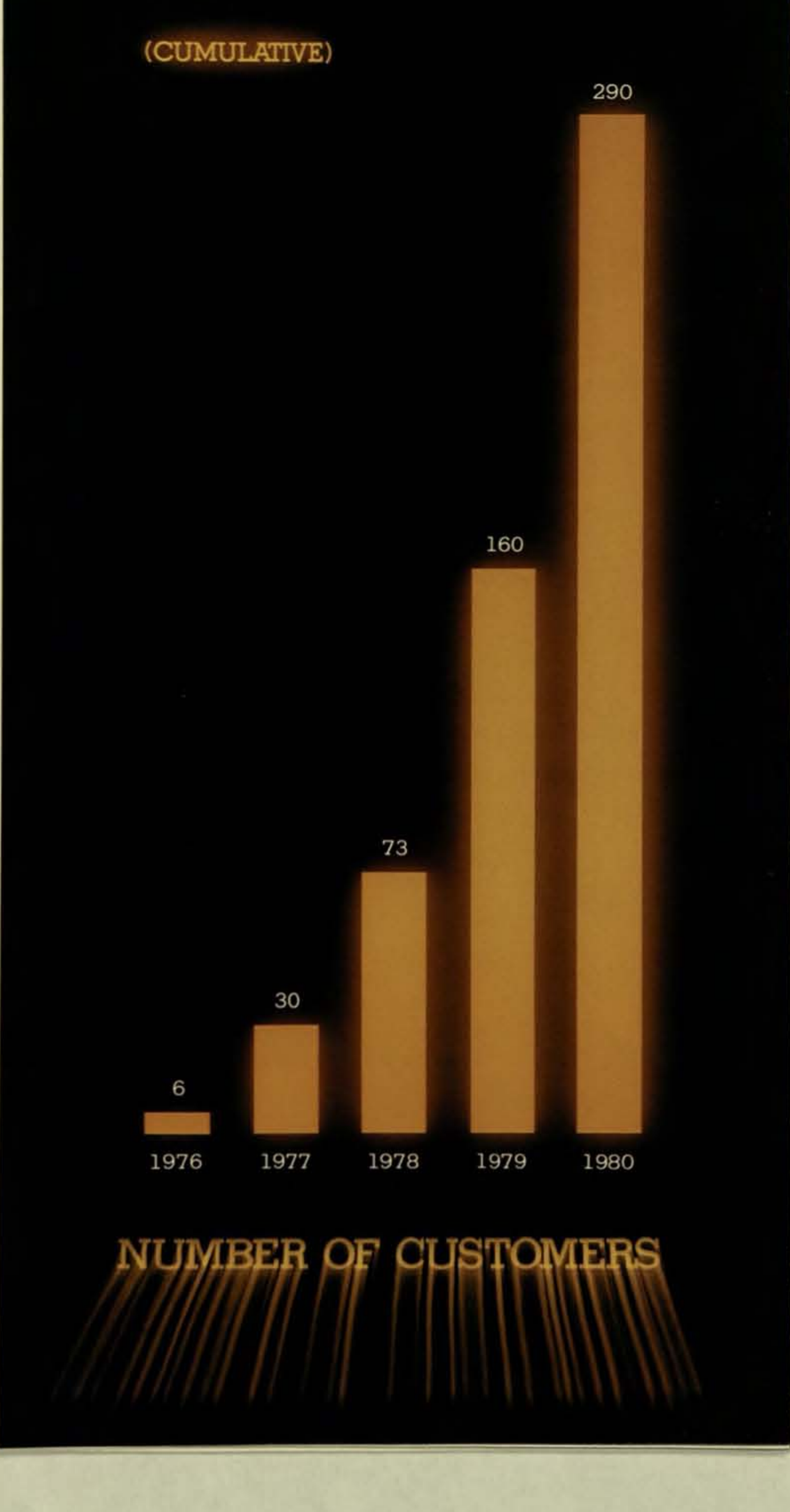
If a conventional, overnight batch processing computer fails and is down for several hours, the users' customers never know it. When a business' vital functions are on-line, however, loss of computer power means loss of business and serious degradation of customer service. This marketplace, then, must have a computer that will run continuously without interruption—and the Tandem NonStop system is the only commercially available computer that has that capability.

A user's data base—it could be thousands of orders for products or services—is also subject to sudden and total loss from a computer system malfunction or failure. It is, therefore, critical that an on-line computer prevent damage or loss to the data base—another exclusive feature of the NonStop system.

With conventional computers, adding more computing capacity is costly and disruptive. Re-programming is necessary, and everything stops while the new hardware is installed. With the NonStop system, however, additional processors are routinely added—while the power is on, while business proceeds uninterrupted, with no retraining of personnel, and with no re-programming.

Similarly, developing networks with a distributed data base is a slow, complex and costly affair with conventional systems. However, the Tandem architecture — in conjunction with Tandem's innovative EXPAND software — inherently allows the quick, simple and economic building of networks with absolutely no change in the users' applications programming.

The marketplace for Tandem computers is large and rapidly expanding because of the universal appeal of on-line transaction processing, and because computer users are increasingly recognizing that, to be successful with their on-line applications, they need the unique system features available only with Tandem NonStop systems.



Computers working at on-line tasks are interacting directly and constantly with people having immediate need to acquire and update information that is essential to the normal conduct of business.

On-line transaction processing is, therefore, the most demanding environment for a computer system—and the most visible to users and to their customers.

CONTINUOUS OPERATION

When an on-line computer stops in a business that is dependent on its computers for vital business transactions, business stops.

The Tandem NonStop system is the only commercially available computer system designed to run without interruption even if a component fails. It is also the only computer system that can be repaired—parts removed and replaced—when the power is on and the system continues to perform the user's work.

Previous attempts to create a high-availability system by connecting together conventional computers have proved to be costly and inefficient. With the Tandem system, however, there is no cost premium, no performance degradation, and no idle standby processors.

Continuous availability, however, is just one of the critical requirements

Customer acceptance of Tandem's NonStop system is widespread because it is the only commercially available computer with proven capabilities to run continuously, safeguard data, expand modularly, and to be integrated economically into a network of geographically dispersed systems with a distributed data base.

At United Airlines Maintenance Operations Center in San Francisco—the largest commercial aircraft maintenance facility in the world—three computer applications coming on-line in early 1981 will reduce energy consumption, improve fire safety, and tighten plant security.

With 8,000 employees working in three million square feet of buildings, United's maintenance operation is, itself, larger than many companies.

One of the main purposes of the new Tandem-driven system is to reduce energy costs by monitoring and automatically controlling lighting, ventilation and heating. In addition to reducing costs, the system will facilitate United's compliance with local utility company conservation standards.

United is also upgrading fire safety with the Tandem system by being able to immediately identify the nature and location of fire, provide a video display of the endangered area and actual fire, and eliminate costly false alarms.

In a third application, the system will automate plant security by controlling entry, movement within the facility, and departure of the 8,000 employees.

United is the free world's largest airline, with a fleet of over 300 jet aircraft. Application software for the system was developed and managed by Eyring Research Institute of Provo, Utah, one of the many software houses that acquire Tandem systems and develop programs for their customers.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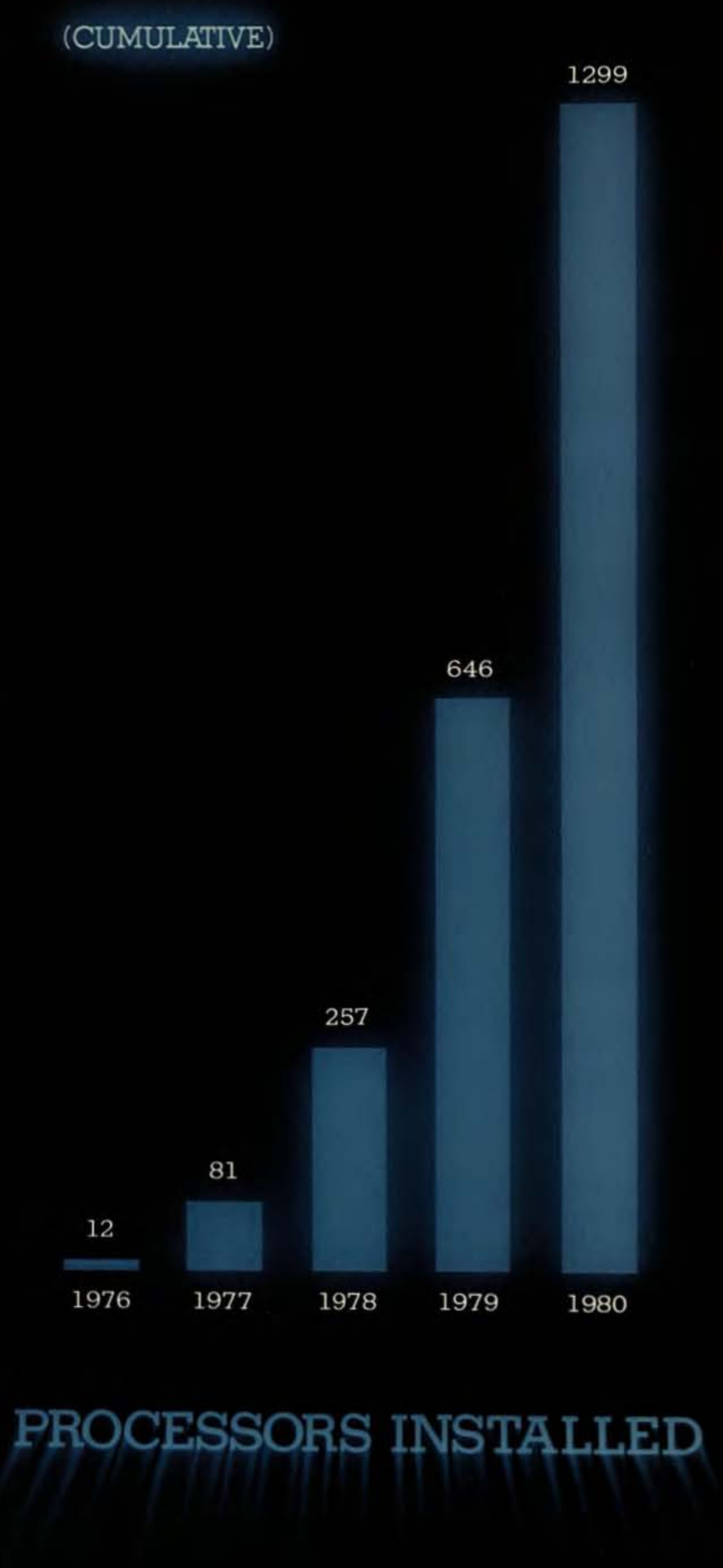


of on-line computing. Uniquely, Tandem fulfills all these other customer needs:

DATA INTEGRITY

Malfunctions in a conventional computer system can damage, even destroy, a business' on-line data base—the files of information essential to day-to-day operations.

If the data base is destroyed, it can mean the loss of thousands of business transactions. If it is damaged, the garbling can cause irreversible and costly errors—such as a funds transfer to the wrong account. However, because Tandem's NonStop architecture provides continuous operation, data bases are inherently safeguarded and data integrity assured.

MODULAR EXPANSION

The Tandem NonStop system, unlike all other computer systems, can be quickly and easily expanded from a mid-size, two-processor system to a large-scale, 16-processor system ranging in price from \$150,000 to over \$3,000,000 with no downtime, no retraining of personnel and no re-programming. Tandem customers enjoy substantial savings by installing a minimum-size system for applications development work, and then adding processing power for the production system only when it's needed.

Later, as business grows or as new applications are added, Tandem customers again add processors to their working systems without disrupting operations—while the power is on, while work flow proceeds, and with exactly the same software.

INHERENT NETWORKING

Just as each NonStop system can be expanded at a single site, users of

EXPAND software can link multiple sites and create a network of up to 255 Tandem system nodes with a distributed data base—without costly and disruptive hardware or software changes. The unique networking capabilities of the NonStop system are inherent in the Tandem architecture.

Unlike other approaches to distributed processing where the data bases are distributed, but kept independent, Tandem views the network as one *single* data base with multiple files distributed geographically. With proper security, any file within the network may be accessed and updated. What this means to users is simple: instantaneous access to critical business information which is updated automatically as new information is entered. This is truly on-line operation.

Once a business has put critical operating information on-line, it must be sure that it can get to the data and that the data is accurate. Only Tandem provides an integrated hardware and software solution to this important business need.

Network communications costs can be minimized using EXPAND because the automatic route-through capabilities of the software eliminate the requirement for point-to-point communications lines, and preserve NonStop operation in the event of a single communication line failure.

With the Tandem NonStop system, the same architectural features that virtually eliminate system failures, protect data bases, and enable modular expansion also provide for an inherent capability to build distributed data processing networks quickly and economically. Using Tandem's EXPAND software, all of the NonStop system's capabilities are extended to large, geographically dispersed networks without reprogramming. Tandem shipped its 1,000th processor during fiscal 1980.

PRODUCTIVE SOFTWARE TOOLS

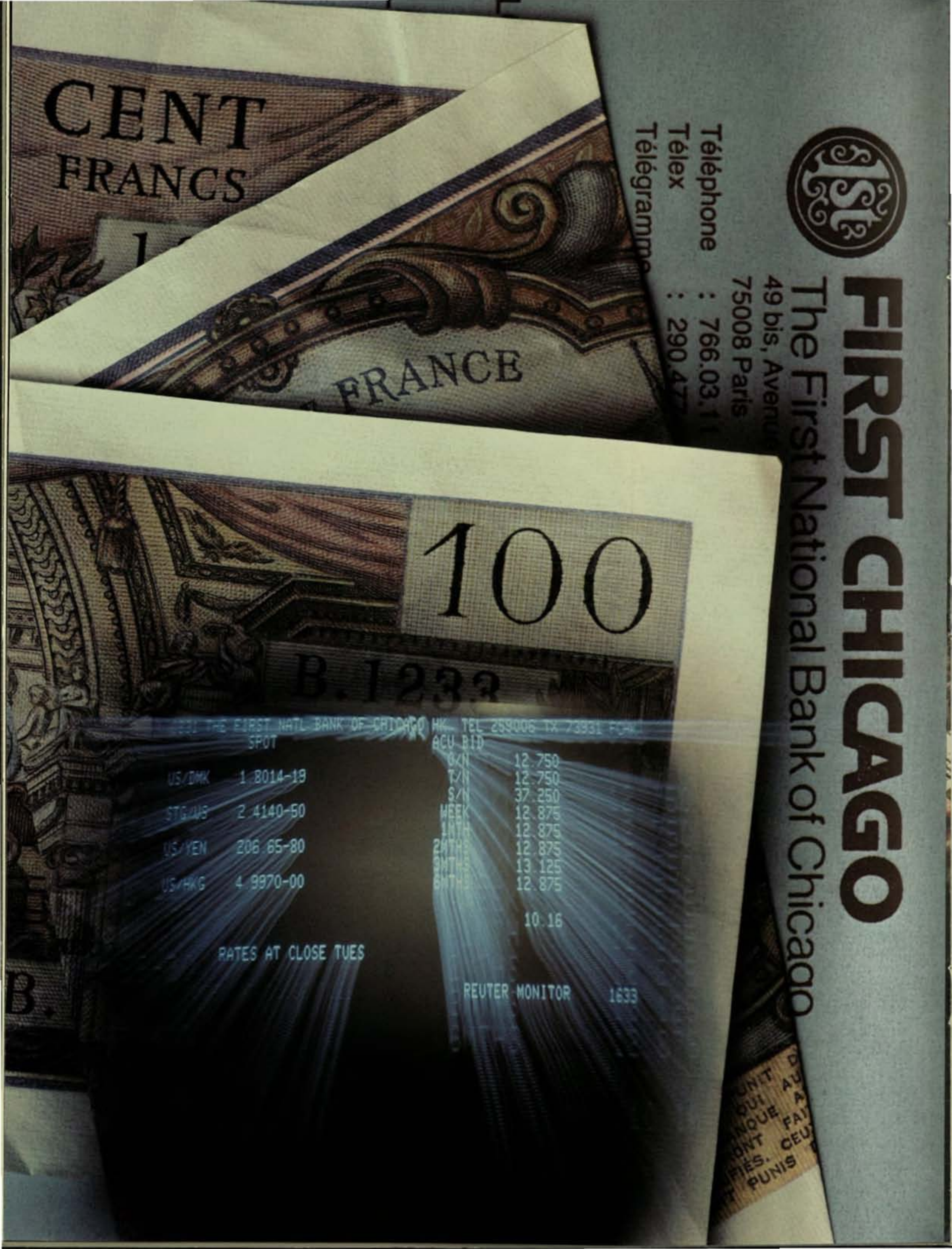
In converting to on-line transaction processing, or when developing a network of on-line systems, the user's major expenditures of time and money are on programming.

In addition to EXPAND, Tandem's many other software products enable users to implement on-line systems and distributed data processing (DDP) networks with much greater ease, speed and economy than ever before experienced in the industry.

For example, with ENCOMPASS, Tandem's relational data base management system, on-line applications go into operation at a fraction of the typical time and cost because the software package handles most of the complex terminal, transaction control and monitoring functions. Users' programmers are free to concentrate on their applications.

Another powerful software tool, Tandem's relational query/report writing language called ENFORM, makes it easier for users to extract information from multiple files in a data base and write reports quickly. The benefits of ENFORM are compounded when used with EXPAND in a DDP network because information can be swiftly and simply accessed regardless of its geographical location.

All of Tandem's innovative software products increase users' productivity, make the system easier to use, and represent major breakthroughs in reducing programming time and costs.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RATES AT CLOSE TUES
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FIRST CHICAGO
The First National Bank of Chicago
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◀ First Chicago Corporation, with assets over $28 billion ranking it among the top ten U.S. bank holding companies, is bringing up a number of innovative, on-line applications in its developing worldwide distributed data processing network using Tandem computers and EXPAND software exclusively.

In many of the world's major financial centers, First Chicago has Tandem systems to manage international currency transactions. The principal benefits of the application are greater speed and accuracy and reduced transaction processing costs on purchases and sales of huge blocks of currency.

A number of other advanced, automated international banking applications together with the bank's EXPAND-based network will come on-line during 1981 to give First Chicago an edge on customer service and competitiveness.

In the U.S., some five million transactions annually are being handled by First Chicago's Tandem-driven automatic teller machines and on-line teller stations. Other Tandem systems in Chicago and overseas are dedicated to developing future applications.

First Chicago acquired its first Tandem systems in early 1979. By the close of Tandem's 1980 fiscal year in the fall, the total complement of Tandem processors at First Chicago had grown to 31.

Six years ago, in 1974, Tandem was founded on the then-unfulfilled, critical needs of the on-line transaction processing marketplace.

Today, Tandem remains the only computer manufacturer concentrating solely on this marketplace. Although there is intense selling competition in the computer industry, the company's exclusive, market-specific hardware and software products are without direct competition, and have been proven at hundreds of customer sites.

Tandem has no direct product competition, leads the industry in experience in on-line transaction processing, and is years ahead of any potential competition.

MOVING TARGET

Over the years, Tandem has been a moving target for potential competition as the company's competitive advantages have rapidly multiplied.

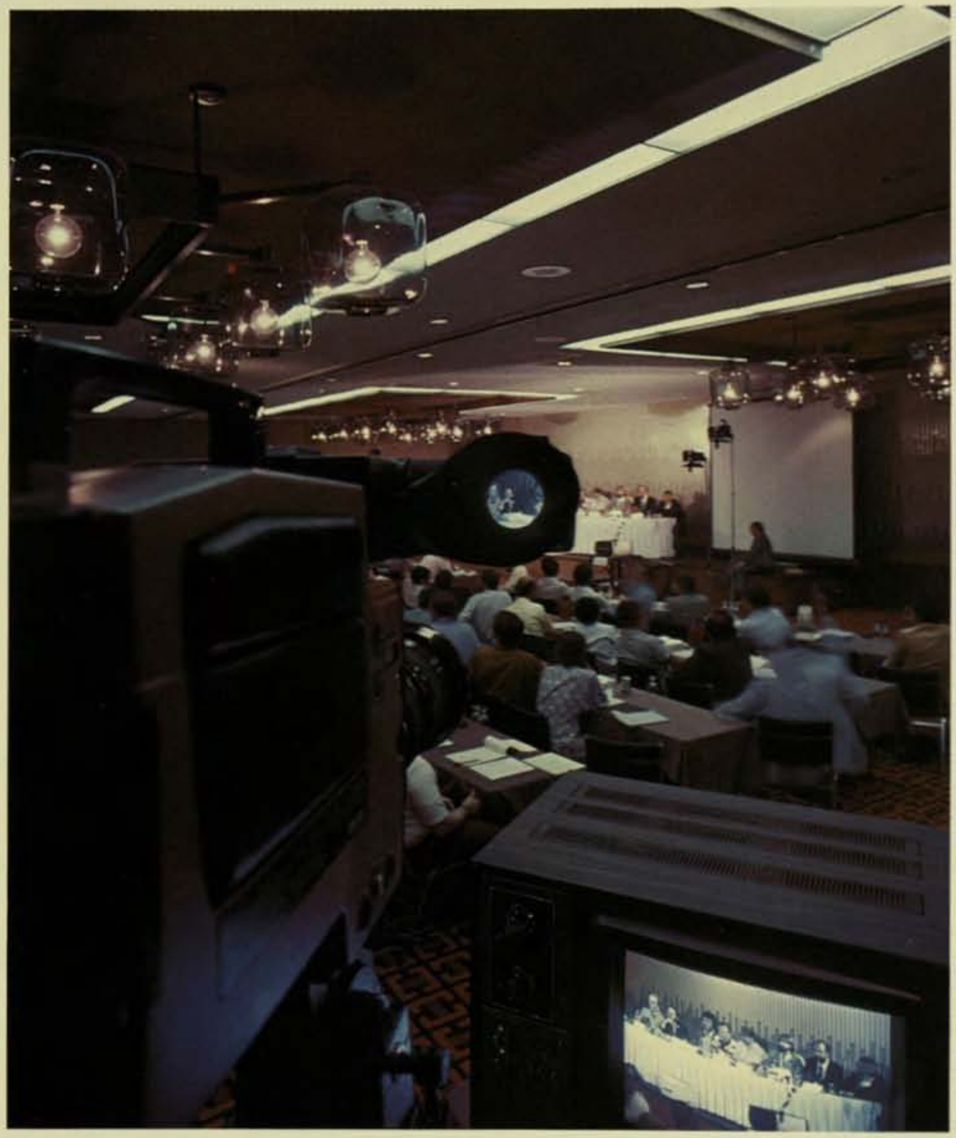
Clearly, Tandem has more experience in on-line transaction processing than any other organization. This experience has been translated into the continual introduction of system enhancements and software products that have established new productivity standards.

Tandem's original contributions of NonStop architecture, data integrity, modular expansion and inherent networking have been compounded with added features, functions and software systems in response to marketplace experience.

Fault-tolerant hardware, for instance, demands *fault-free* software. Without it, the system architecture is meaningless.

PROVEN SOFTWARE

Tandem's software, like the system hardware, has been proven in billions upon billions of working transactions in customer business. All of Tandem's software products build on the company's experience in on-line transaction processing and are designed to



Nearly 300 representatives from Tandem customer organizations around the world participated in the third annual Tandem Users' Group meeting in 1980 in San Diego, California.

Tandem systems undergo extensive quality control testing before leaving the company's plants in the United States and Germany. After component and subassembly testing and final system integration, all NonStop systems are subjected to a series of simulated failures to assure that, even under such severe, unlikely conditions, the system continues to operate.

Computer users select system suppliers only after conducting thorough studies and analyses of a complex set of competitive factors.

Of particular interest to potential buyers are cost per transaction, equipment reliability, software productivity, programming ease and after-sale support.

When the system to be installed is to serve front-line duty at on-line transaction processing tasks, the importance of those primary selection factors is magnified many times.

Tandem customers internationally have a high regard for the company and its products as evidenced by strong repeat business and as confirmed by major independent surveys ranking Tandem among the highest of all computer companies in overall customer satisfaction.

UPTIME CRITICAL

Whereas a user will, for instance, install a conventional computer for batch processing that has a history of 98.8% availability—a highly respectable number for a non-Tandem computer—the 1.2% downtime is unacceptable in on-line transaction processing. It means that the system, if it must operate 24 hours a day, will be inoperative for an average of once a month for a full eight-hour shift.

The problems of downtime are magnified many times in a DDP network. If the same 98.8%-availability computer is tied into an identical machine in a DDP network, the entire network will be down for an average of eight hours *twice* a month. Add a third system, and the network will stop working three times a month. And, in a hypothetical 10-system network, transactions would be interrupted for *eight*

The Securities Industry Automation Corporation (SIAC), subsidiary of the New York and American Stock Exchanges, develops and operates automated information-handling systems. These systems support securities order-processing, trading, reporting, and clearance and settlement for stocks, bonds, options, and financial futures.

In all, SIAC uses Tandem equipment in six different systems. Among the most widely known is the Intermarket Trading System (ITS), which was created in 1978 to provide the competition among exchanges requested by the U.S. Congress in its mandate for a national market system. ITS provides an electronic link for six participating stock exchanges—New York, American, Boston, Philadelphia, Midwest, and Pacific. A participant in one exchange may send a buy or sell order to another for execution at a better price and rapidly receive a report of the transaction. At present, nearly two million shares are traded over ITS each day.

SIAC also uses Tandem equipment in support of order delivery and execution reporting systems for the New York and American Stock Exchanges.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AXP&X 33.5/34.1 1x1
AXP&P 33.5/34.3 2x2
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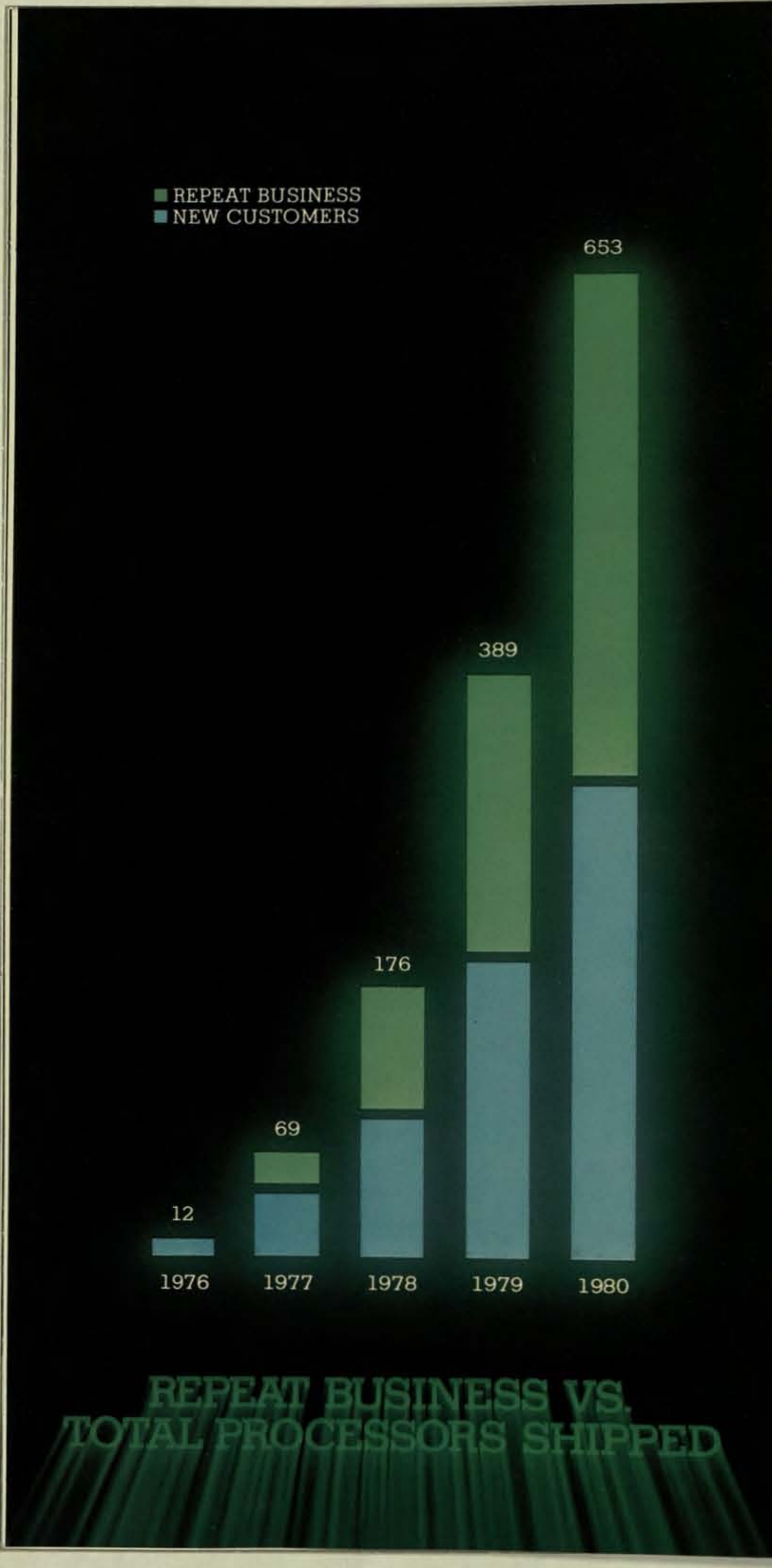


hours every third day.

In addition, the time required to recover distributed data bases after a failure in a network of conventional systems may exceed system downtime itself, as recovery must involve stopping operations so that complex, concurrent reconstruction of the data bases can take place at each system node in order to preserve data integrity.

Availability, then, is a critical consideration in on-line transaction processing. It is absolutely essential to the successful implementation of an on-line DDP network.

A great deal of customer satisfaction with the Tandem system obviously comes from the computer's unmatched NonStop capability. But, this only partially explains the high level of Tandem customer satisfaction. Tandem's significant repeat business results directly from the commitment of its people to excellent customer support.

HIGHEST CUSTOMER SATISFACTION

In the *1980 User Ratings of Computer Systems* published by Datapro Research Corporation, Tandem scored highest in overall customer satisfaction among all manufacturers with 10 or more survey respondents: 3.8 on a 4.0 scale.

Nearly 5,000 computer users in the Datapro survey rated the significant advantages and disadvantages of 44 suppliers. They were asked 87 questions in 14 categories.

Fully 100% of Tandem customers surveyed said they would recommend Tandem to other users.

HIGHEST CUSTOMER LOYALTY

In another major survey of users, conducted by G.S. Grumman/Cowen and

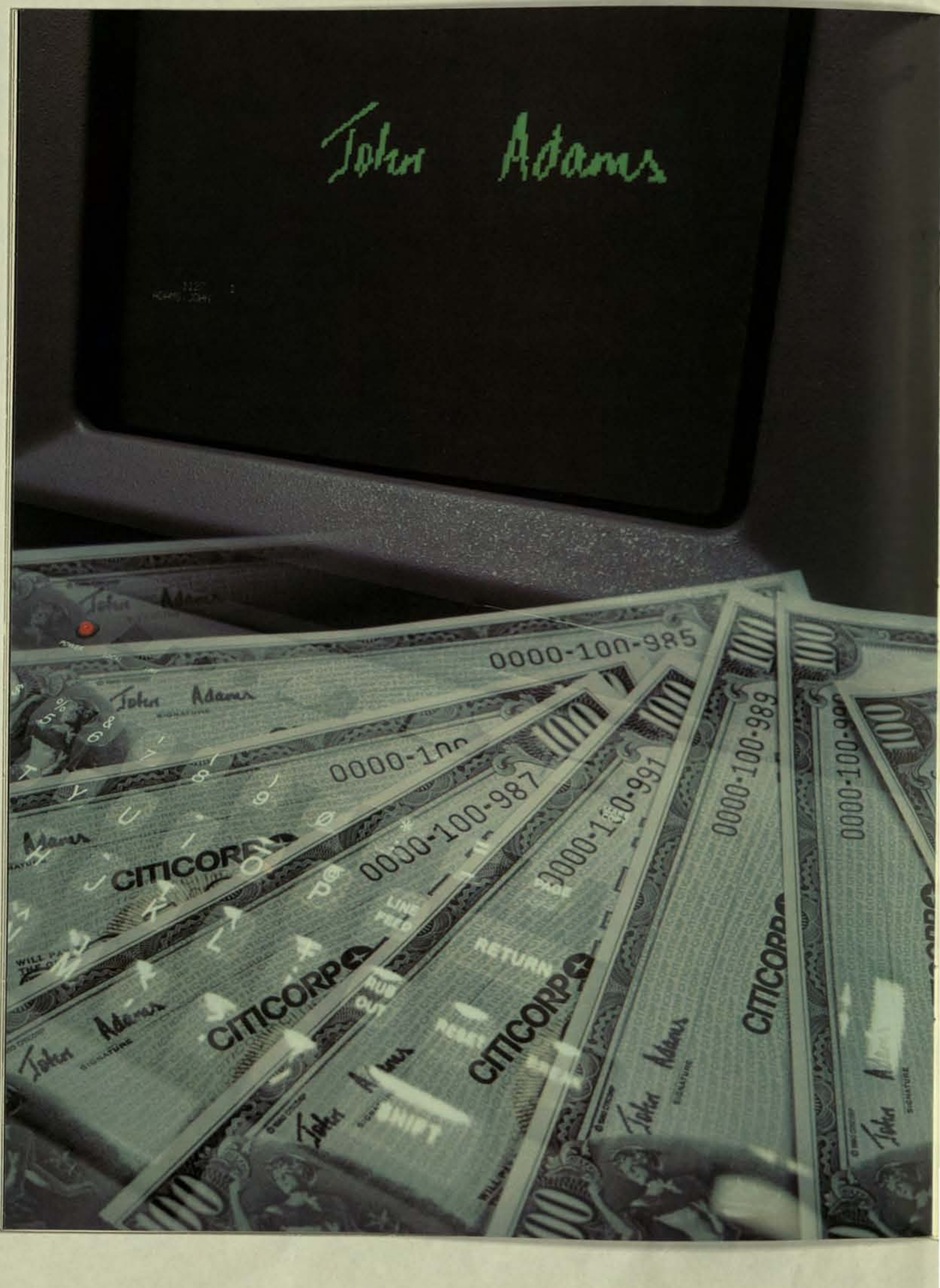
Datamation, Tandem scored the highest in customer loyalty—users reporting that they had no intention of changing suppliers.

This high level of customer satisfaction and loyalty is also evidenced by Tandem's rate of repeat business: During fiscal 1980, half of all Tandem processors shipped went to previous customers.

QUALITY SYSTEMS SUPPORT

Tandem customers in the Datapro survey also rated Tandem above average in effectiveness and responsiveness of field service. One half of all of Tandem's people work at activities that directly support the company's customers. Each sales representative is backed by at least seven support professionals—including customer engineers, systems analysts and customer training instructors—to maintain Tandem's solid base of satisfied customers.

Tandem's commitment to helping its users serve their customers better is evidenced not only by the NonStop system but also by the existence of over 60 customer support offices worldwide. Over half of all Tandem employees are engaged in customer support activities (such as the system analyst at right, above, working with data processing executives at the Forward Trust subsidiary of Midland Bank in Birmingham, England.)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CITICORP
RETURN
SHIFT

◀ To capture a larger share of the $31 billion travelers check market, Citicorp—which has the second largest-selling travelers check in the world—introduced in late 1980 its new automated PassWord Service.

Unlike other travelers check services that require a trip to a bank during normal business hours and the laborious signing of each check, Citicorp's new PassWord checks are ordered by phone, processed by a Tandem system and delivered by Express Mail—presigned.

The checks can be ordered 24 hours a day, seven days a week by telephoning a toll-free number. An operator enters the customer's password and order information into the Tandem system. The system debits the customer's checking or savings account or a designated credit card and passes the order to the equipment which signs the checks and packages them for mailing.

The customer's signature—previously digitized from a sample provided at the time of enrollment in the service—is printed at the top of the check.

To speed development of the system, Citicorp used many software tools developed by Tandem including features of the ENCOMPASS relational data base management system.

PassWord Service, said to be the most sophisticated of its kind, can process more than 1,000 orders per hour. Forty on-line terminals are tied into the Tandem system which currently has three processors.

Approximately 18 additional terminals are tied into a two-processor system which supports software development and training for the telephone representatives.

Tandem truly cares about its people, and its people truly care about Tandem. That is why the company has product leadership and an effective organization. And it explains how Tandem earned the industry's highest overall customer satisfaction and customer loyalty ratings.

TOP TALENT

In an industry continuing to experience an acute shortage of quality people, Tandem is able to attract top talent in all disciplines because of the excitement of the company's leading edge position and its favorable reputation, attitudes, policies and stimulating work environment.

Tandem also keeps its good people. Employee turnover during 1980 was 8%, or one-third the average of the U.S. computer industry.

Job satisfaction at Tandem is largely the result of an intentionally created team spirit that evolves from having a clear corporate focus and a minimal organizational structure. The company endeavors to bring to employees an understanding of corporate objectives within the context of how the business works and the impact of each individual's specific work on the company as a whole.

Tandem functions under individual responsibility and peer pressure. Everyone has well-defined goals and is delegated the authority to achieve those goals. Responsibility is pushed downward to nourish creativity and the development of managerial talents.

PRODUCTIVE

Tandem sales per employee exceeded $98,000 during fiscal 1980, or more than double the average of the U.S. computer industry. This achievement was aided by the design concept of the NonStop system.

In manufacturing, the simplicity of the design—each processor is made up of some combination of just 17 printed circuit boards— has many productivity and inventory control advantages.

In marketing, the productivity of salesmen is also enhanced by the modularity feature. Inasmuch as the

Tandem's success emanates directly from the conscientious, competent hard work of its people. And their productivity is enhanced by the product concept itself.

Highly qualified people with the ability to accept responsibility are imperative to the success of rapidly-growing, high-technology companies. At upper left, Jim Treybig (third from left), Tandem president and chief executive officer, reviews progress with the engineering design team responsible for Tandem's first LSI chip, one of the many programs demonstrating the company's commitment to advanced technologies. In adjacent photo, a Tandem software development team takes their meeting outdoors while working on Hyper Link, one of the five new data communications products introduced by Tandem in late 1980. Bob Marshall, senior vice president and chief operating officer (in bottom photo), talks to a group of new Tandem employees about the company's philosophy and goals. Total employment grew by 68% during fiscal 1980.

NonStop system represents the equivalent of a family of systems ranging from mid-size to large scale, any one salesman can address the needs of virtually any size user.

In field support, Tandem's customer engineers and systems analysts are more efficient because the NonStop system eliminates the likelihood of working under the pressure of customer irritation with a down system. And the modularity feature makes customer engineers equally proficient in servicing small and large systems, while repairs are simplified because the system is maintained while the power is on and running the customer's work. There is only one set of spares for any size system, and repairs are made by simply removing and replacing modular components.

Even in research and development, expenditures and productivity are highly leveraged because all software and hardware enhancement programs apply across the board to any system size or network configuration.

UNIQUE BENEFITS

These productivity advantages have enabled Tandem to implement many unique benefits that express the company's recognition of the importance of its people to the continued growth of the company. Among them:

☐ Tandem is committed to having its people share in the company's financial success. Virtually all employees are stockholders or option holders. In fact, Tandem employees represent one of the company's largest stockholder groups.

☐ The company operates on a flexible working hours policy, enabling employees to arrive and leave on a schedule that best suits their needs in concert with the demands and responsibilities of their positions.

☐ Tandem believes that its people are the best judge of where the company should direct its expenditures on general benefits, hence employees have a voice in deciding benefit programs.

☐ After four years with Tandem, all North American employees are eligible for a fully-paid, six-week sabbatical in addition to vacation time. (Elsewhere in the world, Tandem employees take extended vacations annually in accordance with local customs.)

Opportunities at Tandem abound because management is committed to providing and nurturing a fertile environment, and because the company's rapid growth affords individuals career growth at a rate consistent with their abilities to manage more responsibility.

Focal to Tandem's original and ongoing strategy are high growth with sustained profitability, experienced management, and a strong financial position.

It has been Tandem's intent since the time of founding to build a large company. This continuing objective gains momentum from numerous advantages that include the explosive growth of the marketplace, the unique compatibility of Tandem's products with marketplace needs, the company's rapidly expanding base of large users, and Tandem's well-qualified people.

Of equal importance to Tandem's current and future success, however, is the solid framework within which the company manages and finances high growth. Key elements of the framework are:

Consistent Revenue and Profit Growth. Tandem has enjoyed excellent revenue growth, while maintaining pretax operating margins in the 16-20% range since commencement of volume shipments in early 1977. Revenue and profit goals of the business plan have been consistently met within 5% throughout the company's history, and Tandem has retained all profits to reinvest in growth.

Equity Financing. As a result of consistent financial performance, Tandem enjoys investor recognition of the company's potential. This recognition, in turn, has enabled Tandem to fund growth in excess of that possible with internally generated cash through equity financing.

Financial Strength. Significant retained earnings and equity financing

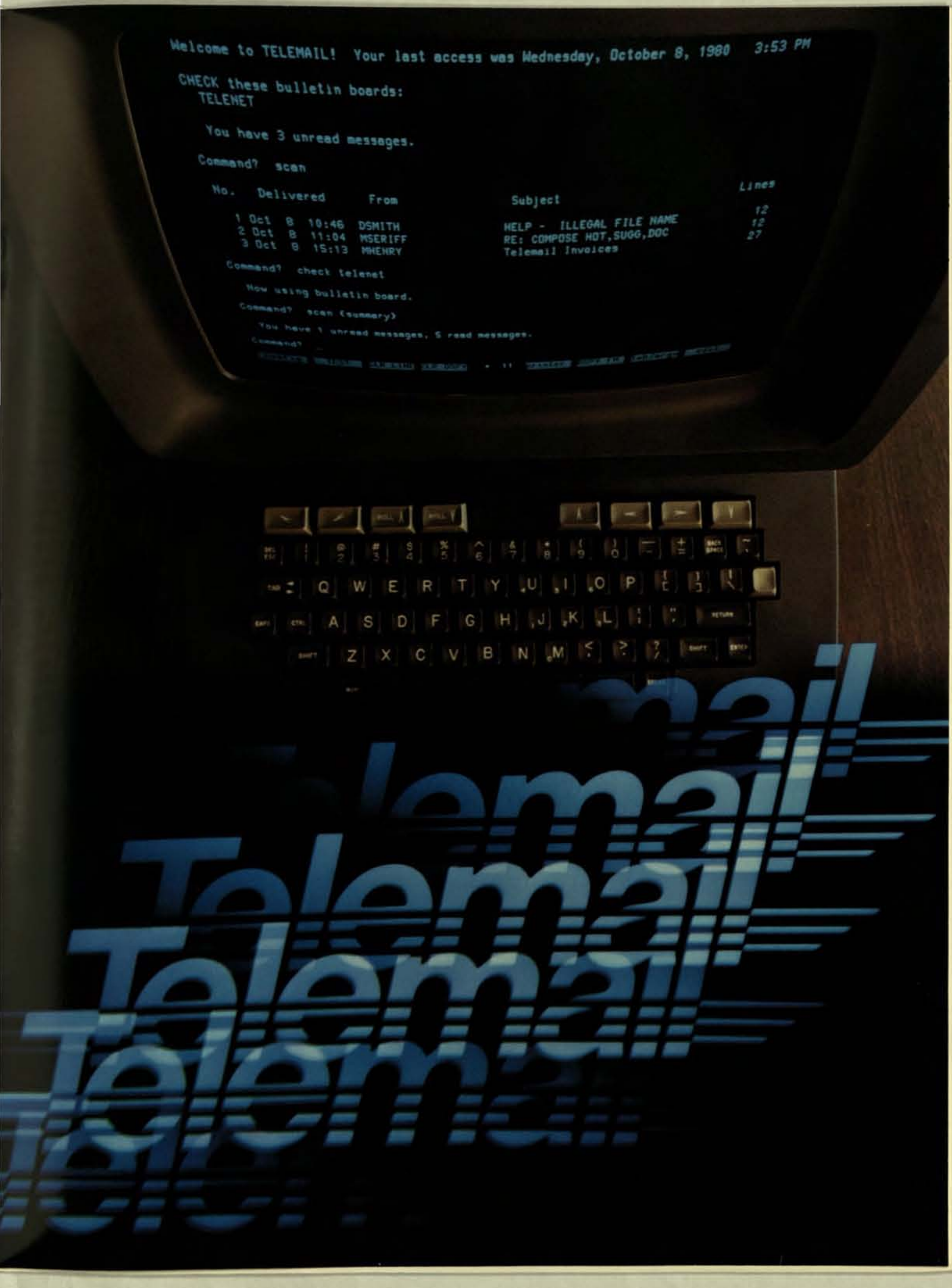
Tandem headquarters facilities in California more than doubled during fiscal 1980 with the addition of 165,000 square feet of manufacturing, marketing, and research and development space. Elsewhere during the year Tandem opened 16 new offices and 10 additional educational centers for customer training.

Moving into the office of the future ▶ today with a new nationwide electronic mail service. GTE Telenet came on-line with its Tandem-driven Telemail in mid-1980.

Intended to increase office productivity, particularly among executives and managers, the new service provides instantaneous delivery of messages anywhere in the U.S. on a 24-hour basis. Telemail enables users, through GTE Telenet's nationwide common carrier network for data communications, to send, receive and file messages electronically with a wide variety of existing data terminals and communicating word processors.

Telemail provides each user with an electronic "mail box" which can be accessed from office, home or any out-of-town location using a telephone and a desk-top or portable terminal.

Over the next several years, the subsidiary of General Telephone & Electronics Corporation intends to expand Telemail into a high-speed, multi-media information distribution system incorporating electronic data bases. The U.S. market for electronic mail is expected to grow to $2.5 billion by 1984.


Welcome to TELEMAIL! Your last access was Wednesday, October 8, 1980 3:53 PM
CHECK these bulletin boards:
TELENET
You have 3 unread messages.
Command? scan
No. Delivered From Subject Lines
1 Oct 8 10:46 DSMITH HELP - ILLEGAL FILE NAME 12
2 Oct 8 11:04 MSERIFF RE: COMPOSE HOT,SUGG,DOC 12
3 Oct 8 15:13 MHENRY Telemail Invoices 27
Command? check telenet
Now using bulletin board.
Command? scan (summary)
Telemail

have yielded the strong balance sheet essential to high growth. Total assets have grown from $5.4 million immediately prior to the company's initial public offering of common stock in December 1977 to $95.7 million at the close of this fiscal year in September 1980.

Financial Flexibility. With virtually no debt and having equity approaching $100 million, Tandem has a large capacity to fund future growth with borrowings as a back-up to its equity financing strategy.

Aside from the marketplace advantages, consistent profitability, and financial strengths, Tandem is run by experienced managers with proven capabilities to thrive on and function efficiently in a rapid growth environment. Management has established and is aided by control systems—computerized and on-line—that envision future needs for each functional area. These systems are tied together in a network of Tandem computers using EXPAND software and a distributed data base to coordinate and control the company's worldwide operations.

In fact, there are probably few companies of Tandem's size that use computers in operations control to the extent of Tandem. As the company grows, these control systems increase in sophistication and effectiveness to strengthen further Tandem's high-growth framework.

Tandem's financial strength and strategy, coupled with the company's unique products and high-quality people, constitute the vital resources for continued success.

BOARD OF DIRECTORS

Thomas J. Perkins (1), Chairman of the Board; Partner, Kleiner, Perkins, Caufield & Byers
Morton Collins (2), Partner, DSV Associates
Thomas J. Davis, Jr. (1)(2), Partner, Mayfield II
Franklin P. Johnson, Jr., President, Asset Management Capital Company
Eugene Kleiner (2), Partner, Kleiner, Perkins, Caufield & Byers
Robert C. Marshall, Senior Vice President and Chief Operating Officer, Tandem Computers Incorporated
Alvin C. Rice, President and Chairman, Imperial Bank
Robert G. Stone, Jr., Chairman of the Board, West India Shipping Company
James G. Treybig (1), President and Chief Executive Officer, Tandem Computers Incorporated

(1) Member of Executive Committee
(2) Member of Audit Committee

OFFICERS

James G. Treybig, President and Chief Executive Officer
Robert C. Marshall, Senior Vice President and Chief Operating Officer
Michael D. Green, Senior Vice President
Lawrence A. Laurich, Vice President—Engineering
David R. Mackie, Vice President—Headquarters Marketing
Henry V. Morgan, Vice President, Controller and Secretary
Jeanne D. Wohlers, Vice President, Treasurer and Assistant Secretary

AUDITORS

Arthur Andersen & Co.,
San Jose, California

REGISTRAR AND TRANSFER AGENT

Bank of America N.T. & S.A.,
San Francisco, California

FORM 10-K

A copy of the company's Form 10-K, as filed with the Securities and Exchange Commission, is available on written request. Please direct request to:

Treasurer's Office
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014

ANNUAL MEETING

The annual meeting of stockholders will be held at 10:00 a.m. on Friday, January 30, 1981, at the corporation's headquarters.

TANDEM

Corporate Headquarters
19333 Vallco Parkway
Cupertino, CA 95014
(408) 725-6000

DIVISIONAL HEADQUARTERS

EASTERN DIVISION

Victor DeSouza, Vice President
One Penn Plaza
New York, NY 10119

CENTRAL DIVISION

Michael Bateman, Vice President
1827 Walden Office Square
Schaumberg, IL 60195

WESTERN/INTERNATIONAL DIVISION

Charles W. Ryle, Vice President
245 Santa Ana Court
Sunnyvale, CA 94086

EUROPEAN DIVISION

Horst Enzelmueller, Vice President
Bernerstrasse 34
6000 Frankfurt/Main 56
Germany

DOMESTIC SALES AND SERVICE OFFICES

ARIZONA, Phoenix
CALIFORNIA, Los Angeles, San Diego, San Francisco, San Mateo, Santa Clara
COLORADO, Denver
FLORIDA, Tampa
GEORGIA, Atlanta
ILLINOIS, Chicago, Schaumburg
INDIANA, Indianapolis
IOWA, Cedar Rapids
KANSAS, Kansas City
LOUISIANA, New Orleans
MASSACHUSETTS, Boston
MICHIGAN, Detroit
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NEBRASKA, Omaha
NEVADA, Las Vegas
NEW JERSEY, Hasbrouck Heights
NEW YORK, New York City, Rochester
NORTH CAROLINA, Greensboro
OHIO, Cincinnati, Cleveland, Columbus
OKLAHOMA, Tulsa
OREGON, Portland
PENNSYLVANIA, Philadelphia, Pittsburgh
TENNESSEE, Memphis
TEXAS, Dallas, Fort Worth, Houston
UTAH, Salt Lake City
VIRGINIA, Falls Church
WASHINGTON, Seattle
WISCONSIN, Milwaukee

INTERNATIONAL SUBSIDIARIES

CANADA

Bjorn Ahlblad, Managing Director
Tandem Computers Canada Limited
180 Duncan Mill Road
Don Mills, Ontario M3B 1Z6
Offices also located in Calgary, Edmonton, Montreal and Vancouver

ENGLAND

Jack Chapman, Regional Manager
John Louth, Managing Director
Tandem Computers Limited
Peel House, 32-34 Church Road
Northolt, Middlesex UB5 5AB

FRANCE

Claude Raimond, Managing Director
Tandem Computers S.A.
1, Place Des Etats Unis
Silic 255
94568 Rungis-Cedex

GERMANY

Horst Enzelmueller, Vice President
Tandem Computers GmbH
Bernerstrasse 34
6000 Frankfurt/Main 56
Offices also in Dusseldorf, Hamburg, Muenchen and Stuttgart

ITALY

Oreste Rospetti, Managing Director
Tandem Computers Italia S.P.A.
Via del Ghisallo 20
Milano

JAPAN

Kazu Adachi, Managing Director
Tandem Computers Japan Limited
3-1-1 Hagashi Ikebukuro
Toshima-Ku
Tokyo

THE NETHERLANDS

Carl Brandt, Managing Director
Tandem Computers B.V.
Koningin Juliana Plein 30-20
2595 AA Den Haag

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Bengt Rindegard, Managing Director
Tandem Computers A.B.
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S-171 48 Solna

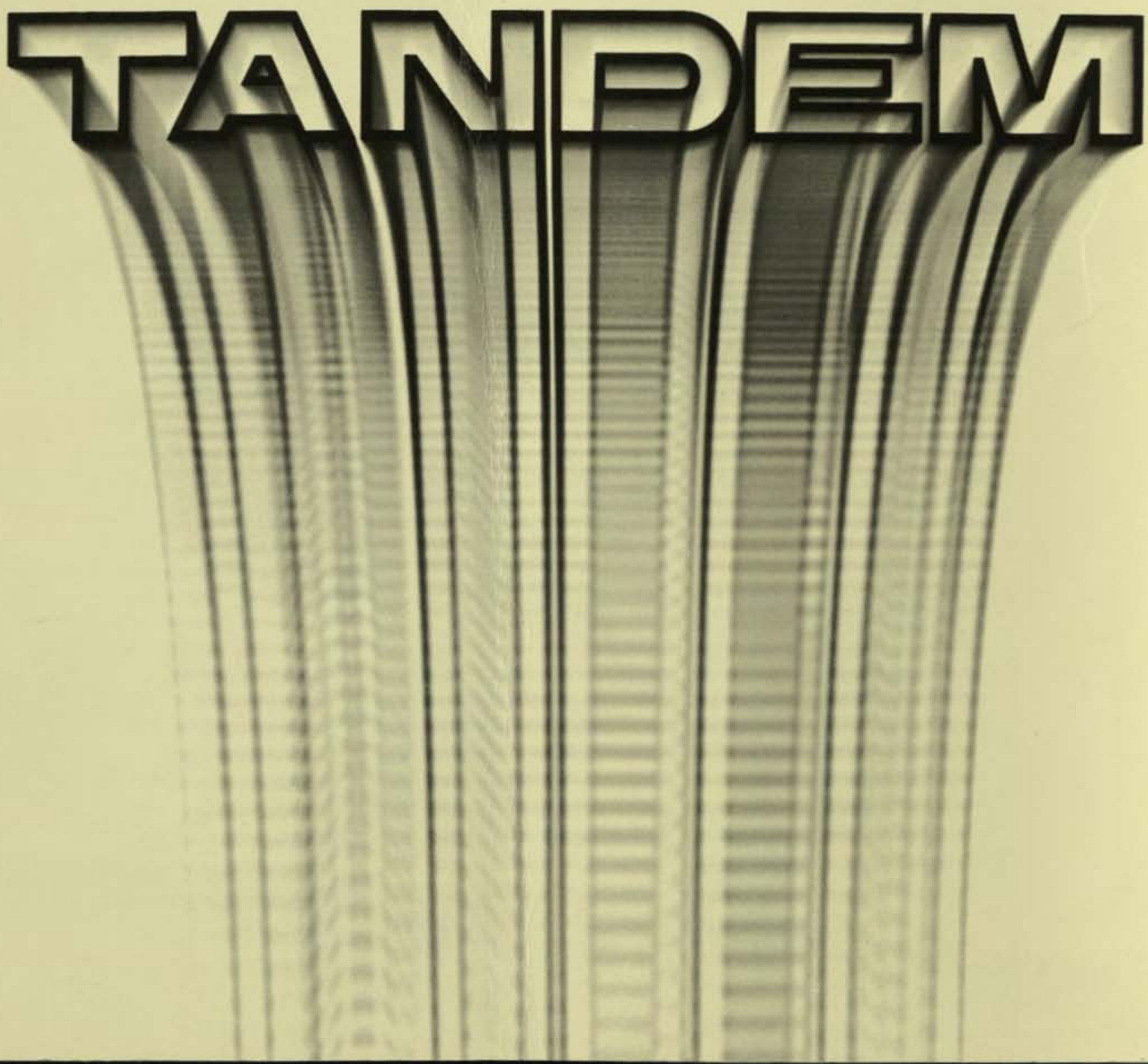
SWITZERLAND

Heinz Studiger, Managing Director
Tandem Computers A.G.
Zweierstrasse 138
8003 Zurich

Produced by George E. Browne & Associates • Graphic Design: Kay Woon • Concept and Copy: George E. Browne • Corporate Coordination: Patricia Becker • Photography: Larry Keenan • Production Control: Don Armstrong • Printed in the U.S. by Anderson Lithograph Company

1980 ANNUAL REPORT

FINANCIAL REVIEW



HIGHLIGHTS OF THE YEAR

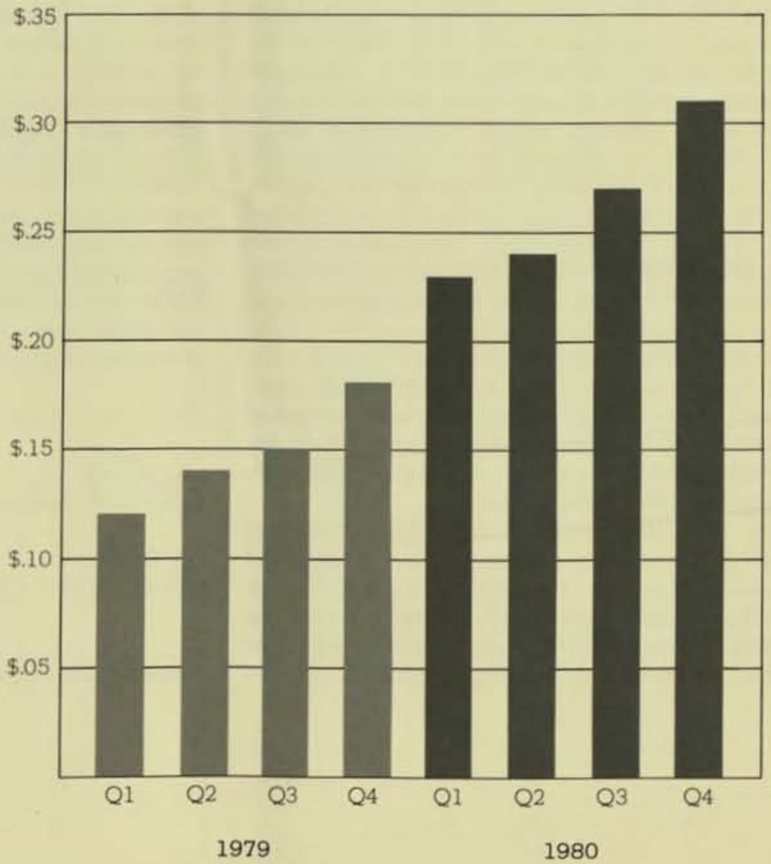
Fiscal year ended September 30	1979	1980
Revenues	$55,974,000	$108,989,000
Income Before Income Taxes	$10,104,000	$ 21,082,000
Pre-Tax Return on Revenues	18.1%	19.3%
Net Income	$ 4,920,000	$ 10,687,000
Income Per Share*	$.59	$1.06
Weighted Average Shares Outstanding*	8,356,756	10,080,372
Working Capital	$27,096,000	$ 61,232,000
Total Assets	$45,947,000	$ 95,701,000
Stockholders' Equity	$31,530,000	$ 70,294,000
Number of Employees	828	1,387

QUARTERLY RESULTS (Unaudited; dollars in thousands except per share amounts)

	1979				1980			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenues	$10,398	$12,471	$14,992	$18,113	$20,826	$24,877	$29,194	$34,092
Net Income	951	1,123	1,295	1,551	2,161	2,414	2,773	3,339
Income Per Share*	$ .12	$ .14	$ .15	$ .18	$ .23	$ .24	$ .27	$ .31

*Adjusted for two-for-one stock split in June, 1980.

INCOME PER SHARE



TO OUR STOCKHOLDERS:

We are pleased to report another year of record growth in revenues and profits. The key to our success has been a continued emphasis on excellence – in people, products and service.

Without question, the effort of each individual Tandem employee was vital to the Company's exceptional record of performance in 1980. Outstanding people are Tandem's most valuable resource, and we remain committed to preserving a stimulating work environment which encourages and rewards productivity, creativity and personal growth through increased individual responsibility. The investment we have made in hiring and developing outstanding people has paid off. Last year productivity at Tandem was among the highest in the computer industry, and turnover was among the lowest.

Tandem is dedicated to maintaining its steady, planned profitable growth, and we are confident that we are well positioned to do so. Geographically based divisions, created in November 1979, have provided the decentralized management structure we believe necessary to support a much larger company while, at the same time, emphasizing a positive working environment and providing high-level technical service and support closer to our customer base. Our management structure has been broadened by numerous internal promotions, and in August 1980, Robert Marshall, Senior Vice President and Chief Operating Officer, was appointed to the Board of Directors.

We continue to increase our R&D program to keep pace with 1980's strong 95% revenue growth and to prepare for further growth in the Eighties. We have made substantial commitments to advanced technologies, including large scale integration and computer aided design, which will enable us to remain on the leading edge of the computer industry.

Building upon five years of experience in on-line transaction processing, the Company announced ENCOMPASS, a relational data base management system, in May 1980. ENCOMPASS software automatically performs complex terminal management and data base control functions and ensures the consistency of information stored in a geographically distributed data base through a unique transaction monitoring facility. This product provides users with additional software tools that increase programmer productivity and decrease the time and costs associated with application software development.

Major new data communications capabilities were added to our product line in November 1980 with the announcement of several software and hardware products that allow users of Tandem systems to interface with mainframes and minicomputers of other vendors while continuing to utilize fully the exclusive software features of the NonStop system for on-line transaction processing.

Tandem has always viewed customer satisfaction and support as a critical part of our success. We are pleased that repeat business continues to represent a substantial portion of our sales volume.

Over the past year, the Company continued to expand its global sales, service and support facilities consistent with our growing customer base. Worldwide, Tandem now maintains over 60 facilities in eleven countries, and employs more than 1400 people. Sixteen new offices were opened during the year, and ten additional educational centers for customer training were opened.

This geographic distribution is important for increasing sales, training new users, and for servicing the multi-location and multinational needs of existing customers, who typically use Tandem systems to convert critical aspects of their business to on-line operations.

Financially, our results speak for themselves. Revenues increased to record levels for the fifth straight year. Net income during fiscal 1980 reached $10,687,000, up 117% over last year, and on a quarterly basis revenues and net income have advanced steadily for 14 consecutive periods. Our balance sheet remains strong with a current ratio of 4 to 1 and a 3% debt to capitalization ratio.

In the six years since its founding, Tandem Computers has become a leader in shaping the future of on-line transaction processing. The Company's unique NonStop systems—providing high availability, modular expansion, data integrity, and increased programmer productivity—are without equal. We are committed to making the investment in product development and support which will keep Tandem at the forefront of the industry. The critical corporate resources to achieve this goal—dedicated personnel, a strong and flexible financial position, and control systems designed for high growth—are in place. Our dedication to maintaining the excellence of these vital resources is our best assurance of continued success in the years ahead.

Sincerely yours,

T.J. Perkins
Chairman of the Board

James G. Treybig
President and
Chief Executive Officer

November 10, 1980

CONSOLIDATED STATEMENT OF OPERATIONS

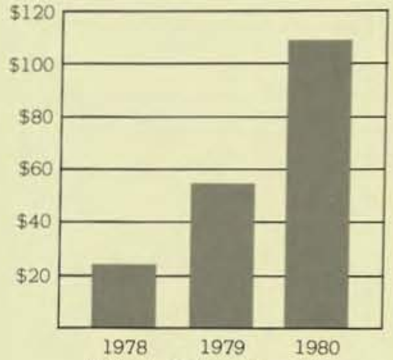
For the Five Years Ended September 30, 1980

(Dollars in Thousands Except Per Share Amounts)

	Year Ended September 30				
	1980	1979	1978	1977	1976
REVENUES	$108,989	$55,974	$24,305	$7,692	$ 581
COSTS AND EXPENSES:					
Cost of revenues	40,831	20,786	9,096	3,514	482
Product development	8,786	4,654	2,169	1,094	979
Marketing, general and administrative	40,049	20,828	8,808	2,719	1,327
Interest, net	(1,759)	(398)	(258)	36	(38)
	87,907	45,870	19,815	7,363	2,750
INCOME (LOSS) BEFORE INCOME TAXES AND EXTRAORDINARY CREDIT	21,082	10,104	4,490	329	(2,169)
Provision for Income Taxes	10,395	5,184	2,337	171	—
INCOME (LOSS) BEFORE EXTRAORDINARY CREDIT	10,687	4,920	2,153	158	(2,169)
Extraordinary Credit—Tax benefit of net operating loss carryforwards	—	—	1,218	167	—
NET INCOME (LOSS)	$ 10,687	$ 4,920	$ 3,371	$ 325	$(2,169)
INCOME (LOSS) PER COMMON SHARE:*					
Income (loss) before extraordinary credit	$ 1.06	$ .59	$ .30	$ .03	$ (2.17)
Extraordinary credit	—	—	.17	.03	—
Net income (loss)	$ 1.06	$ .59	$ .47	$ .06	$ (2.17)
Weighted average shares outstanding*	10,080,372	8,356,756	7,179,948	5,359,846	1,060,540

*Adjusted for a two-for-one stock split in June, 1980.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE CONSOLIDATED STATEMENT OF OPERATIONS

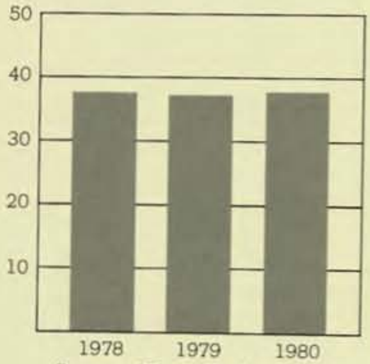


Dollars in Millions; Fiscal Years

REVENUES

Revenues in fiscal 1980 increased 95% to $108,989,000. This gain resulted primarily from increased shipments of systems and software to both new and existing customers and from sales of added processors, peripherals and software for existing systems. During fiscal 1980 the Company shipped 653 processors to 198 customers.

Revenues in fiscal 1979 increased 130% to $55,974,000 from $24,305,000 reported in fiscal 1978. This gain also resulted from a substantial increase in shipments of systems, processors and peripherals. During fiscal 1979 the Company shipped 389 processors to 118 customers.

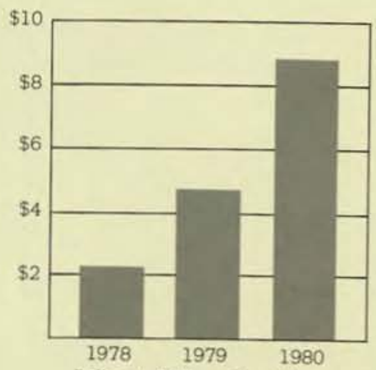


Percent of Revenues; Fiscal Years

COST OF REVENUES

Tandem's products are manufactured at the Company's Cupertino headquarters, and in Watsonville, California, and Neufahrn, West Germany. Production facilities at these locations were expanded by approximately 50% during fiscal 1980 to meet the increased demand for the Company's products.

The cost of revenues in fiscal 1980 increased 96% to $40,831,000. In 1979, cost of revenues advanced 129% over the fiscal 1978 level to $20,786,000. Cost of revenues, as a percentage of revenues, has remained essentially unchanged over the last three years.



Dollars in Millions; Fiscal Years

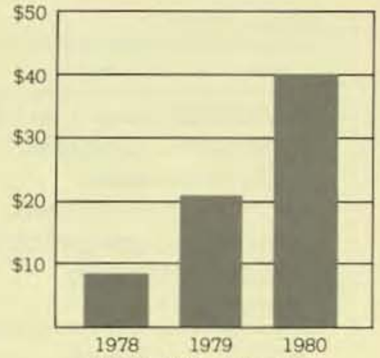
PRODUCT DEVELOPMENT

The Company's product development effort is dedicated to meeting the needs of computer users who are implementing on-line transaction processing or message handling applications. Expenditures on product development in fiscal 1980 were $8,786,000, up 89% over the fiscal 1979 level. In fiscal 1979 product development expenditures were $4,654,000, up 115% from the prior year. These expenditures resulted in many new product introductions in both years and funded research on future products.

Product development expenditures as a percentage of revenues were 8.1% and 8.3% in fiscal 1980 and 1979, respectively. The Company has a long-term objective of maintaining development expenditures at approximately 8% to 9% of revenues.

MARKETING, GENERAL AND ADMINISTRATIVE

The Company focuses its selling efforts on the end user market, where providing a high level of customer support is essential. These support costs are encompassed in marketing, general and administrative expenditures, which increased 92% in fiscal 1980 to $40,049,000. In fiscal 1979 marketing, general and administrative expenditures were $20,828,000, up 136% over the prior year. In fiscal 1980 and 1979 such costs represented 36.7% and 37.2% of revenues, respectively. This expenditure level reflects not only the Company's end user marketing orientation but also the significant geographical expansion of marketing operations over the last two years and the addition of marketing personnel in anticipation of future growth.

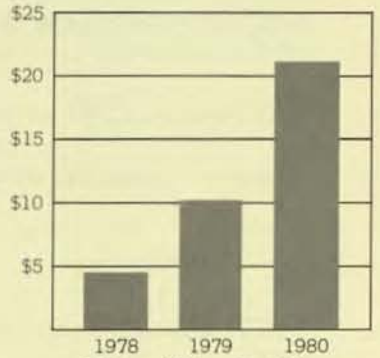


Dollars in Millions; Fiscal Years

PRETAX INCOME

Pretax income increased 109% to $21,082,000 in fiscal 1980, while pretax margins (pretax income as a percentage of revenues) were 19.3% compared with 18.1% reported in fiscal 1979. The increase in pretax margins in fiscal 1980 resulted primarily from the increase as a percentage of revenues in net interest income earned on cash equivalent investments. In fiscal 1979 pretax income was $10,104,000, as compared to $4,490,000 (18.5% of revenues) in fiscal 1978.

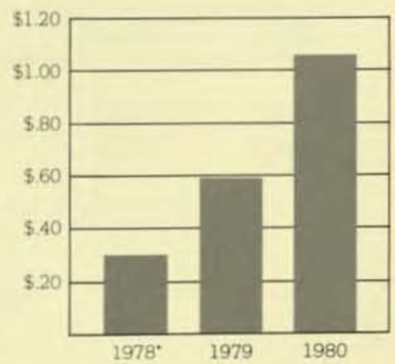
The Company's effective tax rate declined in fiscal 1980 to 49.3% from 51.3% and 52.0%, reported in fiscal 1979 and 1978, respectively. Net income advanced 117% to $10,687,000 in fiscal 1980 from $4,920,000 in fiscal 1979. In fiscal 1978, net income before extraordinary credit was $2,153,000.



Dollars in Millions; Fiscal Years

INCOME PER COMMON SHARE

Income per common share increased 80% to $1.06 in fiscal 1980. Earnings in fiscal 1979 and 1978* were $.59 and $.30 per share, respectively. Per share earnings have not increased as rapidly as net income before extraordinary credit because of increased shares outstanding. The Company completed public offerings of common stock in fiscal 1980 and 1979, and these offerings combined with the sale of stock to employees under the employee stock purchase plan and grants under option plans resulted in increases in weighted average shares outstanding of 21% and 16%, respectively. Proceeds from the sale of these additional shares have been used to finance working capital expansion, which was necessary to support the Company's growth during this period.



Fiscal Years

*Before extraordinary credit.

CONSOLIDATED STATEMENT OF INCOME

For the Years Ended September 30, 1980 and 1979

(In Thousands Except Per Share Amounts)

	1980	1979
REVENUES (Notes 1 and 8)	$108,989	$55,974
COSTS AND EXPENSES:		
Cost of revenues	40,831	20,786
Product development	8,786	4,654
Marketing, general and administrative	40,049	20,828
Interest expense	293	84
Interest income	(2,052)	(482)
	87,907	45,870
INCOME BEFORE INCOME TAXES	21,082	10,104
Provision for Income Taxes (Note 2)	10,395	5,184
NET INCOME	$ 10,687	$ 4,920
INCOME PER COMMON SHARE* (Note 7)	$ 1.06	$ .59

*Adjusted for a two-for-one stock split in June, 1980.

The accompanying notes are an integral part of this statement.

CONSOLIDATED BALANCE SHEETS

As of September 30, 1980 and 1979

(In Thousands)		
ASSETS	1980	1979
CURRENT ASSETS:		
Cash (Note 4)	$ 9,265	$ 2,198
Cash investments	6,980	4,560
Accounts receivable, net of $1,016,000 allowance for doubtful accounts in 1980, none in 1979	42,552	19,881
Inventories (Note 1)	20,901	11,304
Prepaid expenses	1,965	1,385
Total current assets	81,663	39,328
PROPERTY AND EQUIPMENT, at cost (Notes 1 and 3):		
Production and test equipment	4,135	1,982
Computer equipment	4,702	2,417
Office furniture and equipment	1,083	382
Systems spares	4,391	2,141
Leasehold improvements	4,054	1,597
	18,365	8,519
Less—Accumulated depreciation and amortization	4,327	1,900
	14,038	6,619
	$95,701	$45,947

(In Thousands)		
LIABILITIES AND STOCKHOLDERS' INVESTMENT	1980	1979
CURRENT LIABILITIES:		
Current maturities of capitalized lease obligations	$ 476	$ 375
Accounts payable	11,063	5,675
Accrued expenses	3,216	1,269
Accrued income taxes	5,676	4,913
Total current liabilities	20,431	12,232
CAPITALIZED LEASE OBLIGATIONS, net of current maturities (Note 3)	1,651	1,144
DEFERRED INCOME TAXES	3,325	1,041
COMMITMENTS (Note 6)		
STOCKHOLDERS' INVESTMENT (Note 5):		
Preferred stock—$.10 par value, authorized 2,400,000 shares; none outstanding	—	—
Common stock—$.025 par value, authorized 20,000,000 shares; outstanding 8,339,498 shares in 1979 and 10,024,918 shares in 1980	251	209
Additional paid-in capital	53,555	25,520
Retained earnings	16,488	5,801
Total stockholders' investment	70,294	31,530
	$95,701	$45,947

The accompanying notes are an integral part of these balance sheets.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT

For the Years Ended September 30, 1979 and 1980

(In Thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stockholders' Investment
	Shares	Amount	Shares*	Amount			
Balance, September 30, 1978	—	$ —	7,352	$ 184	$14,473	$ 881	$15,538
Sale of common stock, net of related expenses	—	—	840	21	10,054	—	10,075
Sale of stock under stock option and stock purchase plans, net	—	—	148	4	758	—	762
Income tax benefit resulting from exercises of non-qualified stock options and early disposition of shares acquired under qualified stock option and stock purchase plans	—	—	—	—	235	—	235
Net income	—	—	—	—	—	4,920	4,920
Balance, September 30, 1979	—	—	8,340	209	25,520	5,801	31,530
Sale of common stock, net of related expenses	—	—	1,430	36	24,243	—	24,279
Sale of stock under stock option and stock purchase plans, net	—	—	255	6	2,986	—	2,992
Income tax benefit resulting from exercises of non-qualified stock options and early disposition of shares acquired under qualified stock option and stock purchase plans	—	—	—	—	806	—	806
Net income	—	—	—	—	—	10,687	10,687
Balance, September 30, 1980	—	$ —	10,025	$ 251	$53,555	$16,488	$70,294

*Adjusted for two-for-one stock split in June, 1980.

The accompanying notes are an integral part of this statement.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Years Ended September 30, 1980 and 1979

	1980	1979
	(In Thousands)	
WORKING CAPITAL PROVIDED FROM (USED FOR):		
Net income	$10,687	$ 4,920
Add back items not requiring the use of working capital:		
Depreciation and amortization	2,547	1,365
Deferred income taxes	2,284	737
Working capital provided from operations	15,518	7,022
Acquisition of property and equipment	(10,255)	(5,770)
Net book value of equipment sold or retired	289	337
Increase in capitalized lease obligations, net of current maturities	507	429
Increase in deferred income taxes	—	304
Sale of common stock, net of repurchases	27,271	10,837
Tax benefit of stock options and stock purchase plans	806	235
Net increase in working capital	$34,136	$13,394

	1980	1979
WORKING CAPITAL INCREASE REPRESENTED BY:		
Increase in current assets—		
Cash and cash investments	$ 9,487	$ 2,311
Accounts receivable	22,671	11,766
Inventories	9,597	4,985
Prepaid expenses and other	580	766
Increase in current liabilities—		
Current portion of capitalized lease obligations	(101)	(172)
Accounts payable	(5,388)	(1,909)
Accrued expenses	(1,947)	(316)
Accrued income taxes	(763)	(4,037)
Net increase in working capital	$34,136	$13,394

The accompanying notes are an integral part of this statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CONSOLIDATION

The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly owned subsidiaries after elimination of intercompany accounts and transactions. Foreign exchange gains and losses are not significant and are reflected in the results of operations.

REVENUE RECOGNITION

The Company generally recognizes equipment sales revenues at the time of shipment.

INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor, and manufacturing overhead. The components of inventory used to determine cost of revenues were:

(In Thousands)	September 30		
	1980	1979	1978
Purchased parts and subassemblies	$11,832	$ 6,207	$4,196
Work-in-process and finished systems	9,069	5,097	2,123
	$20,901	$11,304	$6,319

INCOME TAXES

The Company provides for income taxes on total DISC income and accounts for investment tax credits as a reduction of the provision for taxes on income in the year in which the related credits are realized.

PROPERTY AND EQUIPMENT

Systems spares are depreciated using the double declining balance method. All other property and equipment are depreciated using the straight-line method. The estimated useful lives are:

	Years
Production and test equipment	5-10
Computer equipment	5-7
Office furniture and equipment	5-10
Systems spares	5
Leasehold improvements	Lease Term

Expenditures for maintenance and repairs are charged to operations as incurred. Expenditures for major betterments and renewals are capitalized and depreciated over the estimated remaining useful life of the asset. The net gain or loss on assets retired or otherwise disposed of is credited or charged to operations and the asset cost and related depreciation are removed from the accounts.

2. INCOME TAXES

The provision for income taxes for the years ended September 30, 1980 and 1979, is comprised of:

	1980	1979
Current:		
Federal	$ 6,022,000	$3,850,000
State	1,682,000	916,000
Foreign	1,120,000	326,000
	8,824,000	5,092,000
Prepaid:		
Federal	(281,000)	(638,000)
State	(29,000)	(7,000)
	(310,000)	(645,000)
Deferred:		
Federal	2,104,000	718,000
State	82,000	—
Foreign	(305,000)	19,000
	1,881,000	737,000
	$10,395,000	$5,184,000

The sources of prepaid and deferred taxes were as follows:

	1980	1979
Prepaid:		
Increase in revenues recognized for income tax reporting, but not for financial statements	$ 115,000	$ 503,000
Expenses recognized for financial statements, but not for income tax reporting	195,000	142,000
	$ 310,000	$ 645,000
Deferred:		
DISC income	$ 1,638,000	$ 449,000
Increase (decrease) in revenues deferred for foreign tax purposes	(403,000)	19,000
Accelerated depreciation and other, net	646,000	269,000
	$ 1,881,000	$ 737,000

The provision for income taxes differs from the amount obtained by applying the expected Federal income tax rate to income before taxes as follows:

	1980	1979
Federal tax provision at expected rate	$ 9,678,000	$4,698,000
State income taxes net of Federal income tax benefit	937,000	486,000
Foreign losses with no tax benefit and foreign income taxes in excess of Federal rate	352,000	294,000
Investment tax credits	(611,000)	(216,000)
Other	39,000	(78,000)
	$10,395,000	$5,184,000

3. CAPITALIZED LEASE OBLIGATIONS

The Company leases certain equipment under agreements that extend through fiscal 1987. The following summarizes the future minimum lease payments together with the present value of the minimum lease payments as of September 30, 1980:

Year Ending September 30	
1981	$ 607,000
1982	554,000
1983	529,000
1984	449,000
1985	283,000
1986-1987	126,000
Total minimum lease payments	2,548,000
Less: Amount representing interest (7%)	421,000
Present value of minimum lease payments	$2,127,000

4. LINES OF CREDIT

The Company has a revolving bank line of credit which provides for unsecured borrowings of up to $10,000,000 at the bank's prime lending rate. The agreement requires the Company to maintain a compensating balance of 2½% of the line of credit amount plus 5% of borrowings in excess of $2,500,000. The line of credit expires December 31, 1980.

The Company has a revolving line of credit with another bank providing for unsecured borrowings of up to $5,000,000. The line of credit expires on June 30, 1981, provides for borrowings at the bank's prime lending rate, and requires the company to maintain a compensating balance of 5% of the commitment.

There were no amounts outstanding under either line of credit during fiscal 1980.

5. STOCK OPTION AND STOCK PURCHASE PLANS

Stock Option Plans

The Company has three stock option plans in effect for employees. Under these plans, the option price may not be less than 100% of the fair market value on the date of grant. Under the qualified plan, adopted in 1976, all options granted are exercisable upon the date of grant and expire five years from the date of grant. Subsequent to May 20, 1981, however, such options will not be eligible for special tax treatment. Under the two non-qualified plans, adopted in 1976 and 1979, options are exercisable upon the date of grant and expire no later than seven years from the date of grant.

In addition, two option plans covering a total of 8,000 shares have been adopted for two directors. Under these plans, options to purchase 4,000 shares are exercisable at $11.75 per share and an additional 4,000 shares are exercisable at $15.13 per share.

At September 30, 1980 and 1979, there were options for 1,047,000 and 719,400 shares, respectively, available for future grant. Following is a summary of activity under the plans:

Options outstanding as of September 30, 1980:

Granted in Fiscal Year	Number of Shares	Option Price		Fair Market Value at Date of Grant	
		Per Share	Total	Per Share	Total
1976	2,000	$ .25- .50	$ 1,000	$ .25- .50	$ 1,000
1977	36,674	.50- 1.75	27,000	.50- 1.75	27,000
1978	229,146	1.75-15.13	2,230,000	1.75-15.13	2,230,000
1979	480,656	11.25-16.44	6,570,000	11.25-16.44	6,570,000
1980	836,848	15.69-46.63	19,037,000	15.69-46.63	19,037,000
	1,585,324		$27,865,000		$27,865,000

Options became exercisable as follows:

Became Exercisable in Fiscal Year	Number of Shares	Option Price		Fair Market Value at Date Option Became Exercisable	
		Per Share	Total	Per Share	Total
1979	585,800	$11.25-15.50	$ 7,612,000	$11.25-15.50	$ 7,612,000
1980	815,950	14.69-46.63	18,472,000	19.57-46.63	20,137,000

Options were exercised as follows:

Exercised in Fiscal Year	Number of Shares	Option Price		Fair Market Value at Date Option Exercised	
		Per Share	Total	Per Share	Total
1979	118,238	$ .25-14.37	$ 653,000	$11.63-18.00	$ 1,676,000
1980	203,326	.25-19.82	2,056,000	15.38-56.25	6,142,000

Stock Purchase Plan

As of September 30, 1980 and 1979, the Company has reserved 97,766 and 156,446 shares, respectively, of Common Stock for future issuance under its employee stock purchase plan adopted in fiscal 1978. Eligible employees may elect to purchase shares of Common Stock at 85% of the lower of the fair market value at the beginning or end of a three-month offering period. During 1980 and 1979, the Company issued 58,680 and 35,778 shares, respectively, of Common Stock pursuant to this plan.

On October 5, 1980, the Board of Directors approved an amendment to the employee stock purchase plan. Among other things, the amendment provides for an increase of 500,000 shares in the total shares authorized. The amendment is subject to stockholder approval.

Proceeds from the sale of Common Stock under the stock option plans and the stock purchase plan are credited to the common stock account to the extent of par value and the remainder to additional paid-in capital. No charges or credits have been reflected in the income statement with respect to stock option or stock purchase plans.

6. COMMITMENTS

The Company leases its headquarters, operating facilities, field offices and automobiles under operating lease agreements which expire through fiscal 2004. Future lease payments are as follows:

Year Ending September 30	
1981	$ 6,518,000
1982	6,392,000
1983	5,520,000
1984	4,415,000
1985	3,932,000
1986-90	15,044,000
1991-95	7,646,000
1996-2000	639,000
2001-2004	447,000
	$50,553,000

Rent expenses included in the results of operations for the years ended September 30, 1979 and 1980, are $1,738,000, and $4,509,000, respectively.

The Company has entered into a lease for 140,000 square feet of additional space. The lease term will be for 15 years, beginning with occupancy, which is expected to be March 31, 1982. The initial annual rental rate is expected to be $1,922,000. The annual rental rate will be increased by 9% every three years.

7. INCOME PER COMMON SHARE

Net income per common share for the years ended September 30, 1980 and 1979, has been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares in 1980 and 1979 result from the assumed exercise of stock options outstanding that have a dilutive effect when applying the treasury stock method. Total shares used in the computation were 10,080,372 for 1980 and 8,356,756 for 1979. Fully diluted income per share is substantially the same as reported income per share.

8. GEOGRAPHIC SEGMENT INFORMATION

The Company designs, develops, manufactures, markets and services multiple processor computer systems. The following table sets forth information about the Company's operations in different geographic areas for the years ended September 30, 1980 and 1979.

1980 (In Thousands)

	Geographic Area			Adjustments and	
	United States	Europe	Other	Eliminations	Consolidated
REVENUES—					
Customers	$78,758	$25,760	$4,471	$ —	$108,989
Intracompany	17,452	1,868	56	(19,376)	—
Total revenues	$96,210	$27,628	$4,527	$(19,376)	$108,989
INCOME BEFORE INCOME TAXES	$21,469	$ 801	$ 140	$ (1,328)	$ 21,082
IDENTIFIABLE ASSETS	$76,181	$19,889	$2,109	$ (2,478)	$ 95,701

1979 (In Thousands)

	Geographic Area			Adjustments and	
	United States	Europe	Other	Eliminations	Consolidated
REVENUES—					
Customers	$41,292	$13,501	$1,181	$ —	$ 55,974
Intracompany	8,846	102	—	(8,948)	—
Total revenues	$50,138	$13,603	$1,181	$ (8,948)	$ 55,974
INCOME (LOSS) BEFORE INCOME TAXES	$11,127	$ 230	$ (173)	$ (1,080)	$ 10,104
IDENTIFIABLE ASSETS	$35,667	$10,113	$1,319	$ (1,152)	$ 45,947

Intracompany transfers are made at approximately arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operation of each geographic area.

United States customer revenues include export sales of $3,973,000 in 1980, and $1,663,000 in 1979.

9. UNAUDITED QUARTERLY FINANCIAL DATA

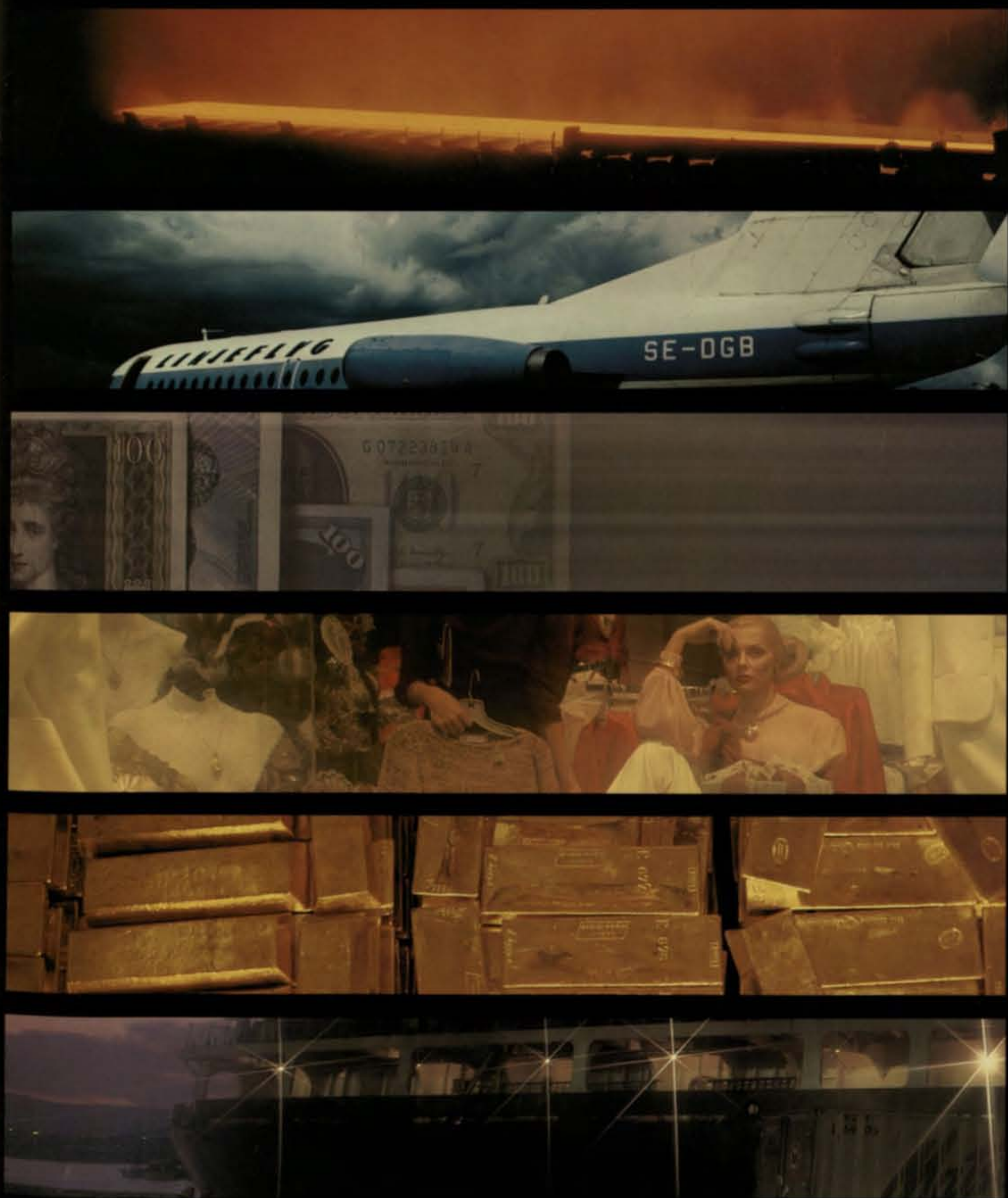
Shown below are quarterly financial data (in thousands except for per share amounts) for the two years ended September 30, 1980 and 1979:

	Quarters Ended			
	Dec 31	March 31	June 30	Sept 30
Year Ended September 30, 1980:				
Revenues	$20,826	$24,877	$29,194	$34,092
Costs and Expenses:				
Cost of revenues	7,535	9,272	10,915	13,109
Product development	1,542	2,013	2,426	2,805
Marketing, general and administrative	7,733	9,339	10,759	12,218
Interest, net	(305)	(576)	(451)	(427)
	16,505	20,048	23,649	27,705
Income Before Income Taxes	4,321	4,829	5,545	6,387
Provision for Income Taxes	2,160	2,415	2,772	3,048
Net Income	$ 2,161	$ 2,414	$ 2,773	$ 3,339
Net Income Per Common Share*	$ .23	$ .24	$ .27	$ .31
Year Ended September 30, 1979:				
Revenues	$10,398	$12,471	$14,992	$18,113
Costs and Expenses:				
Cost of revenues	3,446	4,791	5,725	6,823
Product development	976	1,039	1,208	1,430
Marketing, general and administrative	3,978	4,589	5,500	6,763
Interest, net	(57)	(214)	(53)	(74)
	8,343	10,205	12,380	14,942
Income Before Income Taxes	2,055	2,266	2,612	3,171
Provision for Income Taxes	1,104	1,143	1,317	1,620
Net Income	$ 951	$ 1,123	$ 1,295	$ 1,551
Net Income Per Common Share*	$ .12	$ .14	$ .15	$ .18

*Adjusted for two-for-one stock split in June, 1980.

1981 ANNUAL REPORT

TANDEM



BUSINESS REVIEW

Tandem Computers Incorporated designs, develops, manufactures, markets and supports a unique computer system for the on-line transaction processing marketplace. Called the NonStop system, its innovative architecture virtually eliminates the risk of system failures and protects the customers' data bases from damage caused by electronic malfunctions. Tandem systems can be expanded modularly from a mid-size to a large-scale system, or extended into a distributed data processing network of up to 255 geographically dispersed systems, without hardware replacement or software conversion.

Tandem has manufacturing operations in five locations in the United States and one in Germany. The company supports customers' NonStop systems throughout North America, Europe and Asia from 77 offices.

By the end of fiscal 1981, Tandem had shipped over 2,500 processors to 460 customers. Fiscal 1981 earnings per share rose 106% on a 91% increase in revenues over the preceding year, while stockholders' equity grew 191%.

Tandem Computers

NASDAQ Symbol TNDM (Eligible for purchase on margin)

Price	Range	P-E Ratio	Dividend	Yield	S&P Ranking
Apr. 29'81	1981				
86½-86¾	91¾-61¼	57	None	None	NR

Summary

This young company's principal product is a unique multiple processor computer system designed to minimize the risk of system failure or data loss.

Business Summary

Tandem Computers designs, develops, manufactures, markets and services multiple processor computer systems that have been designed to minimize the risk of system failure or data loss. The company offers a family of system configurations, which include from two to 16 processors together with controllers, peripherals, operating system software and programming languages.

Among its software products, the company offers a network operating system, Guardian/Expand, which allows up to 255 geographically dispersed Tandem systems to be interconnected in a distributed data processing network. The systems, whether operating in a stand-alone environment or in a distributed data processing network, are designed to minimize cost per transaction and are intended for use primarily by businesses that depend on the continuous availability of their computer systems, such as those with heavy volume online transaction processing or message handling requirements. In addition, Tandem systems are designed to protect the information stored, or in process, from damage due to module failure and to provide for flexible modular expansion without reprogramming.

In fiscal 1980, the company shipped systems comprising 653 processors to 198 customers; such systems sold at prices ranging from $105,000 to $1,011,000, for a new two-processor system and an eight-processor system, respectively. Since the company's inception, about two-thirds of its sales have been to end users, which either develop their own applications programs or subcontract the development of such programs; the remaining one-third has been to software and systems development companies.

The geographical breakdown of sales in fiscal 1980 was U.S. 72.3%, Europe 23.6%, other countries 4.1%.

Principal facilities are in Cupertino, Calif.

Employees: About 1,600.

Important Developments

Apr. '81—Tandem introduced a new multiprocessor computing system, named Nonstop II. The new system is designed for large, on-line processing applications, and its basic configuration is priced at about $144,000.

Mar. '81—The company began construction of a 220,000 square feet manufacturing facility in Reston, Virginia. The facility will begin operations in the spring of 1982 and will employ 200 people.

Next earnings report due in late July.

Per Share Data ($)

Yr. Ended Sept. 30	1980	1979	1978	1977
Book Value	7.01	3.78	2.11	d2.23
Earnings[1]	1.06	0.59	0.30	0.03
Dividends	Nil	Nil	Nil	Nil
Payout Ratio	Nil	Nil	Nil	Nil
Prices[2]—High	76	21¼	18⅜	7⅞
Low	18½	11⅜	6⅝	5⅞
P/E Ratio—	72-17	36-19	61-22	NM

Data as orig. reptd. Adj. for stk. div. of 100% Jul. 1980. 1. Bef. spec. items of +0.17 in 1978, +0.03 in 1977. 2. Cal. yr. NM-Not Meaningful. d-Deficit.

May 8, 1981

Standard & Poor's Corp.
25 Broadway, NY, NY 10004

Income Data (Million $)

Year Ended Sept. 30	Revs.	Oper. Inc.	% Oper. Inc. of Revs.	Cap. Exp.	Depr.	Int. Exp.	Net Bef. Taxes	Eff. Tax Rate	'Net Inc.	% Net Inc. of Revs.
1980	**109**	**21.9**	**20.1%**	**10.3**	**2.55**	**0.29**	**21.1**	**49.3%**	**10.7**	**9.8%**
1979	56	11.1	19.8%	5.8	1.37	0.08	10.1	51.3%	4.9	8.8%
1978	24	4.7	19.3%	2.4	0.46	0.07	4.5	52.0%	2.2	8.9%
1977	8	0.5	6.9%	0.5	0.17	0.05	0.3	52.0%	0.2	2.1%

Balance Sheet Data (Million $)

Sept. 30	Cash	———Current——— Assets	Liab.	Ratio	Total Assets	Ret. on Assets	Long Term Debt	Common Equity	Total Cap.	% LT Debt % Cap.	Ret. on Equity
1980	**16.2**	**81.7**	**20.4**	**4.0**	**95.7**	**14.2%**	**1.65**	**70.3**	**75.3**	**2.2%**	**19.8%**
1979	6.8	39.3	12.2	3.2	45.9	13.9%	1.14	31.5	33.7	3.4%	20.0%
1978	4.5	19.5	5.8	3.4	22.1	8.0%	0.72	15.5	16.3	4.4%	NM
1977	0.1	4.7	2.3	2.0	5.4	NA	0.32	d2.8	3.1	10.4%	NA

Data as orig. reptd. 1. Bef. spec. items. NA-Not Available. NM-Not Meaningful. d-Deficit.

Revenues (Million $)

Quarter:	1980-1	1979-80	1978-9	1977-8
Dec.	40.61	20.83	10.40	3.91
Mar.	47.42	24.88	12.47	5.26
Jun.		29.19	14.99	6.70
Sep.		34.09	18.11	8.44
		108.99	55.97	24.31

Revenues for the six months ended March 31, 1981, almost doubled, year to year, to $88,026,000, from $45,703,000. Margins widened, and net income was up 143%, to $11,138,000, from $4,575,000. On a larger number of shares outstanding, per share earnings were $0.94 versus $0.47, as adjusted for the 2-for-1 stock split in July, 1980.

For the March, 1981 quarter alone, revenues rose 91% from those for the corresponding 1980 interim and net before taxes scored a 2.6-fold increase. After respective tax provisions of 49.2% and 50.0%, net income advanced 2.7-fold. Earnings were $0.52 a share, against $0.24.

Common Share Earnings ($)

Quarter:	1980-1	1979-80	1978-9	1977-8
Dec.	0.41	0.24	0.12	0.06
Mar.	0.52	0.24	0.14	0.07
Jun.		0.27	0.15	0.08
Sep.		0.31	0.18	0.10
		1.06	0.59	0.31

Dividend Data

No cash dividends have been paid. A 2-for-1 stock split was distributed July 18, 1980.

Finances

In November, 1980, the company sold publicly 1,500,000 common shares, at $66.50 each, through underwriters headed by L. F. Rothschild, Unterberg, Towbin. Proceeds were earmarked for general corporate purposes.

In June, 1980, Tandem signed an agreement with United States Leasing Corp. under which U.S. Leasing became the endorsed domestic commercial leasing agent for Tandem's NonStop multiple processing computer systems. Tandem said the agreement will facilitate the purchase of its systems by providing third-party, full-payout lease terms for domestic Tandem customers through the nationwide network of U.S. Leasing offices.

In December, 1979, the company sold, through underwriters led by L. F. Rothschild, Unterberg, Towbin, 715,000 common shares at $36 each.

Tandem amended its $5,000,000 line of bank credit in 1979, increasing the amount of borrowings available to $10,000,000 at the bank's prime lending rate.

Capitalization

Long Term Debt: $1,616,000 lease obligation (12/80).

Common Stock: 11,679,573 shs. ($0.02½ par).
About 25% is closely held, incl. 10% by H. L. Hillman.
Institutions hold about 44%.
Shareholders: 4,034 of record.

Options: To purchase about 1,400,000 shs.

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Office—19333 Vallco Parkway, Cupertino, Calif. 95014. **Tel**—(408) [illegible]6000. **Chrmn**—T. J. Perkins. **Pres & CEO**—J. G. Treybig. **Sr VP & Chief Oper Officer**—R. C. Marshall. **VP & Secy**—H. V. Morgan. **VP-Treas & Investor Contact**—Jeanne D. Wohlers. **Dirs**—M. Collins, T. J. Davis Jr., F. P. Johnson Jr., E. Kleiner, R. C. Marshall, T. J. Perkins, A. C. Rice, R. G. Stone Jr., J. G. Treybig. **Transfer Agent & Registrar**—Bank of America, San Francisco. **Incorporated** in California in 1974; reincorporated in Delaware in 1980.

ROTAN MOSLE

PORTFOLIO MANAGER'S SUMMARY
TANDEM COMPUTERS
TNDM: OTC

August 5, 1981

Recent Price	26-Week Range	Earnings Per Share* 1980	1981E	1982E	Price/Earnings 1981E	1982E	Value Ratio 1981E	1982E
30	35-21	$0.35	$0.70	$1.05	42.8	28.6	1.17	1.75

*36.3 million shares outstanding. Fiscal year ends September 30.

Tandem's founders correctly identified a major need in the marketplace for a "NonStop" computer system specifically designed for on-line transactions processing, such as travel reservations, electronic funds transfers by banks, credit verification, order entry and inventory control. After five years, Tandem still has no direct product competition. Moreover, we believe the market for these systems is large enough to accommodate future competitors without significantly slowing Tandem's rapid growth. The Company is racing toward a sales goal of $1 billion in 1985. This year, sales are on track to pass $200 million versus $109 million in fiscal 1980. For these reasons, Tandem has the potential to become a major computer company. We view the stock as a core holding in our technology portfolio.

1. Tandem's computer systems are unique. In addition to minimizing the risk of system failure, they provide for modular expansion without reprogramming, protection of the user's data base from damage due to module failure, and low costs per transaction. Each system includes from 2 to 16 processors, related peripherals, operating system software and programming languages. Tandem's proprietary software package, "EXPAND," allows up to 255 geographically dispersed systems to operate as a single distributed data processing network. The Company's proprietary position is indicated by an exceptionally high gross profit margin of 63%.

2. Tandem has earned high customer acceptance. In a 1980 survey of computer users conducted by Datapro Research, Tandem received the highest rating for product excellence among 34 computer companies. Moreover, 100% of Tandem's customers surveyed said they would recommend the system to others. A new customer typically starts out with the minimum two-processor configuration and adds to his system and/or network in modular fashion over time. This pattern has resulted in a large element of repeat business (over 50% of sales) with existing customers. It also provides unusually high visibility for future growth from the existing customer base. Although the Company has now delivered over 2,100 processors to about 400 customers, no units have ever been returned. Tandem is currently adding about 40 new customers per quarter.

3. Tandem's strategy is to stay on the leading edge of technology, thereby presenting a "moving target"to potential competitors. The Company has already developed "NonStop II," a new, more powerful system providing improved price/performance for users with very large on-line transactions processing requirements. While we fully expect one or more major companies will ultimately offer a comparable system, Tandem has a significant head start. Software development for such complex systems is a costly, slow procedure, which must progress serially. Because there are no significant economies of scale in software development, a large company cannot significantly reduce the time needed for development by simply adding more people to the project. Thus, Tandem's leadership position is likely to be maintained.

4. Concentration and simplicity are major assets. Tandem operates in one market and sells only one product. Each system is made up of some combination of 21 printed circuit boards. Thus, any size system--from 2 to 16 processors-- can be assembled and tested from these standard boards, enabling the same software to be run. This factor results in simplicity in manufacturing and service. Moreover, since Tandem's salesmen concentrate on a single product, they are more expert than general purpose computer salesmen. This is reflected by the company sales productivity which is the highest in the industry.

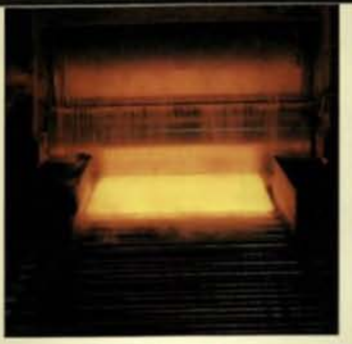
5. Tandem is on its way to becoming a billion dollar Company. The initial long-range plan was developed by a group of Hewlett-Packard alumni in conjunction with a venture capital firm that provided the seed money to launch Tandem. The Company was founded and began operations with seasoned management which had prior experience in building large companies. The potential market for on-line systems has been estimated at over $14 billion, growing at 20% to 30% per year. Any operation with a large volume of transactions and a need to continuously access and update its data base is a candidate for a Tandem "NonStop" system. As time passes, more and more prospective customers become committed to Tandem, thereby pre-empting future competitors.

Allan J. Waldron

STATISTICAL SUMMARY
($ millions except per share data)

	1977	1978	1979	1980
Revenue	$ 7.3	$14.8	$30.8	$56.5
Pretax Margin	20.5%	22.3%	20.1%	16.4%
Pretax Income	$ 1.5	$ 3.3	$ 6.3	$ 9.4
Tax Rate	47.8%	49.8%	47.7%	46.2%
Earnings Per Share	$ 0.3	$ 0.10	$ 0.20	$ 0.35
Return on Average Equity	77.8%	72.9%	68.0%	41.2%

The data processing industry is undergoing a rapid, evolutionary change from centralized, batch-processing computers to distributed, on-line transaction processing systems communicating in networks. This evolution represents the area of greatest growth in commercial data processing. Tandem, with revolutionary concepts embodied in the company's NonStop and NonStop II on-line transaction processing systems, is having a fundamental impact on the changing marketplace. The company believes its advanced hardware/software solutions not only are favored by the market trends, but that the company is in a better position than any other to evolve as the major force in the new wave of data processing in this decade. This report explains why.

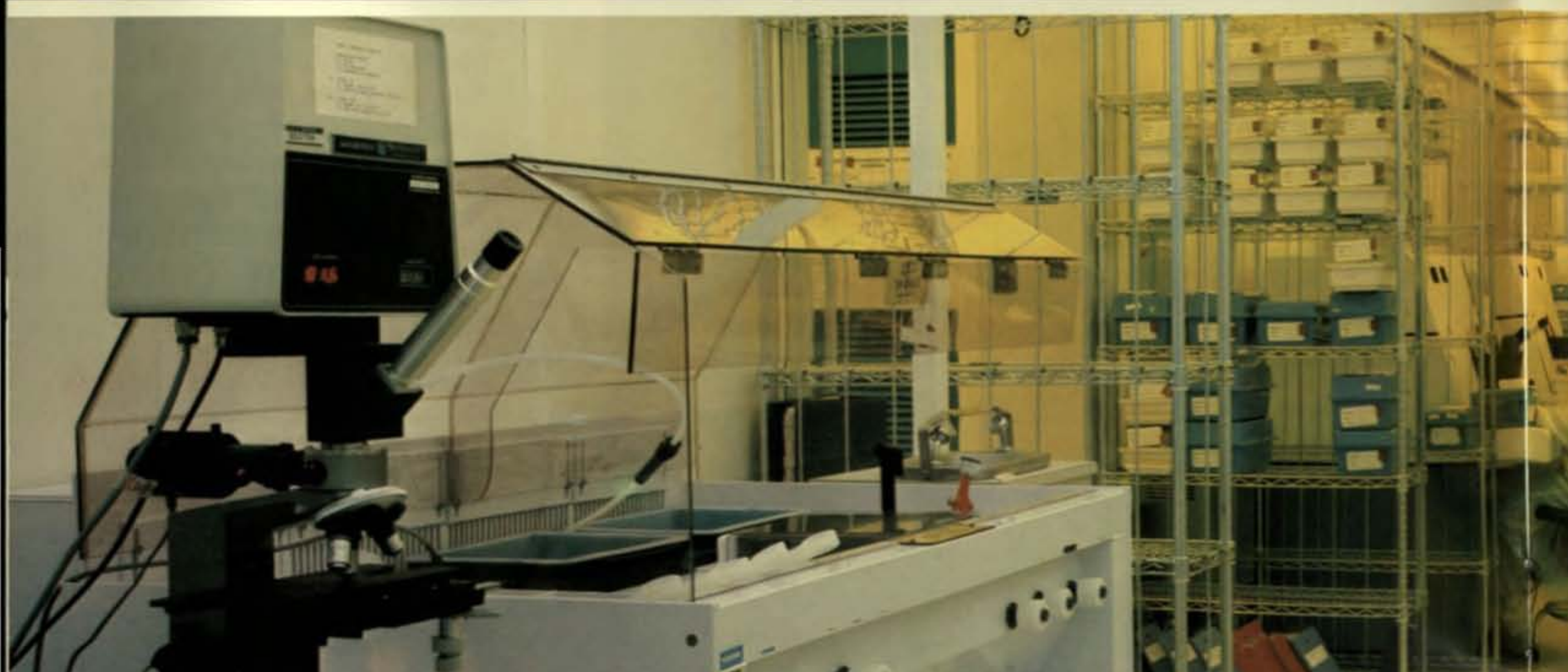


It is no coincidence that Thyssen Aktiengesellshaft, Europe's largest non-government owned steel producer, was Tandem's first customer on that continent. Thyssen is a recognized leader in on-line transaction processing, having installed its first on-line computer in 1965—long before the rest of industrialized Europe.

Thyssen ordered its first Tandem system in 1977 to achieve the uninterrupted production operations essential to a steel plant that must continually run 24 hours a day.

Here, up to 32-ton slabs of hot steel from the smelter are pressed into giant coils at a rate of up to one every minute, or 400,000 tons per month.

Since its first Tandem system, Thyssen has been aggressively upgrading automation at its widespread, massive facilities in Western Germany. By mid-1981, Thyssen had systematically added processor modules to create a complement of 7 systems with 21 processors. The systems currently order materials and con-



Talk to anyone in the electronics industry: the semiconductor segment—the business of fabricating the miniature circuitry and microprocessors used in advanced products—is fiercely competitive.

Talk to anyone in the semiconductor industry, and they will add that the business is also incredibly complicated.

Motorola, for instance, produces over 300,000 *different* devices used by makers of a wide variety of products including computers, communications equipment, automobiles and consumer electronics.

At Motorola's Mesa, Arizona facility alone, the company has millions of devices undergoing a complex series of delicate processes. The task of merely tracking the process is monumental.

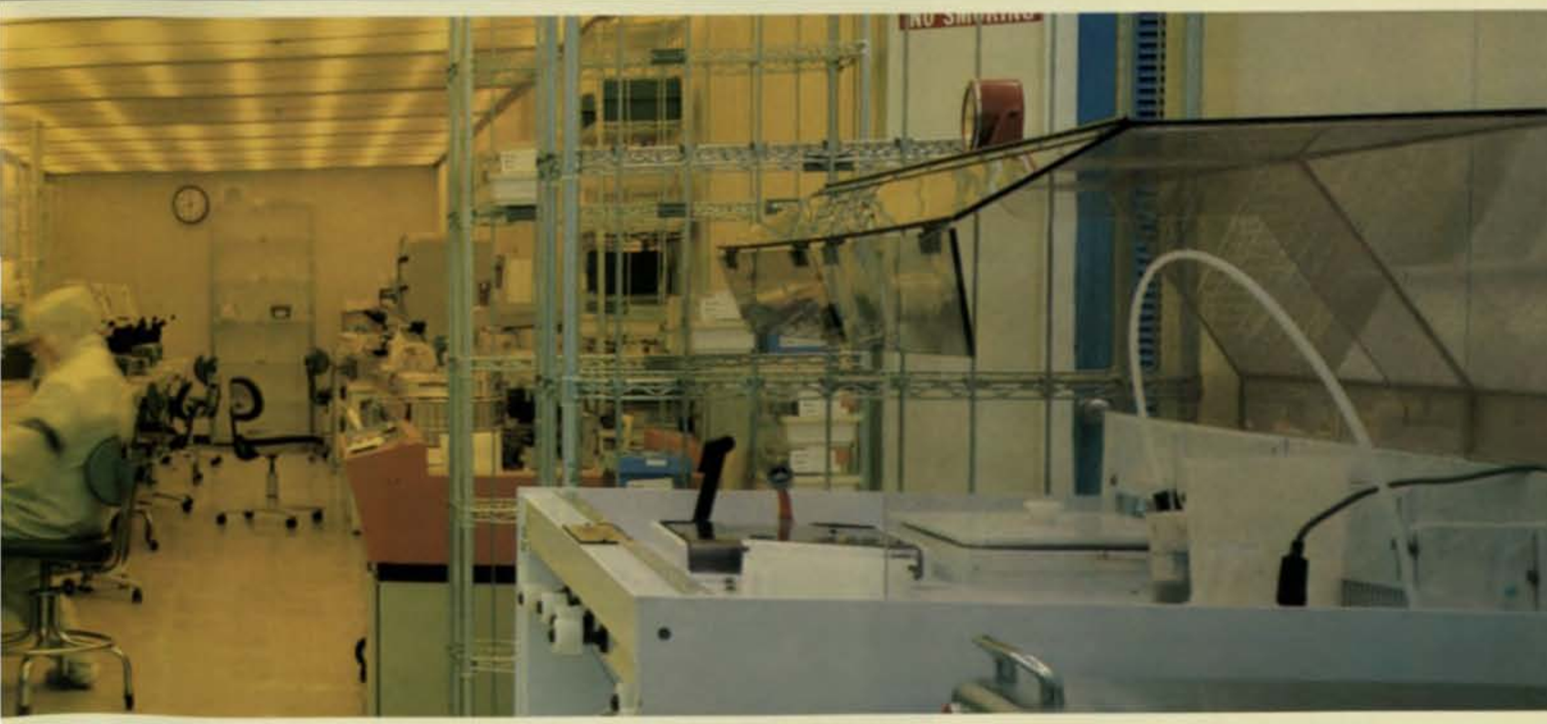
Add to that the crucial quality requirements to control and classify yields and the task appears to be impossible.

Now, multiply those tasks over a vast, worldwide network of facilities, and the belief trol the complex production flow at three separate plants which interact in an EXPAND network.

The company's EDP management, in its on-going, online upgrade program, specifically cites the advantages of Tandem's relational data base and the modularity feature in achieving goals rapidly.

"With Tandem it has not been necessary to define the entire, complex distributed data processing problem before taking action. We are doing it one area at a time, and then easily integrating that system into the EXPAND network."

Thyssen has over 150,000 employees, and in its most recent fiscal year had revenues of approximately $13.5 billion.



that the semiconductor industry is "probably one of the most data-intensive in the world" begins to take on meaning.

To help sharpen its competitive edge, Motorola installed its first Tandem system in the fall of 1980 to track, *on-line*, progress and quality of semiconductor wafers during the fabrication processes. Using ENCOMPASS software to speed development of application software, the first production system was running in the first quarter of 1981.

With built-in capabilities to interconnect readily—without programming changes—the worldwide-dispersed systems in a massive, distributed data processing network using Tandem's EXPAND software, Motorola has the option of later providing its managers with the ability to view instantly the status of many billions of devices undergoing fabrication around the world.

Tandem's innovativeness has

Tandem is one of only a few hundred of the thousands of publicly-held companies in the U.S. that addressed the New York Society of Security Analysts during 1981. Seen at the mid-year meeting are Jim Treybig (above, at left), Tandem president and chief executive officer, and Bob Marshall, (opposite page), Tandem senior vice president and chief operating officer.

"Planning for $l billion in sales is neither arrogant nor farfetched. The Cupertino, Calif.-based company has one of the hottest track records in a hot industry." *Forbes*

The timing of Tandem's contributions is propitious. It neatly dovetails with the rapidly-paced changes that are sweeping the computer industry.

Worldwide, businesses are caught between a critical need to control the unprecedented escalation of costs of doing business, and a seemingly contrary, compelling requirement to invest even more resources in improving customer services to meet competitive challenges.

At the same time, individual businesses are growing more complex. To survive and prosper, all types of businesses are actively searching for ways to gain better control of their operations. It is a much faster moving world today than it was just ten years ago.

Not long ago, getting vital information to the people who need it on a daily basis was done exclusively by a relatively slow, costly computing method called batch processing. As the name implies, vast amounts of data—such as customer orders, raw materials flow, inventories, invoices and bookkeeping records—were processed in batches at some point in time *after* the updating information occurred.

Today, the costs/services/control dilemma is exerting strong pressure on large numbers of organizations, spanning all industries, to abandon batch processing programs and convert their vital business functions to *on-line transaction processing*—to achieve instantaneous updating of information at the point and moment of each transaction.

That is why Tandem prospers: Tandem is the only experienced company that is dedicated solely to the new wave of on-line transaction processing with a total concept that fulfills the specific, critical needs of organizations converting from batch processing.

Making other businesses more efficient has been good business for Tandem. In fact, Tandem is one of the fastest growing publicly-held companies in the world.

Consistently, for 18 consecutive quarters through Tandem's fiscal 1981 year-end, every period has been record-setting.

Revenues have grown from under $8 million in fiscal 1977 to over $208 million in 1981. Operating margins during the past four years have been between 17.3% and 19.4%.

This consistent performance is in accordance with the company's long-term plans, as is the manner in which Tandem has financed its growth through retained earnings and equity offerings instead of borrowings.

Stockholders' equity has increased nearly 75 times since fiscal 1977, from under $3 million to over $204 million. At the close of fiscal 1981, debt represented less than 1% of total capital.

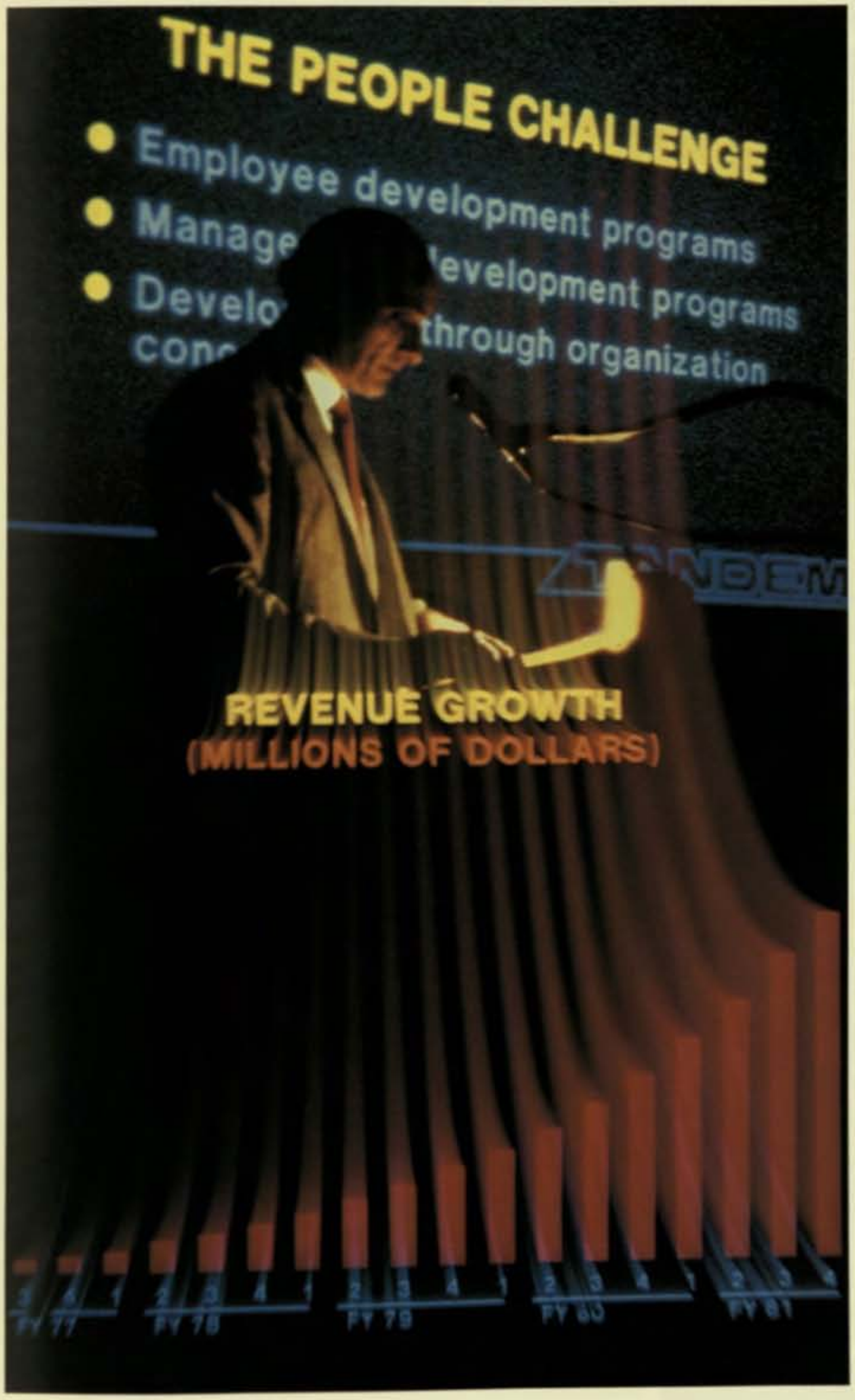
Much of this uncommon growth with exceptional financial soundness can be attributed to another of the innovative aspects of the Tandem concept: true modularity. Because NonStop systems represent a full family of systems ranging from mid-size to large-scale—by merely adding processor modules—the company's products fill a broad spectrum of customer requirements. Tandem also benefits from the product modularity because product development expenditures are highly leveraged: all software and hardware enhancements apply across the board to any system size or network configuration. Manufacturing operations, as well as the management of field service spare parts, are also simplified by the product's modularity. Likewise, Tandem's marketing, support and training functions share the productivity benefits of the product's simplicity.

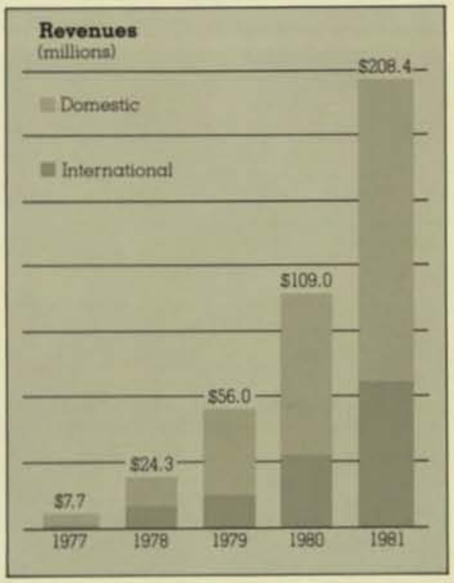
NonStop systems also play an important role in management of Tandem's operations. The entire company is run on a worldwide network of over 100 NonStop systems at more than 40 locations.

Similarly, the combination of Tandem's dedication to on-line transaction processing and the product simplicity give the company a unique control advantage in being able to forecast and prepare for demand.

Most of all, however, Tandem's remarkable growth emanates from the increased awareness among progressive companies of the fundamental impact on their businesses of all aspects of the innovative Tandem concept.

fueled consistent, profitable growth





The Scandanavian Airlines System, the cooperative domestic and international airline of Denmark, Norway and Sweden, has always had a fine reputation for innovativeness and customer service.

It was SAS that developed the necessary systems to fly the first Polar Route, shortening flight time between the European and overseas continents. SAS was also among the first airlines to convert from batch processing to on-line, laying down system-wide plans in 1969, and was first, in 1971, with an automated cargo system.

Today, SAS is the first international carrier to "break the old philosophy of mainframe computers" by developing a data processing network including Tandem's EXPAND software to improve efficiencies and customer service further. By the end of 1981, in an evolutionary process that will continue through the decade, SAS had eight Tandem systems with a total of 26 processors. Their 5-node EXPAND network includes Oslo, Stock-

Norton, Lilly & Co., Inc. (NL), like all other companies that have developed on-line networks to run complex, fast-moving businesses, cannot afford a computer failure.

NL is one of the nation's largest general agents for foreign-flag steamship companies, with offices in all major U.S. ports. It is the oldest ship-

ping company in the U.S., founded in 1841 as John Norton & Company, merchants and charterers, and owners of sailing packets to South America. Over the years, the company has been involved in all aspects of international ocean transportation.

Although today it owns no ships, in practice the company functions as if its customers' ships were their own.

When one of their ships is in a U.S. port, NL is responsible for all aspects of the ship's business. NL arranges tugs, berths, stevedores, cargo distribution over land, and, even provides fuel and provisions as well as paying the crews.

At all times, NL is the

holm and Copenhagen.

The Tandem systems are controlling station operations, group tour bookings, and accounting functions.

At Linjeflyg, the SAS Swedish domestic airline serving that country's 25 airports, the entire airline is now running on Tandem systems. Over 300 programs were developed within two years on the Tandem network to control all aspects of managing an airline, including an entire airport management system at Stockholm.

SAS decided during late fiscal 1981 to develop a new cargo handling and sales system on Tandem's NonStop II systems to cope with the fact that cargo rates will not increase at a rate consistent with major increases in the cost of manpower and fuel. The new system will reduce aircraft departing with less than full loads, will keep high service levels in sales and handling, and, by distributing up-to-the-minute information to SAS cargo agents, will provide SAS cargo customers with better service.

SAS is replacing the mainframe computer used in its cargo handling system with Tandem systems because of the ability to distribute the system in the future using Tandem's EXPAND network. SAS is the first carrier worldwide to put key applications on Tandem systems, enabling SAS to market them to other airlines.

American marketing force for 14 major steamship lines and scores of tramp vessel owners. Each month, the company generates over 12,000 bills of lading and controls 15,000-20,000 freight containers. Annually, NL controls 4,000 port calls.

NL also acts as the lines' American bookkeeper—paying all bills and collecting all its customers' receivables.

Prior to converting to a Tandem system with four processors in 1979, NL was vulnerable to computer failures.

"When the old system went down, the whole country went down." Interaction between New York headquarters and NL's 18 branch offices came to a virtual standstill.

In sharp contrast, today NL believes it offers "leading-edge services" with a network that responds three times faster and is always on the air.

"Total service to both the shipping community and the shipping line is our goal, and we now find ourselves in a most advantageous competitive position."

And NL is prepared for significant increases in its business: Another reason the company converted to Tandem is the ability for their system to grow quickly without reprogramming, and, in fact, without even shutting down the working portion while additional processors are added.

The uniqueness of Tandem's concept

Tandem's NonStop II system, introduced during 1981, provides increased capabilities and capacities to users of very large on-line applications, and is designed for flexibility in accepting future system enhancements.

"By bringing out a system [NonStop II] that contains significant enhancements to its original product, the company has reaffirmed its intention to keep its place in the forefront of the on-line transaction processing market...the complete software compatibility and serviceability features show a real concern for the customer's needs and welfare." *Dataquest*

Thousands of organizations around the world that are changing their ways of doing business through on-line transaction processing have one common, principal concern:

When an organization commits its vital business functions to on-line transaction processing, the business becomes truly computer-dependent. The ramifications are manifold.

Before Tandem, any organization considering on-line transaction processing had to weigh carefully a series of risks against the anticipated benefits. Because, before Tandem, no other company addressed all of the critical needs of on-line transaction processing, nor was any other company dedicated solely to providing simple, practical and cost-effective solutions to the emerging on-line transaction processing marketplace.

Among the user's concerns and risks were:

If the computer system stops, the business stops.

Tandem's NonStop systems are designed to run continuously, even during component failure—and even during maintenance, with parts being removed and replaced.

In the past, attempts to achieve uninterrupted computer operations have been approached by either installing idle back-up computers or by developing special purpose hardware and software—both of which were expensive and inefficient. With Tandem, the entire system performs productive work.

If the computer manufacturer's support organization is not responsive and effective, the business remains stopped.

If a NonStop system should require service, Tandem's field support personnel perform maintenance while the system continues to run the customer's programs. Tandem has a ratio of one field support person for each customer, and the field organization is backed-up by headquarters experts who assist trouble-shooting with Tandem's state-of-the-art, remote diagnostics system.

Before Tandem, system contamination of the user's on-line data base, or electronic malfunctions that could send data to the wrong place would disrupt business and profits.

Every Tandem system automatically protects the users' data bases from damage or destruction caused by electronic malfunctions. Tandem's data integrity features also prevent hardware errors from sending data to the wrong place.

Before Tandem, when a company's business grew and new computers were brought in to increase capacity, reprogramming and retaining costs soared, and the business, again, was disrupted.

Each Tandem system can be expanded to 16 processors with no reprogramming and no retraining of personnel. That is, a user can start with a two-processor Tandem system to develop applications programming, add processors when the application goes into production, and then continue to add processors as the business and applications grow. In effect, the user has a painless, incremental growth path from the power of a mid-size system through a large-scale mainframe.

Before Tandem, when geographically dispersed company locations were tied together in a distributed data processing network, programming and equipment costs again soared, the business was again disrupted—and all of the above concerns were amplified many times.

NonStop system users can distribute data processing over geographically dispersed locations with ease and efficiency—using Tandem's unequalled, powerful EXPAND software—effectively to build a regional, national or worldwide network of up to 255 16-processor systems with thousands of terminals in a fraction of the time, and at a fraction of the cost, of networks based on conventional computers.

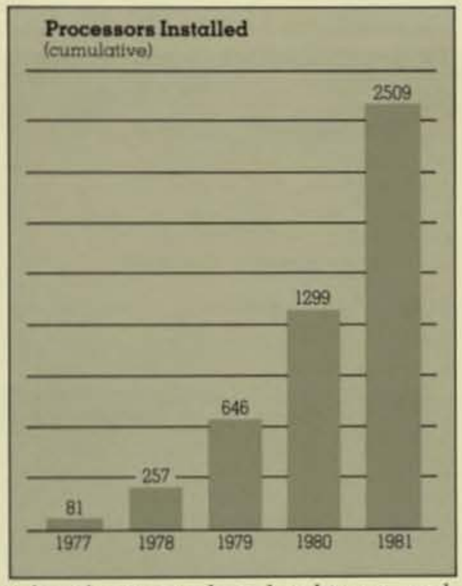
And even before the conventional system was put to productive work—or when new applications were later developed—the leadtimes and costs of writing programs frequently exceeded estimates.

Programming for on-line applications on NonStop systems requires no specialized software to be written by customers, nor does the customer have to hire a large staff of highly-skilled programmers experienced in on-line applications.

Tandem's NonStop software is as innovative as the NonStop hardware, and is integral to the architecture. For example, Tandem's relational data base management system, ENCOMPASS, makes programming for on-line applications as easy as for batch processing. With ENCOMPASS software, on-line projects become productive much faster and at much lower cost because the Tandem software handles the complex terminal, transaction control and monitoring functions.

From the beginning, Tandem

paves the way for the future



takes the worry, long leadtimes, and excessive costs out of developing on-line transaction processing with practical, integrated hardware/software solutions proven at hundreds of user sites throughout the world.

And Tandem's dedication to on-line transaction processing carries through with commitments to remain at the forefront. The company focuses all of its experience, and product development resources, on continual efforts to increase the users' on-line data processing productivity.

During 1981, Tandem introduced and began delivering the new NonStop II system with even greater capabilities and capacities. The NonStop II system, compatible with the original system, improves price/performance for users implementing very large on-line transaction processing applications, incorporates state-of-the-art fault-isolation techniques to speed servicing, and can significantly out-perform other computers in an on-line transaction processing environment.

Even more importantly, the NonStop II system is engineered to accommodate significant system enhancements over the next several years as Tandem aggressively addresses the growing needs of the on-line transaction processing marketplace.

Established in 1853, Samuel Montagu & Co. Limited is a major merchant bank in the city of London. It is a member of the Accepting Houses Committee, which is the trade association of the leading merchant banks in London, as well as one of five members of the London Gold Market which meets twice daily to determine the price of gold.

Samuel Montagu operates in the United Kingdom through five divisions—banking, corporate finance, dealing, international capital markets, and investment.

The major part of its business is made up of fewer, more complex and relatively higher value transactions than clearing banks in the U.K. or state

banks in the U.S., with the largest number of daily transactions originating from the dealing division.

It was, therefore, understandable that in 1980 Samuel Montagu decided to turn to Tandem's NonStop system, with its emphasis on reliability and data integrity, for its future computers development, and away from its old, batch processing computer system.

When fully developed, the new Tandem-based system will enable the dealing division to have up-to-date information on-line and instantly available.

"We must have our transaction data entered rapidly, and deliver the results quickly to those who need them."

Essential, also, is a highly flexible system that can be programmed and expanded easily to respond to changes in the dynamic markets in which Samuel Montagu operates.

"With Tandem, we know we can add on additional processors as our computer developments proceed and our business grows."

With interest rates on $1 billion exceeding $400,000 daily, any business involved with massive transfers of funds—such as Crocker Bank, which daily transfers many billions of dollars internationally—puts an extremely high priority on speed, accuracy and reliability of the transfer mechanisms.

Crocker's international division, headquartered in San Francisco, is a leading provider of money transfer and cash management services to foreign banks and large corporations.

Before 1979, Crocker had complex, separate automated functions spread throughout its international operations. There were many redundant func-

tions that were costly to operate and, more importantly, delayed the movement of funds.

"In the international arena, you live and die on your communications capabilities. Because of international time differences, they must run constantly, 24 hours a day."

In mid-1979, Crocker inaugurated its high-speed, fully-integrated International Data Automation (IDA) network using Tandem computers and Tandem's EXPAND networking software to improve speed, accuracy, reliability and cost of international funds transfers.

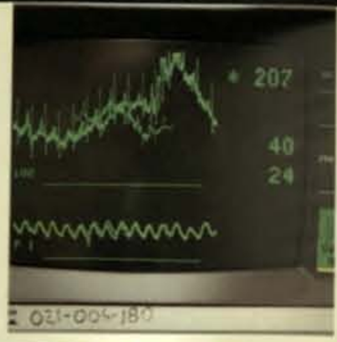
By the end of 1981, Crocker offices in San Francisco, Los Angeles, New York, Chicago and London were tied together by the on-line IDA network, with the New York-Los Angeles link backed-up by satellite. Crocker will have a total of five Tandem systems with 23 processors to support the IDA network and for developing future links and applications. During 1982, Hong Kong, Tokyo, Manila and Seoul are scheduled to be added to the network.

The network also provides for connections with all of the major record carriers, as well as Fedwire, CHIPS, and SWIFT.

A quarter of a century ago, at the University of Alberta Hospitals (UAH) in Canada's northern most major city of Edmonton, that country's first open heart surgery was successfully performed. Since then, UAH has done over 5,000 of the delicate operations, and today the 1400-bed hospital, through its many achievements, has earned an international reputation for quality health care and medical research.

As short a time as ten years ago, this premature child at UAH's Neo Natal Intensive Care Unit, weighing barely two pounds at birth, probably would not have survived. Today, he has a 50% better chance.

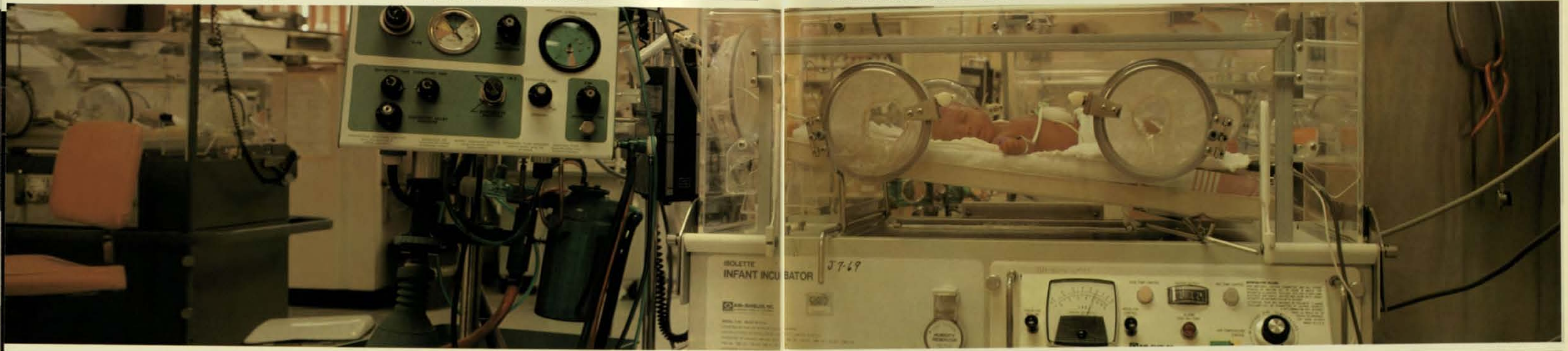
The hospital's approach to computerization embraces the same high standards. Complete patient care records—from admission through discharge, and including such activities as drug administration and radiology—are maintained on UAH's 4-processor Tandem system (which has doubled in size since installed



in mid-1979 as the first customer of Tandem Canada Limited.)

Additional capabilities automate the management of materials and equipment maintenance, and provide instant patient movement data to the laboratory and administrative/financial systems.

UAH has been awarded a $300 million grant by the provincial government for medical research, and will complete the first phase of the new Walter C. McKenzie Health Service Center in early 1982. With the opening of the center, each nursing station will have a Tandem terminal. In the second phase, terminals will increase from 90 to 150.



To improve customer service by speeding-up the processing of claims, and to gain a cost-competitive advantage by reducing administrative and communications costs, the Blue Cross and Blue Shield Associations implemented in 1980 a massive data communications network called PLAN-NET.

The network links together 96 regional sites throughout the U.S. to facilitate faster and more accurate flow of information used to verify Blue Cross and Blue Shield subscribers' eligibility and coverage.

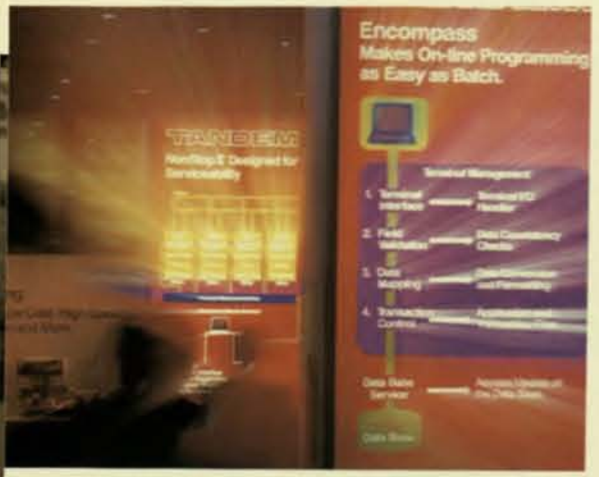
In addition, the network, (driven by eight geographically dispersed Tandem systems with a current complement of 21 processors) administers the heavy reimbursement workload between Plans caused by subscribers of one Plan filing claims within another state or region. PLAN-NET also acts as an intermediary in collecting and processing claims information from throughout the U.S. for the federal government's Medicare program.

While PLAN-NET is already moving data at some 16 times the rate of the replaced system, the two Associations view the network as a foundation for the future.

"PLAN-NET was designed to be adapted quickly to future system needs of Plans, even those needs which aren't practical yet or even apparent today."

Custom applications software for PLAN-NET was developed by International Micor Systems, Inc., of Phoenix, a wholly-owned subsidiary of Ramada Inns.

Tandem's distributed data base and network software are the wave of the future



Tandem's advanced software for on-line transaction processing and network applications greatly improves programmer productivity.

"Tandem's advanced networking software EXPAND, combined with ENCOMPASS -- an excellent relational data base management system—provide an important competitive edge." *E.F. Hutton*

Along with the fundamental shift from batch to on-line transaction processing, large organizations are searching for efficient ways to distribute and exchange vital business information among their far-flung operations.

In fact, *on-line distributed data processing* is a primary focus of most large-organization data processing departments. It is also the area of highest growth in the commercial computer industry.

The basic idea is to decentralize data processing to improve efficiencies and vastly reduce costs. Instead of concentrating all data processing under a single roof with large, batch computers—which is the way computing began—smaller, on-line systems are now being distributed throughout an organization's many locations.

Each location manages its own essential business data, thereby dramatically reducing response time, central computer overhead burden, and the cost of telecommunications (a major data processing expense).

But any given company location also needs, from time-to-time, information from other locations. A European marketing office of a New York-headquartered company with manufacturing operations worldwide may, for instance, need to know immediately if product is available to fill a large order.

With on-line distributed data processing, then, comes a need for *on-line computer networks*—the linking together of geographically dispersed on-line computers to enable the instantaneous sharing of constantly updated information essential to the efficient, competitive conduct of business.

The need is not new, but has been constrained by two key factors.

First, businesses have been reluctant to expose themselves to regional, national or worldwide computer failures that bring businesses to a halt.

The most dependable conventional computers boast of availability in the high 90% range. For batch processing, the implied periodic failure is an inconvenience. For on-line networks, it is a catastrophy.

A conventional computer with a respectable 98.8% availability history that runs 24 hours a day will, statistically, fail once every month for a full eight-hour shift.

Whereas a batch processing operation can, perhaps, make up the lost time, a business conducted by on-line transaction processing depends on constant computer availability.

Imagine, now, a company-wide network of the same conventional computers at, say, 10 locations: Statistically, *a portion of the network will be inoperative, and normal business operations will be interrupted, for eight hours every third day!*

That stark reality has seriously constrained the growth of computer networking; the risks, obviously, have outweighed the benefits.

Tandem has changed all of that.

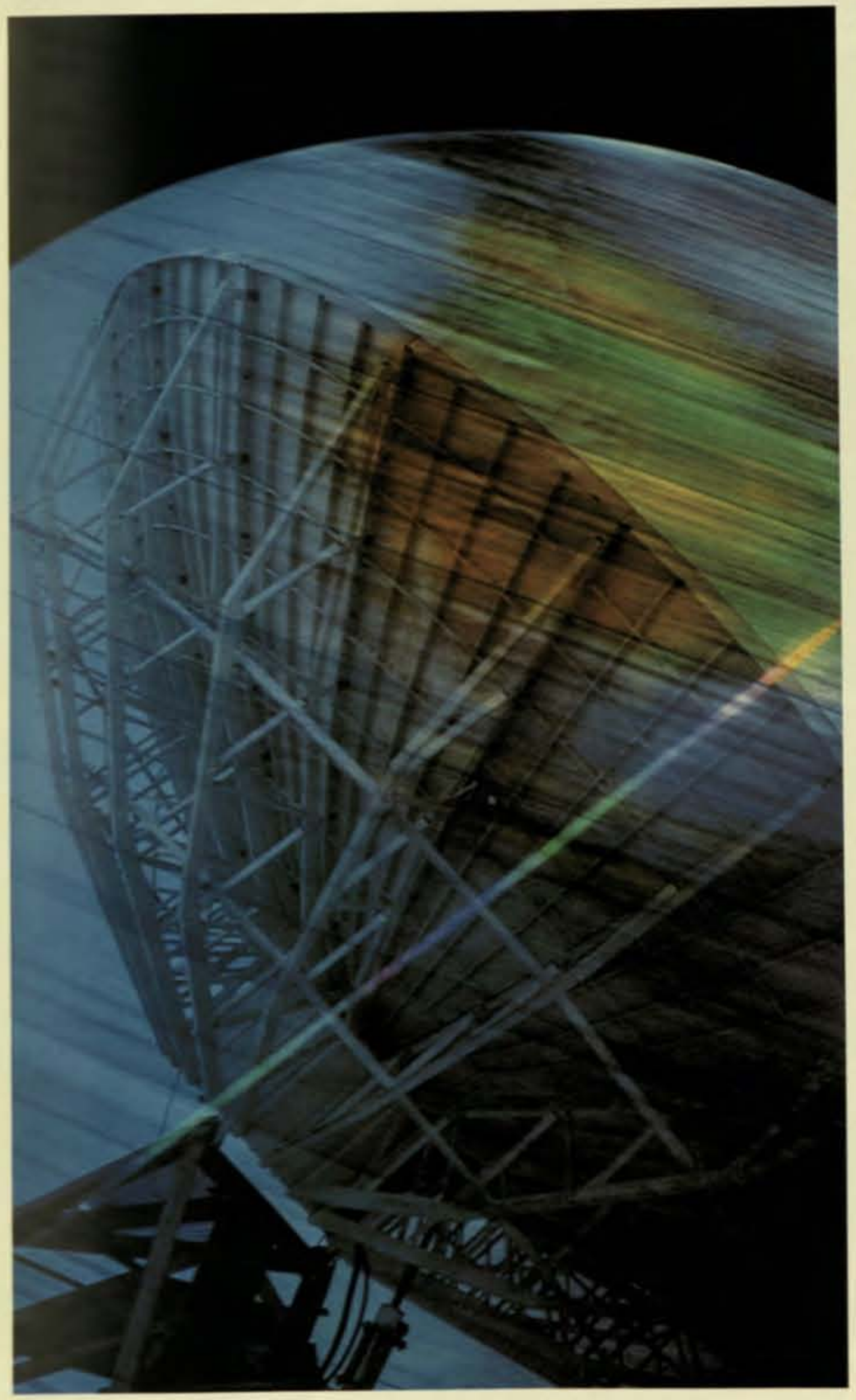
The reliability inherent in the NonStop architecture is extended across networks of Tandem systems, as are Tandem's data integrity and modularity features.

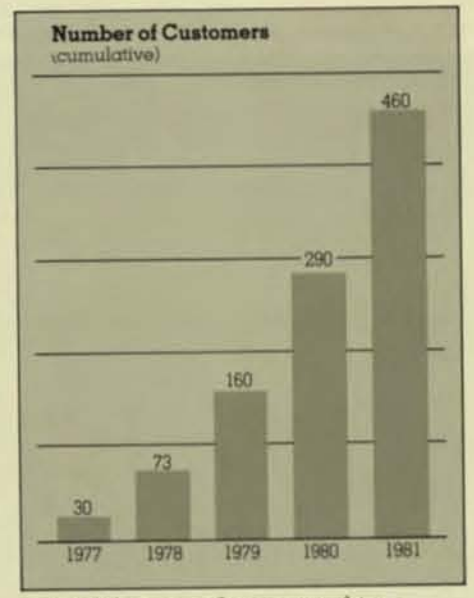
Over a third of Tandem's large base of customers are already planning or conducting business routinely on reliable Tandem distributed data processing networks.

The second major constraining factor to users developing extensive networks has been the unavailability of easy-to-use, effective networking software.

Before Tandem, developing software for a large computer network was an extremely complicated, expensive and time-consuming task requiring highly-skilled user programmers. With Tandem's remarkable EXPAND software, the user's batch-trained programmers can write an on-line, distributed, NonStop application completely in COBOL with unprecedented ease, speed and economy.

Consequently, users' programmers are free to concentrate on solving the business application problem, because Tandem has solved the complex networking problem.





When the Tandem network comes on-line, it also manages data in a unique manner. Unlike other approaches that distribute data bases, but keep them independent, Tandem's EXPAND networks update data with consistency across multiple systems regardless of a communications line failure or power outage.

Tandem's superior distributed data processing and networking capabilities cannot be duplicated in other systems because the capabilities are integral to the architecture of NonStop systems—as opposed to the conventional, less efficient technique of grafting software onto software.

The full impact of Tandem's long technological lead in this area is yet to come. Tandem's advanced capabilities provide its users, as well as Tandem itself, with a strong foundation to exploit the opportunities that lie around the corner with the convergence of data processing and communications. Therein lies the next wave of the future, and Tandem and its users are in the best possible position to enjoy its benefits.

America's first two-way, interactive cable television service went on the air in late 1981 in a pilot program in San Diego, offering the first of a series of revolutionary in-home services.

Developed and introduced by Cox Cable Communications, INDAX™ transforms ordinary television sets into computer terminals. It will enable subscribers of the Cox Cable San Diego cable system—the nation's largest cable TV system—to bank and shop at home.

INDAX users gain access to Cox Cable's Tandem systems by means of a small, hand-held keypad. With a secret code, a family can look at their current bank balance, pay bills and see the balance immediately updated, and make funds transfers. The INDAX user can also do catalog shopping—even see complete product demonstrations—and order and pay for merchandise at their TV set.

In the near future, INDAX will be offered to subscribers in Cox Cable's new cable franchises in Omaha, Vancouver, New Orleans and Tucson, as well as in two of its existing cable systems in Santa Barbara and Macon. As the service grows, additional programs will be offered—such as airline and hotel reservations, entertainment tickets, home security, and educational programs that turn subscriber's homes into classrooms for one-on-one instruction.

After development work on a 3-processor Tandem system in Cox Cable's Atlanta-based Science Center, Cox Cable initiated INDAX in San Diego and Omaha with 2-processor systems, and will add processors at all INDAX locations as the service grows. Cox Cable, the fourth largest cable provider in the U.S. with 62 cable systems serving more than one million subscribers, projects a need for one 16-processor NonStop II system for each 15,000-20,000 INDAX subscribers.

The company believes its innovative, two-way interactive INDAX communications service gives it a strong edge in competing for new franchises.

There are currently some 19.3 million cable users in the U.S., or 25% of the total TV market. The market is projected to grow to 45 million, or 50% of the total, by 1990.

INDAX services across the U.S. will be tied together in an EXPAND network.

Imagine you are a Canadian businessperson who has been travelling much of the week. Mail and memos have stacked up on your desk along with telephone calls and notes.

You were unable to call the office today, and, at the end of the busy day, it's too late to reach the office—especially if you're on the opposite side of the continent and the office closed three hours ago.

Too bad, because some urgent matters needed your immediate attention. The delay could be costly.

If, however, you are in (or out of) the "office of the future" with *Envoy 100*, the new, national electronic mail service of the Computer Communications Group (CCG) of the TransCanada Telephone System, you can be in constant touch with your office, at your convenience, regardless of where you are or the time of the day.

Using any of a variety of compact, portable terminals, you merely dial-up your personal *Envoy 100* access code to reach your "mailbox." You can scan all messages, read those that are urgent and immediately respond, and file the remainder for later action or recall.

Once back at the office, *Envoy 100* works the same way. Letters are instantaneous rather than days in the mail. Memos are simultaneously and instantly distributed to selected persons. And *Envoy 100* services cost surprisingly little: a 60-word "letter" anywhere in Canada costs 35 cents because it is digitized and packet-switched over Datapac, a network service of CCG and the TransCanada Telephone System.

Envoy 100 was introduced nationally in mid-1981, supported by an initial four-processor Tandem NonStop II system. It is the first in a family of Canadian communications services for the "office of the future." A similar U.S. national service, called Telemail and operated by GTE Telenet, is also driven by Tandem computers.

Technology applied to end-user needs sharpens Tandem's leading edge

In the past five years, Tandem has spent some $35 million on product development to maintain the company's long lead in advanced on-line transaction processing systems.

"Tandem Computers has achieved impressive business growth with an outstanding set of well differentiated products. We expect the company to be a major participant in the convergence of communications and data processing in the mid-1980s." *E.F. Hutton*

The future looks bright for Tandem and its marketplace.

No other company has invested the time, energy and resources to meet the onrush of demand for systems capable of efficiently and reliably driving an array of users' innovative on-line applications.

Nor is any other company better prepared, or better positioned, to emerge as a major force in the changing marketplace during this decade.

With a unique, multi-faceted concept that embodies all that the marketplace needs today as well as anticipating its needs for tomorrow, Tandem has filled a long-standing requirement for practical, proven systems for on-line transaction processing, distributed data processing and on-line networks that are without peer.

No other company has the critical mass of Tandem to effectively serve the new evolution:

☐ An advanced concept expressed in total integration of unique, problem-solving hardware with advanced, highly-productive software that has been proven by hundreds of users in billions of on-line transactions.

☐ More years of dedicated experience in on-line transaction processing than any other company.

☐ A widespread base of satisfied, loyal customers—each with rapidly expanding applications—that span virtually all industries.

☐ Strong financial and talent resources to support customers' current applications, and to continue to provide leading-edge solutions for the future.

☐ The ability to enable organizations quickly and relatively inexpensively to build large, on-line networks of up to 255 16-processor NonStop systems with thousands of terminals.

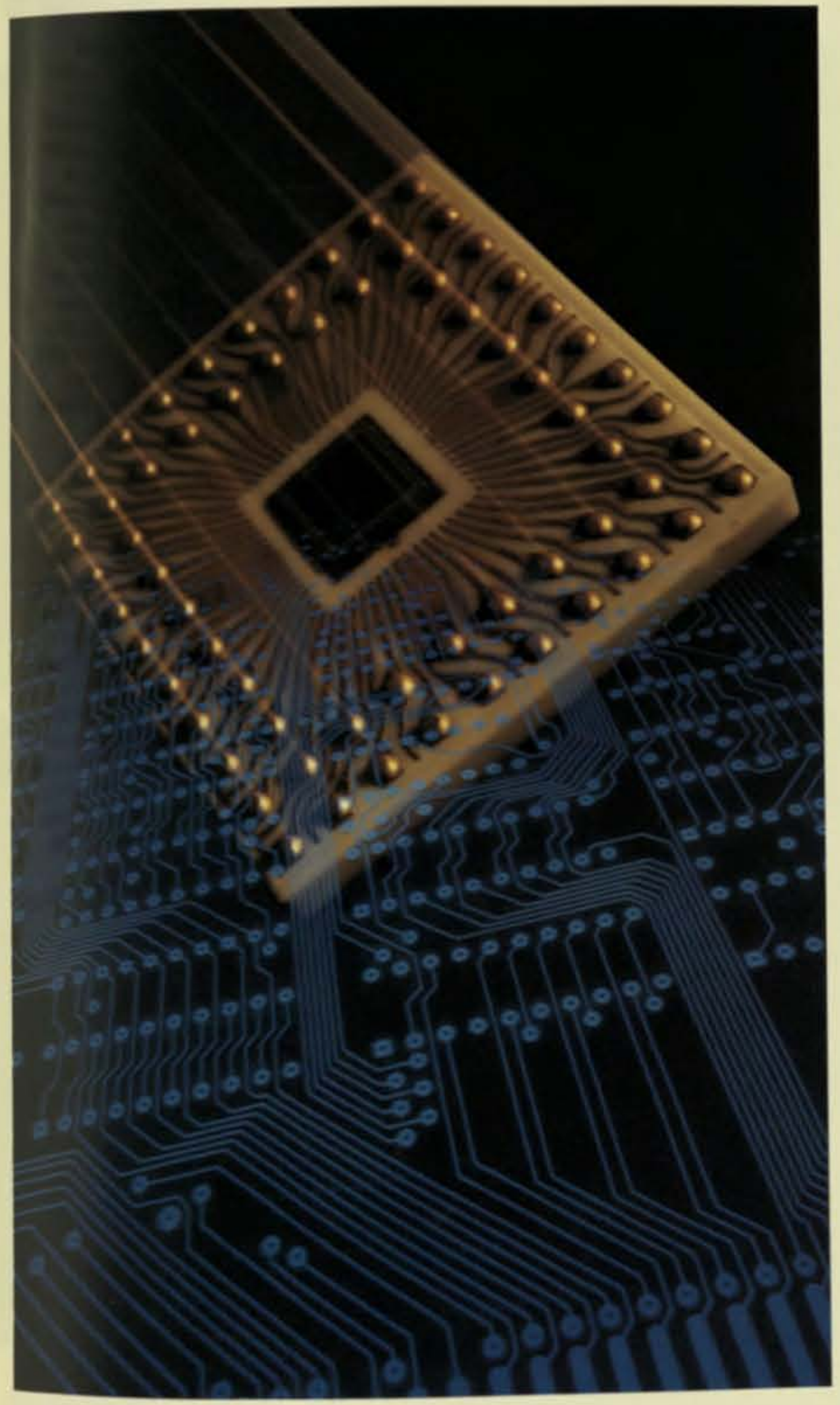
☐ The new NonStop II system that is already proven in demanding environments, and is specifically engineered to accommodate readily future technological advancements.

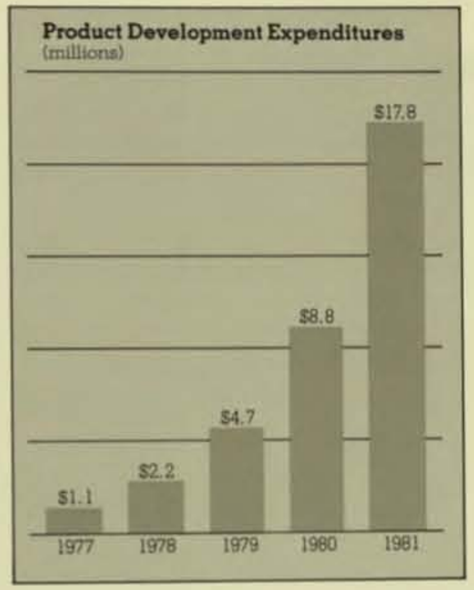
☐ A unique, inherent advantage in the modular product concept that enables the company to concentrate all of its product development resources toward a common goal, a leveraging ability not shared by others who must dilute efforts over a range of independent, non-modular models with incompatible goals.

☐ An active awareness of the evolving role of the integration of data processing and communications with technologies addressing information management of the future.

E.F. Hutton, in a research report published for institutional investors a half a month prior to the close of Tandem's fiscal year-end in September, 1981, put it this way:

"The information processing arena is currently undergoing dramatic changes. The once separate spheres of data processing, office products and communications are merging rapidly. Emphasis is shifting from individual hardware products to overall systems and the many subtle factors involved in their installation and implementation. This changing emphasis is expected to dramatically reshape the data processing marketplace, bringing to the fore companies that can respond to the evolving opportunities. Tandem Computers is well positioned with outstanding products and an effective communication networking strategy. We expect Tandem to participate strongly in this rapid evolution."





Although tegut Handelszentrale, one of Germany's large food distributors, now regards itself as the most advanced user of automatic data processing in that country's grocery business, just two years ago the company viewed its massive warehouse operation as typically "chaotisch."

With over 36,000 different inventory items located along 65 aisles, tegut management was spending a lot of time, money and paperwork to control the inventory for the 100 stores in its Ha We Ge and OKAY Kauf chains.

In late 1978, tegut installed its first, 2-processor Tandem system to convert the company's operations from batch computing to on-line transaction processing. By mid-1981, tegut's Tandem system had grown, along with the company, to eight processors. And a series of dramatic changes occured.

Fifteen new stores were opened during the period with no increase in warehouse staff.

Warehouse orders are being filled much faster. Whereas it used to take over a half hour from receipt of order to pick the goods in the warehouse, the average order is now processed in two and a half minutes.

Positive control has been gained over stock rotation. Using small, portable infra-red terminals tied into the Tandem system, warehousemen are directed to the first-in stock for all items to be picked—and the inventory is instantly, automatically adjusted.

And many other warehouse administrative tasks that used to take a day to complete are now done in an hour.

As a result, customers of Ha We Ge and OKAY Kauf

stores are always receiving fresh merchandise, and, because tegut is able to handle much greater volumes with significantly lower manpower costs, its customers benefit from lower prices.

Meanwhile, tegut has increased its confidence in its ability to grow rapidly as a result of the better control and its competitive advantages.

The company plans to improve further its competitiveness with the installation of point-of-sale terminals at its stores that will create suggested replenishment orders, enabling managers automatically to place store orders directly to the warehouse Tandem system.

The May Department Stores Company began implementing a far-sighted program in 1978 that will link together the major retailer's 138 department stores, 45 discount outlets and 20 principal warehouses across the U.S. in a totally interactive network. Other May operating companies, such as the 1100-store Volume Shoe Corp., may also be tied into the network.

The foundation for the growing, nationwide network has been established using Tandem's EXPAND software to tie together St. Louis, Los Angeles, Cleveland and Washington, D.C., with the Los Angeles-Washington telecommunications land lines backed-up with a satellite link.

The objective of the project, which began with a single, 2-processor Tandem system that had grown to six systems with 19 processors by the end of fiscal 1981, is to put powerful tools in the hands of store personnel to increase efficiency, accuracy, and customer service.

At the same time, the distributing of data over the on-line network eventually will enable the shifting of more personnel resources to selling floors from back-office, batch processing functions.

A myriad of new functions to improve management control are being introduced. At the May Company in California, one of the 13 store companies of the parent firm headquartered in St. Louis, buyers are now using interactive terminals to simplify the involved task of merchandise planning while assuring customers of well-stocked stores, at the same time satisfying the complex criteria of timing, values and gross margin planning.

On the merchandise receiving end, a new purchase order management system now in the trial stages will automate the labor-intensive checking and marking of incoming goods.

Another new program undergoing tests will provide instant sales audit through cash register balancing. From some 200 registers in the pilot program, it will grow to include many thousands.

And, at corporate headquarters, on-line management terminals now provide the capability to generate constantly up-dated analysis of comparative store performance.

Confidence in the future comes from a clear sense of direction

Tandem's employees, aided by the basic product concept, are over twice as productive as the industry median. Tandem also has one of the industry's lowest employee turnover rates, and all of the original design team (including Mike Green, at left on opposite page, now a senior vice president) are still with the company.

"...most reassuring of all is that Tandem is developing corporate muscle tone now, in the heady growth days, that should serve it well..." *Forbes*

A great deal has been written in national publications about Tandem's management philosophy and the resulting employee productivity.

The philosophy is not complex.

In essence, Tandem believes that its success emanates from a clear sense of direction throughout the company, and from a sharing of responsibilities and rewards with all employees.

Tandem is an exciting place to work, and a good place to work. Because the company is on the leading edge, the environment is stimulating and challenging. Because the company is growing rapidly, advancement opportunities abound for capable people who can take the initiative in accepting responsibility.

Individual performance is nurtured by an open door policy, and by the company's belief that self-management and peer pressure, in a high-technology environment, is more productive than a strict structure.

The Tandem philosophy encourages teamwork by sharing corporate objectives with all employees. Through various communications techniques, from one-to-one sessions at weekly informal gatherings to the company's quarterly journal, *Center*, Tandem strives to give employees opportunities to see where they fit in the overall scheme of the business. The company's objective is to impress upon everyone that each area of the company and each individual contributes to Tandem's success.

Interrelationships between the varied functions of the company are explained to employees to foster a clear understanding of Tandem's goals. The intent is to aid Tandem's employees in making correct judgements in their own areas of expertise, for it is they who are responsible for making the company's strategic plan work.

The company's attitudes and practices not only make Tandem a good place to work, but serve the company well.

In a survey late in fiscal 1981, 83% of employees said they believe advancement opportunities at Tandem are greater than at any other place they have worked. Tandem believes that promotions from within will perpetuate consistency and produce the management quality essential to the company's continued, prosperous growth.

Tandem's philosophy and environment also enable the company to keep its good people. In an industry that, nationwide, experiences a 26% annual turnover of employees (almost 29% in California's Silicon Valley where Tandem is headquartered), only 6.7% left Tandem during fiscal 1981. Some of those 6.7%, of course, are asked to leave; 98% of Tandem employees, according to the survey, believe Tandem is the best place they've ever worked.

And Tandem employees are more productive. While the electronic industry's median revenues per employee is under $50,000, Tandem employees during fiscal 1981 averaged over $100,000.

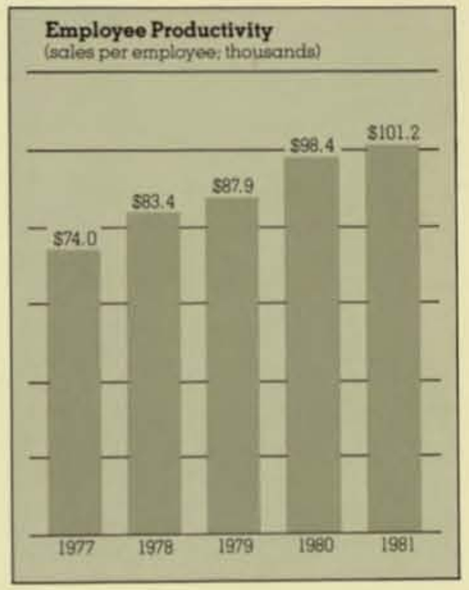
Because all employees, through their individual good work, have contributed to the company's success, Tandem believes that they should share in the rewards.

Virtually all employees, regardless of position, are stockholders or optionholders. In fact, employees represent one of the largest blocks of company ownership.

Exceptional employees are recognized and rewarded through the company's TOPs (Tandem Outstanding Performers) program.

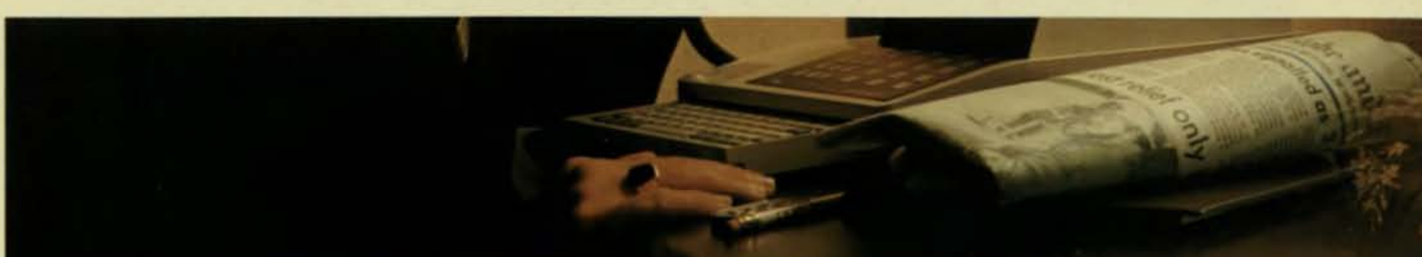
After four years, every Tandem employee in the U.S. and Canada earns a six-week, fully-paid sabbatical that can be taken in addition to the earned three weeks vacation. (Outside North America, Tandem employees take the customary longer vacations annually.)

A great deal of the company's confidence in the future comes from the belief that everyone at Tandem understands where the company is headed, and has the drive and ability to get it there.



1981 ANNUAL REPORT

TANDEM

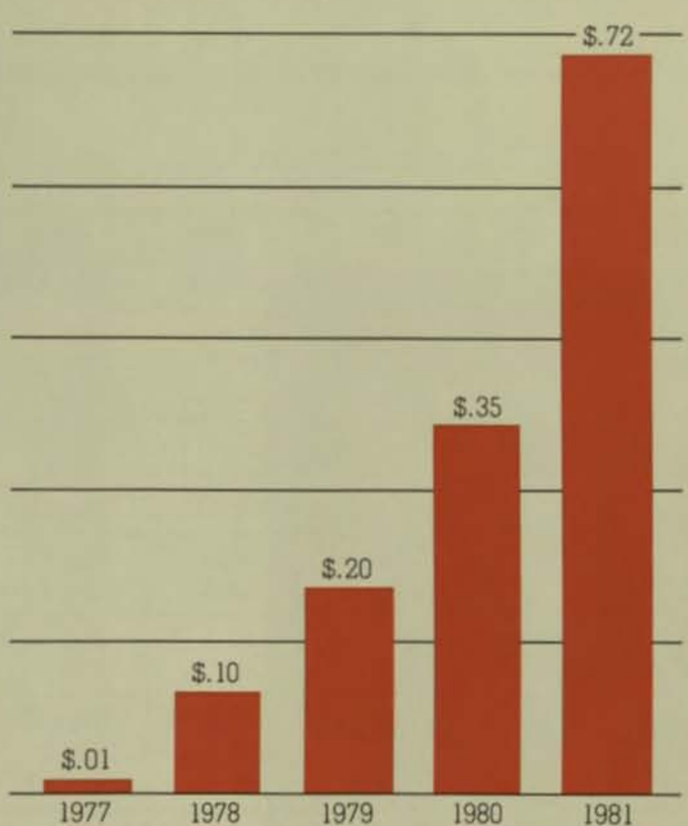


FINANCIAL REVIEW

HIGHLIGHTS

Fiscal Year Ended September 30	1981	1980	% Change
Revenue	$208,397,000	$108,989,000	91
Operating Income	$ 40,391,000	$ 19,323,000	109
Operating Margin	19.4%	17.7%	
Net Income	$ 26,549,000	$ 10,687,000	148
Earnings Per Share	$.72	$.35	106
Working Capital	$179,102,000	$ 61,232,000	192
Total Assets	$255,971,000	$ 95,701,000	167
Equity	$204,810,000	$ 70,294,000	191
Number of Employees	2,730	1,387	97

Earnings per Share



TO OUR STOCKHOLDERS

It is a pleasure to report to you the outstanding performance of Tandem Computers over the last year. Our fiscal 1981 operating results showed consistent high growth: Revenues increased 91% to $208,397,000; pretax operating margins were 19.3% compared with 17.7% in fiscal 1980; and earnings per share increased 106% to $.72. These financial results attest to the validity of the strategic market posture Tandem established seven years ago, and today reflect both the Company's technical leadership position in the market for on-line transaction processing systems, and the productivity, creativity and dedication of Tandem's employees.

Expanding Marketplace

The marketplace that Tandem addresses is growing rapidly, and the importance of the unique product features of our NonStop systems is increasingly being recognized by computer users who are implementing on-line transaction processing and distributed data processing network applications. During fiscal 1981 our customer base expanded 59% to include 460 users. The applications being implemented by these customers allow for the more efficient management of critical resources such as people, time, capital and inventory.

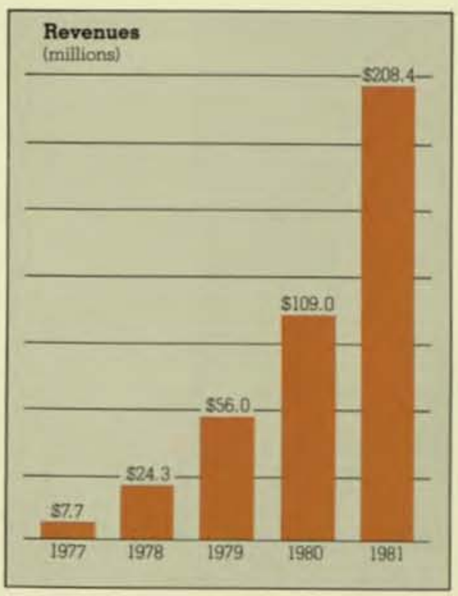
These users recognize that the ability to access and update information as events occur—to process transactions in an on-line environment—is highly dependent on having a computer system with Tandem's capabilities of NonStop processing and assured data integrity.

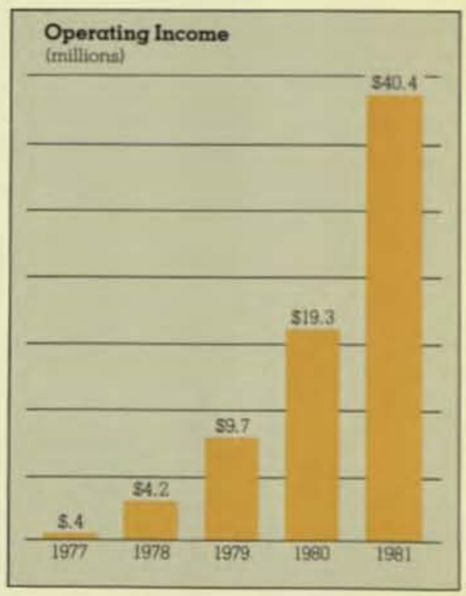
Increasingly, we find that our systems are being installed in large network applications where hundreds of processors and thousands of terminals will be required. To meet the needs of these users we have continued to open new marketing and support offices in the United States and internationally, and our manufacturing operations were expanded during the last year to two additional sites in California, as well as to Reston, Virginia. At year end we employed 2,730 people in 77 facilities located in 14 countries.

Technological Lead

Tandem's focus on on-line transaction processing since our founding has provided our organization with a vast amount of knowledge about the unique needs of this marketplace. The thrust of our development efforts both today and in the future is to use this experience to widen our technological lead.

During fiscal 1981 Tandem introduced a major new product, the NonStop II system. Designed to provide improved price/performance for users implementing very large on-line transaction processing applications, this system is also completely compatible with our existing products. Shipments of NonStop II systems began in March 1981, and customer acceptance has been excellent.





Tandem's commitment to on-going technical innovation is evidenced by our continued, rapidly growing investment in product development. In fiscal 1981 our development budget increased 103% to $17.8 million. These funds were invested in products addressing numerous dimensions of our marketplace, including programmer productivity, equipment serviceability, and advanced distributed data base, networking and communications technologies.

Outstanding People

Without question, Tandem's position of technological leadership and record of growth has allowed us to attract outstanding people to our organization. We feel that it is important that each of our employees understand how our business strategy, organizational philosophy and financial performance relates to the innovative and challenging environment in which they work. Preserving an environment that fosters creativity and professional growth is the responsibility of each individual who works at Tandem. Our employees are highly productive and dedicated: average revenue per employee exceeded $100,000 and turnover was below 7% in fiscal 1981. Tandem's performance is in every sense a credit to our employees, and we recognize that continuing to attract and retain outstanding people, and ensuring that they are prepared to manage our growth, is no doubt our most important challenge for the future.

Strong Financial Position

Tandem is committed to sound fiscal management. Internally, we use over 100 Tandem systems at more than 40 locations that are linked in an EXPAND network to give us on-line control of many aspects of our business. Our unique product features have directly assisted us in the management of our growth.

Our financial position is strong. We ended fiscal 1981 with a current ratio of 5.4 to 1 and an equity base of $204,810,000. Borrowings represented less than 1% of capitalization. This balance sheet strength, combined with our consistent operating profitability, provide us with enormous flexibility to fund our future growth.

Although the coming year appears to be one of some economic uncertainty, we believe that Tandem has the critical resources—outstanding people, strategically-positioned products, market leadership, and financial strength—in place to assure our continued success.

Sincerely yours,

T.J. Perkins
Chairman of the Board

James G. Treybig
President and
Chief Executive Officer

October 30, 1981

TANDEM COMPUTERS INCORPORATED AND SUBSIDIARIES

SELECTED FINANCIAL DATA
For the Five Years Ended September 30, 1981

(In thousands except per share amounts)	1981	1980	1979	1978	1977
Revenue	$208,397	$108,989	$55,974	$24,305	$7,692
Cost of revenue	75,547	40,831	20,786	9,096	3,514
Product development	17,833	8,786	4,654	2,169	1,094
Marketing, general, and administrative	74,626	40,049	20,828	8,808	2,719
Operating Income	40,391	19,323	9,706	4,232	365
Interest income, net	10,707	1,759	398	258	(36)
Provision for income taxes	(24,549)	(10,395)	(5,184)	(2,337)	(171)
Income Before Extraordinary Credit	26,549	10,687	4,920	2,153	158
Net income	26,549	10,687	4,920	3,371	325
Earnings Per Share Before Extraordinary Credit	$ .72	$ .35	$ .20	$ .10	$ .01
Earnings per share	.72	.35	.20	.16	.02
Total Assets	$255,971	$ 95,701	$45,947	$22,051	$5,370
Long Term Capitalized Lease Obligations	2,054	1,651	1,144	715	316
Stockholders' Investment	204,810	70,294	31,530	15,538	2,735

Per share amounts have been adjusted here and throughout financial statements for three-for-one stock split effective June 30, 1981.

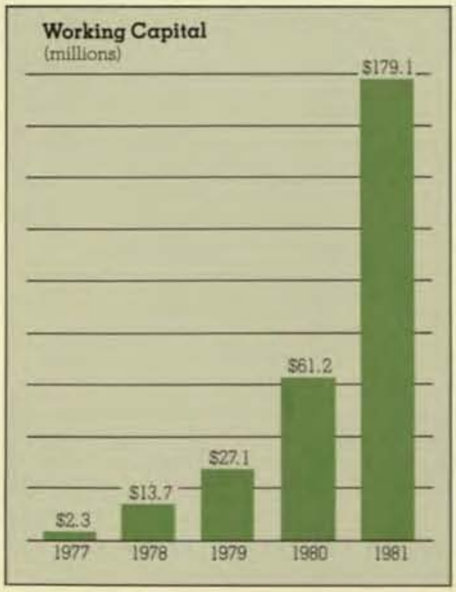
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Tandem Computers is committed to being a technological leader in the rapidly growing market for on-line transaction processing computer systems. Continued achievement of this goal by the Company involves many factors, including strategic market positioning, an ongoing commitment to product development, and an organizational structure and philosophy that fosters employee productivity and creativity. Also critical to the achievement of this goal is the maintenance of a financial position and operating record that allows the Company to maximize its performance in a high growth environment.

Financial Condition

Tandem Computers believes that its financial position is very sound. Over the past three years, the Company has grown rapidly, with revenues, operating income, and earnings per share before extraordinary credit having increased at compound annual rates of 105%, 112%, and 93%, respectively. In order to fund the working capital requirements of this high growth, all profits after taxes have been reinvested in the business, and external financing has also been required. Such external financing has been primarily in the form of equity issues sold to public investors and to employees through option and stock purchase programs. The Company's facilities have been leased, and capital equipment has been funded through a combination of lease and equity financing.



As of September 30, 1981 Tandem Computers had a cash and cash investments balance of $89,806,000, unused lines of credit of $15,000,000, and an equity base of $204,810,000. The Company had a current ratio of 5.4:1, and long term debt was less than 1% of total capital at fiscal year-end 1981. The Company's financial strategy includes maintaining a sound ratio of current assets to current liabilities and a conservative capital structure. The Company believes this strategy provides it with maximum near term and long term flexibility to consider the full range of financing alternatives to fund the capital needs of its projected future growth.

Results of Operations

The table below summarizes the changes in important operating indicators for the fiscal years presented. The numbers on the left account for the revenue dollar by showing various income and expense items as a percentage of revenue. The numbers on the right measure the yearly percentage increase in the same items.

% of Revenue				% Increase		
1981	1980	1979		1981	1980	1979
100.0	100.0	100.0	Revenue	91	95	130
36.3	37.5	37.1	Cost of Revenue	85	96	129
8.6	8.1	8.3	Product Development	103	89	115
35.8	36.7	37.2	Marketing, General, and Administrative	86	92	136
19.4	17.7	17.3	Operating Income	109	99	129
5.1	1.6	.7	Interest (net)	509	342	54
			Earnings Per Share	106	75	100*

*Fiscal 1979 before extraordinary credit.

Revenue

Tandem Computers' revenue gains over the last three years have resulted directly from increased shipments of its computer hardware and software products to new and existing customers, and from increases in the number of customers using its support and training services. In fiscal 1981 first deliveries were made of NonStop II systems and ENCOMPASS Transaction Monitoring Facility software. The Company shipped 1210 processors to 310 customers during the year, compared to 653 processors to 198 customers in 1980. Foreign revenue accounted for 34.3% of total revenue for fiscal 1981, compared to 31.4% and 29.2% for fiscal 1980 and 1979, respectively.

Operating Margins

While Tandem Computers has realized its revenue growth goals throughout its corporate history, the Company believes that achievement of its 16–20% operating margin goal is its most important financial operating priority. This goal has been met in each of the last four years and continues to be the Company's objective for the 1982 fiscal year. During the last three years the Company's cost structure has been essentially unchanged. An important factor contributing to this consistent performance has been the relatively low employee turnover rate, which has been below 8% annually during this period.

Operating margins increased slightly despite the start up of new production facilities in Watsonville and Santa Clara, California and in Reston, Virginia during fiscal 1981. The Company plans to open a facility in Austin, Texas during fiscal 1982. Tandem's products are also manufactured at the Company's Cupertino headquarters, in a second facility in Watsonville, and in Neufahrn, Germany.

The company's product development effort is dedicated to meeting the needs of computer users who are implementing on-line transaction processing applications at a single site or in geographically distributed data processing networks. Product development expenditures have been in the range of 8–9% of revenue over the last three years. Such expenditures are expected to increase to 9–10% of revenue in 1982, as the incentives provided by the Economic Recovery Tax Act of 1981 enable the Company to fund additional worthwhile projects. Product development expenditures resulted in many new product introductions during the past three years, including the most important product of 1981, the NonStop II system. A significant portion of these expenditures fund the development of future products.

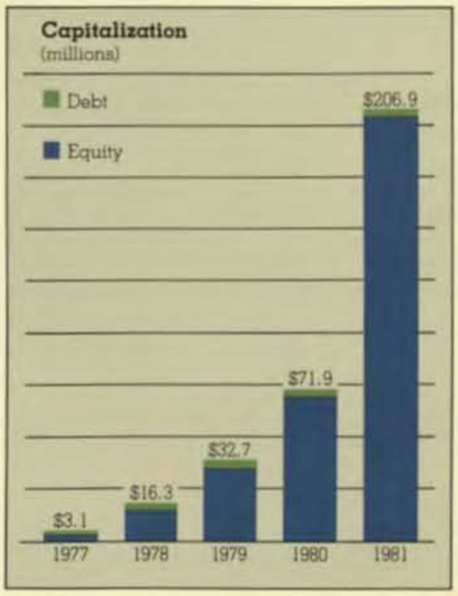
Tandem's marketing strategy is focused on the end-user market where providing a high level of customer support is essential. Therefore, the Company has pursued an aggressive program of establishing sales and support offices in the United States and subsidiaries throughout the world during the past three years. In the last year, many of these offices have become fully operational, resulting in increased efficiency and in a slight decline in marketing, general, and administrative costs as a percentage of revenue.

Earnings Per Share

Earnings per share growth has been somewhat less than operating income growth in each of the last three years. The favorable influence of increased interest income and a declining tax rate have been offset by the dilution of added shares outstanding. Interest income increased substantially in fiscal 1981 as the $96,033,000 raised in the Company's November, 1980 public offering were invested in short-term securities prior to being required for investment in operating assets of the business. The Company's tax rate was 48% in 1981, versus 49% in 1980 and 51% in 1979. This decline in tax rate reflects the lessening negative impact of start-up losses of foreign subsidiaries, which cannot be consolidated for Federal income tax purposes, and the effect of research and development tax credits that began in the fourth quarter of fiscal 1981. The Company's public offerings of common stock in the past three years, combined with sale of stock to employees under the employee stock purchase plan and grants under option plans, resulted in increases in weighted average shares outstanding of 22% in 1981, 21% in 1980, and 16% in 1979. Proceeds from the sale of these additional shares have been used to finance the working capital expansion required to support the Company's growth during this period, and at fiscal 1981 year-end provided a substantial pool of cash investments that is available to fund future growth.

Effect of Inflation

The Company believes that the effect of inflation on labor rates has been offset by increases in productivity and decreases in materials costs.



CONSOLIDATED STATEMENT OF INCOME

For the Three Years Ended September 30, 1981

(In thousands except per share amounts)	1981	1980	1979
Revenue	$208,397	$108,989	$55,974
Costs and Expenses			
Cost of revenue	75,547	40,831	20,786
Product development	17,833	8,786	4,654
Marketing, general, and administrative	74,626	40,049	20,828
Total costs and expenses	168,006	89,666	46,268
Operating Income	40,391	19,323	9,706
Interest expense	(282)	(293)	(84)
Interest income	10,989	2,052	482
Income Before Income Taxes	51,098	21,082	10,104
Provision for income taxes	(24,549)	(10,395)	(5,184)
Net Income	$ 26,549	$ 10,687	$ 4,920
Earnings Per Share	$ .72	$ .35	$ .20
Weighted average shares outstanding	37,025,000	30,241,000	25,070,000

The accompanying notes are an integral part of this statement.

CONSOLIDATED BALANCE SHEET
As of September 30, 1981 and 1980

(In thousands)	1981	1980
Assets		
Current Assets		
Cash	$ 9,377	$ 9,265
Cash investments	80,429	6,980
Accounts receivable, net of allowance for doubtful accounts of $1,000,000 in 1981 and $1,016,000 in 1980	70,671	42,552
Inventories	54,543	20,901
Prepaid expenses and other	5,046	1,965
Total current assets	220,066	81,663
Property and Equipment, at cost		
Production and test equipment	11,395	4,135
Computer equipment	11,122	4,702
Office furniture and equipment	2,466	1,083
Systems spares	8,610	4,391
Leasehold improvements	10,746	4,054
	44,339	18,365
Accumulated depreciation and amortization	(8,434)	(4,327)
Net property and equipment	35,905	14,038
Total Assets	$255,971	$95,701

Liabilities and Stockholders' Investment		
Current Liabilities		
Current portion of capitalized lease obligations	$ 682	$ 476
Accounts payable	23,634	11,063
Accrued liabilities	6,373	3,216
Accrued income taxes	10,275	5,676
Total current liabilities	40,964	20,431
Capitalized Lease Obligations	2,054	1,651
Deferred Income Taxes	8,143	3,325
Commitments		
Stockholders' Investment		
Common stock $.025 par value, authorized 60,000,000 shares, outstanding 36,409,631 in 1981 and 30,074,754 in 1980	910	251
Additional paid-in capital	161,468	53,555
Retained earnings	42,432	16,488
Total stockholders' investment	204,810	70,294
Total Liabilities and Stockholders' Investment	$255,971	$95,701

The accompanying notes are an integral part of this balance sheet.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT
For the Three Years Ended September 30, 1981

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1978	22,056	$184	$ 14,473	$ 881	$ 15,538
Sale of common stock, net of related expenses	2,520	21	10,054	—	10,075
Sale of common stock under stock option plan	337	3	351	—	354
Sale of common stock under stock purchase plan	107	1	407	—	408
Tax benefit from employee transactions in common stock	—	—	235	—	235
Net income	—	—	—	4,920	4,920
Balance September 30, 1979	25,020	209	25,520	5,801	31,530
Sale of common stock, net of related expenses	4,290	36	24,243	—	24,279
Sale of common stock under stock option plan	589	5	2,037	—	2,042
Sale of common stock under stock purchase plan	176	1	949	—	950
Tax benefit from employee transactions in common stock	—	—	806	—	806
Net income	—	—	—	10,687	10,687
Balance September 30, 1980	30,075	251	53,555	16,488	70,294
Sale of common stock, net of related expenses	4,500	38	95,995	—	96,033
Sale of common stock under stock option plan	1,692	15	7,381	—	7,396
Sale of common stock under stock purchase plan	143	1	2,272	—	2,273
Capitalization of retained earnings for three-for-one stock split	—	605	—	(605)	—
Tax benefit from employee transactions in common stock	—	—	2,265	—	2,265
Net income	—	—	—	26,549	26,549
Balance September 30, 1981	36,410	$910	$161,468	$42,432	$204,810

The accompanying notes are an integral part of this statement.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
For the Three Years Ended September 30, 1981

(In thousands)	1981	1980	1979
Working Capital Provided From (Used For):			
Net income	$ 26,549	$10,687	$ 4,920
Add back items not currently using working capital			
Depreciation and amortization	4,107	2,547	1,365
Deferred income taxes	4,818	2,284	1,041
Working capital provided from operations	35,474	15,518	7,326
Acquisition of property and equipment, net	(25,974)	(9,966)	(5,433)
Increase in capitalized lease obligations	403	507	429
Sale of common stock, net	105,702	27,271	10,837
Tax benefit from employee transactions in common stock	2,265	806	235
Net increase in working capital	$117,870	$34,136	$13,394

	1981	1980	1979
Working Capital Increase Represented By:			
Increase in current assets			
Cash and cash investments	$ 73,561	$ 9,487	$ 2,311
Accounts receivable	28,119	22,671	11,766
Inventories	33,642	9,597	4,985
Prepaid expenses and other	3,081	580	766
Increase in current liabilities			
Current portion of capitalized lease obligations	(206)	(101)	(172)
Accounts payable	(12,571)	(5,388)	(1,909)
Accrued liabilities	(3,157)	(1,947)	(316)
Accrued income taxes	(4,599)	(763)	(4,037)
Net increase in working capital	$117,870	$34,136	$13,394

The accompanying notes are an integral part of this statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Consolidation
The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition
The Company generally recognizes revenue from equipment sales at the time of shipment.

Exchange Gains and Losses
Foreign exchange translation gains and losses are not significant and are reflected in the results of operations.

Inventories
Inventories are stated at the lower of cost (first-in, first-out) or market and include material, labor, and manufacturing overhead. The components of inventory as of September 30 were:

(In thousands)	1981	1980
Purchased parts and subassemblies	$33,625	$11,832
Work-in-process and finished systems	20,918	9,069
Total	$54,543	$20,901

Income Taxes
The Company provides for income taxes on total DISC income and accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are realized.

Property and Equipment
Systems spares are depreciated using the double declining balance method. All other property and equipment are depreciated using the straight-line method. The estimated useful lives are:

Production and test equipment	5–10 years
Computer equipment	5– 7 years
Office furniture and equipment	5–10 years
Systems spares	5 years
Leasehold improvements	Lease Term

Earnings Per Share
Earnings per common share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of stock options outstanding that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

2. Income Taxes

The provision for income taxes included the following:

(In thousands)	1981	1980	1979
Current Federal	$15,356	$ 6,022	$3,850
Current State	3,771	1,682	916
Current Foreign	1,401	1,120	326
	20,528	8,824	5,092
Prepaid Federal	(1,205)	(281)	(638)
Prepaid State	(180)	(29)	(7)
Prepaid Foreign	588	—	—
	(797)	(310)	(645)
Deferred Federal	4,325	2,104	718
Deferred State	194	82	—
Deferred Foreign	299	(305)	19
	4,818	1,881	737
Total Provision	$24,549	$10,395	$5,184

Sources of prepaid and deferred taxes were as follows:

(In thousands)	1981	1980	1979
Prepaid:			
Increase in revenues recognized for income tax reporting, but not for financial statements	$ (100)	$ 115	$ 503
Expenses recognized for financial statements, but not for income tax reporting	897	195	142
Total Prepaid	$ 797	$ 310	$ 645
Deferred:			
DISC income	$ 3,230	$ 1,638	$ 449
Other items	1,588	243	288
Total Deferred	$ 4,818	$ 1,881	$ 737

The provision for income taxes differed from the amount obtained by applying the Federal statutory income tax rate to income before taxes as follows:

	1981	1980	1979
Federal statutory tax rate	46%	46%	46%
State taxes, net of Federal income tax benefit	4	4	5
Foreign losses with no tax benefit and foreign income taxes in excess of Federal rate	1	2	3
Investment tax credits	(3)	(3)	(2)
Research and development tax credits	(1)	—	—
Other	1	—	(1)
Effective Tax Rate	48%	49%	51%

3. Lease and Other Commitments

The Company leases its headquarters, operating facilities, field offices, and automobiles under operating lease agreements. The Company also has capitalized leases for certain equipment. Future lease payments as of September 30, 1981 were as follows:

(In thousands)	Leases	
Fiscal Year	Operating	Capital
1982	$ 16,320	$ 889
1983	17,921	771
1984	15,487	722
1985	14,313	555
1986	14,435	314
1987–2004	70,103	37
Total minimum lease payments	$148,579	3,288
Less: Amount representing interest (7%)		552
Present value of minimum lease payments		$2,736

Rent expenses were $8,908,000 in 1981, $4,509,000 in 1980, and $1,738,000 in 1979.

The Company has entered into lease agreements for new facilities in Reston, Virginia and Cupertino, California which are expected to be occupied in July, 1982 and May, 1982. The Company has guaranteed construction financing for these facilities for a total amount of $24,600,000.

4. Lines of Credit

The Company has a revolving bank line of credit that provides for unsecured borrowings of up to $10,000,000 at the bank's prime lending rate. The agreement requires the Company to maintain a compensating balance of 2½% of the line of credit amount plus 5% of borrowings in excess of $2,500,000. The line of credit expires December 31, 1982. The Company has a revolving line of credit with a second bank providing for unsecured borrowings of up to $5,000,000. The line of credit expires June 30, 1982, provides for borrowings at the bank's prime lending rate, and requires the Company to maintain a compensating balance of 5% of the commitment. There were no amounts outstanding under either line of credit during fiscal 1981 or 1980.

5. Preferred and Common Stock

Stock Split
In June, 1981 the Company effected a three-for-one common stock split and increased the number of authorized common shares from 20,000,000 to 60,000,000. The accompanying consolidated financial statements have been restated to reflect this stock split, and an amount equal to $605,000, reflecting the aggregate par value of the additional shares issued, was transferred from retained earnings to the common stock account.

Preferred Stock
The Company has 2,400,000 shares of preferred stock authorized.

Stock Option Plans
The Company has employee stock option plans under which permanent employees may be granted shares at 100% of fair market value at the time of the grant. Options generally are exercisable upon the date of grant and expire no later than seven years after grant. As of August 13, 1981 all option plans were amended to qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981. At the employee's choice, all outstanding option agreements may be amended to qualify as well. On October 30, 1981, the Company reserved 5,000,000 shares for issuance under the Incentive Stock Option plan.

As of September 30, 1981 options for 4,723,419 shares were outstanding at prices ranging from $.17 to $26.58, with an average price of $13.68. All outstanding options are exercisable. Options for 1,479,562 are available for future grant. Options were exercised at prices ranging from $.08 to $22.88 in 1981, $.08 to $6.61 in 1980, and $.08 to $4.79 in 1979.

Employee Stock Purchase Plan
As of September 30, 1981 the Company has reserved 1,650,406 shares for future issuance under its employee stock purchase plan. Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of common stock at 85% of fair market value at the beginning or end of a three month offering period. Under the second method, the Company may grant to employees the option to purchase common stock at not less than 85% of fair market value at the grant date. As of September 30, 1981 options to purchase 406,200 common shares at $17.04 per share were outstanding under the second method. Such options are exercisable through January 4, 1983.

6. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three years ended September 30, 1981.

(In thousands)	Geographic Area United States	Europe	Other	Adjustments and Eliminations	Consolidated
1981					
Revenue-Customer	$144,392	$47,294	$16,711	$ —	$208,397
Revenue-Intracompany	37,580	—	—	(37,580)	—
Revenue-Total	181,972	47,294	16,711	(37,580)	208,397
Pre-Tax Income	50,297	4,145	2,139	(5,483)	51,098
Identifiable Assets	213,693	34,592	12,471	(4,785)	255,971
1980					
Revenue-Customer	$78,758	$25,760	$4,471	$ —	$108,989
Revenue-Intracompany	17,452	1,868	56	(19,376)	—
Revenue-Total	96,210	27,628	4,527	(19,376)	108,989
Pre-Tax Income	21,469	801	140	(1,328)	21,082
Indentifiable Assets	76,181	19,889	2,109	(2,478)	95,701
1979					
Revenue-Customer	$41,292	$13,501	$1,181	$ —	$ 55,974
Revenue-Intracompany	8,846	102	—	(8,948)	—
Revenue-Total	50,138	13,603	1,181	(8,948)	55,974
Pre-Tax Income (Loss)	11,127	230	(173)	(1,080)	10,104
Identifiable Assets	35,667	10,113	1,319	(1,152)	45,947

Intracompany transfers are made at approximately arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue included export sales of $7,397,000 in 1981, $3,973,000 in 1980, and $1,663,000 in 1979.

7. Unaudited Quarterly Financial Data

(In thousands except per share amounts)	Quarters Ended Dec. 31	March 31	June 30	Sept. 30
Year ended September 30, 1981:				
Revenue	$40,609	$47,417	$55,865	$64,506
Costs and Expenses				
Cost of revenue	14,901	17,484	20,908	22,254
Product development	3,435	4,058	4,617	5,723
Marketing, general, and administrative	14,752	16,863	18,872	24,139
Total costs and expenses	33,088	38,405	44,397	52,116
Operating Income	7,521	9,012	11,468	12,390
Interest income, net	1,809	3,726	2,715	2,457
Income Before Income Taxes	9,330	12,738	14,183	14,847
Provision for income taxes	4,668	6,262	6,992	6,627
Net Income	$ 4,662	$ 6,476	$ 7,191	$ 8,220
Earnings Per Share	$ .14	$ .17	$ .19	$ .21
Year ended September 30, 1980:				
Revenue	$20,826	$24,877	$29,194	$34,092
Costs and Expenses				
Cost of revenue	7,535	9,272	10,915	13,109
Product development	1,542	2,013	2,426	2,805
Marketing, general, and administrative	7,733	9,339	10,759	12,218
Total costs and expenses	16,810	20,624	24,100	28,132
Operating Income	4,016	4,253	5,094	5,960
Interest income, net	305	576	451	427
Income Before Income Taxes	4,321	4,829	5,545	6,387
Provision for income taxes	2,160	2,415	2,772	3,048
Net Income	$ 2,161	$ 2,414	$ 2,773	$ 3,339
Earnings Per Share	$ .08	$ .08	$ .09	$ .10

AUDITORS' REPORT

To Tandem Computers Incorporated:

We have examined the consolidated balance sheet of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1981 and 1980, and the related consolidated statements of income, stockholders' investment, and changes in financial position for each of the three years in the period ended September 30, 1981. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1981 and 1980, and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1981, all in conformity with generally accepted accounting principles applied on a consistent basis.

San Jose, California
October 30, 1981

Arthur Andersen & Co.

TANDEM STOCK PRICE

Calendar Quarter Price	High	Low
1981 3rd Quarter	32	24
2nd Quarter	34⅝	24¾
1st Quarter	25½	20½
1980 4th Quarter	25⅜	18⅛
3rd Quarter	18⅜	9⅞
2nd Quarter	9⅞	6½
1st Quarter	9	6⅛
1979 4th Quarter	7⅛	5⅛
3rd Quarter	6	4⅝
2nd Quarter	5⅝	4¾
1st Quarter	5	3¾

Tandem Computers Incorporated common stock is traded in the over-the-counter market under NASDAQ symbol TNDM. The above quotations, which have been adjusted for stock splits, represent prices between dealers without adjustment for mark-up, markdown, or commissions and may not represent actual transactions. No dividends have been declared on the common stock.

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Kleiner, Perkins, Caufield & Byers

Morton Collins (2),
Partner, DSV Associates

Thomas J. Davis, Jr. (1) (2),
Partner, Mayfield II

Franklin P. Johnson, Jr.,
Chairman, Asset Management
Capital Company

Eugene Kleiner (2),
Partner, Kleiner, Perkins, Caufield &
Byers

Robert C. Marshall,
Senior Vice President and Chief
Operating Officer, Tandem
Computers Incorporated

Alvin C. Rice,
President and Chairman, Imperial
Bank

Robert G. Stone, Jr.,
Chairman of the Board, West India
Shipping Company

James G. Treybig (1),
President and Chief Executive Officer,
Tandem Computers Incorporated

(1) Member of Executive Committee
(2) Member of Audit Committee

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Robert C. Marshall,
Senior Vice President and Chief
Operating Officer

Michael D. Green,
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Marketing

Henry V. Morgan,
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D. Chris Larson,
Director, Austin Division

Dennis L. McEvoy,
Vice President, Software
Development

Jerald D. Reaugh,
Vice President, Corporate Materials

Auditors

Arthur Andersen & Co.,
San Jose, California

Registrar and Transfer Agent

Bank of America N.T. & S.A.,
San Francisco, California

Form 10-K

A copy of the company's Form 10-K, as filed with the Securities and Exchange Commission, is available on written request. Please direct request to:

Treasurer's Office
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Friday, February 5, 1982, at the corporation's headquarters.

Tandem
Corporate Headquarters
19333 Vallco Parkway
Cupertino, CA 95014-2599
(408) 725-6000

Domestic Sales and Service Offices

ARKANSAS, Little Rock

ARIZONA, Phoenix

CALIFORNIA, Los Angeles, San Diego, San Francisco, Sunnyvale, Santa Clara, Long Beach

COLORADO, Denver

CONNECTICUT, Stamford

FLORIDA, Tampa, Orlando

GEORGIA, Atlanta

ILLINOIS, Chicago, Schaumburg

INDIANA, Indianapolis

KANSAS, Kansas City

LOUISIANA, New Orleans

MARYLAND, Linthicum

MASSACHUSETTS, Boston

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MINNESOTA, Minneapolis

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NEVADA, Las Vegas

NEW JERSEY, Hasbrouck Heights

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TEXAS, Dallas, Fort Worth, Houston, Austin, Irving

UTAH, Salt Lake City

VIRGINIA, Falls Church, Richmond, McLean

WASHINGTON, Seattle

WISCONSIN, Milwaukee

International Subsidiaries

CANADA
Tandem Computers Canada Limited
Edmonton, Montreal, Vancouver,
Toronto

DENMARK
Tandem Computers A/S
Taastrup

ENGLAND
Tandem Computers Limited
Northolt, London, High Wycombe

FRANCE
Tandem Computers S.A.
Rungis-Cedex

GERMANY
Tandem Computers GmbH
Dortmund, Düsseldorf, Frankfurt,
Hamburg, Mannheim, München,
Neufahrn, Stuttgart

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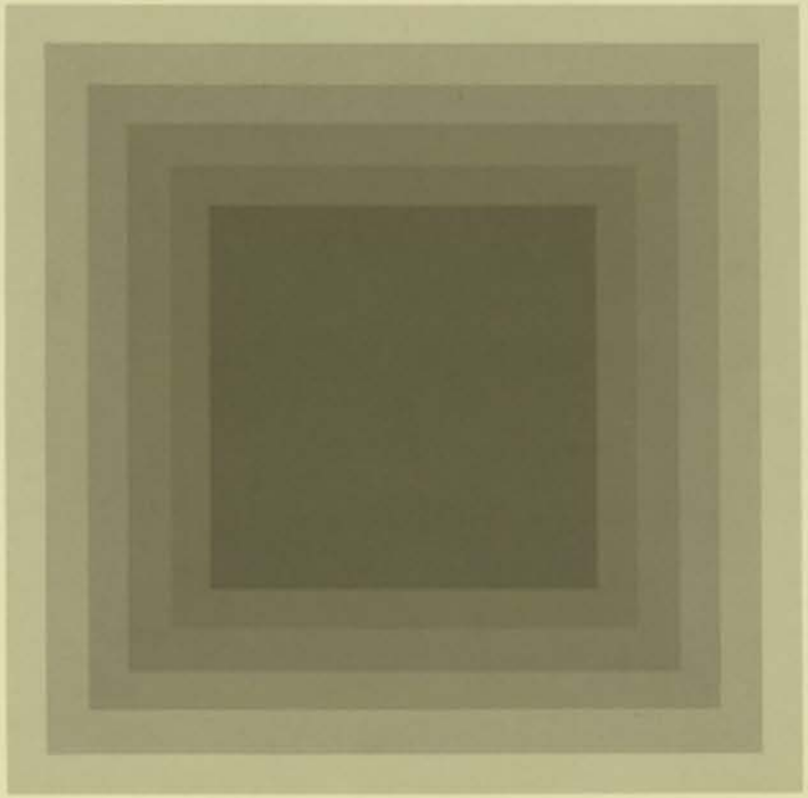
1981 ANNUAL REPORT

TANDEM

FINANCIAL REVIEW

1982 ANNUAL REPORT

Technological Leadership in the Rapidly Evolving Market for On-Line Transaction Processing



TANDEM

BUSINESS REVIEW

TANDEM

FINANCIAL REVIEW

Profile

Tandem Computers Incorporated designs, develops, manufactures, markets and supports a unique computer system for on-line transaction processing. The company's customers are primarily large, diversified organizations.

The Tandem NonStop system—the first on-line, distributed computer architecture for mainframe applications—virtually eliminates the risk of system failures; protects users' data bases from damage or loss; expands modularly from a mid-size system to mainframe power without hardware replacement or software conversion; and extends into a distributed data processing network of up to 255 geographically dispersed systems.

Tandem has manufacturing operations in six locations in the United States and one in Germany. The company supports customers' NonStop systems throughout North America, Europe and Asia from 96 offices.

At the end of fiscal 1982, 599 organizations—of which 139 were new customers during the year—were using over 4,000 NonStop processors worldwide. Within the five-year reporting period, Tandem's annual revenue (1982 versus 1978 fiscal years) has grown by a multiple of 13 to $312 million, and stockholders' equity has increased by a factor of 16 to $251 million.

Preface

When commercial data processing was born a quarter of a century ago, it marked the start of using computers as business tools for increasing productivity and improving competitiveness. Business in the Eighties, however, is much faster paced—and much more changeable, complex and competitive—than it was in the Fifties. Consequently, enterprises need a new generation of productivity-enhancing computers that complement today's business environment. Conventional, centralized, mainframe computers are no longer state-of-the-art because they are not 'state-of-the-business,' and large organizations throughout the world are looking for ways to bring their core business functions in line with on-line needs. Only one computer manufacturer, Tandem, has created an entirely new architecture to address those crucial needs for instantaneous and accurate information. This report describes that architecture and the organization that created the NonStop system . . . and explains how Tandem is playing a key role in the dramatically changing marketplace for on-line computer systems.

Providing Comprehensive Solutions to Complex Information Requirements

"A growth rate for fault-tolerant transaction processing of 30–50% may leave traditional mainframes and super-minis in the dust in transaction processing applications, and there will be dislocations for companies which cannot or choose not to respond."

—Gideon I. Gartner
President,
Gartner Group, Inc.

Gideon Gartner is one of the most highly regarded analysts following the information industry.

The marketplace for computers that perform the functions at the heart of business operations is undergoing rapid change. Businesses are redefining the Fifties mainframe concept to address the dramatically changed needs of the Eighties and Nineties. It is no longer adequate to rely on yesterday's information—the output of batch processing—to make today's decisions.

The first major shift started in the Seventies when many businesses began to move applications on-line in order to obtain up-to-the-minute information that accurately reflects the state of the business. The effect of on-line transaction processing is the immediate and automatic capture and updating of business information that supports timely decisions.

The second major change is the shift from centralized to distributed computing, putting information where it is used in the business. As businesses distribute data to sites where transactions occur, they naturally want to be able to link the locations together in on-line networks to vastly enrich the information flow and automation benefits.

These important changes—the clear trends to on-line computing and distributed data processing networks—have made the conventional, centralized mainframe architecture obsolete.

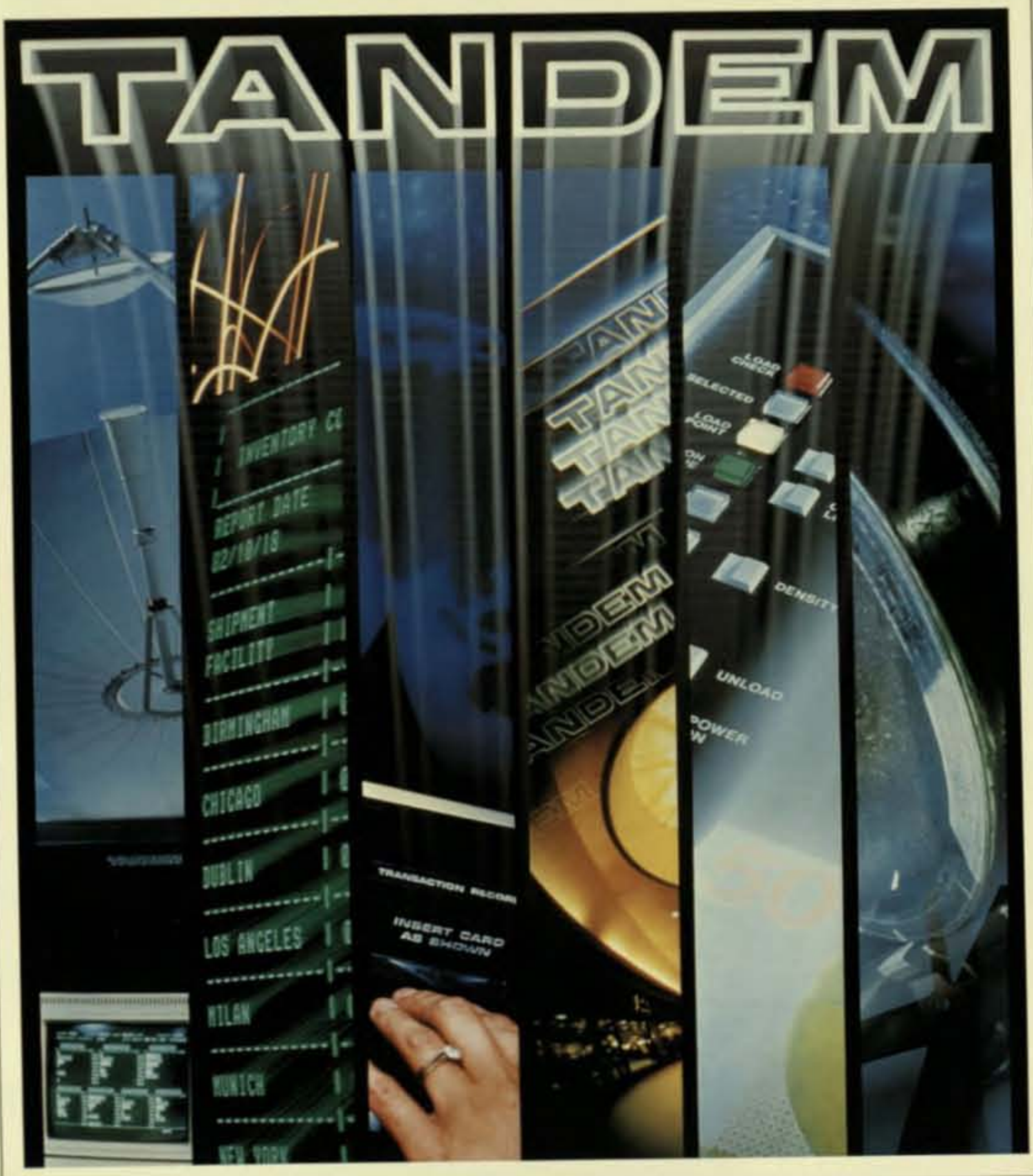
The new requirements for computers in this environment are continuous availability, modular expandability, data integrity, programmer productivity, and efficient system performance, tied together in a network that is transparent to the user.

Recognizing the early signs of these trends, Tandem created a totally new architecture designed expressly to serve the emerging on-line transaction processing marketplace. The fault-tolerant, modularly expandable Tandem NonStop system is the first on-line, distributed computer system for mainframe applications.

Tandem's unmatched experience in this new marketplace is the foundation of its leadership position. It is fortified by a strong base of nearly 600 satisfied customers using more than 4,000 Tandem processors, and a capable organization of creative people dedicated to supporting the needs of this dynamic marketplace.

"Tandem's vision of the marketplace of the Eighties and Nineties led us to build in the critical features right from the start. This means that Tandem has an unbeatable eight-year lead in understanding and serving this market."

—Charles W. Ryle
Vice President,
U.S. Marketing
Tandem Computers



Merging and Moving All Forms of Corporate Information

TRANSFER

"Competition has arrived with a vengeance for commercial banks, demanding worldwide, intersystem linkages that go beyond just the traditional processing of data."

—Donald R. Hollis
Senior Vice President,
Systems & Management
Information Services
First National Bank of Chicago

First Chicago, among the top ten U.S. banks, has an extensive and growing series of domestic and international computer applications which are based on 28 NonStop systems and 87 processors in 17 countries.

Large organizations rely upon information in many forms from many sources to make business decisions.

To initiate a routine customer order, an office in Paris may need to send a packet to New York that includes a cover letter, memos, an order form, a purchase order, and a drawing.

Before the transaction is completed, the New York office will communicate with a manufacturing facility in Atlanta which, in turn, will need information from a Chicago warehouse.

The process may entail telephone calls, telex, telecopiers, photocopiers, word processors, electronic mail and a range of incompatible computers. The interdependence of information delivery on these diverse technologies slows and complicates decisions, and keeps communications costs high.

Traditional data processing and centralized mainframe computers cannot efficiently address this spectrum of business information requirements. Business needs demand an on-line computer system with distributed data bases connected in a global network that can merge and manage all corporate information resources while preserving investments in a variety of computers and office devices.

During 1982, Tandem announced a far-reaching new product called TRANSFER that will do just that. Based on an EXPAND network, TRANSFER will manage the dynamic interchange of information. It will link together people, equipment and data independent of form, location or application.

Tandem offers a wide variety of flexible communication links to support such activity. The most innovative among them is INFOSAT, Tandem's newly announced, fully-integrated, low-cost satellite communications network.

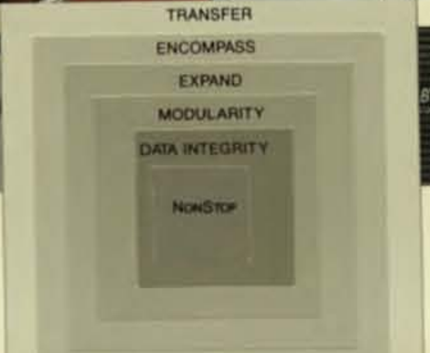
The new TRANSFER and INFOSAT capabilities build upon the unique attributes of the powerful Tandem NonStop architecture to provide a flexible, highly reliable backbone network, transforming Tandem NonStop systems into a truly integrated information management and delivery system.

"Tandem provides the leading edge products for innovative customers who are pushing the limits of traditional computer usage."

—David R. Mackie
Vice President,
Tandem Computers

TRANSFER will allow users to merge different forms of information and move them over a Tandem EXPAND network. To facilitate the economical movement of large volumes of information, Tandem has also introduced the first commercially available, fully-integrated satellite communications network. INFOSAT brings all the inherent NonStop system advantages to satellite communications.

Tandem, which runs its own worldwide operations on a 100-node on-line EXPAND network, is testing TRANSFER on this network utilizing INFOSAT earth stations. Tandem provides an ideal test environment for TRANSFER because its on-line network, one of the largest in the world, is the key corporate information resource for managing all aspects of the business. Initial TRANSFER and INFOSAT deliveries are scheduled during 1983.



Logotypes appearing throughout this report are a representative sampling of the 599 organizations worldwide that are using Tandem NonStop systems at the close of fiscal 1982.

Bringing Applications On-Line Quickly and Cost-Effectively

"The most important trend in data processing today is facilities for obtaining results fast . . . to achieve much higher DP productivity. This, coupled with the ability to distribute the relevant data, is essential for putting computers to use to meet end users' true needs."

—James Martin
Author and Lecturer

James Martin is a leading authority on data base and applications development. He is a computer industry author and lecturer of international repute.

Data is the foundation for every business decision. Whether for booking reservations, billing customers, transferring funds, or checking inventory, the information must be complete, current and accurate.

As business grows, data proliferates. The larger the organization, the greater the need to access and exchange information at all levels, yet the more difficult it is to manage and control. If the organization is diversified structurally or geographically, the problem is even more complex.

On-line transaction processing, by its nature, involves large data bases, many users, frequent on-line updates, fast response time, and numerous terminals communicating with the system simultaneously.

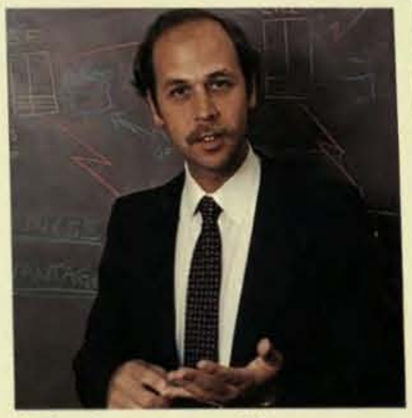
Only Tandem, through its ENCOMPASS relational data base management system, meets these requirements.

ENCOMPASS makes the programmer's job as simple as writing batch processing applications because it monitors every transaction, manages data files, handles the complex terminal functions, and delivers fast, accurate answers ensuring data integrity and consistency.

ENCOMPASS makes the end-user more productive as well as providing an easy-to-use relational query language/report formatter called ENFORM.

Consequently, Tandem users typically become operational with new applications at a fraction of the time and cost—and begin enjoying benefits much sooner—than do users of other systems that require specialized programming and highest-skill programmers.

And that explains why, according to the 1982 Cowen/DATAMATION survey of computer users, Tandem has the highest level of customer usage of data base management and networking software of all computer manufacturers in the survey.

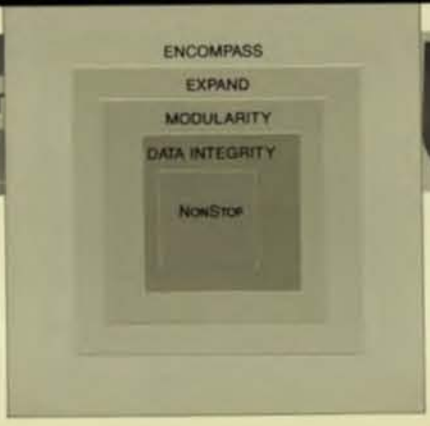


"The key to making business more productive is bringing the information asset closer in time and space to the point of the business transaction."

—Gerald D. Held
Director,
Software Research
Tandem Computers

Tandem's ENCOMPASS software—a powerful tool that makes programming for distributed, on-line transaction processing no more difficult than writing programs for batch processing—is widely used by Tandem customers in all industries to increase both programmer and end-user productivity dramatically.

In the manufacturing sector, Pirelli, a major tire producer, is using ENCOMPASS to bring quickly into production numerous state-of-the-art programs at four manufacturing facilities in Italy. The company's interactive EXPAND network is scheduled to be extended to Pirelli plants worldwide.



Easily Integrating Widespread Information Assets into a Fault-Tolerant Network

"We're putting more and more of our business onto computers—including linking together more than 4,400 stores. To make that commitment, we absolutely require computer systems that can be quickly linked together in a rapidly expanding network without having to write new programs."

—Carroll Leu
Vice President,
Data Processing
Tandy Corporation

The purpose of on-line transaction processing networks is to provide everyone in a geographically-dispersed organization some part of the total information asset to make the business function more completely, competitively and efficiently.

Tying together the information assets requires an on-line network of computers that is continuously available, cost-effective, and easy to use.

The only architecture that is ideally suited to on-line networks comes from Tandem technology.

Tandem's EXPAND networking software makes writing applications across a network easy. And, once the network is in place, it can grow and change to accommodate increased business, new functions or new locations swiftly and inexpensively without rewriting application software or retraining people. An EXPAND network can, in fact, painlessly grow to 255 mainframe-power NonStop systems.

Tandem systems are the logical choice for on-line networks. The fault-tolerance of the NonStop system architecture inherently extends across networks of Tandem systems.

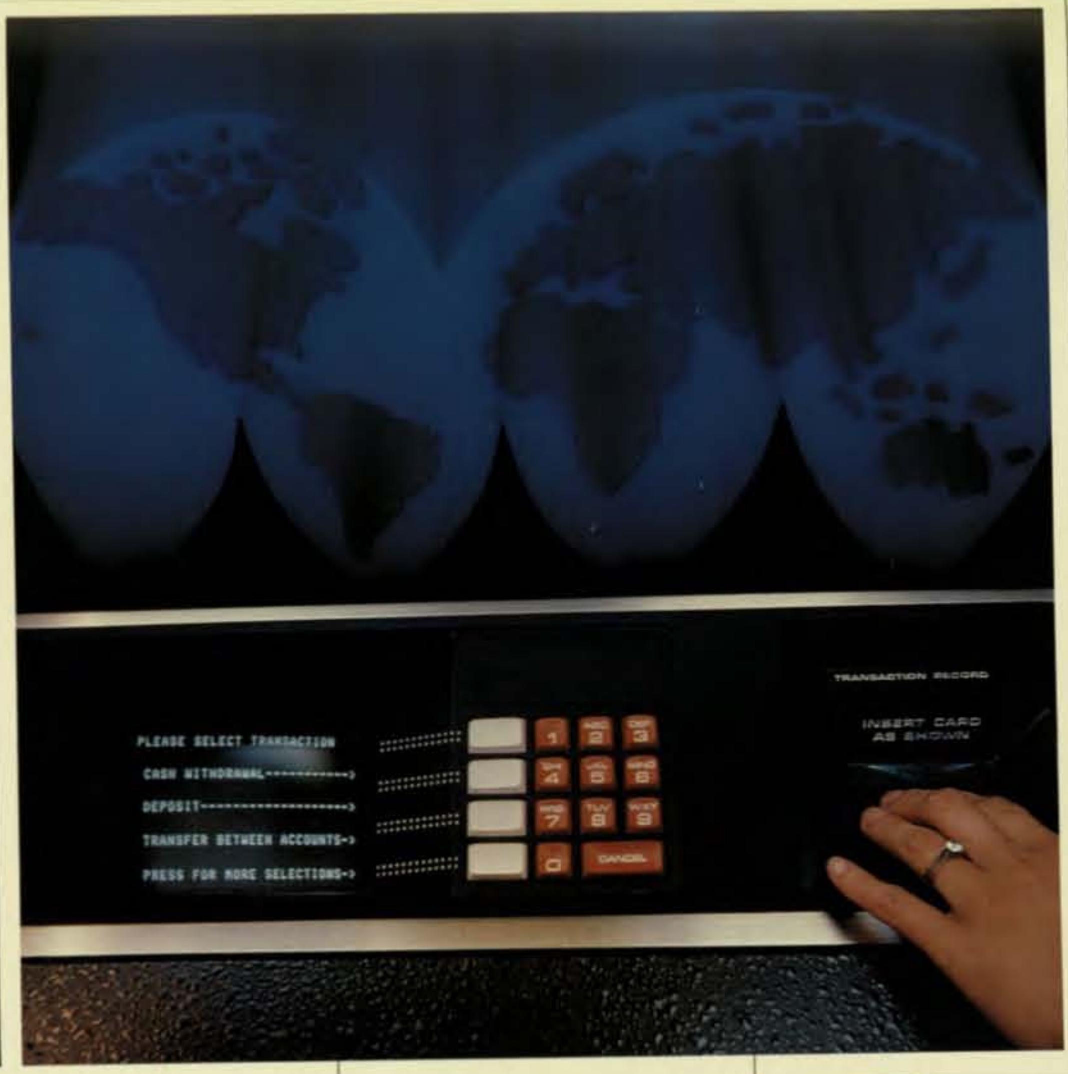
In contrast, consider the most advanced conventional mainframe computers claiming 99% availability. A business running its computers around the clock statistically would be out of business eight hours—one full shift—once a month. The statistical probability of failure for such non-Tandem systems tied together in an on-line network is even less acceptable: *In just a 10-system network of conventional computers, the network would be down for eight hours every third day.*

In a 100-node network like Tandem's own corporate information system, an organization using conventional mainframes would be off the air more than on—and that is why NonStop systems will form the backbone networks of the world's largest organizations.

"We understand our customers' networking needs because our own international on-line network is one of the largest in the world."

—Jeanne D. Wohlers
Vice President, Treasurer
Tandem Computers

Tandy sells its popular TRS-80 small computers and other electronic products through its nationwide Radio Shack stores that link into a Tandem EXPAND network.



The ultimate size and configuration of a new and growing application may not, during the planning stage, be immediately discernible. With Tandem systems, the network configuration can easily change as the business changes.

At Wells Fargo Bank, some 50 Tandem processors are dispersed at a variety of wholesale and retail banking applications including a network of 500 automated teller machines. Wells Fargo plans to upgrade to an EXPAND network for greater network availability, disaster recovery capability, increased maintainability, and lower communications costs.

Sizing Systems for Today's Needs, Easily Adding Power for Tomorrow's

Modularity

"Large, dynamic organizations that are constantly adding interdependent functions to their interactive computer networks need a computer system that is quickly and inexpensively expandable without disrupting the business."

—Christer Magnusson
President,
Vingressor

With 35 bureaus in Scandinavia, Vingressor, the travel agency subsidiary of the Scandinavian Airline System, books over 390,000 packaged tours annually to 30 destinations.

Businesses change, as does the environment in which they operate. Yet, traditional data processing systems do not. Once in place, they are immutable until uprooted and replaced by an equally inflexible successor.

Tandem systems, in contrast, are inherently flexible.

Module by module, Tandem systems grow in power from mid-size to mainframe—without reprogramming applications or retraining personnel—and without disrupting business operations. Routinely, Tandem users add incremental processing power to their existing NonStop systems while they continue to run without interruption.

Instead of purchasing a $2 or $3 million mainframe that will ultimately be needed to run an application, Tandem users develop the application on a minimum-size NonStop system for a tenth the investment. Later, when the application goes on-line, the precise amount of required processing power is added with no additional programming.

When the application grows, or when new functions are added that will require more computing power, or when the application is distributed to other facilities, or when all facilities are linked together in a network, the requisite power is 'metered' to each system by again simply adding more processor modules.

Each Tandem system can be expanded from two to 16 processors. And up to 255 full-size systems can be interconnected in an EXPAND network without rewriting applications programs.

The dynamics of large organizations and complex marketplaces often change computing requirements between the time an application is planned and the time it is executed, and as the users' needs change. The Tandem architecture is forgiving of changes by virtue of its inherent modularity.

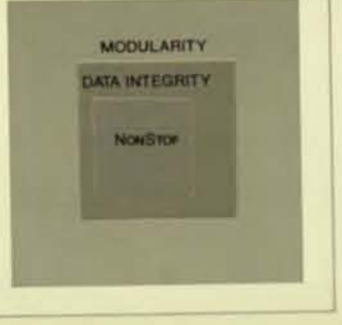
"The beauty of a computer system that can match the requirements of a rapidly growing business is obvious. That it can do it while running continuously and at no cost premium is an undeniable business advantage."

—Laurence A. Laurich
Vice President,
Engineering
Tandem Computers

Growing enterprises need true modularity of computers to accommodate their growth and added on-line activities. In the retail and distribution markets, particularly within large chains, the number of automated locations increase while at the same time the number of on-line services expand. To accommodate both types of growth, an easily expandable computer resource is key to cost-efficiency.

Target Stores, a $2 billion retailer and the largest subsidiary of Dayton-Hudson Corporation, is an excellent example of the need for true modularity. Within three years of installing its first two-processor Tandem system to begin developing applications for distribution centers and a chain-wide network, Target had five Tandem systems on-line using 25 processor modules, with many other on-line applications planned.

Mobil | MOORE | TIME ELECTRONICS | Peugeot | SmithKline Beckman CORPORATION | COX Broadcasting Corporation



Consistently Delivering Information as Accurate as the Input

Data Integrity

"Cable television systems in over 950 cities depend on us to accurately and timely bill their 12 million subscribers every month, utilizing their on-line data bases interconnected with ours. We cannot tolerate lost or damaged data—or computer failures—that would jeopardize nearly $2.5 billion of the cable industry's annual revenues."

—Robert J. Matthews
President,
Cable Data

Cable Data, an information systems company, provides complete packages of data processing products and services to over 60% of the U.S. cable TV systems. The company has over 150 Tandem processors deployed in the U.S. and Canada in the growing cable TV industry and at Cable Data offices.

Fundamental to the integrity of the corporate information management resource is the assurance that what comes out of the computer is as accurate as what goes in, and that the information is delivered to the intended recipient.

The Tandem architecture and software tools such as Transaction Monitoring Facility combine to achieve an unprecedented level of data integrity, both within a single system and throughout a geographically distributed network.

Data contamination and loss caused by system malfunctions and failures are risks taken by all users of conventional computers. Such occurrences with batch applications are sometimes recoverable, but in fast-paced on-line transaction processing environments—where an organization's critical business functions are dependent upon the accuracy of rapidly changing information—system errors are intolerable.

In passenger reservations systems, for instance, many days of departures could be underbooked or overbooked because of data loss or damage.

In international electronic funds transfers, millions of dollars can be lost if conventional computers inadvertently deposit cash in the wrong accounts.

Data integrity is inherent to the Tandem NonStop architecture. To some Tandem users, this feature alone is reason enough to acquire NonStop systems—and all of the other unique capabilities are regarded as free benefits.

"The most valuable part of the computer resource is not the hardware or the software but the data—the information on which the business relies to operate. Tandem offers the highest level of data integrity available today."

—Dennis McEvoy
Vice President,
Software Development
Tandem Computers

Tandem's data integrity features lend important advantages to all Tandem users, especially to those having extremely active and large on-line data bases. And among the world's largest data bases are those of national governments.

In the Netherlands, where all dependent children are entitled to regular government allowances from birth through college graduation, Tandem's data integrity advantage is an important reason for the government's conversion to NonStop systems. The Sociale Verzekerings Bank is responsible for keeping accurate, current records on some 3.5 million children and making timely, correct payments of over $200 million monthly. The agency's growing Tandem systems are being linked together in an EXPAND network around the country, extending data integrity to hundreds of on-line terminals.

DATA INTEGRITY
NONSTOP

Keeping Corporate Information Assets Constantly Available

"According to the results of the survey we conducted with DATAMATION magazine, Tandem users were notable for two factors: the highest levels of usage of both data base management software and networking software, and the highest level of customer loyalty for any vendor covered in the survey."

—Barry Rosenberg
Partner,
Cowen & Company

Barry Rosenberg is a leading computer industry securities analyst and director of the annual Cowen/DATAMATION survey of computer users.

When enterprises move to on-line systems, if the computer stops, the business stops.

Failures of batch processing mainframes are, by comparison with an on-line system failure, merely nuisance factors. Time lost by idle batch mainframes may be recoverable. But on-line systems deal in real time: Time lost is opportunity lost forever.

At the heart of the NonStop architecture is the technology developed by Tandem that prevents a failure at any single point from causing the system to stop. A component failure is transparent to users; the remaining processor or processors automatically take up the work. Data remains intact, business continues as usual.

Earlier attempts to achieve continuous operations employed redundant, conventional computers hooked together. One system stood idle until the other failed. When that happened, data processing professionals flipped a switch and hoped the second system was healthy. This approach doubled the cost of computer hardware.

The entire NonStop system performs useful work constantly. There is no wasteful redundancy. Even when a NonStop system is undergoing maintenance, the system can continue to run.

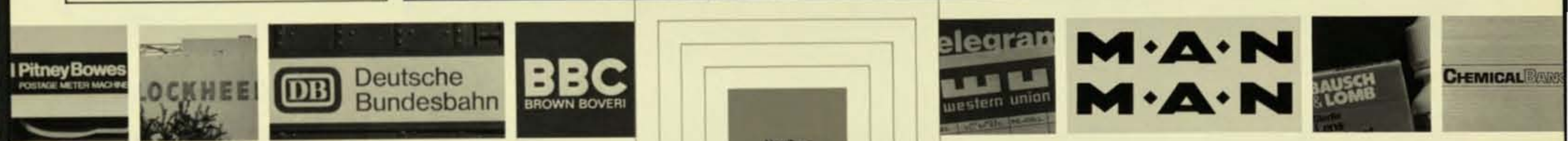
And there is no cost premium for fault-tolerance—nor for the other inherent NonStop features of modularity, data integrity and ease of networking. Tandem's price/performance is second to none in on-line transaction processing environments.

"The basic building block of the Tandem architecture—as well as the foundation of our customer loyalty—is the NonStop feature. Why buy a computer that fails?"

—Gerald L. Peterson
Vice President,
International Marketing
Tandem Computers

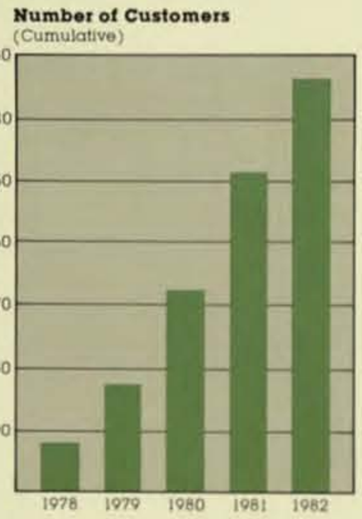
Tandem NonStop systems are assuring continual operations and improved customer service for air, rail, sea and road transportation companies worldwide. Around the clock, millions of Tandem transactions occur daily to manage passenger reservations, station operations, cargo bookings and distribution, railroad yards, dockside activities, and total airport facilities.

In railway-dependent Germany, for instance, the heavily traveled national Bundesbahn began converting its domestic and international passenger reservations systems to Tandem in 1982. By early 1983, the network will be handling over 20,000 transactions hourly.



Assuring Successful Customer Applications through Superior Support

Customer Service and Support



Now more than ever, with the movement of critical business applications to on-line transaction processing, users of large systems need responsive, effective and proven support systems from the manufacturer. The best products can be no better than the support, and the support can be no less distributed than the data bases, systems and networks themselves.

That Tandem excels in customer support is clearly evidenced in the 1982 Cowen/DATAMATION survey of computer users in which Tandem, for the third consecutive year, ranked number one in the industry for customer satisfaction and loyalty.

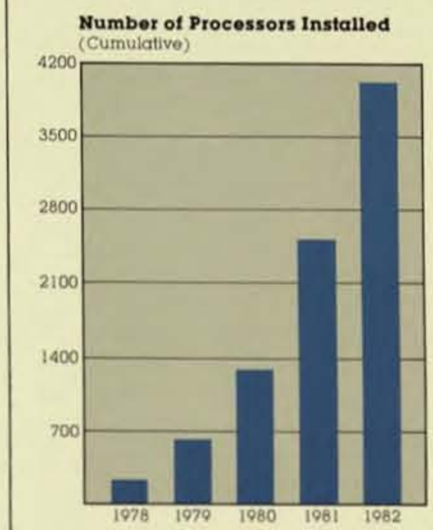
Fully half of the entire Tandem organization—at some 100 locations in 16 countries—is dedicated to some aspect of the company's broad-based, far-reaching support activities including sales support, customer education, field service and applications support.

Even before system delivery, Tandem's responsive attitude is apparent. The Tandem Account Support Team, including both hardware and software specialists, assists prospective users in planning on-line applications.

In many cases, Tandem's unique Application Design Support group conducts in-depth studies of customer plans and intended software, and recommends ways the user can improve the success of the application through changes that take full advantage of the Tandem architecture.

Before shipment, every NonStop system is tested in failed-component modes to ensure continued operation. Once installed, Tandem systems are much more serviceable than conventional computers. The modularity of the architecture lets maintenance and repair take place while the system continues to run user programs uninterruptedly.

Service is provided by an integrated hardware-software Customer Engineering team working with advanced, Tandem-developed diagnostic systems and support techniques as comprehensive as the architecture itself.



The objective of Tandem customer support in all its aspects is to help make customers' applications successful. One way this is achieved is through Tandem's Application Design Support group which, during 1982, reviewed some 150 customer applications and made recommendations on ways to enhance them by making changes to take maximum advantage of the NonStop architecture. Further assistance was provided during the year via 885 technical training classes for customers totaling over 8,000 student-weeks that were conducted at Tandem customer education facilities.

Efficiency of Tandem technical support personnel is enhanced by on-line tools such as the self-contained, microcomputer-based diagnostics console of the NonStop II (above) that is used for on-site and remote troubleshooting. Customer engineers around the world also use Tandem's corporate EXPAND network to retrieve technical assistance automatically from company headquarters. Low turnover within the Tandem field support organization helps the company maintain a consistently high level of technical support.

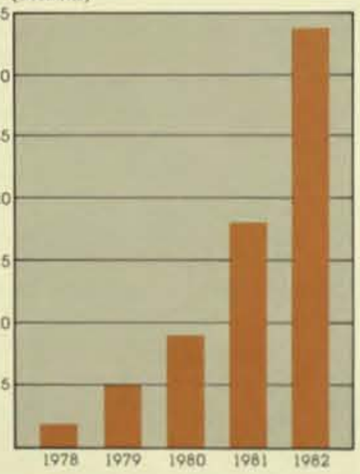
Customer feedback as well as service monitoring is facilitated by Tandem's on-line Product Reporting System (left) that captures and disseminates NonStop system service activity as well as customer requests for enhancements and new capabilities.

At Tandem headquarters, the Tandem Executive Institute conducts seminars for senior executives of customer and prospective customer organizations within specific industries. Outside experts define industry trends, Tandem speakers tell how NonStop systems can help companies address those trends competitively, and a Tandem user within the given industry reports on successful NonStop system applications.

Protecting Users' Investment with Flexibility for Future Enhancements

Product Development

Product Development Expenditures
(Millions)



In the final analysis, large organizations that are committing to on-line transaction processing and networks seek a supplier that will preserve and enhance their original investment by remaining responsive to the ever-changing business and technology environments.

Tandem's NonStop architecture provides unprecedented flexibility and adaptability by creating elegant solutions from simple modules.

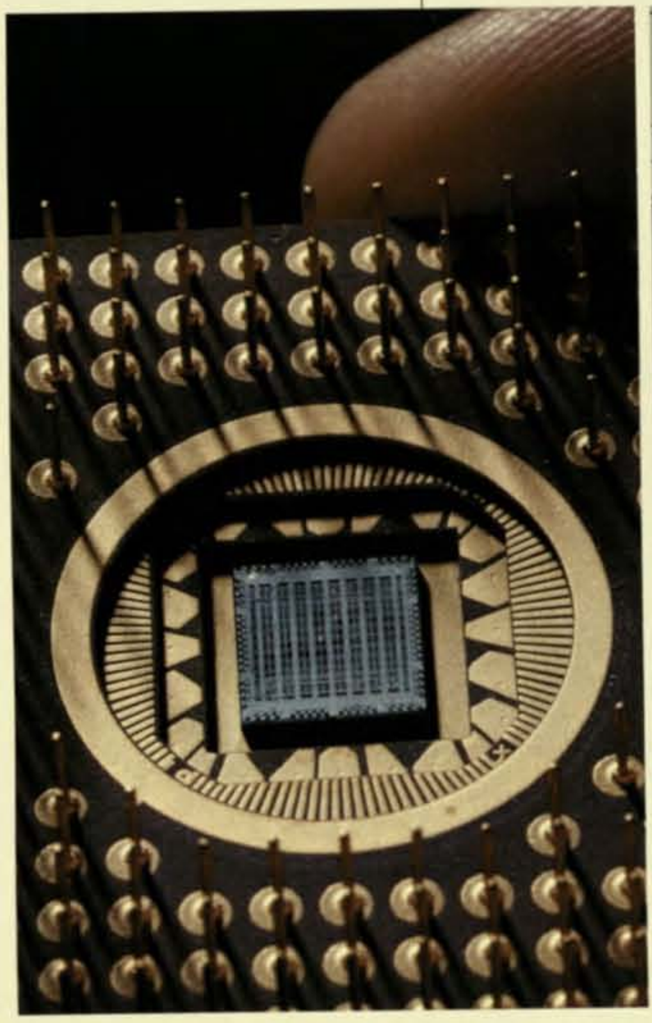
Since introduction of the original NonStop system, Tandem has spent some $70 million on product development programs—an investment that is heavily leveraged and highly productive for users because the modularity of the architecture, both hardware and software, spreads each enhancement over a full range of system sizes from mid to mainframe. This design also provides unique economies in manufacturing, inventory, and service as well as product development.

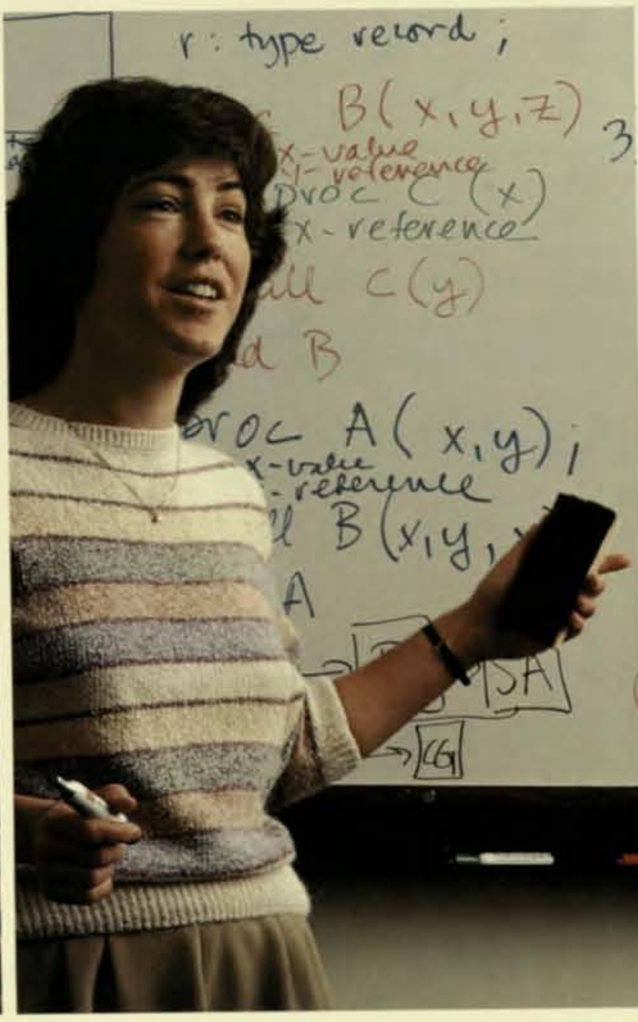
The ultimate goal of Tandem's product development programs is increasing the functionality, efficiency, and ease of operation of the users' backbone resource. Toward this end, the company's spectrum of projects covers new product introductions, enhancements to existing products, and new technology.

Product enhancements include microcode changes for the NonStop II system that led to as much as a 25% performance improvement at no additional cost to the customer. New products ranged from the 6530 ergonomic terminal, to TRANSFER information management and delivery software, to INFOSAT satellite communications system, to SNAX. SNAX software will enable EXPAND network users to access IBM SNA networks, devices and applications programs while retaining the reliability and flexibility of NonStop systems.

Using Tandem-developed tools for the design of custom logic, the company shipped the first products containing gate arrays of its own design during fiscal 1982. Tandem will soon offer customers a product that is the outgrowth of its work in fiber optics. Tandem customers will be able to link up to 14 maximum-size 16-processor systems that are up to one kilometer apart—without reprogramming—effectively creating a single system with more power than the world's largest conventional mainframe computer.

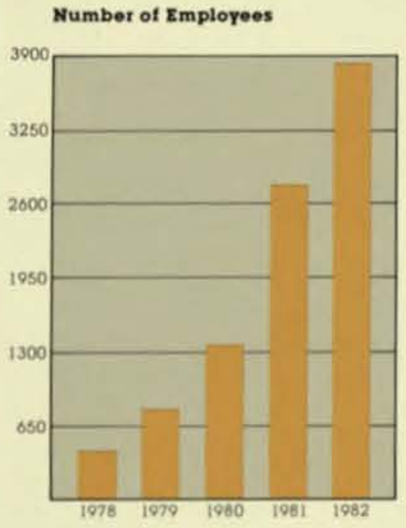
Tandem's development expenditures—$34 million during fiscal 1982—are divided equally between hardware and software projects. Introduction of LSI gate arrays and fiber optics into NonStop systems is enhancing system performance and reliability, while a steady stream of advanced software products contributes further to system flexibility and ease of programming.





A Unique Organization Focused on

Ensuring Customer Satisfaction through Creative, Dedicated People



Tandem places high value on employee communications to facilitate sharing the responsibility for managing a rapidly growing business, and to perpetuate the successful corporate environment. Although emphasis is on open communications within the company's unstructured environment, formal media are also used.

Earning the industry's highest rating for customer satisfaction is not accidental; Tandem employees care about the company's customers because Tandem cares about its employees. And because Tandem is a good place to work.

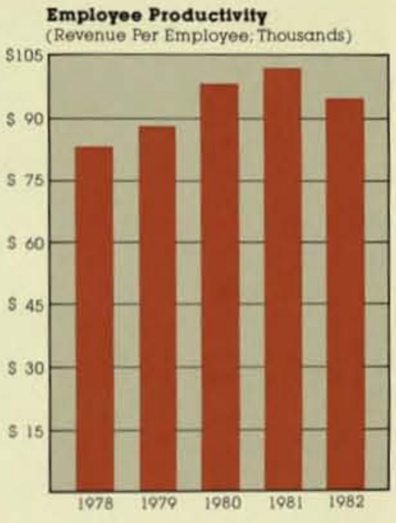
Tandem's ability to recruit and keep quality, creative people is nurtured by the company's reputation for innovativeness and market leadership, the excitement and challenge of being part of a major factor in the industry, and the resultant opportunities for individuals that abound in such a dynamic business.

The Tandem environment is good for its people and good for the company. Employee productivity is far higher than is typical in the computer industry, and the company's turnover rate is less than one-third of the industry average.

High growth consistent with keeping customers satisfied is achieved through shared responsibility, open communications, and performance recognition. Creativity, teamwork and individual dedication flourishes at Tandem in an unstructured environment that is guided by a clear sense of direction communicated throughout the company.

Individual growth is not left to chance. The self-education process that is promoted by the nature of the workplace is augmented with formal training. Over 150 individuals monthly attend courses in the Tandem Management Development Program. And throughout the organization, the company strives to explain the impact of each individual's performance on the company's success—and how that success affects each individual.

Job satisfaction is a major reward at Tandem, but the company also pays its people well, provides stock ownership opportunities (nearly all employees are optionholders or stockholders), gives employees a voice in selecting benefits, and provides North American employees six-week, fully-paid sabbaticals every four years, while employees outside North America take the customary longer vacations annually.



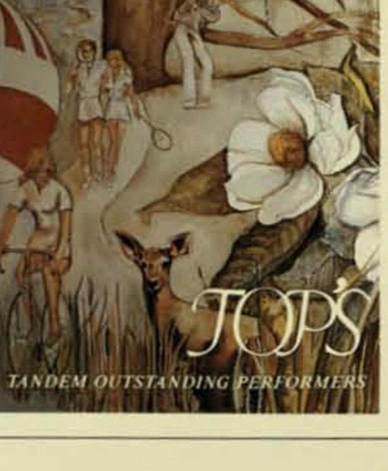
Center magazine focuses on the range of human and business aspects of life at Tandem, candidly written by individuals from all areas of the organization.

Teleconferences, initiated during 1982, communicate technical and business information to all U.S. sites simultaneously and interactively.

Tandem's shared-management philosophy works at the top level of the company as well. Decision-making is shared by the Management Committee, comprised of the senior managers from Tandem's domestic and international operations.

And company facilities are intentionally designed with an open feeling to encourage easy interaction.

One method of employee recognition is the international Tandem Outstanding Performers program that rewards exceptional individuals with a company-paid group trip. The program also promotes idea exchange among many of Tandem's highest achievers.



Quiz

1. The biggest change taking place in commercial data processing within large organizations is
   a. Batch processing is making a comeback.
   b. Companies are consolidating and centralizing data processing.
   c. Businesses are moving their data processing from batch to on-line to better control resources, offer improved service to customers, and have more timely management information.

2. Tandem's marketplace is
   a. Limited niche applications where users require a fail-safe computer.
   b. The rapidly growing realm of on-line transaction processing.
   c. Traditional batch computing applications.

3. Tandem is selling
   a. A minicomputer.
   b. A mainframe computer.
   c. A continuously available computer system that can grow modularly from the power of a minicomputer to that of a mainframe.

4. Why is continuous availability important in an on-line environment?
   a. When the computer stops, the business stops.
   b. When the computer stops, sales are lost.
   c. When the computer stops and you can't take the customer's order, the customer goes somewhere else.

5. Tandem NonStop systems assure continuous availability through
   a. Coupled processors in a "hot standby" mode where the standby waits for the working processor to fail.
   b. Total system redundancy, where processing is replicated on a set of duplicate components.
   c. A combined hardware and software solution that allows the entire system to do useful work at all times.

6. What is the advantage of Tandem's satellite link versus a long distance telephone link in computer communications?
   a. None, because telephones are the established technology.
   b. Costs are lower, speeds are faster, and you can broadcast to multiple locations simultaneously.
   c. You never get a busy signal.

7. The level of Tandem's customer satisfaction and loyalty is determined by
   a. The number of people in Tandem's customer support functions.
   b. The customer's mood on any given day.
   c. How successful the customers' applications are.

8. Who needs Tandem system data integrity features?
   a. A bank that wants a multi-million dollar deposit recorded accurately.
   b. An airline that wants fully booked cargo operations.
   c. A hospital that wants patients to have the correct medication.

9. Which statement is false?
   a. Tandem's employee productivity is really not much different than the industry average.
   b. Tandem's employee turnover rate is well below the industry average.
   c. Paid sabbaticals are a really nice benefit.

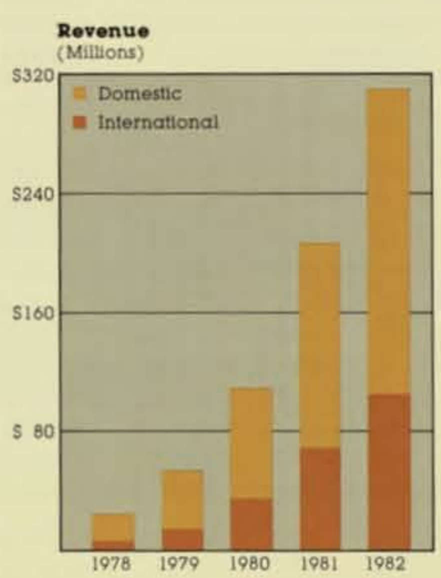
10. Why would anyone buy a computer that fails?
    a. S/he does not yet know about Tandem.
    b. S/he does not understand the cost of downtime.
    c. S/he does not use a computer.

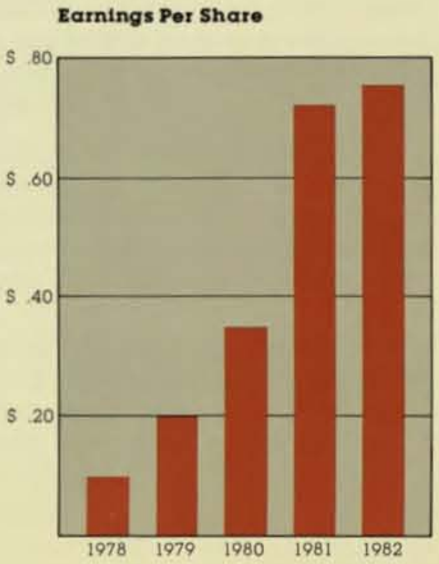
Answers

1. c 2. b 3. c 4. all 5. c 6. b 7. c 8. all 9. a 10. all

HIGHLIGHTS

Fiscal Year Ended September 30	1982	1981	1980
Revenue	$312,143,000	$208,397,000	$108,989,000
Operating Income	$ 40,708,000	$ 40,391,000	$ 19,323,000
Operating Margin	13.0%	19.4%	17.7%
Net Income	$ 29,856,000	$ 26,549,000	$ 10,687,000
Earnings Per Share	$.76	$.72	$.35
Working Capital	$194,761,000	$179,102,000	$ 61,232,000
Total Assets	$337,366,000	$255,971,000	$ 95,701,000
Equity	$250,988,000	$204,810,000	$ 70,294,000
Number of Employees	3,821	2,730	1,387





TO OUR STOCKHOLDERS

In the comparatively short period of time since the Company was formed in November, 1974 until today, Tandem Computers has become a significant factor in the computer industry as well as a leader in the on-line transaction processing marketplace. This outstanding performance is one in which we take a great deal of pride. When a company achieves such success and attendant size, however, it is no longer possible to be totally immune to the effects of the economy. Most of our business regions remained strong relative to the industry in fiscal 1982, but not in line with our traditional growth rates. A few geographic areas have been more affected by the recession, with the result that Tandem's sales in those regions grew at a slower pace this year and our overall growth rate moderated somewhat. At the same time we believe that we strengthened our competitive position, adding to our customer base of large corporations making major commitments to Tandem, investing in new products, and gaining experience lead-time.

For the fiscal year ended September 30, 1982, revenue grew at a rate of 50% to $312,143,000 from $208,397,000 in fiscal 1981. Operating margins were 13% in fiscal 1982, compared with 19% in the previous period. Net income was $29,856,000 or $.76 per share, versus $26,549,000 or $.72 per share, in 1982 and 1981 respectively. The combination of revenue that was below target and continued high investment to support product development and expansion of our organization led to margins that were below our goal.

Nonetheless, as our 50% growth rate indicates, Tandem's marketplace is one of the most robust in the computer industry. We are committed to developing the resources—the products, the sales and service organization, and the people—necessary to continue to be a leader in this high-growth market. As an indication of our level of commitment, the Company spent $34 million on product development and $64 million on property, plant, and equipment in fiscal 1982.

Investment in Products

During fiscal 1982, the Company introduced a number of enhanced products and announced a series of new products that will become available during 1983. Among the product enhancements, the Company began offering a two-megabyte memory board for the NonStop II that provides users with increased memory capacity for each processor. In addition, we introduced a completely new line of higher performance peripheral products, including disk drives, a high capacity tape drive, printers, and a terminal. The most important of these products is the Tandem-designed and manufactured 6530 ergonomic terminal which we introduced at the Annual Stockholders Meeting last February. The market acceptance of this product is very good; we have ramped up production and now ship terminals exclusively of our own manufacture.

The Company extended its market focus with the announcement of our planned comprehensive corporate information system. The first products, which will be available during 1983, are TRANSFER information delivery system that allows users to move office information along with traditional data processing over a Tandem EXPAND network; TRANSFER/MAIL electronic mail manager; and TRANSFER/FAX facsimile manager. The Company unveiled the first commercially available, fully integrated computer/satellite communications network, called INFOSAT, that will provide a low-cost, highly reliable alternative to terrestrial communications facilities. This product will be marketed jointly by Tandem and American Satellite Company. Tandem also announced a new communications product, SNAX, that will provide users of Tandem distributed networks with access to IBM SNA networks, devices, and application programs while retaining the high-reliability benefits inherent in all Tandem products.

Investment in Facilities

In order to maintain our commitment to provide a superior level of support to our customers, Tandem opened twelve new branch sales offices in the United States, Canada, and England; opened new sales subsidiaries in Belgium and Norway; and established distributors in Argentina and Israel.

Facilities expanded with the opening of a plant to manufacture the 6530 terminal in Austin, Texas, a manufacturing facility in Bensenville, Illinois, and an addition to the corporate headquarters in Cupertino, California. Further, the Company broke ground for a printed circuit board automated assembly and testing plant in Watsonville, California.

Investment in Productivity and Technology

Tandem has a continuing dedication to manufacturing efficiency and to developing new technology. Toward this end, a state-of-the-art board testing system was developed by Tandem and introduced into the manufacturing process. Thus far we have attained significant gains in productivity. In addition, a pilot program for automated board assembly was very successful, which has led us to expand our operations in Watsonville.

Investing in technology has resulted in a unique contribution in Tandem-developed tools for design of custom logic. Using these tools, during 1982 we developed and shipped the first products containing gate arrays of our own design.

Outstanding People

This rather formidable list of achievements is the result of the creativity and hard work of Tandem's people. The dedication of our people is indicated by their high productivity: average revenue per employee was $95,000. Turnover, at 9%, remains far below the industry standard.

Each person at Tandem works at maintaining an environment that encourages such outstanding performance. The Company supports its people's efforts by providing technical training as well as management training through the Tandem Management Development Program. The Company also provides recognition of superior performance through its TOPS—Tandem Outstanding Performers—program. TOPS is a way both to reward people, and to provide a mechanism for outstanding people to share their ideas. In addition, we realize that all our people need a time to recharge, and we try to find ways to support that. For example, each employee in the United States earns a paid sabbatical every four years.

Outlook

We believe that Tandem possesses all the necessary attributes for continuing success. Our marketplace is one of great potential throughout the Eighties. We have an impressive customer base, a unique and innovative product, outstanding people, and a well developed organization.

Since the worldwide economic environment continues to be uncertain, we have taken steps to control our expenses better, with the objective of improving our margins to historic rates. Perhaps most importantly, we are educating all our people about their individual responsibility for attaining our goals. Overall, we anticipate fiscal 1983 to be a year of challenge, but also a year when Tandem continues to be a growth leader in the industry.

Sincerely yours,

Thomas J. Perkins
Chairman of the Board

James G. Treybig
President and Chief Executive Officer

December 1, 1982

TANDEM COMPUTERS INCORPORATED AND SUBSIDIARIES

SELECTED FINANCIAL DATA
For the Five Years Ended September 30, 1982

(In thousands except per share amounts)	1982	1981	1980	1979	1978
Revenue	$312,143	$208,397	$108,989	$55,974	$24,305
Cost of revenue	109,305	75,547	40,831	20,786	9,096
Product development	33,642	17,833	8,786	4,654	2,169
Marketing, general and administrative	128,488	74,626	40,049	20,828	8,808
Operating Income	40,708	40,391	19,323	9,706	4,232
Interest income, net	6,033	10,707	1,759	398	258
Provision for income taxes	(16,885)	(24,549)	(10,395)	(5,184)	(2,337)
Income Before Extraordinary Credit	29,856	26,549	10,687	4,920	2,153
Net income	29,856	26,549	10,687	4,920	3,371
Earnings Per Share Before Extraordinary Credit	$ .76	$ .72	$ .35	$ .20	$ .10
Earnings per share	.76	.72	.35	.20	.16
Total assets	$337,366	$255,971	$ 95,701	$45,947	$22,051
Long-term debt and capitalized lease obligations	21,102	2,054	1,651	1,144	715
Stockholders' investment	250,988	204,810	70,294	31,530	15,538

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Tandem Computers continues its commitment to being a technological leader in the rapidly growing market for on-line transaction processing systems and networks of on-line systems. The Company believes that fault tolerance is a fundamental architectural design criterion for computer systems that support such applications. Achieving the Company's technological leadership goal involves many factors, including strategic market positioning, an ongoing commitment to product development, and an organizational structure and philosophy that fosters employee productivity and creativity. Also critical is maintaining a financial position and operating record that allows the Company to maximize its performance in an environment of rapid growth.

Financial Condition

Financial soundness is a high priority within Tandem. The Company's rapid growth has required increasing investment in working capital and property, plant, and equipment. Working capital has been funded through internally generated sources of funds and external financing, primarily equity issues sold to public investors and to employees through option and stock purchase programs. All profits after taxes have been reinvested in the business. Capital equipment has been funded with equity, lease financing, and Industrial Revenue Bonds. During fiscal 1982 the Company began construction of major facilities in Austin, Texas and Watsonville, California. These facilities are being financed during the construction phase under revolving lines of credit. All existing facilities being used by the Company are leased.

As of September 30, 1982 Tandem Computers has a cash and cash investment balance of $24,816,000, unused revolving lines of credit totalling $63,276,000, and an equity base of $250,988,000. The Company has a current ratio of 5:1, and long-term debt was less than 8% of total capital at fiscal 1982 year-end. The Company's financial strategy includes maintaining a sound ratio of current assets to current liabilities and a conservative capital structure. The Company believes this strategy provides it with maximum near term and long term flexibility to consider the full range of financing alternatives to fund the capital needs of its projected future growth.

Results of Operations

The table below summarizes the changes in important operating indicators for the fiscal years presented. The numbers on the left account for the revenue dollar by showing various income and expense items as a percentage of revenue. The numbers on the right measure the yearly percentage increases (decreases) in the same items.

% of Revenue				% Increase (Decrease)		
1982	1981	1980		1982	1981	1980
100	100	100	Revenue	50	91	95
35	36	37	Cost of revenue	45	85	96
11	9	8	Product development	89	103	89
41	36	37	Marketing, general and administrative	72	86	92
13	19	18	Operating income	1	109	99
2	5	2	Interest, net	(44)	509	342
15	25	19	Pretax income	(9)	142	109
5	12	10	Provision for taxes	(31)	136	101
10	13	10	Net income	12	148	117
			Earnings per share	6	106	75
			Weighted average shares outstanding	6	22	21

(Totals may not add due to rounding.)

Revenue

Tandem Computers' revenue gains over the last three years have resulted directly from increased shipments of its computer hardware and software products to new and existing customers, and from increases in the number of customers using its support and training services. During fiscal 1982 the Company did experience a slowing in its revenue growth particularly in certain geographic regions, which the Company believes related to unfavorable economic conditions in those areas. Fiscal 1982 was also a year of significant product transitions, as the NonStop II, first shipped in mid-1981, accounted for about 60% of processor shipments in the year, and as the new Tandem designed and manufactured 6530 terminal entered volume production and shipment. During the year, the Company shipped 1,542 processors, compared with 1,210 processors in fiscal 1981. Foreign revenue accounted for 33.5% of total revenues for fiscal 1982, compared to 34.3% and 31.4% for fiscal 1981 and 1980 respectively.

Operating Margins

Tandem Computers has a goal of achieving 16-20% operating margins. During fiscal 1982 the Company did not meet this goal because shipments recognized as revenue during the year did not meet projections. This was due primarily to the previously mentioned economy-related pressure on revenue growth and the Company's high level of committed expenses in product development and marketing. In addition, revenue for some $24,000,000 in shipments was deferred into fiscal 1983, but indirect costs associated with these shipments were charged in fiscal 1982.

The Company's cost of revenue as a percent of revenue declined slightly in fiscal 1982 and 1981 despite the opening of new manufacturing facilities in Watsonville, California; Austin, Texas; Bensenville, Illinois; and Reston, Virginia, and despite the start-up costs of manufacturing significant new products including the NonStop II system and the 6530 terminal.

Tandem's product development effort is focused on meeting the needs of computer users who are implementing on-line systems, both at single sites and in geographically distributed on-line information processing networks. The Company believes that the opportunities for technological innovation in this marketplace are enormous. Investment in product development is targeted to be in the range of 9–10% of revenue in fiscal 1983. These funds are being invested in enhancements to existing products and in important new products that will be introduced over the years to come.

The Company has focused its marketing strategy on selling to end-users who are implementing major on-line applications. Providing a high level of service and support is essential to meeting the needs of this customer base. To maximize its long-term opportunities in this marketplace, Tandem has built a direct selling and support organization in the United States and, primarily through wholly-owned subsidiaries, in industrial markets throughout the world. The Company's marketing, general and administrative expenditures in fiscal 1982 were higher as a percentage of revenue than in previous years due to the rapid expansion of the marketing organization during a period of slower revenue growth than anticipated. Looking ahead, the Company believes that a relatively high level of expenditures on marketing and support, such as has been the case in each of the last three years, is required to compete successfully in its marketplace.

Net Income and Earnings Per Share

Net income growth has differed from operating income growth due to substantial changes in the Company's net interest income and a decline in the effective tax rate. Interest income has been earned on funds raised from public equity financings in advance of operating requirements. As these funds have been drawn into the operating assets of the Company, interest income has declined.

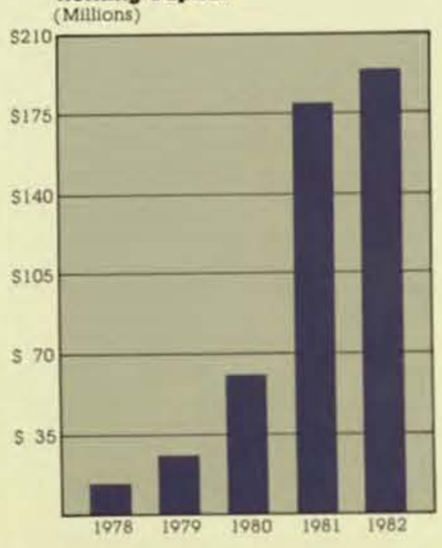
The Company's tax rate was 36% in 1982, compared with 48% in 1981 and 49% in 1980. The decline in the Company's effective tax rate in 1982 resulted primarily from tax incentives provided by the Economic Recovery Tax Act of 1981 for research and development expenditures and investment in capital equipment.

Earnings per share have grown less rapidly than net income due to increases in shares outstanding. The Company's public offerings of common stock in fiscal 1981 and 1980, combined with sales of stock to employees under the stock purchase plan and grants under option plans, resulted in increases in weighted average shares outstanding of 6% in 1982, 22% in 1981, and 21% in 1980. Proceeds from the sale of these additional shares have been used to finance the capital expansion required to support the Company's growth during this period.

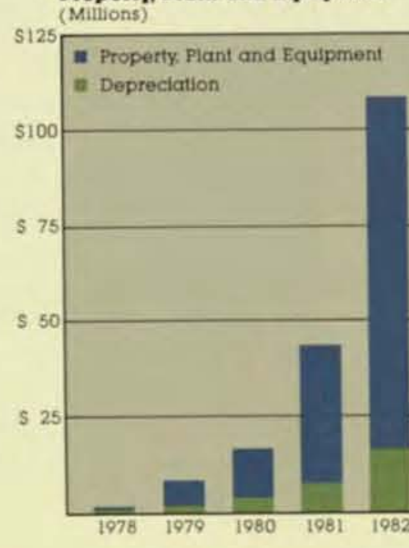
Effect of Inflation

The Company believes that the effect of inflation on labor rates has been offset by increases in productivity and decreases in materials costs.

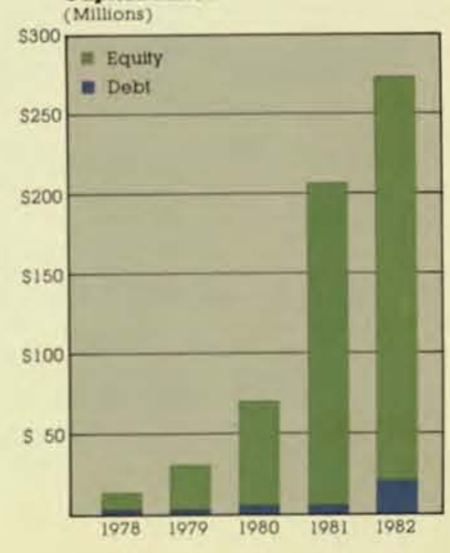
Working Capital
(Millions)



Property, Plant and Equipment
(Millions)



Capitalization
(Millions)



CONSOLIDATED STATEMENT OF INCOME
For the Three Years Ended September 30, 1982

(In thousands except per share amounts)	1982	1981	1980
Revenue			
Product revenue	$272,591	$186,897	$ 98,030
Service and other revenue	39,552	21,500	10,959
Total revenue	312,143	208,397	108,989
Costs and Expenses			
Cost of revenue	109,305	75,547	40,831
Product development	33,642	17,833	8,786
Marketing, general, and administrative	128,488	74,626	40,049
Total costs and expenses	271,435	168,006	89,666
Operating Income	40,708	40,391	19,323
Interest expense	(967)	(282)	(293)
Interest income	7,000	10,989	2,052
Income Before Income Taxes	46,741	51,098	21,082
Provision for income taxes	(16,885)	(24,549)	(10,395)
Net Income	$ 29,856	$ 26,549	$ 10,687
Earnings Per Share	$ .76	$ .72	$ .35
Weighted average shares outstanding	39,221	37,025	30,241

The accompanying notes are an integral part of this statement.

A new facility in Reston, Virginia for systems integration and testing was being readied for occupancy at the close of fiscal 1982. Other new facilities this year include an extension to the corporate headquarters complex in California and leased manufacturing facilities in Bensenville, Illinois and Austin, Texas. Other buildings are under construction, due on-stream in 1983.

CONSOLIDATED BALANCE SHEET
As of September 30, 1982 and 1981

(In thousands)	1982	1981
Assets		
Current Assets		
Cash and cash investments	$ 24,816	$ 89,806
Accounts receivable, net of allowances of $3,000,000 in 1982 and $1,000,000 in 1981	98,810	70,671
Inventories	101,335	54,543
Prepaid expenses and other	17,013	5,046
Total current assets	241,974	220,066
Property, Plant and Equipment, at cost		
Land	4,441	—
Machinery and equipment	25,767	13,154
Computer equipment and spares	44,274	20,439
Leasehold improvements	21,788	8,147
Construction in process	11,196	2,599
	107,466	44,339
Accumulated depreciation and amortization	(18,080)	(8,434)
Net property and equipment	89,386	35,905
Other Assets	6,006	—
Total Assets	$337,366	$255,971

The accompanying notes are an integral part of this balance sheet.

(In thousands)	1982	1981
Liabilities and Stockholders' Investment		
Current Liabilities		
Current portion of capitalized lease obligations	$ 2,060	$ 682
Accounts payable	22,918	23,634
Accrued liabilities:		
Wages, payroll taxes, and employee benefits	8,913	3,969
Income taxes	7,136	10,275
Other accrued liabilities	6,186	2,404
Total current liabilities	47,213	40,964
Capitalized Lease Obligations	10,378	2,054
Long Term Debt	10,724	—
Deferred Income Taxes	18,063	8,143
Stockholders' Investment		
Common stock $.025 par value, authorized 60,000,000 shares, outstanding 37,634,754 in 1982 and 36,409,631 in 1981	941	910
Additional paid-in capital	177,759	161,468
Retained earnings	72,288	42,432
Total stockholders' investment	250,988	204,810
Total Liabilities and Stockholders' Investment	$337,366	$255,971

CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT
For the Three Years Ended September 30, 1982

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1979	25,020	$209	$ 25,520	$ 5,801	$ 31,530
Sale of common stock, net of related expenses	4,290	36	24,243	—	24,279
Sale of common stock under stock option plans	589	5	2,037	—	2,042
Sale of common stock under stock purchase plan	176	1	949	—	950
Tax benefit from employee transactions in common stock	—	—	806	—	806
Net income	—	—	—	10,687	10,687
Balance September 30, 1980	30,075	251	53,555	16,488	70,294
Sale of common stock, net of related expenses	4,500	38	95,995	—	96,033
Sale of common stock under stock option plans	1,692	15	7,381	—	7,396
Sale of common stock under stock purchase plan	143	1	2,272	—	2,273
Capitalization of retained earnings for three-for-one stock split	—	605	—	(605)	—
Tax benefit from employee transactions in common stock	—	—	2,265	—	2,265
Net income	—	—	—	26,549	26,549
Balance September 30, 1981	36,410	910	161,468	42,432	204,810
Sale of common stock under stock option plans	863	22	5,028	—	5,050
Sale of common stock under stock purchase plan	362	9	7,190	—	7,199
Tax benefit from employee transactions in common stock	—	—	4,073	—	4,073
Net income	—	—	—	29,856	29,856
Balance September 30, 1982	37,635	$941	$177,759	$72,288	$250,988

The accompanying notes are an integral part of this statement.

This year Tandem began to manufacture an ergonomic terminal of its own design. The new terminal features user comfort, high throughput, and data integrity. In addition to the 6530 terminal, Tandem introduced a completely new line of higher performance peripheral devices.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
For the Three Years Ended September 30, 1982

(In thousands)	1982	1981	1980
Working Capital Provided From (Used For):			
Net Income	$ 29,856	$ 26,549	$10,687
Add back items not currently using working capital			
Depreciation and amortization	10,196	4,107	2,547
Deferred income taxes	9,920	4,818	2,284
Working capital provided from operations	49,972	35,474	15,518
Acquisition of property, plant and equipment, net	(63,677)	(25,974)	(9,966)
Increase in other assets	(6,006)	—	—
Increase in capitalized lease obligations	8,324	403	507
Increase in long term debt	10,724	—	—
Tax benefit from employee transactions in common stock	4,073	2,265	806
Sale of common stock, net	12,249	105,702	27,271
Net increase in working capital	$ 15,659	$117,870	$34,136
Working Capital Increase Represented By:			
Increase (decrease) in current assets			
Cash and cash investments	$(64,990)	$ 73,561	$ 9,487
Accounts receivable	28,139	28,119	22,671
Inventories	46,792	33,642	9,597
Prepaid expenses and other	11,967	3,081	580
(Increase) decrease in current liabilities			
Current portion of capitalized lease obligations	(1,378)	(206)	(101)
Accounts payable	716	(12,571)	(5,388)
Accrued liabilities other than income taxes	(8,726)	(3,157)	(1,947)
Accrued income taxes	3,139	(4,599)	(763)
Net increase in working capital	$ 15,659	$117,870	$34,136

The accompanying notes are an integral part of this statement.

ORACLE, a Tandem-developed system for automatic testing of printed circuit boards introduced into Tandem manufacturing locations during 1982, provides testing functions not previously possible, and dramatically boosts manufacturing productivity. Other manufacturing enhancements brought on-stream during 1982 include new capabilities for automated assembly of printed circuit boards.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly-owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition

The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Exchange Gains and Losses

Foreign exchange and translation gains and losses are not significant and are reflected in the results of operations.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include materials, labor, and manufacturing overhead. The components of inventories as of September 30 were:

(In thousands)	1982	1981
Purchased parts and subassemblies	$56,822	$33,625
Work-in-process	13,413	8,819
Finished goods	31,100	12,099
Total	$101,335	$54,543

Income Taxes

The Company provides for income taxes on total DISC income and accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are realized.

Property, Plant and Equipment

Systems spares ($15,869,000 in 1982 and $8,610,000 in 1981) are depreciated over a five-year period using the double declining balance method. All other property, plant and equipment are depreciated using the straight-line method. The estimated useful lives are:

Machinery and equipment	5–10 years
Computer equipment and spares	5– 7 years
Leasehold improvements	Lease term

Earnings Per Share

Earnings per common share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of stock options outstanding that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

2. Income Taxes

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1982	1981	1980
Current Federal	$ 5,516	$15,356	$ 6,022
Current State	3,633	3,771	1,682
Current Foreign	2,244	1,401	1,120
	11,393	20,528	8,824
Prepaid Federal	(3,333)	(1,205)	(281)
Prepaid State	(253)	(180)	(29)
Prepaid Foreign	(842)	588	—
	(4,428)	(797)	(310)
Deferred Federal	6,656	4,325	2,104
Deferred State	239	194	82
Deferred Foreign	3,025	299	(305)
	9,920	4,818	1,881
Total Provision	$16,885	$24,549	$10,395

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1982	1981	1980
Installment sale method for income tax reporting	$ 3,657	$ —	$ —
Expenses recognized for financial statements, but not for income tax reporting	(1,505)	(897)	(195)
Effect of intercompany profit eliminations	(2,654)	(2,522)	(611)
Other items	(3,926)	2,622	496
Total Prepaid	$(4,428)	$ (797)	$ (310)
DISC income	$ 3,918	$ 3,230	$ 1,638
Accelerated depreciation	2,799	1,192	538
Other items	3,203	396	(295)
Total Deferred	$ 9,920	$ 4,818	$ 1,881

The provision for income taxes differs from the amount obtained by applying the Federal statutory income tax rate to income before taxes as follows:

	1982	1981	1980
Federal statutory tax rate	46%	46%	46%
State taxes, net of Federal income tax benefit	4	4	4
Investment tax credits	(8)	(3)	(3)
Research and development tax credits	(8)	(1)	—
Other	2	2	2
Effective Tax Rate	36%	48%	49%

3. Lease and Other Commitments

The Company leases its headquarters, operating facilities, field offices, and automobiles under operating lease agreements. The Company also has capitalized leases for certain equipment. Future lease payments as of September 30, 1982 are as follows:

(In thousands)	Leases	
Fiscal Year	Operating	Capital
1983	$ 27,084	$ 3,567
1984	25,709	3,481
1985	23,665	3,314
1986	22,699	3,068
1987	19,151	3,873
1988–2004	112,731	—
Total minimum lease payments	$231,039	17,303
Less: Amount representing interest (4%-17%)		4,865
Present value of minimum lease payments		$12,438

Rent expenses were $20,895,000 in 1982, $8,908,000 in 1981, and $4,509,000 in 1980.

The Company has entered into a lease agreement for a new facility in Reston, Virginia, which is expected to be occupied in fiscal 1983, and for which the Company has guaranteed construction financing of $13,495,000. In addition, the Company has standby letters of credit totaling approximately $3,800,000 for other operating purposes.

4. Long Term Debt

As of September 30, 1982 long term debt consisted of $8,724,000 in construction financing and $2,000,000 of Industrial Revenue Bonds, all related to facilities under construction in Watsonville, California and Austin, Texas. Interest costs of $508,000 related to this construction were capitalized in fiscal 1982. The Industrial Revenue Bonds bear interest at 12% and 12³/₈% and are due in 1992.

The Company has entered into unsecured credit agreements totaling $72,000,000 with several banks. The agreements provide for revolving borrowings through various dates in 1984, at which time outstanding amounts may be converted into term loans repayable in equal quarterly installments through 1987. Domestic borrowings bear interest at or below the banks' prime rates during the revolving period and approximately ¹/₄% above these rates during the term period. The Company is required to pay a commitment fee of ³/₈% per annum. Of these facilities $22,000,000 have been earmarked by Tandem for the construction referred to above. The remaining $50,000,000 are for working capital purposes and contain provisions for Eurocurrency and foreign local currency borrowings at interest rates prevailing in these markets. There are no compensating balances required under any of these arrangements.

Certain financial covenants and restrictions are included in the loan agreements, including a restriction on payment of cash dividends. The Company was in compliance with all such covenants and restrictions at September 30, 1982.

5. Preferred and Common Stock

PREFERRED STOCK

The Company has 2,400,000 shares of preferred stock authorized.

STOCK OPTION PLANS

The Company has employee stock option plans under which permanent employees may be granted options to purchase shares at 100% of fair market value at the time of the grant. Options generally become exercisable six months after the effective date and expire no later than seven years after the effective date. At the discretion of the Company, options granted under the stock option plans may qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981.

As of September 30, 1982 options for 5,041,824 shares were outstanding at prices ranging from $.58 to $26.88, with an average price of $16.01. Options for 4,282,209 shares were exercisable as of September 30, 1982. Options for 5,249,407 are available for future grant. Options were exercised at prices ranging from $.17 to $26.88 in 1982, $.08 to $22.88 in 1981, and $.08 to $6.61 in 1980.

EMPLOYEE STOCK PURCHASE PLAN

As of September 30, 1982 the Company has reserved 1,288,526 shares for future issuance under its employee stock purchase plan. Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of common stock at 85% of fair market value at the beginning or end of a three-month offering period. Under the second method, the Company may grant to employees the option to purchase common stock at not less than 85% of fair market value at the grant date. As of September 30, 1982 options to purchase 275,700 common shares at $17.04 per share, 39,600 at $26.90, and 370,400 at $12.75, were outstanding under the second method. Such options are exercisable through January 4, 1983; from November 1, 1982 through January 30, 1984; and from August 16, 1983 through November 15, 1984 respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three years ended September 30, 1982.

(In thousands)	Geographic Area: United States	Europe	Other	Adjustments and Eliminations	Consolidated
1982					
Revenue—Customer	$215,154	$74,958	$22,031	$ —	$312,143
Revenue—Intercompany	60,126	—	—	(60,126)	—
Revenue—Total	275,280	74,958	22,031	(60,126)	312,143
Pre-Tax Income	43,949	9,267	22	(6,497)	46,741
Identifiable Assets	276,886	56,685	15,863	(12,068)	337,366
1981					
Revenue—Customer	$144,392	$47,294	$16,711	$ —	$208,397
Revenue—Intercompany	37,580	—	—	(37,580)	—
Revenue—Total	181,972	47,294	16,711	(37,580)	208,397
Pre-Tax Income	50,297	4,145	2,139	(5,483)	51,098
Identifiable Assets	213,693	34,592	12,471	(4,785)	255,971
1980					
Revenue—Customer	$78,758	$25,760	$ 4,471	$ —	$108,989
Revenue—Intercompany	17,452	1,868	56	(19,376)	—
Revenue—Total	96,210	27,628	4,527	(19,376)	108,989
Pre-Tax Income	21,469	801	140	(1,328)	21,082
Identifiable Assets	76,181	19,889	2,109	(2,478)	95,701

Intercompany transfers are made at approximately arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $7,687,000 in 1982; $7,397,000 in 1981; and $3,973,000 in 1980.

7. Unaudited Quarterly Financial Data

(In thousands except per share amounts)	Quarters Ended: Dec. 31	March 31	June 30	Sept. 30
Year ended September 30, 1982:				
Revenue				
As previously reported	$74,684	$85,593	$84,440	$91,182
As restated	70,985	74,101	79,823	87,234
Gross Margin				
As previously reported	48,208	54,914	55,855	59,302
As restated	45,804	47,444	52,855	56,735
Operating Income				
As previously reported	13,669	15,634	13,385	12,903
As restated	11,352	8,434	10,493	10,429
Net Income				
As previously reported	$ 8,944	$ 9,815	$ 8,956	$ 9,568
As restated	7,788	6,222	7,513	8,333
Earnings Per Share				
As previously reported	$ .23	$ .25	$ .23	$ .24
As restated	.20	.16	.19	.21
Year ended September 30, 1981:				
Revenue	$40,609	$47,417	$55,865	$64,506
Gross Margin	25,708	29,933	34,957	42,252
Operating Income	7,521	9,012	11,468	12,390
Net Income	$ 4,662	$ 6,476	$ 7,191	$ 8,220
Earnings Per Share	$ .14	$ .17	$ .19	$ .21

The Company's previously reported fiscal 1982 quarterly results have been restated primarily to reflect the deferral of certain sales transactions into subsequent fiscal quarters. In connection with the preparation of its year-end financial statements, the Company determined that these transactions were more properly recognized in the later quarters.

AUDITORS' REPORT

To Tandem Computers Incorporated:

We have examined the consolidated balance sheet of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1982 and 1981, and the related consolidated statements of income, stockholders' investment, and changes in financial position for each of the three years in the period ended September 30, 1982. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1982 and 1981, and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1982, all in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

San Jose, California
December 14, 1982

TANDEM STOCK PRICE

Calendar Quarter Price	High	Low
1982 3rd Quarter	$25\frac{3}{8}$	$14\frac{1}{2}$
2nd Quarter	29	22
1st Quarter	$28\frac{1}{2}$	21
1981 4th Quarter	34	$27\frac{1}{4}$
3rd Quarter	32	24
2nd Quarter	$34\frac{5}{8}$	$24\frac{3}{4}$
1st Quarter	$25\frac{1}{2}$	$20\frac{1}{2}$
1980 4th Quarter	$25\frac{3}{8}$	$18\frac{1}{8}$
3rd Quarter	$18\frac{5}{8}$	$9\frac{7}{8}$
2nd Quarter	$9\frac{7}{8}$	$6\frac{1}{2}$
1st Quarter	9	$6\frac{1}{8}$

In the second calendar quarter of 1982, Tandem Computers Incorporated common stock began trading via the NASDAQ National Market System under the trading symbol TNDM. For the second and third quarters of 1982, the quotations represent the high and low sales prices. Quotations that pertain to earlier periods represent prices between dealers without adjustment for mark-up, markdown, or commissions and may not represent actual transactions. All prices have been adjusted for stock splits. No dividends have been declared on the common stock.

Board of Directors

Thomas J. Perkins (1),
Chairman of the Board; Partner, Kleiner, Perkins, Caufield & Byers

Morton Collins (2),
Partner, DSV Associates

Thomas J. Davis, Jr. (1) (2),
Partner, Mayfield II

Franklin P. Johnson, Jr.,
Chairman, Asset Management Capital Company

Eugene Kleiner (2),
Partner, Kleiner, Perkins, Caufield & Byers

Robert C. Marshall,
Senior Vice President and Chief Operating Officer, Tandem Computers Incorporated

Alvin C. Rice,
President and Chairman, Imperial Bank

Robert G. Stone, Jr.,
Chairman of the Board, West India Shipping Company

James G. Treybig (1),
President and Chief Executive Officer, Tandem Computers Incorporated

(1) Member of Executive Committee
(2) Member of Audit Committee

Officers

James G. Treybig,
President and Chief Executive Officer

Robert C. Marshall,
Senior Vice President and Chief Operating Officer

Michael D. Green,
Senior Vice President

Jan E. Jensen,
Vice President–Human Resources

Laurence A. Laurich,
Vice President–Engineering

David R. Mackie,
Vice President

Dennis McEvoy,
Vice President–Software Development

Henry V. Morgan,
Vice President, Controller and Secretary

Charles W. Ryle,
Vice President–U.S. Marketing

Jeanne D. Wohlers,
Vice President, Treasurer and Assistant Secretary

Vice Presidents and Operating Managers

Michael D. Bateman,
Vice President, Central Division

Thomas Bechler,
Director, Eastern Division

Jack W. Chapman,
Director, Central European Division

Victor DeSouza,
Vice President

George Eckert,
Vice President, Reston Operations

Lary Evans,
Vice President, Product Manufacturing

Gerald D. Held,
Director, Software Research

James A. Katzman,
Vice President

D. Chris Larson,
Director, Austin Division

Michael C. Moore,
Director, Western Division

Gerald L. Peterson,
Vice President, International Marketing

Jerald D. Reaugh,
Vice President, Systems Manufacturing

Charles J. Yazel,
Director, Pacific/Latin America Division

Auditors

Arthur Andersen & Co.,
San Jose, California

Registrar and Transfer Agent

Bank of America N.T. & S.A.,
San Francisco, California

Form 10-K

A copy of the company's Form 10-K, as filed with the Securities and Exchange Commission, is available on written request. Please direct request to:

Treasurer's Office
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Friday, February 25, 1983, at the corporation's headquarters.

Tandem

Corporate Headquarters
19333 Vallco Parkway
Cupertino, CA 95014-2599
(408) 725-6000

Domestic Sales and Service Offices

ARKANSAS, Little Rock
ARIZONA, Phoenix
CALIFORNIA, Los Angeles, San Diego, San Francisco, Sunnyvale, Santa Clara, Long Beach, Universal City
COLORADO, Denver
CONNECTICUT, Hartford, Stamford
FLORIDA, Tampa, Orlando, Jacksonville, Miami
GEORGIA, Atlanta
HAWAII, Honolulu
ILLINOIS, Chicago, Schaumberg, Itasca
INDIANA, Indianapolis, Ft. Wayne
IOWA, Des Moines
KANSAS, Kansas City
LOUISIANA, New Orleans
MARYLAND, Baltimore
MASSACHUSETTS, Boston
MICHIGAN, Detroit, Ann Arbor, Grand Rapids
MINNESOTA, Minneapolis
MISSOURI, St. Louis
NEBRASKA, Omaha
NEVADA, Las Vegas
NEW JERSEY, Hasbrouck Heights, Atlantic City
NEW MEXICO, Albuquerque
NEW YORK, New York City, Rochester, Jericho
NORTH CAROLINA, Greensboro, Charlotte
OHIO, Cincinnati, Cleveland, Columbus
OKLAHOMA, Tulsa
OREGON, Portland
PENNSYLVANIA, Philadelphia, Pittsburgh
TENNESSEE, Memphis
TEXAS, Dallas, Fort Worth, Houston, Austin
UTAH, Salt Lake City
VIRGINIA, Falls Church, Richmond, Reston
WASHINGTON, Seattle
WEST VIRGINIA, Charleston
WISCONSIN, Milwaukee

International Subsidiaries

AUSTRALIA
Tandem Computers Limited
Sydney, Melbourne

BELGIUM
Tandem Computers SA/NV
Brussels

CANADA
Tandem Computers Canada Limited
Calgary, Edmonton, Montreal, Ottawa, Toronto, Vancouver, Victoria, Windsor

DENMARK
Tandem Computers A/S
Taastrup

ENGLAND
Tandem Computers Limited
Birmingham, High Wycombe, London, Northolt

FRANCE
Tandem Computers S.A.
Paris

GERMANY
Tandem Computers GmbH
Dortmund, Dusseldorf, Frankfurt, Hamburg, Mannheim, Munich, Stuttgart

HONG KONG
Tandem Computers (Hong Kong) Limited
Kowloon

ITALY
Tandem Computers Italia S.p.A.
Milan

JAPAN
Tandem Computers Japan Limited
Tokyo

THE NETHERLANDS
Tandem Computers BV
The Hague

NORWAY
Tandem Computers (Norway) A/S
Oslo

SINGAPORE
Tandem Computers International Incorporated
Singapore

SWEDEN
Tandem Computers (Sweden) AB
Stockholm, Malmo

SWITZERLAND
Tandem Computers AG
Zurich

International Distributors

Argentina
Finland
Greece and The Middle East
Israel
Korea
Mexico
Philippines
Taiwan
Venezuela

Trademark

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders

To Be Held February 5, 1982

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on February 5, 1982, at 10 A.M. for the following purposes:

1. To elect three Directors.
2. To consider and vote upon a proposal to approve the Tandem Computers Incorporated 1981 Stock Option Plan.
3. To ratify the selection of independent auditors.
4. To transact such other business as may properly come before the meeting and any adjournment thereof.

The Board of Directors has fixed the close of business on December 8, 1981, as the record date for determining the stockholders entitled to notice of and to vote at the Annual Meeting and any adjournment thereof. A complete list of stockholders entitled to vote will be available at the Company's headquarters, 19333 Vallco Parkway, Cupertino, California, for ten days prior to the meeting.

IF YOU DO NOT EXPECT TO ATTEND IN PERSON, IT WOULD BE APPRECIATED IF YOU WOULD PROMPTLY SIGN AND RETURN THE ENCLOSED PROXY.

Henry V. Morgan
Secretary

December 16, 1981

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders To Be Held February 5, 1982

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on February 5, 1982, at 10 A.M. for the following purposes:

1. To elect three Directors.

2. To consider and vote upon a proposal to approve the Tandem Computers Incorporated 1981 Stock Option Plan.

3. To ratify the selection of independent auditors.

4. To transact such other business as may properly come before the meeting and any adjournment thereof.

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Henry V. Morgan
Secretary

December 16, 1981

PROXY STATEMENT

This Proxy Statement is furnished in connection with the solicitation by the Board of Directors of Tandem Computers Incorporated, a Delaware corporation (the "Company"), 19333 Vallco Parkway, Cupertino, California 95014, of proxies in the accompanying form to be used at the Annual Meeting of Stockholders to be held on February 5, 1982, and any adjournment thereof. The shares represented by the proxies received pursuant to this solicitation and not revoked will be voted at the Annual Meeting. A proxy may be revoked at any time before it is exercised. On the matters coming before the meeting as to which a choice has been specified by the stockholders by means of the ballot on the proxy, the shares will be voted accordingly. If no choice is so specified, the shares will be voted FOR the election of the three nominees for Director listed in this Proxy Statement and FOR approval of proposals 2 and 3 described in the Notice of Meeting and in this Proxy Statement.

The close of business on December 8, 1981, has been fixed as the record date for determining the holders of the Common Stock entitled to notice of and to vote at the meeting. On such date the Company had 36,717,508 shares of Common Stock outstanding and entitled to vote. Each such share is entitled to one vote on all matters, except that in voting for Directors, each stockholder entitled to vote at the meeting is entitled to one vote for each share held as of the record date and to cumulate votes for the election of Directors whose names have been placed in nomination; that is, a stockholder may cast as many votes as there are Directors to be elected multiplied by the number of shares which the stockholder holds. All such votes may be cast for one candidate or distributed among the nominees for Director as the stockholder sees fit. The persons authorized to vote shares represented by executed proxies in the enclosed form (if authority to vote for the election of Directors is not withheld) will have full discretion and authority to vote cumulatively and to allocate votes among any or all of the Board of Directors nominees as they may determine or, if authority to vote for a specified candidate or candidates has been withheld, among those nominees for whom authority to vote has not been withheld.

The expense of printing and mailing proxy material will be borne by the Company. In addition to the solicitation of proxies by mail, solicitation may be made by certain Directors, officers and other employees of the Company by personal interview, telephone or telegraph. No additional compensation will be paid for such solicitation.

ELECTION OF DIRECTORS

The Company's Certificate of Incorporation provides for three classes of Directors, Classes I, II and III, each to consist of three Directors. The term of each class of Directors ends on the date of the third annual meeting of stockholders following the annual meeting at which such class was elected. Notwithstanding the foregoing, each Director shall serve until his successor shall have been duly elected and qualified.

Unless authority to vote for Directors is withheld, it is intended that the shares represented by the enclosed proxy will be voted for the election of Franklin P. Johnson, Jr., Thomas J. Perkins and Alvin C. Rice as Class II Directors for a three-year term expiring on the date of the annual meeting in 1985. Each of the nominees named is currently a member of the Board of Directors of the Company. In the event any of them shall become unable or unwilling to accept nomination or election, the shares represented by the enclosed proxy will be voted for the election of such other person as the Board of Directors may recommend in his place. The Board of Directors has no reason to believe that any such nominee will be unable to serve.

The following information is furnished with respect to the nominees and the Directors of the Company:

Name and Principal Occupation at Present and for the Past Five Years(1); Directorships	Director Since(1)	Age
Class I		
Morton Collins(2)	1975	45
General partner since 1974 and 1981 of DSV Associates and DSV Partners III, respectively, Princeton, New Jersey private investment partnerships; director of MSI Data Corporation		
Eugene Kleiner(2)	1974	58
General partner since 1972 and 1978 of Kleiner & Perkins and Kleiner, Perkins, Caufield & Byers, respectively, San Francisco, California private investment partnerships; director of Drexler Technology Corporation and Monolithic Memories, Inc.		
Robert C. Marshall	1980	50
Senior vice president since July 1980; vice president and chief operating officer of the Company since 1979; vice president since 1975		
Class II		
Franklin P. Johnson, Jr.	1975	53
Owner since 1967 of Asset Management Company, a Palo Alto, California private investment proprietorship; chairman of the board since 1974 of Asset Management Capital Company, a Palo Alto, California small business investment company; director of California Microwave, Inc., Coherent, Inc., SBE, Inc. and Teradyne, Inc.		
Thomas J. Perkins(3)	1974	49
Chairman of the board of the Company since 1974; general partner since 1972, 1978 and 1980 of Kleiner & Perkins; Kleiner, Perkins, Caufield & Byers; and Kleiner, Perkins, Caufield & Byers II, respectively, San Francisco, California private investment partnerships; director of Collagen Corporation, Genentech, Inc., Hybritech Incorporated and Spectra-Physics, Inc.		
Alvin C. Rice	1978	58
Chairman of the board and president of Imperial Bank since 1979; various management positions from 1964 to 1978 with Bank of America National Trust and Savings Association, including vice chairman of the board with responsibility for the world banking division		
Class III		
Thomas J. Davis, Jr.(2)(3)	1976	69
General partner since 1973, 1979 and 1981 of Mayfield II, Mayfield III and Mayfield IV, respectively, Menlo Park, California private investment partnerships		
Robert G. Stone, Jr.	1978	58
Chairman of the board of West India Shipping Company, Inc. since 1974; chairman of the board of General Energy Corporation since 1971; director of Chubb Corporation, Combustion Engineering, Inc., Core Industries, Inc., Corning Glass Works, Great Northern Nekoosa Corp., Hamilton Bros. Petroleum Corp., The Japan Fund, Inc. and Western Pacific Industries, Inc.		
James G. Treybig(3)	1974	41
President and chief executive officer of the Company since 1974		

(1) Reflects the period during which such persons have served as officers and Directors of Tandem Computers Incorporated, a Delaware corporation, and its predecessor California corporation.

(2) Member of Audit Committee.

(3) Member of Executive and Compensation Committees.

STOCK OWNERSHIP OF MANAGEMENT

The following table sets forth information as of November 1, 1981, as to shares of Common Stock beneficially owned by the persons named under "Election of Directors" above and the Directors and officers of the Company as a group. Except as otherwise indicated, each person has sole investment and voting power with respect to the shares shown. Ownership information is based upon information furnished by the respective individuals.

Name of Individual or Identity of Group	Amount of Beneficial Ownership	
	Number of Shares	Percent
Eugene Kleiner	560,993	1.5%
James G. Treybig	562,812(1)	1.5
Thomas J. Perkins	535,468	1.4
Franklin P. Johnson, Jr.	259,998(2)	0.7
Robert C. Marshall	184,650(3)	0.5
Robert G. Stone, Jr.	111,450(4)	0.3
Thomas J. Davis, Jr.	82,644	0.2
Morton Collins	31,704(5)	0.1
Alvin C. Rice	18,000(6)	0.1
All officers and directors as a group (15 persons)	3,232,862(7)	8.7

(1) Includes presently exercisable options to purchase 87,000 shares of Common Stock; also includes 1,800 shares of Common Stock held by a trust of which Mr. Treybig is a trustee.

(2) All such shares are held by Asset Management Capital Company, a corporation all of whose stock is owned by Mr. Johnson and members of his family.

(3) Includes presently exercisable options to purchase 75,000 shares of Common Stock and 300 shares owned by a minor child of Mr. Marshall.

(4) Includes presently exercisable options to purchase 12,000 shares of Common Stock; also includes 26,100 shares of Common Stock held by trusts of which Mr. Stone is a trustee and 44,982 shares owned by Mr. Stone's wife and children. Mr. Stone disclaims beneficial interest in the shares held by such trusts and by his wife and children.

(5) Includes 1,800 shares of Common Stock held in trust for the benefit of Mr. Collins' children. Mr. Collins disclaims beneficial interest in the shares held by such trust.

(6) Includes presently exercisable options to purchase 12,000 shares of Common Stock.

(7) Includes shares of Common Stock held by trusts as discussed in notes 1, 4 and 5 above and presently exercisable options to purchase 465,600 shares of Common Stock.

REMUNERATION

The following table sets forth as to each of the five most highly compensated executive officers or Directors of the Company whose total cash and cash equivalent remuneration exceeded $50,000, and as to all officers and Directors as a group, information concerning all remuneration from the Company for services in all capacities during the fiscal year ended September 30, 1981.

Information concerning Directors and officers is included in this Proxy Statement only for the period each served as a Director or officer of the Company.

Name of Individual or Persons in Group and Capacities in Which Served	Salaries, Fees, Directors' Fees, Commissions and Bonuses
James G. Treybig President and Director	$ 180,846
Robert C. Marshall Senior Vice President and Director	$ 149,454
Michael D. Green Senior Vice President	$ 149,454
David R. Mackie Vice President	$ 119,092
Lawrence A. Laurich Vice President	$ 117,687
All officers and directors as a group (15 persons)	$1,121,135(1)

(1) For the first and second quarters of fiscal 1981, nonmanagement Directors received fees at the following annual rates, plus expenses: $6,000 for serving on the Board of Directors; an additional $2,500 for serving on the executive, compensation or audit committee, or all such committees; and an additional $1,500 for serving as chairman of the board. For the third and fourth quarters of fiscal 1981, nonmanagement Directors received fees at the following annual rates, plus expenses: $7,200 for serving on the Board of Directors; an additional $3,000 for serving on the executive, compensation or audit committee, or all such committees; and an additional $1,800 for serving as chairman of the board. For fiscal 1982, fees will be at the same annual rates as for the third and fourth quarters of fiscal 1981.

(2) The Company has an incentive cash bonus plan in which the executive officers of the Company are eligible to participate. Awards under the plan may be made if certain increases in quarterly revenues and operating profits are attained by the Company.

(3) The Company has no annuity, pension or retirement plans.

(4) In February 1981, the Company loaned $47,625, $21,375 and $31,000 to Mr. Laurich, Jeanne D. Wohlers, Vice President and Treasurer, and Henry V. Morgan, Vice President and Secretary, respectively, in connection with the exercise of stock options. The loans were at an interest rate of 18%, and were in each case secured by a pledge of the shares. All such amounts have been repaid in full.

CERTAIN TRANSACTIONS

With respect to options to purchase Company Common Stock which had been granted to certain officers and to all officers and Directors as a group as of December 1, 1981, the following table sets forth (i) the aggregate amount of Common Stock subject to options granted during the specified period, (ii) the average per share option exercise price thereof, (iii) the net value of shares (market value less any exercise price) realized during the specified period upon the exercise of such options during the specified period or prior thereto, (iv) the numbers of shares of Common Stock sold during the specified period in which options were exercised, (v) the aggregate amount of Common Stock subject to all such options outstanding as of the end of the specified period, and (vi) the potential (unrealized) value of such outstanding options as of the end of the specified period (market value less any exercise price).

Common Stock(1)	James G. Treybig	Robert C. Marshall	Michael D. Green	Lawrence A. Laurich	David R. Mackie	All Officers and Directors as a Group (15 Persons)
Granted—October 1, 1977 to December 1, 1981:						
Number of shares	87,600	93,600	81,600	93,600	45,000	552,000
Weighted average per share exercise price	$10.65	$10.54	$11.13	$6.77	$13.21	$10.00
Exercised—October 1, 1977 to December 1, 1981:						
Net value realized in shares (market value less exercise price)	—	$383,256	—	$908,248	$306,504	$2,292,808
Sales—October 1, 1977 to December 1, 1981:						
Number of shares	—	76,500	—	—	43,800	121,500
Unexercised at December 1, 1981:						
Number of shares	87,000	75,000	81,000	33,000	45,000	429,000
Potential (unrealized) value—(market value less exercise price)(2)	$1,557,735	$1,236,375	$1,417,905	$548,955	$693,675	$7,240,941

(1) All Common Stock figures are adjusted for a two-for-one stock split effective June 30, 1980, and a three-for-one stock split effective June 30, 1981.

(2) All options are currently exercisable.

(3) This table does not include information pertaining to transactions by any individual before such individual became an officer or Director, and does not include options to purchase 400 shares granted to each of the six officers who are not directors under the Company's Employee Stock Purchase Plan.

No options were granted to officers or Directors of the Company at any time prior to October 1, 1977.

In addition, during the period from October 1, 1976 to December 1, 1981, employees were granted options for 8,738,253 shares at an average option price of $8.38, adjusted to reflect a two-for-one stock split effective June 30, 1980, and a three-for-one stock split effective June 30, 1981.

PRINCIPAL STOCKHOLDER

To the Company's knowledge, no person owned beneficially more than 5% of the Company's outstanding Common Stock on November 1, 1981, except the following stockholder, whose name, address and beneficial ownership are given below:

Name	Number of Shares	Percent
The Hillman Company(1) .... Grant Building Pittsburgh, PA 15219	2,030,000	5.49%

(1) A corporation the controlling portion of whose voting stock is owned by Henry L. Hillman.

APPROVAL OF THE TANDEM COMPUTERS INCORPORATED 1981 EMPLOYEE STOCK OPTION PLAN

On October 30, 1981, the Board of Directors adopted, subject to stockholder approval, the Tandem Computers Incorporated 1981 Stock Option Plan (the "1981 Plan") under which 5,000,000 shares of Common Stock will be available for the grant of options. The Board of Directors believes that stock options are an effective means of securing to the Company and its stockholders the advantages of the incentive inherent in stock ownership by participating employees, upon whose judgment, initiative and efforts the Company is largely dependent for the successful conduct of its business. Consequently, the Board of Directors believes that the use of stock options as a supplement to other forms of compensation paid by the Company is desirable.

On December 11, 1981, the closing bid and asked quotations for the Company's Common Stock as reported by NASDAQ (National Association of Securities Dealers' Automated Quotations System), were 28½ and 28¾, respectively.

The full text of the 1981 Plan is set forth as Exhibit A to this Proxy Statement. The following is a general summary of the principal provisions of the 1981 Plan.

Administration

The 1981 Plan is administered by a three-member Option Committee, which has the authority to select the employees to be granted options, determine the number of shares to be optioned to each employee, fix the terms and conditions of options and interpret the 1981 Plan and any option granted thereunder.

Eligibility

All employees of the Company and its 50% or more owned subsidiaries, including officers and Directors who are also employees, are eligible to receive options under the 1981 Plan.

Option Price and Non-Assignability

Options granted under the 1981 Plan are required to have an option price of not less than 100% of the fair market value of the Company's Common Stock on the date of grant. Options are not assignable except by will or the laws of descent and distribution.

Term and Exercise of Options

Options may be made exercisable at such time or times as determined by the Option Committee and provided in the option agreement entered into between the Company and the employee. However, except when the optionee's employment terminates because of death or permanent disability, an option may not be exercisable before six months following its effective date.

The Option Committee, at the time of grant, may designate certain options as Incentive Stock Options for the purpose of falling within Section 422A of the Internal Revenue Code. An Incentive Stock Option may not be exercised while any previously granted Incentive Stock Option remains outstanding. The aggregate fair market value of stock (determined as of the date the option is granted) for which Incentive Stock Options are granted to any employee may not, in any calendar year, exceed $100,000, plus one half the unused portion of the $100,000 limit from each of the three preceding calendar years (excluding any year prior to 1981).

An employee may exercise an option only while employed by the Company or one of its subsidiaries, or within 30 days following the termination of such employment (three months, if termination is due to permanent disability). If an optionee dies while in the employ of the Company or a subsidiary, the optionee's legal representative may exercise the option within one year following the optionee's death. In no event may an option be exercised more than seven years after the date of grant.

Shares purchased upon the exercise of an option must be paid for in full at the time of exercise, except that, with the consent of the Company, an optionee may deliver a full recourse, interest-bearing promissory note to the Company, calling for periodic repayments over a period not to exceed ten years from the date of exercise.

Right of Repurchase

The Option Committee may determine that an option to be granted under the 1981 Plan will provide that the shares to be issued upon exercise of the option shall be subject to a right of repurchase by the Company at the option price. In such case, the option agreement will provide that if the optionee's employment terminates, the Company may repurchase a specified percentage of the shares.

Adjustment Upon Recapitalization

The 1981 Plan provides for appropriate adjustment by the Board of Directors of the number of shares subject to outstanding options and of the purchase price thereof and of the number of shares available for issuance pursuant to the 1981 Plan in the event of reorganization, stock splits, combinations of shares, stock dividends or other recapitalizations of the Company.

Amendment and Termination

The Board of Directors may at any time amend, suspend or discontinue the 1981 Plan. Certain amendments, described in Section 14 of the 1981 Plan, will not become effective until approved by stockholders. If not earlier terminated by action of the Board of Directors, the 1981 Plan will terminate automatically on October 29, 1991.

Federal Income Tax Effects

The following is a summary of the Federal income tax treatment of options granted under the 1981 Plan.

Options designated as Incentive Stock Options are intended to fall within the provisions of Section 422A of the Internal Revenue Code. An optionee is deemed not to have realized any taxable income as the result of the grant of an option. For employees who do not dispose of their shares for two years following the date the option was granted nor within 12 months following the transfer of the shares upon exercise of the options, the gain on sale of the shares (which is defined to be the difference between the sale price and the purchase price of the option) will be taxed as long-term capital gain. If an employee is entitled to long-term capital gain treatment upon a sale of the stock, the Company will not be entitled to any deduction for Federal income tax purposes. Participants who dispose of their shares within two years after the date of grant or within one year after their shares were received will realize a combination of ordinary income and/or short- or long-term capital gain or loss, depending upon the option price, the fair market value of the stock on the date of exercise, the sale price and the length of time the shares were held. Any ordinary income realized by the optionee upon the disposition of stock will be deductible by the Company for Federal income tax purposes.

Options not designated as Incentive Stock Options have no special tax status. An optionee is deemed not to have realized any taxable income as the result of the grant of an option. Upon exercise of an option which is not subject to a repurchase right, the optionee realizes ordinary income in the amount of the difference between the option price and the fair market value on the date of exercise. However, an individual who exercised such an option and who is subject to the insider trading rules of Section 16 of the Securities Exchange Act of 1934 will not realize ordinary income until six months from the date of exercise (based on the fair market value of the stock on that later date), unless such individual makes an election under Section 83(b) of the Internal Revenue Code within 30 days after the date of exercise. This amount will constitute earned income eligible for the 50% maximum tax on personal service income. Upon the sale of stock acquired by the exercise of an option, any gain or loss, based on the difference between the sale price and the fair market value on the date of recognition of income, will be taxed as short- or long-term capital gain or loss, depending upon the length of time the optionee has held the stock from the date of recognition of income. No tax deduction is available to the Company with respect to the grant of the option or the sale of stock acquired pursuant thereto. The Company does have a deduction equal to the amount of ordinary income that the optionee is required to recognize as a result of the exercise of the option.

Depending upon the circumstances, the deductible portion of a participant's long-term capital gains, as described above, may be subject to an alternative minimum tax at graduated rates ranging from 10% to 20%.

The inclusion of the repurchase right described above may affect the time of recognition, the amount of the optionee's ordinary income and the Company's deduction.

Approval of the Plan will require the affirmative vote of a majority of the outstanding shares of Common Stock of the Company present in person or by proxy at the meeting.

THE BOARD OF DIRECTORS RECOMMENDS THAT THE TANDEM COMPUTERS INCORPORATED 1981 STOCK OPTION PLAN BE APPROVED.

CERTAIN COMMITTEES OF THE BOARD OF DIRECTORS

The Company has a standing Audit Committee and a standing Compensation Committee of the Board of Directors. The Company has no standing Nominating Committee of the Board of Directors.

The Audit Committee consists of Morton Collins, Thomas J. Davis, Jr. and Eugene Kleiner. The Audit Committee held four meetings during the fiscal year ended September 30, 1981. Its functions are to monitor the effectiveness of the audit effort and the Company's financial and accounting organization and financial reporting and to select a firm of certified public accountants, whose duty it is to audit the books and accounts of the Company for the fiscal year for which they are appointed.

The Compensation Committee consists of Thomas J. Perkins, James G. Treybig and Thomas J. Davis, Jr. The Compensation Committee did not hold any meetings during the fiscal year ended September 30, 1981. Instead, issues relating to compensation were considered and approved by the Board of Directors. The Compensation Committee's functions are to review and approve salaries of officers of the Company and to set the criteria for payments to be made to officers and certain selected employees under the Company's incentive cash bonus plan.

The Company's Board of Directors held four meetings during the fiscal year ended September 30, 1981.

INDEPENDENT AUDITORS

The Board of Directors of the Company has selected the firm of Arthur Andersen & Co. as its independent auditors for the fiscal year ending September 30, 1982. Representatives of Arthur Andersen & Co. are expected to be present at the Company's Annual Meeting with the opportunity to make a statement, if they desire to do so, and they are expected to be available to respond to appropriate questions.

Audit services performed by Arthur Andersen & Co. for the year ended September 30, 1981 consisted of their examinations of the financial statements of the Company and its subsidiaries for the years ended September 30, 1981 and 1980, and services related to filings with the Securities and Exchange Commission. Nonaudit services performed during the year ended September 30, 1981, and the percentage relationship which the fee for each such service bore to the audit fee are as follows: tax consultation (27%) and assistance in the preparation and filing of the Company's Federal and state tax returns (22%). Nonaudit services were approved in advance by the Audit Committee which considered, among other things, the possible effect of the performance of such services on the auditors' independence.

THE BOARD OF DIRECTORS RECOMMENDS RATIFICATION OF THE APPOINTMENT OF ARTHUR ANDERSEN & CO.

STOCKHOLDER PROPOSALS

To be considered for presentation to the Annual Meeting of Stockholders to be held in 1983, a stockholder proposal must be received at the offices of the Company, 19333 Vallco Parkway, Cupertino, California 95014, not later than September 16, 1982.

OTHER MATTERS

The Board of Directors knows of no other business which will be presented to the meeting. If any other business is properly brought before the meeting, it is intended that proxies in the enclosed form will be voted in respect thereof in accordance with the judgment of the persons voting the proxies.

Whether you intend to be present at this meeting or not, you are urged to return your proxy promptly.

By order of the Board of Directors.

HENRY V. MORGAN
Secretary

EXHIBIT A

TANDEM COMPUTERS INCORPORATED
1981 STOCK OPTION PLAN

1. *Purpose.* This 1981 Stock Option Plan (the "Plan") of Tandem Computers Incorporated (the "Company") is intended to provide incentive to employees of the Company and its subsidiaries, to encourage employee stock ownership and proprietary interest in the Company, and to encourage employees to remain in the employ of the Company or of its subsidiaries.

2. *Effective Date of Plan.* This Plan was adopted by the Board of Directors, and was effective, on October 30, 1981.

3. *Definitions.*

"*Board*" shall mean the Board of Directors of the Company.

"*Code*" shall mean the Internal Revenue Code of 1954, as amended.

"*Common Stock*" shall mean the $0.025 par value Common Stock of the Company.

"*Company*" shall mean Tandem Computers Incorporated, a Delaware corporation.

"*Employee*" shall mean an individual (who may be an officer or a director) employed by the Company or a Subsidiary (within the meaning of Code Section 3401 and the regulations thereunder).

"*Fair Market Value*" of a Share as of a specified date shall mean the average of the bid and asked price of such Share as reported by the National Association of Securities Dealers' Automated Quotations System (NASDAQ) at the close of business on such date.

"*Incentive Stock Option*" shall mean an Option described in Code Section 422A(b).

"*Nonstatutory Stock Option*" shall mean an Option not described in Code Section 422(b), 422A(b), 423(b) or 424(b).

"*Option*" shall mean a stock option granted pursuant to the Plan.

"*Option Committee*" shall mean the committee appointed by the Board in accordance with Section 5 of the Plan.

"*Option Price*" shall mean the price per Share of Common Stock determined by the Option Committee at which an Option may be exercised.

"*Optionee*" shall mean an Employee who has received an Option.

"*Plan*" shall mean this Tandem Computers Incorporated 1981 Stock Option Plan.

"*Purchase Price*" shall mean the Option Price times the number of Shares with respect to which an Option is exercised.

"*Share*" shall mean one Share of Common Stock adjusted in accordance with Section 8 of the Plan.

"*Subsidiary*" shall mean a corporation 50% or more of the voting stock of which is owned, directly or indirectly, by the Company.

4. *Stock Subject to Option.* The stock subject to Options granted under the Plan shall be Shares of the Company's authorized but unissued or reacquired Common Stock. Subject to the pro-

visions of Section 8, the total number of Shares with respect to which Options may be granted under the Plan is 5,000,000 Shares. The number of Shares subject to Options outstanding under the Plan at any time may not exceed the number of Shares remaining available for issuance under the Plan. In the event that any outstanding Option under the Plan for any reason expires or is terminated, the Shares allocable to the unexercised portion of such Option may again be subjected to an Option under the Plan.

5. *Administration of the Plan.* The Plan shall be administered by an Option Committee appointed by the Board and consisting of not less than three members thereof. The Board may from time to time remove members from, or add members to, the Option Committee. Vacancies on the Option Committee, howsoever caused, shall be filled by the Board.

The Option Committee shall hold meetings at such times and places as it may determine. Acts of a majority of the Option Committee at which a quorum is present, or acts reduced to or approved in writing by a majority of the members of the Option Committee, shall be the valid acts of the Option Committee. The Option Committee shall from time to time at its discretion make determinations with respect to Employees who shall be granted Options, the number of Shares to be optioned to each and the designation of such Options as Incentive Stock Options or Nonstatutory Stock Options.

All questions of interpretation, construction and application of the Plan and of any Options issued under it shall be determined by the Option Committee, and such determination shall be final and binding upon all persons. No member of the Option Committee shall be liable for any action or determination made in good faith with respect to the Plan or any Option granted thereunder.

6. *Participants.* Participants will be selected by the Option Committee from among Employees, but subject to the terms and conditions set forth below:

(a) *Ten Percent Shareholders.* An Employee who owns more than ten percent of the total combined voting power of all classes of outstanding stock of the Company, or any of its Subsidiaries, is not eligible to receive an Incentive Stock Option pursuant to this Plan unless, at the time such Option is granted to him or her, the Exercise Price of the Shares subject to such Option to such Employee is at least one hundred ten percent of the Fair Market Value of such Shares, and such Option by its terms is not exercisable after the expiration of five years from the date such Option is granted.

For purposes of this Subsection 6(a), in determining stock ownership, an Employee shall be considered as owning the Shares owned, directly or indirectly, by or for his or her brothers and sisters, spouse, ancestors, and lineal descendants. Shares owned, directly or indirectly, by or for a corporation, partnership, estate or trust shall be considered as being owned proportionately by or for its shareholders, partners or beneficiaries. Stock with respect to which such Employee holds an Option shall not be counted.

For purposes of this Subsection 6(a) "Outstanding Stock" shall include all shares actually issued and outstanding immediately after the grant of the Option to the Optionee. Outstanding Stock shall not include treasury Shares or Shares authorized for issue under outstanding Options held by the Optionee or by any other person.

(b) *Number of Options.* An Optionee may hold more than one Option, but only on the terms and subject to the restrictions hereinafter set forth.

7. *Award of Options and Effective Date.*

(a) *Award.* The Option Committee may, in its discretion, grant Options under the Plan from time to time prior to the termination of the Plan on October 29, 1991.

(b) *Effective Date of 1981 Stock Option Agreement.* Each 1981 Stock Option Agreement required by Section 9 hereof shall specify an effective date ("Effective Date") which shall be not earlier than the date upon which the Optionee became an Employee of the Company and not later than the date of such 1981 Stock Option Agreement.

8. *Adjustments.* Subject to any required action by the stockholders, in the event that the outstanding shares of Common Stock of the Company are hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company or of another corporation by reason of reorganization, merger, consolidation, recapitalization, reclassification, stock split, combination of shares, share dividends or any other increase or decrease in the number of Shares effected without receipt of consideration by the Company, the number and kind of shares for the purchase of which Options may be granted under the Plan, and the number and kind of shares as to which outstanding Options, or portions thereof then unexercised, shall be exercisable, and the Option Price thereof shall be proportionately adjusted. Such adjustment in outstanding Options shall be made without change in the total price applicable to the unexercised portion of the Option and with a corresponding adjustment in the Option Price per share.

To the extent that the foregoing adjustments relate to stock or securities of the Company, such adjustments shall be made by the Option Committee, whose determination in that respect shall be final, binding and conclusive.

Except as hereinbefore expressly provided in this Section 8, the Optionee shall have no rights by reason of any subdivision or consolidation of shares of stock of any class or the payment of any stock dividend or any other increase or decrease in the number of shares of stock of any class or by reason of any dissolution, liquidation, merger, or consolidation or spin-off of assets or stock of another corporation, and any issue by the Company of shares of stock of any class or securities convertible into shares of stock of any class, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to the Option.

The grant of any Option pursuant to the Plan shall not affect in any way the right or power of the Company to make adjustments, reclassifications, reorganizations, or changes of its capital or business structure or to merge or consolidate or to dissolve, liquidate, sell or transfer all or any part of its business or assets.

9. *Terms and Conditions of Options.* Options granted under the Plan shall be subject to the following terms and conditions and shall be evidenced by 1981 Stock Option Agreements in such form not inconsistent with the Plan as the Option Committee shall from time to time determine:

(a) *Stockholder Approval and Option Term.* Effectiveness of the Plan, including the issuance of Shares hereunder, is conditioned upon obtaining stockholder approval of the Plan at the first annual meeting of stockholders of the Company following the adoption of the Plan. Provided, however, Options may be granted prior to obtaining such stockholder approval, but no such Option may be exercised prior to the date such approval is obtained. No Option will be exercisable after the expiration of seven years from the Effective Date of the Option, and no

Incentive Stock Option granted to an Optionee described in Subsection 6(a) hereof shall be exercisable after the expiration of five years from the date it is granted.

(b) *Option Price and Number of Shares.* Each Option shall state the number of Shares to which it pertains and shall provide for the adjustment thereof in accordance with the provisions of Section 8 hereof.

Each Option shall state the Option Price, which price shall be the price per share fixed by the Option Committee, but not less than the Fair Market Value of a Share on the date of grant, or, in the case of an Option granted to an Optionee who is described in Subsection 6(a) hereof, not less than one hundred ten percent of the Fair Market Value of a Share on the date of grant.

(c) *Exercise of Options.* Each Option shall state the time or times when it becomes exercisable. However, no Option shall be exercisable for a period of six months from the Effective Date of the Option. At the discretion of the Option Committee, Options may be exercisable in whole or in part at any time, subject to the restrictions provided in Subsections 9(a), 9(g) and 9(j) and subject to the right of repurchase provided in Section 10, if applicable.

(d) *Method of Exercise.* Options may be exercised from time to time by written notice to the Company stating the number of Shares with respect to which the Option is being exercised, which notice shall be accompanied by payment in full in United States dollars for the Purchase Price of the Shares acquired (which payment may be by personal check). Notwithstanding the foregoing, with the consent of the Company, an Optionee (or his or her legal representative or the person entitled to the Option under his or her will or the laws of intestate succession, in the event of the exercise of an Option upon the death of the Employee, as provided in Subsection 9(f) below), may purchase such Shares upon exercise of an Option by delivery of a full recourse promissory note payable to the Company. In such case, such note shall bear interest at a rate specified by the Company, and provide for repayment in periodic installments over a period not to exceed ten years from the date of exercise. No Share shall be issued until full payment therefor has been made (whether in cash, by promissory note or partially in cash and partially by promissory note, as provided above).

(e) *Non-Assignability of Option Rights.* No Option shall be assignable or transferable by an Optionee otherwise than by will or the laws of descent and distribution. During the life of an Optionee, the Options shall be exercisable only by such Optionee and shall not be assignable or transferable.

(f) *Exercise After Termination of Employment or Death.*

(i) *Termination by Reason Other than Death or Disability.* If for any reason other than his or her death or permanent disability an Optionee shall cease to be employed by the Company and its Subsidiaries, unexercised Options held at the date of termination, as to which (if exercised) there would be no right of repurchase under Section 10, may be exercised by the Employee in whole or in part at any time within thirty days after the date of termination of employment, subject to the restrictions of Subsections 9(a), 9(c) and 9(j) hereof. For this purpose, the employment relationship will be treated as continuing intact while the Optionee is on military leave, sick leave or other bona fide leave of absence (to be determined in the sole discretion of the Option Committee, in accordance with rules and regulations construing Code Section 422A(a)(2)). Notwithstanding the foregoing, in the case of an Incentive Stock Option, employment shall not be deemed to continue beyond the ninetieth day after the Optionee ceased active employment, unless the Optionee's reemployment rights are guaranteed by statute or by contract.

(ii) *Termination by Death.* In the event of the termination of employment of an Optionee by reason of death, notwithstanding the prohibition on exercise in Subsection 9(c), unexercised Options held at the date of termination may be exercised, to the extent of the greater of 20% of the total Shares covered by the 1981 Stock Option Agreement (less such number of Shares as have previously been issued under the 1981 Stock Option Agreement) or the number of Shares as to which (if exercised) there would be no right of repurchase under Section 10, within one year from the date of death by the executors or administrators of the Optionee's estate or by any person or persons to whom the Option is transferred by will or the applicable laws of descent and distribution, subject to the restrictions of Subsections 9(a) and 9(j) hereof.

(iii) *Termination by Disability.* In the event of the termination of employment of an Optionee by reason of permanent disability (as determined by the Option Committee), notwithstanding the prohibition on exercise in Subsection 9(c), unexercised Options held at the date of termination may be exercised, to the extent of the greater of 20% of the total Shares covered by the 1981 Stock Option Agreement (less such number of Shares as have previously been issued under the 1981 Stock Option Agreement) or the number of Shares as to which (if exercised) there would be no right of repurchase under Section 10, within three months from the date of termination of employment, subject to the restrictions of Subsections 9(a) and 9(j) hereof.

(g) *Limitation on Issuance of Shares.* The Company shall not be obligated to sell or issue any Shares if such sale or issuance would violate applicable law.

(h) *Rights as a Stockholder.* An Optionee or a transferee of an Optionee shall have no rights as a stockholder with respect to any Shares covered by his or her Option until the date of issuance of a stock certificate for such Shares. No adjustment shall be made for dividends (ordinary or extraordinary, whether in cash, securities or other property) or distributions or other rights for which the record date is prior to the date such stock certificate is issued, except as provided in Section 8.

(i) *Modification, Extension and Renewal of Options.* Subject to the terms and conditions and within the limitations of the Plan, the Option Committee may modify, extend or renew outstanding Options granted under the Plan, or accept the exchange of outstanding Options (to the extent not theretofore exercised) for the granting of new Options in substitution therefor. Notwithstanding the foregoing, however, no modification of an Option shall, without the consent of the Optionee, alter or impair any rights or obligations under any Option theretofore granted under the Plan.

(j) *Sequential Exercise.* An Option (the "New Option") which is designated by the Option Committee as an Incentive Stock Option shall not be exercisable with respect to all or any part of the Shares subject thereto while there is outstanding any other Incentive Stock Option, granted to the Optionee prior to the grant of the New Option, to purchase Common Stock in the Company or Subsidiary of the Company. For purposes of the preceding sentence, an Incentive Stock Option shall be treated as "outstanding" until such Option is exercised in full or expires by reason of the lapse of time.

(k) *Other Provisions.* The option agreements authorized under the Plan shall contain such other provisions not inconsistent with the terms of the Plan, including, without limitation, restrictions upon the exercise of the Option, as the Option Committee shall deem advisable.

10. *Repurchase Option.* The Option Committee may, in its discretion, determine that an Option to be granted under the Plan shall provide that the Shares to be issued upon the exercise of the Option shall be subject to a right of repurchase by the Company. In such case, the Option and the Shares issued pursuant thereto shall be subject to, and the 1981 Stock Option Agreement shall include, the following terms and conditions:

(a) *Right of Repurchase.* Shares purchased upon exercise of Options shall be subject to a right of repurchase by the Company at the Option Price provided in the 1981 Stock Option Agreement if the Optionee ceases for any reason to be an Employee of the Company or its Subsidiaries prior to the expiration of four years from the Effective Date of the Option. Such right of repurchase shall be limited to the number of Shares, if any, purchased by the Optionee pursuant to his exercise of Options granted under this Plan in excess of the number of Shares equal to the product (rounded to the nearest integer) of the number of days of the Optionee's continuous employment (including all days of any approved leaves of absence) from the Effective Date times the number of Shares covered by the Option times 0.000685. Such right of repurchase shall terminate if not exercised by written notice from the Company to the Optionee within 60 days of the date on which the Optionee ceases to be employed by the Company or its Subsidiaries. In the event the Company exercises its right of repurchase hereunder, the Shares subject to repurchase shall be delivered to the Company, fully endorsed or accompanied by a duly executed stock transfer power, within 60 days of said written notice by the Company to the Optionee, against receipt of the Company's payment therefor. The certificate for Shares issued pursuant to the exercise of such an Option shall (with respect to Shares subject to a right of repurchase) have stamped upon its face and reverse sides a legend indicating that the Company has a right to purchase the Shares pursuant to this Section 10.

(b) *Lapse of Option and of Repurchase Option.* In the event Optionee shall cease to be an Employee of the Company or its Subsidiaries, outstanding Options covering Shares which would be subject to repurchase by the Company under Subsection 10(a) hereof shall immediately lapse and terminate. In the event the Company does not elect to exercise the repurchase option as to all or part of the Shares covered thereby, the repurchase option shall expire as to all Shares not elected to be purchased.

11. *Limitation on Annual Awards.*

(a) *General Rule.* The aggregate Fair Market Value (determined as of the date an Option is granted) of the stock for which any Optionee may be granted Incentive Stock Options in any calendar year commencing after December 31, 1980, under this Plan and all other plans maintained by the Company or its Subsidiaries shall not exceed the sum of (i) $100,000 plus (ii) any unused limit carryover(s) to such year.

(b) *Carryovers.* For purposes of Subsection 11(a), an "unused limit carryover" shall arise only in a calendar year commencing after December 31, 1980, and shall be equal to one half of the excess of (i) $100,000 ("basic $100,000 limit") over (ii) the aggregate Fair Market Value (determined as of the date an Option is granted) of the Shares for which the Optionee is granted Incentive Stock Options in such year under the Plan or under any other plan maintained by the Company or any Subsidiary. The unused limit carryover arising in any calendar year may be carried over to any of the three consecutive calendar years next following such year, but only to the extent not used in an earlier calendar year. The value of the Shares for which Options are granted in any calendar year shall be applied first against the basic $100,000 limit for such year and then against any unused limit carryovers which may be carried over to such year in the order of the calendar years in which such carryovers arose.

12. *Application of Funds.* The proceeds received by the Company from the sale of Common Stock pursuant to the exercise of an Option will be used for general corporate purposes.

13. *No Obligation to Exercise Option.* The granting of an Option shall impose no obligation upon the Optionee to exercise such Option.

14. *Termination or Amendment of Plan.* The Board may, insofar as permitted by law, at any time, with respect to any Shares at the time not subject to Options, suspend or terminate the Plan or revise or amend it in any respect whatsoever except that, without approval of the stockholders, no such revision or amendment shall:

(a) Increase the number of Shares subject to the Plan; or

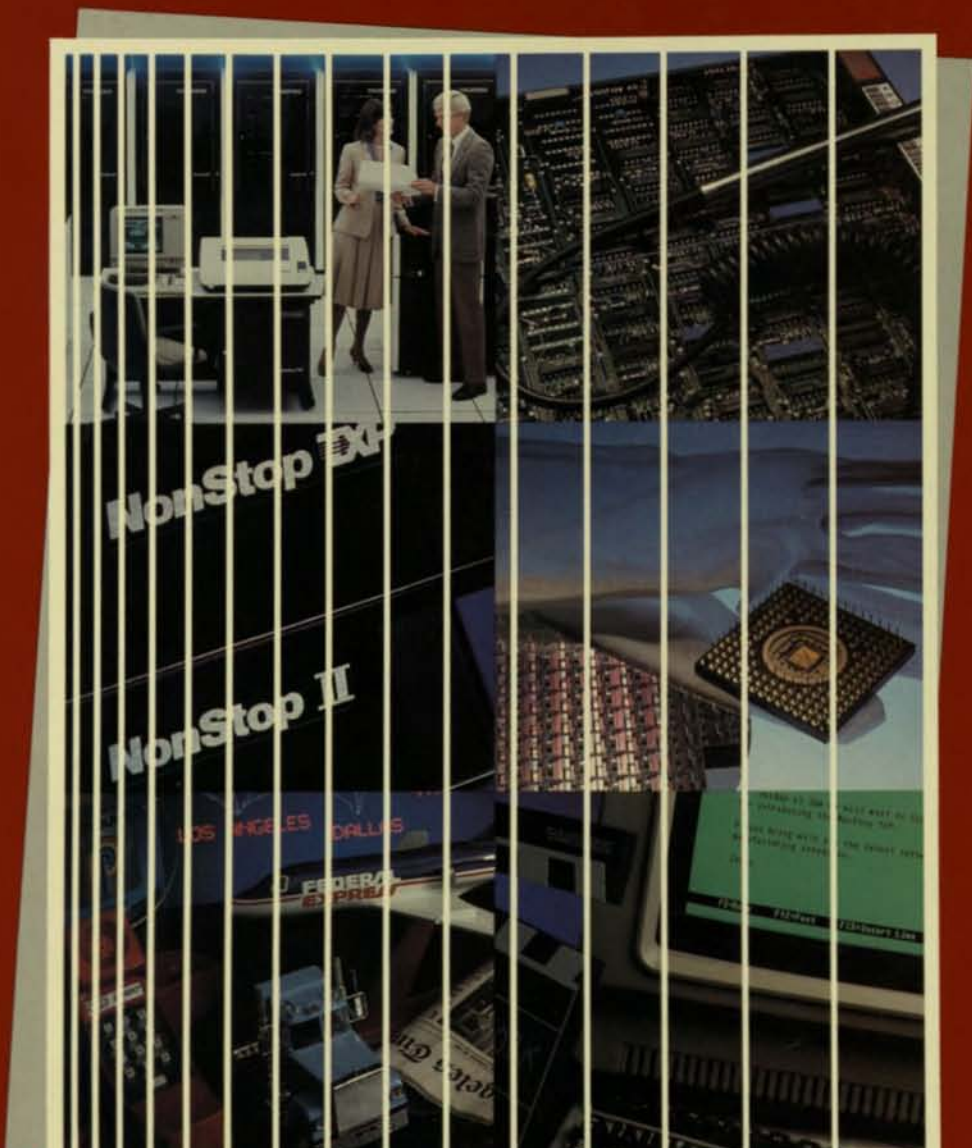
(b) Change the designation in Section 6 of the Plan of the class of Employees eligible to receive Options; or

(c) Amend this Section 14 to defeat its purpose.

Termination or amendment of the Plan will not affect rights and obligations with respect to Options theretofore granted and then in effect.

TANDEM

1983
ANNUAL
REPORT



FINANCIALS

Tandem Computers Incorporated designs, develops, manufactures, markets and supports a family of unique computer systems for on-line transaction processing. The Tandem NonStop system concept provides the first on-line, distributed computer architecture for mainstream business applications. Customers' systems are supported from over 100 locations throughout North America, Europe, Asia and the Pacific. The company operates six manufacturing facilities in the United States and one in Germany. At the close of fiscal 1983, Tandem's 725 customers — principally large, diversified organizations — were using 5,824 NonStop processors worldwide, an increase of 44% over the preceding year.

As the pace and complexity of conducting business intensified in the Seventies, two major trends emerged in the data processing marketplace.

The first trend was to on-line transaction processing. Businesses began to move critical applications on-line in order to obtain timely information that accurately reflects the state of the business.

Following closely on this development, businesses began distributing the computer resource, putting information where it is used. The desire to tie together these distributed locations evolved naturally: on-line networks would vastly increase the information flow and automation benefits.

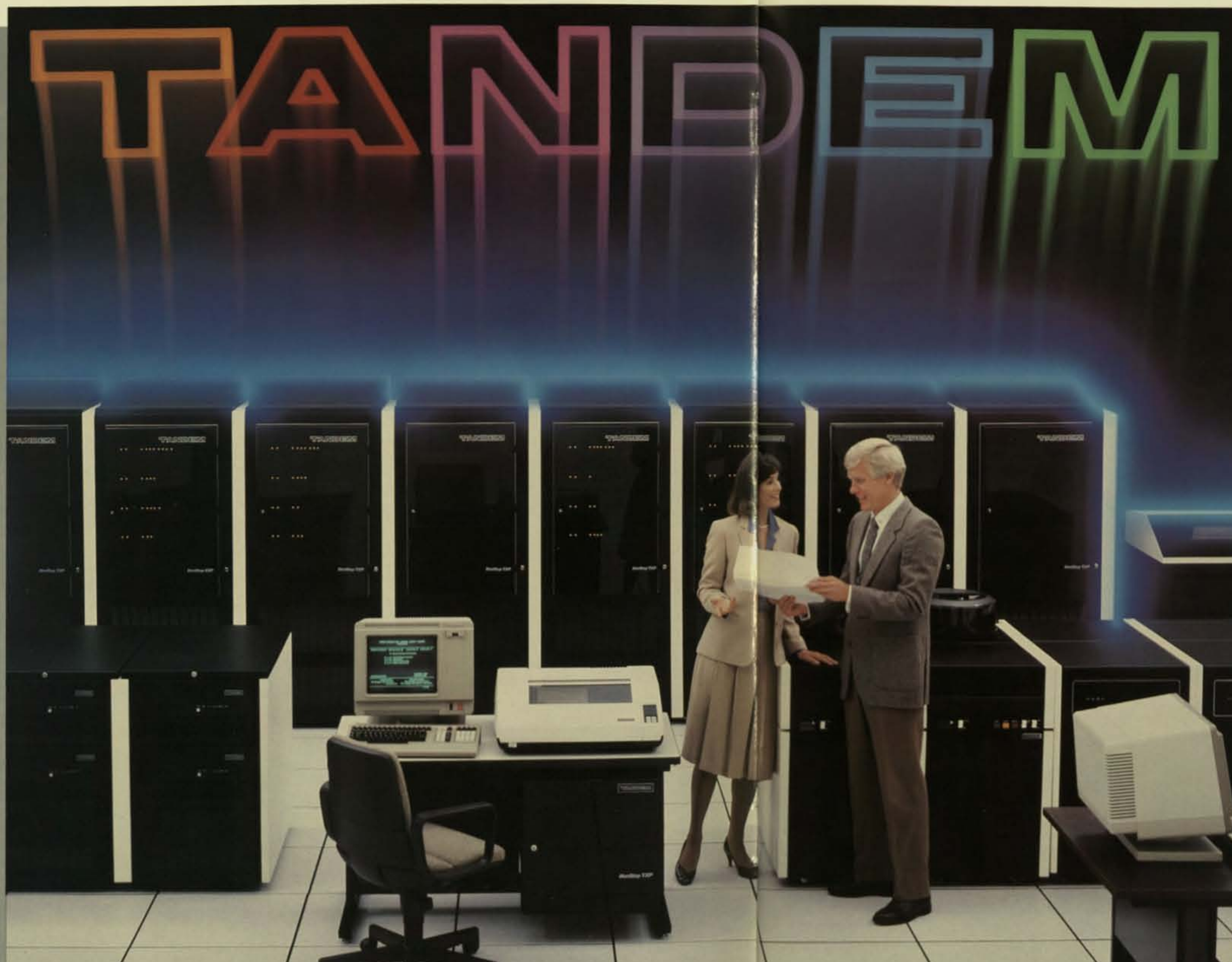
Aggressive organizations began envisioning innovative ways to apply data processing to control daily operations, enhance productivity, reduce costs, improve customer service and sharpen competitiveness. But their mainstay resource—batch-processing, centralized mainframe computers—proved inherently inadequate to the new automation tasks.

Batch processors are not designed to automatically capture, instantly update and immediately deliver constantly changing information. Further, in on-line applications, when the computer stops, the business stops.

Recognizing the early signs of these trends, Tandem alone tailored technology to fit the rapidly evolving requirements for the Eighties and Nineties.

Tandem bases the family of NonStop systems on a revolutionary, proprietary architecture for on-line, distributed mainstream applications that virtually eliminates the risk of system failures. At the same time, the system protects users' data from damage or loss. NonStop systems expand modularly from mid-range to mainframe power—and into networks of up to 255 mainframe-size, geographically dispersed systems—without hardware replacement or software changes.

Complemented by an extensive variety of software tools, NonStop systems uniquely meet the requirements of the growing market for on-line transaction processing.



Nearly a decade ago, Tandem alone responded decisively to what is now widely regarded as one of the most significant marketplace changes in the history of commercial data processing. By contributing the only technology and architecture specifically designed to meet the needs of the new on-line transaction processing marketplace, Tandem has enjoyed rapid growth. Tandem has earned a strong position in an $11 billion market segment that is expected to increase to $27 billion by 1986.

Building on strength in a dynamic marketplace

Few companies in the world are as ideally positioned in their marketplace as Tandem. Five fundamental reasons explain why.

First: Tandem accurately foresaw the impact of an evolving, yet dramatic, change in the marketplace. Needs shifted from centralized, batch-processing computers to distributed, on-line transaction processing systems interacting within networks.

Second: We developed a revolutionary computer architecture to specifically address what we correctly judged would be the critical needs of this changing marketplace.

Third: We carefully built a quality organization that has won us a broad base of prestigious customers worldwide.

Fourth: We have attracted the level and quality of creative, productive people we need to sustain high growth. We are perceived in our industry not only as a principal contributor to technological excellence, but also as a major contributor to quality of work life.

And fifth: We accomplished all of that years before the world recognized the market trend for what it is: *The biggest change in market demand for medium- and large-scale computer applications since the beginning of commercial data processing.*

Potential Transaction Processing Market Size

$ Billions

1981	1982	1983	1984	1985	1986
$6.4	$8.3	$11.0	$15.0	$20.5	$27.8

Source: InfoCorp

As a result, even in the changeable economy of the four year period from 1979 to 1983, our annual revenues grew seven-fold from $56 million to $418 million. Shareholders' equity expanded nearly ten times from $32 million to $311 million. And we earned more than $100 million during the period—nearly a third of it in fiscal 1983 alone.

We are well positioned to take maximum advantage of market opportunities.

Now, as Tandem approaches its second decade as a strong organization with established market presence, we believe we are well positioned to take maximum advantage of market opportunities for these reasons:

The marketplace for on-line transaction processing systems is huge and rapidly growing. In the short span of a decade, the potential market has grown, according to independent research, from an insignificant level to $11 billion. And the market likely will more than double to over $27 billion by 1986.

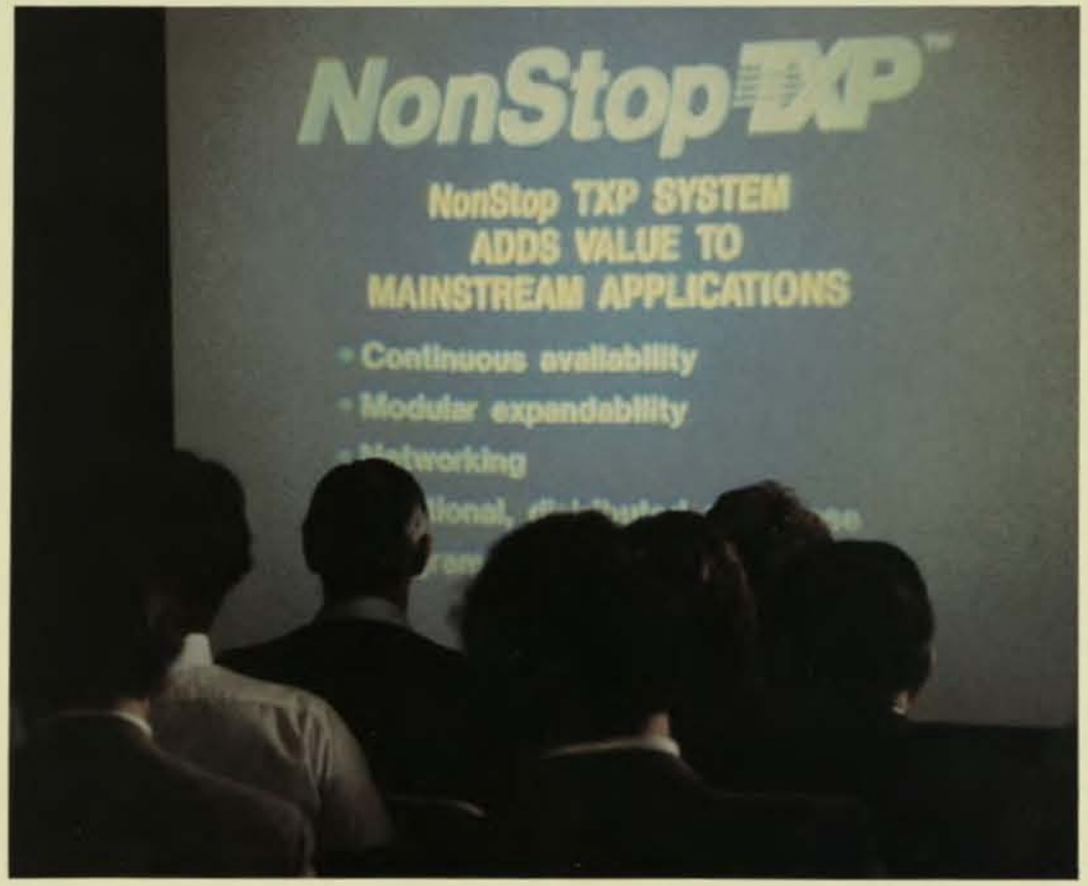
The world's largest organizations are making major, long-term commitments to Tandem as the supplier of multi-million-dollar systems to run their mainstream business operations. They are deploying large Tandem systems as distributed mainframe computers linked in geographically dispersed networks. Only Tandem's NonStop architecture and advanced software tools meet their needs for uninterrupted computer operations, modular expandability, assurance of data integrity, ease and low cost of programming, inherent networking capability and high-speed, low-cost transactions.

Tandem ranks first in satisfied customers. For the fourth consecutive year, Tandem in 1983 ranked number one in customer loyalty and satisfaction in the bellwether Cowen/DATAMATION survey of computer users.

The market trend favors distributed processing. The same survey shows that Tandem has the industry's highest percentage of customers using data base management and networking software. Two-thirds of all Tandem users are employing software to manage large data bases, as compared to an industry average of only one-third. And use of networking software at Tandem installations is nearly double the industry average.

Our installed base has built-in growth potential. NonStop systems expand modularly from minicomputer to mainframe size, and from single systems to networks of up to 255 systems—all without programming changes. This modular expandability creates a natural growth potential for Tandem. We ended 1983 with 725 customers using 5,824 processors—four-and-a-half times more customers using nine times more processors than five years earlier. During fiscal 1983 alone, Tandem shipped 1,773 processors, adding 44% to our installed base. Three-quarters of our 1983 shipments were to customers who are expanding their systems, adding new systems or developing new applications. And 126 customers were first-time users.

In simultaneous customer teleconferences across the country in October 1983, Tandem unveiled the new, high-end NonStop TXP system. The TXP system expands the family of NonStop systems to accommodate the full spectrum of on-line transaction processing price/performance requirements. First TXP processor shipments were made to customers in August 1983. ▼



The dynamic state of the on-line transaction processing marketplace produces a range of rapidly changing requirements for the new backbone networks of Tandem distributed mainframe computers. Tandem's three-tier family of systems leads the industry not only in capabilities, functionality and versatility, but in price/performance, too. Tandem's new NonStop TXP system, announced in October 1983, is the world's highest performance computer for on-line transaction processing applications.

The right products at the right price

Tandem's family of systems is unprecedented in reliability, functionality and compatibility. And they offer the best price/performance for on-line transaction processing.

Tandem's single focus on transaction processing has allowed us to extend our original contribution of system fault tolerance, data integrity and inherent expandability. A stream of new products and product enhancements has met the rapidly evolving requirements of the marketplace. And we fill those needs more cost-effectively than anyone in the market while providing an easy growth path to accommodate users' expanding applications.

Users are making major commitments to Tandem and enjoying the benefits of compatibility and an easy growth path from relatively modest to massive transaction rates.

The Union Bank of Finland, for example, chose Tandem systems to replace their conventional mainframe system whose processing power had become a major bottleneck. Tandem met the new requirements for 99.9% system availability, high transaction rates with short response time, easy expandability, fast application development and reasonable cost. On the very first day of operation, the three-system, 36-processor NonStop II installation processed 500,000 transactions with a peak load of 30 transactions per second (tps). Ten weeks later, transaction volume exceeded one million, and peak load reached 45 tps. With the addition of the new NonStop TXP system, the Union Bank of Finland not only will be able to handle increasing transaction levels. They also will be able to enhance applications and add new services cost-effectively, and without performance penalty.

Tandem's three-tier family of compatible systems spans the performance spectrum from relatively modest to massive transaction rates.

NonStop TXP. Tandem's new high-end system is the world's highest performance computer for on-line transaction processing. The NonStop TXP system is the most cost-effective system for handling transactions in the range of 100 per second. An increasing number of new services and rapidly growing businesses are developing applications requiring such performance. The 32-bit TXP processor has two to three times the performance of the NonStop II processor and reduces the cost per transaction by up to 50%. NonStop TXP processors can be added to an existing NonStop II system.

NonStop II. This system is cost-effective for the middle level of transaction rates. In large configurations, the NonStop II system can process in the 50 tps range, satisfying the current performance requirements of a wide array of applications in all industries. As those requirements change, users can add NonStop II processors or fully compatible NonStop TXP processors to existing NonStop II systems to meet transaction volume demand.

Tandem Installed Base

cumulative

	1979	1980	1981	1982	1983
Customers	160	290	460	599	725
Processors	646	1299	2509	4051	5824

NonStop I+. The NonStop I+ system fills customers' needs for fault-tolerance, easy expandability and NonStop software at lower-demand nodes in a network of NonStop systems. An attractively priced, entry-level system, the NonStop I+ system is cost-effective for smaller applications in major organizations. This system can access data and share information with NonStop II and TXP systems.

Tandem's contribution does not end with processors. Leading-edge communications subsystems and state-of-the-art peripheral products, including our own terminal, enhance system performance. And the company offers the most advanced and complete complement of software tools available for developing distributed, on-line transaction processing applications.

Wells Fargo Bank has made a multi-million-dollar commitment to Tandem to automate its entire retail banking delivery system using NonStop systems in a backbone network of distributed host processors. Transaction rates are expected to begin at ten transactions per second and grow to over 300. Seen here working with Barry E. Young (right), Wells Fargo senior vice president, is Christopher L. Palombi, Tandem major account manager.

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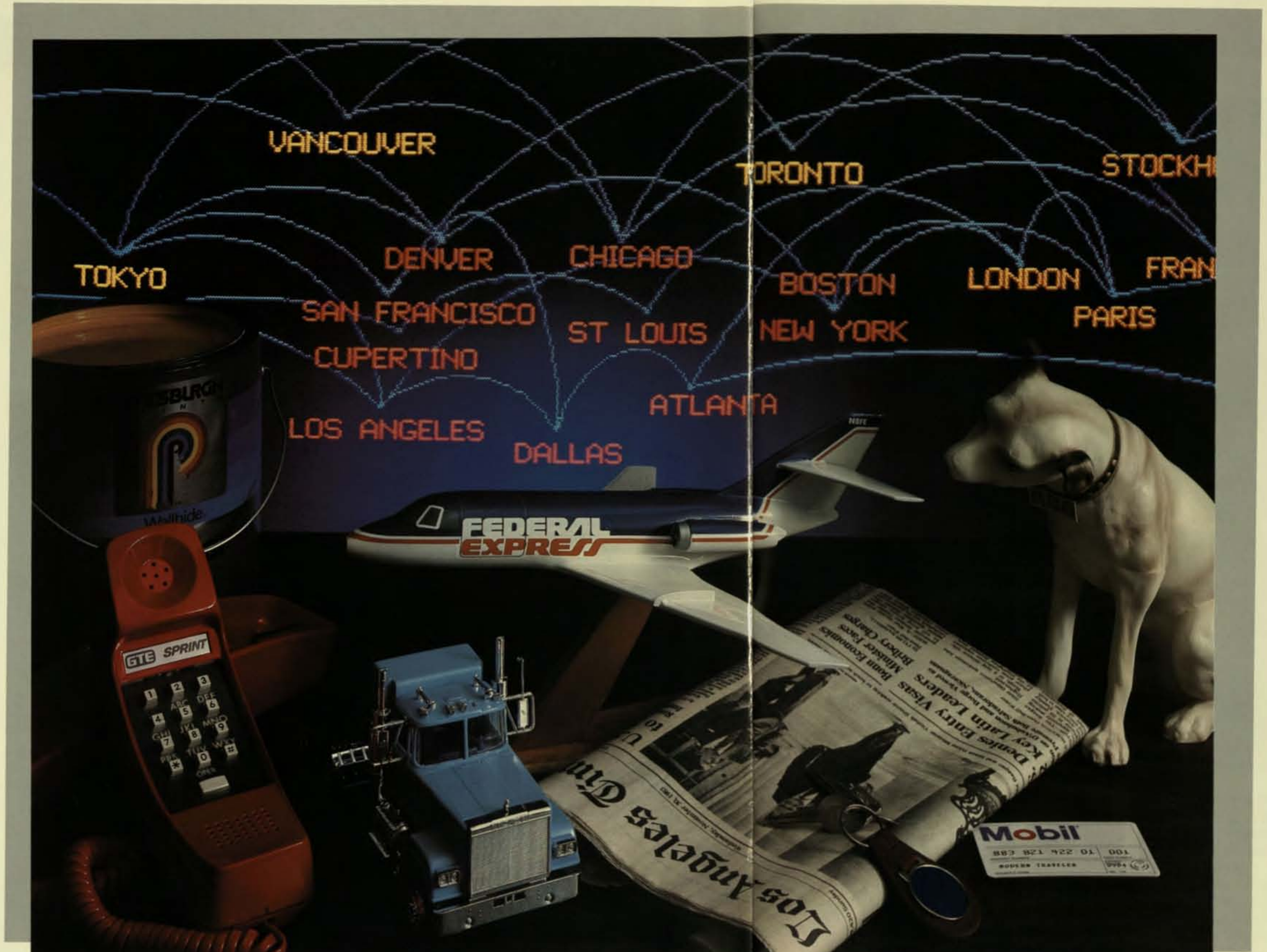


Tandem systems are penetrating major organizations worldwide for a wide range of mainstream applications. Some companies became customers to automate a single function. Later, they moved Tandem systems into multiple mainstream applications at the heart of their business. Others immediately made Tandem systems their new backbone network. Customers buy Tandem systems not only for their hardware attributes, but also for advanced functionality, programmability, networking capabilities, maintainability—and the fact that only Tandem systems can cost-effectively process high transaction volumes.

A broad base of prestigious users

Many customers who began by using Tandem systems to automate a single function are now implementing broad-based, mainstream applications. Wells Fargo Bank, for instance, began by basing the largest automated teller machine (ATM) network in California on Tandem systems—over 700 ATMs in a network of 24 Tandem NonStop processors. This leading bank now is implementing its Retail Outlet Automation program entirely with Tandem equipment. NonStop systems will support thousands of ATMs, teller terminals and administrative terminals in over 350 branch locations throughout California.

Other customers base entire businesses on Tandem systems. NonStop systems provide GTE's *SPRINT*™ long distance telephone service with its backbone, internal administrative network. It is currently the largest Tandem customer network—and expected to triple in size by 1985. Tandem systems are also driving emerging applications like the *Viewtron*™ service of Knight-Ridder's Viewdata subsidiary, a leading contender in the market for videotex services. Viewdata had 16 NonStop processors for their 1983 start-up service, and they plan expansion into 18 cities commencing in 1984, 30 cities within ten years. (By 1990, industry sources estimate that 45 million homes may be using videotex.) And Tandem systems are at the heart of other innovative new services like the *Federal Express Satellite Network.* Federal Express, which delivers 250,000 packages daily, in 1984 will launch a vast, electronic delivery service for documents that ultimately will use a network of multiple earth stations at numerous locations, with Tandem NonStop computers at the heart of the business.

These customers did not buy Tandem systems only because of the NonStop system capabilities of fault-tolerance, data integrity and expandability. They based their decisions on other considerations as well:

Customers buy Tandem NonStop systems for many reasons, not only for their unprecedented reliability.

1. *Advanced Programming Tools.* Tandem supplies superior, high-level tools that dramatically reduce the complexities, leadtime and costs of programming on-line applications. Using Tandem's ENCOMPASS distributed relational data base management system, customer applications can be brought up quickly, maintained easily and enhanced cost-effectively. And EXPAND networking software makes writing applications across a network equally productive. Customers regularly report on new applications coming on-line in record time and below budget. Rockwell International, for example, began operating a plant automation program just four months after programming started.

2. *State-of-the-Art Communications.* Powerful local networks of up to 224 NonStop processors can be quickly, inexpensively created with Tandem's FOX fiber optic link—over 300 times faster than conventional communications lines. Using EXPAND software, users can build a worldwide network of up to 4,080 processors without programming changes. Tandem also provides gateways to other networks, including SNA and X.25. And the company's INFOSAT product is the first commercially available, fully integrated satellite communications network. FOX, EXPAND and INFOSAT extend NonStop system reliability and data integrity across networks.

3. *Advanced Functionality.* Backbone networks of the future will integrate and disseminate information from such diverse office equipment as telex, photocopiers, telecopiers, word processors and a range of incompatible computers. Tandem has already provided the capability for such multi-media transaction processing. TRANSFER moves integrated data from person to person, or program to program, to put the information where it is needed, when it is needed.

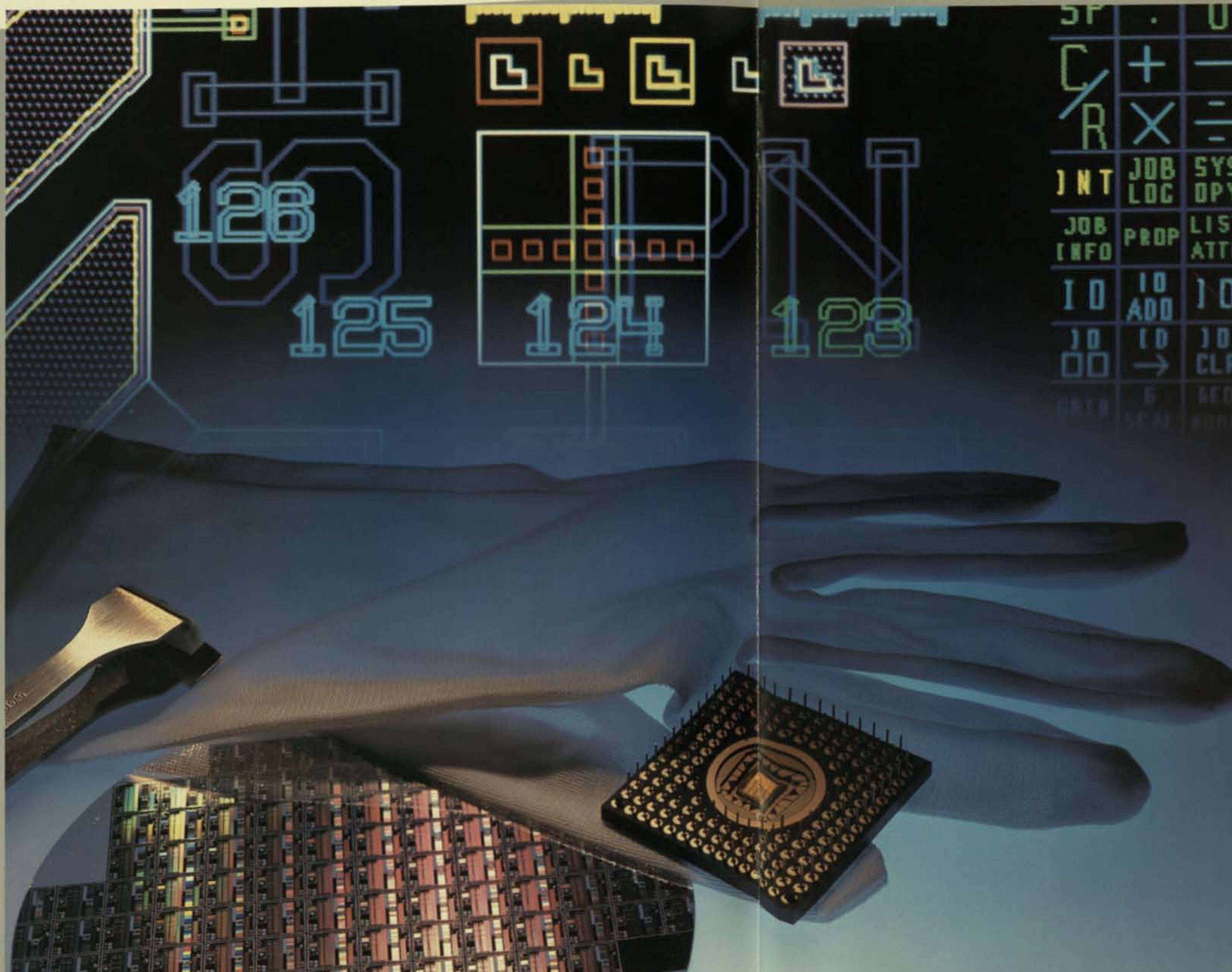
Half of the Tandem organization is dedicated to field service, customer service and support activities. The Tandem Executive Institute, for example, conducts 4-day seminars on using technology to gain competitive advantage for customers and prospects in specific industries. The institute and its industry-expert guest speakers have been host to hundreds of senior management people from the world's largest corporations.

4. *Support and Maintainability.* Half of the entire Tandem organization worldwide is composed of marketing and service people. They support customers through activities that include customer education, field service and applications support—a good part of the reason why Tandem ranks first in the industry for customer satisfaction and loyalty. And the Tandem NonStop architecture allows maintenance to be performed without interrupting customer operations because repairs can be made while the system is running.

5. *Price/Performance.* At all transaction volume levels, Tandem systems offer the best price/performance. More importantly, the total cost of NonStop system ownership is extremely attractive. Reliable data, no downtime and low program development costs ensure economy. And the system's flexibility allows the user to reconfigure systems and networks of systems, without replacing equipment or rewriting software.

6. *Demonstrated Leadership.* Customers make major commitments to Tandem because our dedication to quality and innovative product development protects their investments in Tandem systems.

For the first time in the history of its annual "Supplier Superior Performance Award", Hughes Aircraft's Radar Systems Group honored a computer company. In making the 1983 award to Tandem President Jim Treybig (right), Hughes' Dick Bringuel said, "After the product is delivered, it's the service that counts ...the NonStop II system went on-line ahead of schedule and performed perfectly."



PRODUCT DEVELOPMENT

Tandem is attuned to rapidly changing marketplace requirements. We have unmatched experience in on-line transaction processing and close relationships with users who are developing advanced applications. Over the past five years, the company has invested more than $100 million to develop hardware and software products that make our customers more productive and profitable.

Sustained technological leadership

Tandem's focus on on-line transaction processing since its founding has provided the organization with a vast amount of knowledge about the particular needs of the marketplace. Our experience and understanding enable us to provide products and enhancements specifically designed to allow our customers to do more and more on-line transaction processing applications, and to do them cost-effectively.

Users share the benefits of our unique product development leverage.

Tandem is committed to technological leadership in our marketpace. We have invested more than $100 million in product development activities over the past five years. In the past two years alone, our product development expenditures were more than twice the total amount spent over our entire previous corporate history. This investment is highly leveraged: The modularity and compatibility of our hardware and software products mean that time and dollars directed at product development and enhancement programs benefit our entire family of products. And that means that all users reap the benefits of increased functionality, productivity, ease of use and improved price/performance.

The NonStop TXP system exemplifies the ability of Tandem to develop products that fill the needs of our marketplace. Using our advantages of years of experience in this market and a large customer base, our development team created a technique to model actual applications so they could design the system to maximize transaction processing performance. As a result, the TXP system utilizes a unique combination of 64-bit, 32-bit and 16-bit features that are optimized for on-line transaction processing.

Tandem's software development focus has also been on protecting and leveraging our customers' investments in their Tandem systems—as well as their earlier data processing investments. For example, in 1983 we delivered our SNAX software product that enables EXPAND network users to access IBM SNA networks, devices and applications programs while retaining the reliability and flexibility of NonStop systems. We also delivered the most advanced software products available for distributed relational data base management, networking and communications—all designed to increase our users' programming productivity.

Tandem has invested in technologies and design techniques to further enhance the company's ability to anticipate and meet customers' needs. For example, our engineers extensively used computer-aided techniques to create the NonStop TXP system. We have also built an advanced laboratory where we are designing our next generation of chips and developing techniques to speed the development cycle.

The requirements for on-line transaction processing constantly expand—in part because Tandem has given customers the ability to do more. Tandem will continue to lead the way, capitalizing on our experience and understanding to develop the products for the market of the future.

Tandem Product Development Expenditures

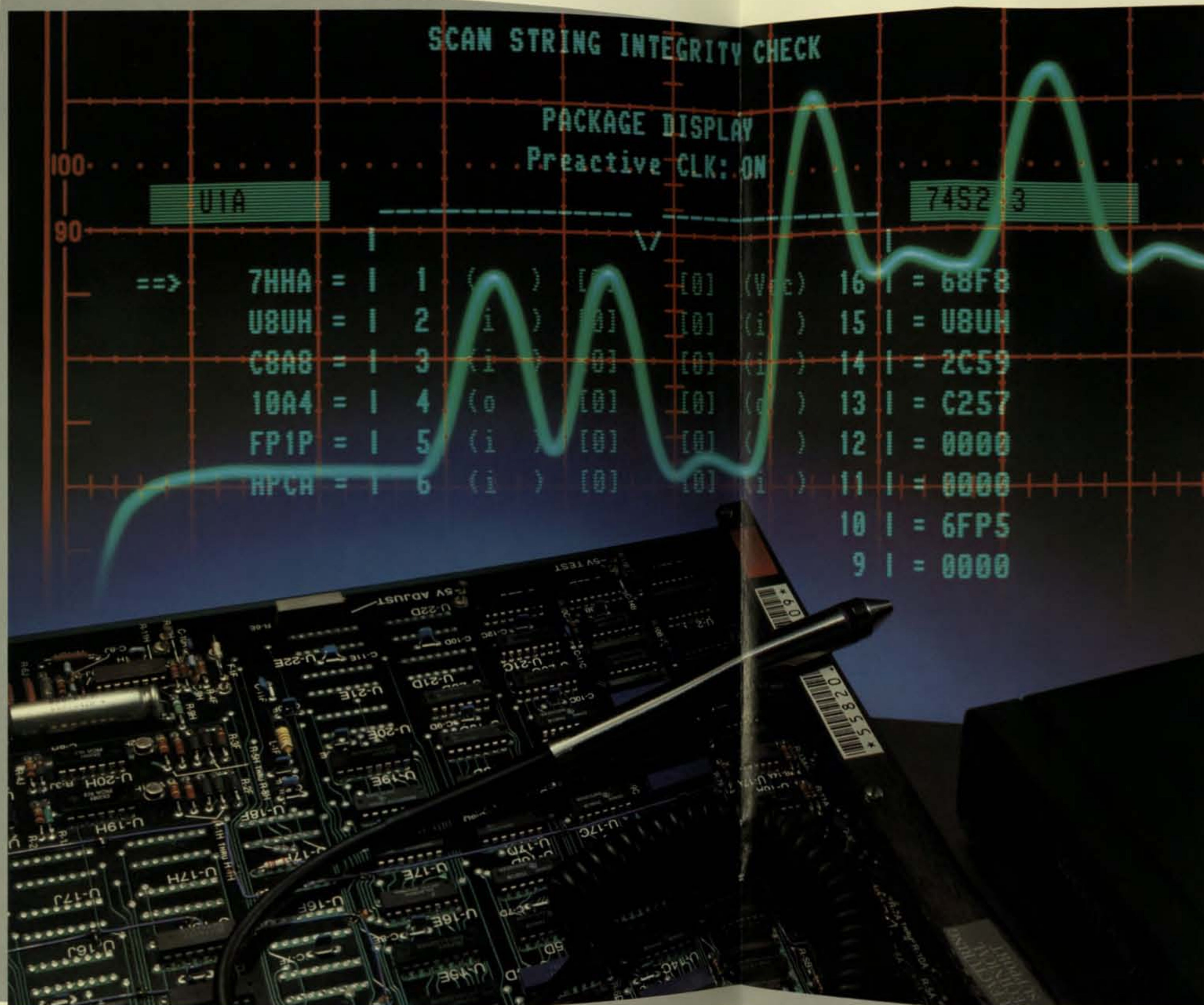
$ Millions

1979	1980	1981	1982	1983
$4.7	$8.9	$17.8	$33.6	$39.2

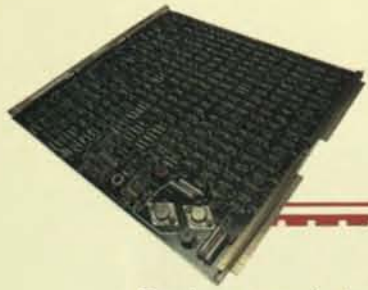
▲
In addition to working on enhancements to disc subsystems, terminals and data base management systems that optimize NonStop system price/performance, functionality, programming ease and user friendliness, Tandem is developing processors for the future.

Tandem's INFOSAT product extends the NonStop system advantages to satellite-based computer networks. INFOSAT's unprecedented reliability is enhanced by a self-diagnostics package, the only one of its kind, that automatically identifies and isolates down to the component level any malfunctions in the dual-path system.
▼

▲
One of Tandem's many product development contributions during 1983 was FOX, Tandem's fiber optic link that quickly and inexpensively ties together up to 224 NonStop processors in a high-speed local network, creating a system more powerful than the largest conventional mainframe computer.



Advanced automation technologies and participative management techniques introduced at Tandem manufacturing facilities have significantly increased productivity and product quality. They play an important part in sustaining Tandem's aggressive price/performance position in the marketplace.



Advanced techniques to achieve high productivity

Tandem manufacturing facilities, which are among the most advanced in the world, contribute to the company's competitiveness in the marketplace.

The integration of technology and participative management techniques at our plants has substantially enhanced productivity and product quality. They are key factors in our ability to deliver products with attractive price/performance ratings while maintaining acceptable product margins.

New techniques and technologies strengthen our ability to meet constantly increasing demand for our products.

At our computer terminal manufacturing plant in Austin, Texas, for example, the combination of automation and participative management resulted in inventory turn rates and sales per employee in 1983 that are well above the industry average.

The Austin plant has no assembly lines: Each Tandem terminal is completely assembled and tested by one person who personally "signs" the completed unit.

The plant is paperless: Everyone uses terminals tied to a Tandem system as production tools to control the manufacturing process.

Production decisions that were once made only by managers are made by the people who make the products: Everyone participates in weekly plant meetings and daily "focus group" meetings to set and review goals.

The meetings are called and run by the workers: Managers attend and provide open-book information on how the business is progressing.

Quality is a major end result: Virtually every unit produced passes all test procedures the first time.

Our Austin operation is so impressive that scores of executives from major industrial companies—prospects for Tandem systems—toured the facility during 1983. And we are adopting the Austin techniques in other Tandem facilities as well.

We have also automated the assembly operations at our circuit board facility in Watsonville, California. Slow, tedious work that was previously performed manually is now accomplished with greater speed and accuracy using computer-controlled equipment.

Our manufacturing emphasis on quality and productivity has led us to develop our own sophisticated testing equipment for NonStop processor circuitry. Last year we developed an automatic testing system called ORACLE that gave us testing capabilities not previously possible—and reduced the circuit board testing cycle from 30-60 minutes to 3-6 minutes, a tenfold increase in productivity.

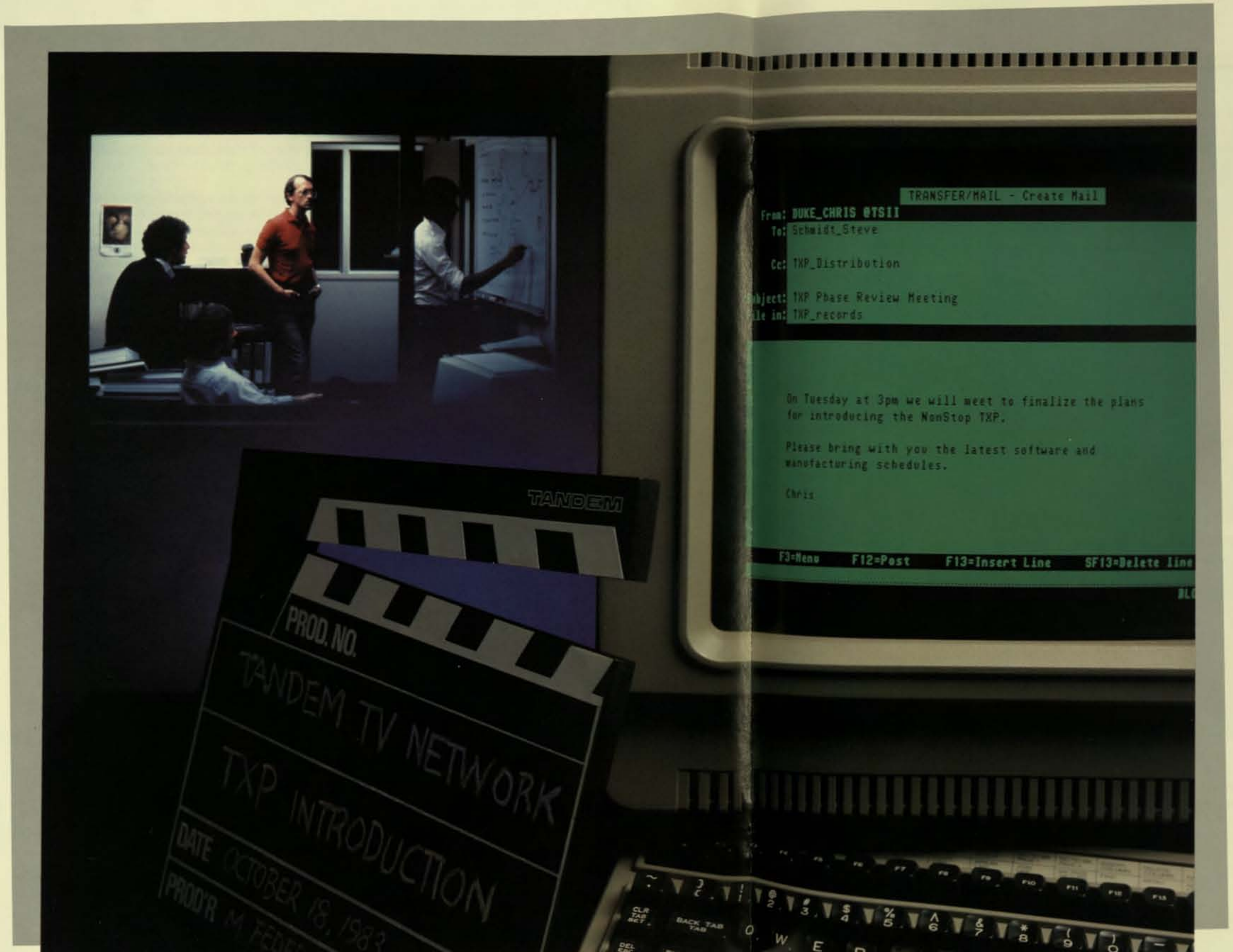
Even as ORACLE was being installed, we were at work on MERLIN, the next generation of automated system diagnostics. To create the new NonStop TXP system, engineers in product development and manufacturing pursued complementary approaches that took advantage of new scan logic design techniques. The result was a system with greatly enhanced testability. Utilizing MERLIN, the need for manual test programming was eliminated.

▲
At Tandem's new paperless plant in Austin, each person builds and tests a complete terminal, and "signs" the finished product.

MERLIN increases testing productivity by as much as 120 times, completing some test phases that would have taken up to six minutes in as little as three seconds.

Tandem has an outstanding record of meeting production targets. The new techniques and technologies, in addition to enabling us to build quality products at lower cost, strengthen our ability to meet constantly increasing demand for our products.

▲
Participative management techniques developed at Tandem's Austin plant are being introduced successfully at other Tandem facilities. At Tandem's power supply manufacturing facility in California, workers use such techniques as this "focus group" meeting to improve performance. The result: a three-fold increase in productivity, lower costs, improved inventory management and enhanced product quality.



Tandem's effectiveness is due in large part to the cohesiveness that results from widespread individual understanding of company goals and how individual performance affects those goals. Much of the employees' understanding comes from our use of advanced techniques and technologies to foster communication and participation.

Creativity, Productivity, Contribution

Tandem's success results directly from the creativity, productivity and contribution of its people. As the company grows larger, a key challenge is facilitating communication within a multinational organization. Tandem is meeting that challenge by utilizing advanced techniques and technologies to foster communication and participation, and to manage the company.

Democratic management practices tap the creativity of employees at all levels and increase our productivity.

Written and electronic media augment personal contact to communicate information and to share ideas.

Tandem's own technology supports people in their jobs via one of the largest computer networks in the world. Our EXPAND network links more than 150 nodes, bringing applications programs and electronic mail to employees at Tandem's worldwide locations.

Along with our commitment to keep Tandem a good place to work, we also focus on the disciplines necessary to achieve growth while maintaining profitability.

Employee publications, including CENTER magazine, NonStop News and technical and marketing publications, distribute information about the company's activities, products, customers, philosophy and goals throughout the organization. Our electronic classrooms utilize videotape, computer programs and live broadcasts along with personal instruction to train employees. Tandem's management development program helps people and the company grow through course offerings in management skills with particular emphasis on communicating. The Tandem Television Network produces live, interactive broadcasts to 37 Tandem locations, bringing timely information about technical issues, our financial performance, programs and objectives, and other important activities within the company.

Along with striving to keep Tandem a good place to work, we also focus on the disciplines necessary to achieve growth while maintaining profitability. We continue to improve our control systems. Over the past year we have added key managers to emphasize critical planning and control functions. And we have seen the results in tremendously increased organizational strength.

Tandem's philosophy includes enabling all employees to participate in the financial success of the company. In addition to the benefits of a stimulating place to work and opportunities for contribution and recognition, employees have the opportunity to own Tandem stock. In fiscal 1983, through purchases of stock and exercises of stock options, employees contributed $25 million in cash to Tandem. The employees' level of participation in these stock ownership plans attests to the commitment and faith of our employees in the company's future.

Tandem Employee Productivity

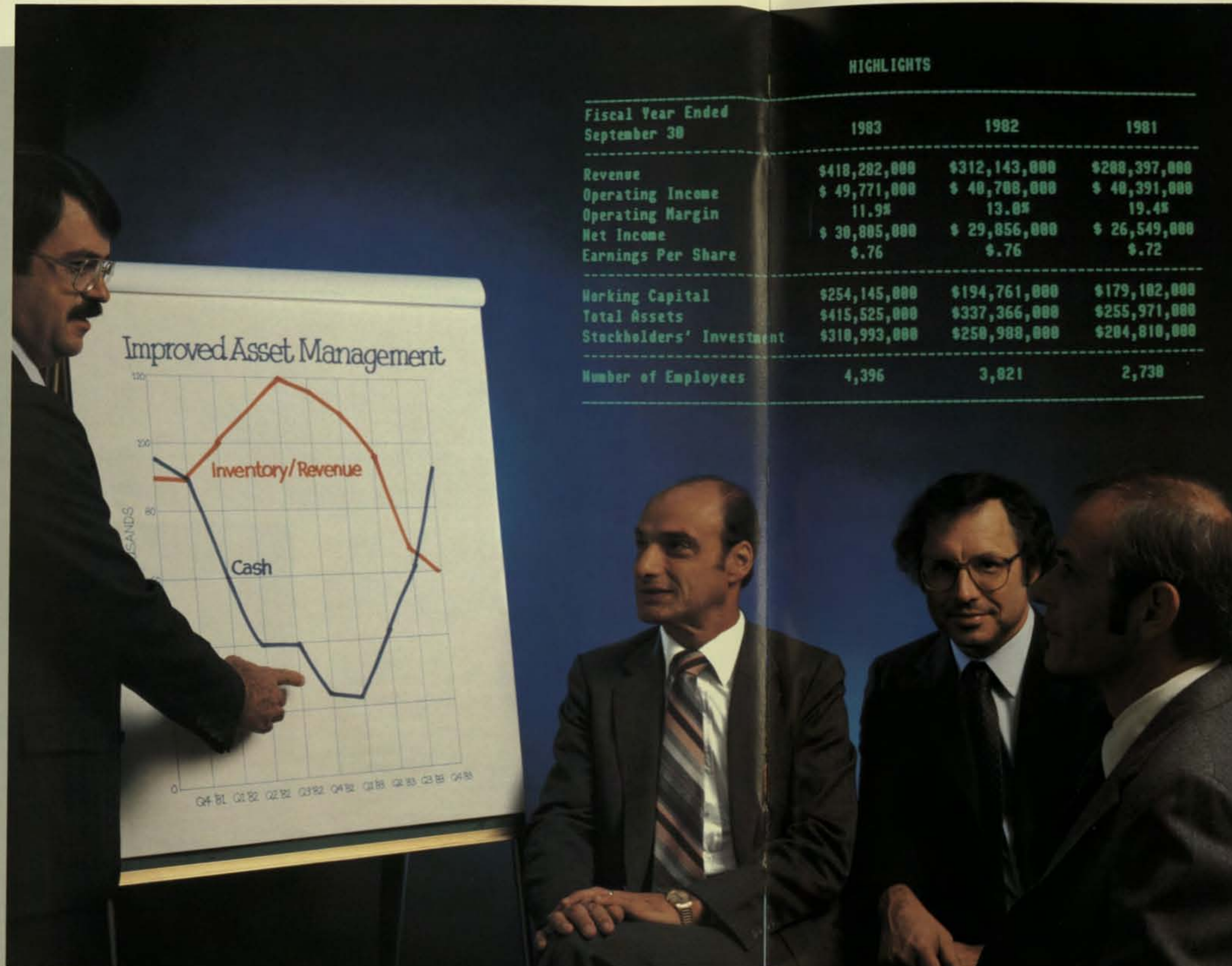
$ Thousands

1979	1980	1981	1982	1983
$87.9	$98.4	$101.2	$95.3	$101.8

Revenue per employee (avg. number of employees)

▲ *Tandem electronic classrooms utilize advanced techniques and technologies to instruct employees in comprehensive courses including sales, manufacturing, technology, professional and management development, and the Tandem philosophy.*

Announcement of an upcoming Tandem Outstanding Performers (TOPS) bonus trip to Hawaii was made during one of the many company-wide Tandem Television Network broadcasts during 1983. TOPS, one way that Tandem recognizes and rewards outstanding contributors, provides an opportunity for exceptional employees from all areas of the company to exchange ideas. ▶



HIGHLIGHTS

Fiscal Year Ended September 30	1983	1982	1981
Revenue	$418,282,000	$312,143,000	$208,397,000
Operating Income	$ 49,771,000	$ 40,708,000	$ 40,391,000
Operating Margin	11.9%	13.0%	19.4%
Net Income	$ 30,805,000	$ 29,856,000	$ 26,549,000
Earnings Per Share	$.76	$.76	$.72
Working Capital	$254,145,000	$194,761,000	$179,102,000
Total Assets	$415,525,000	$337,366,000	$255,971,000
Stockholders' Investment	$310,993,000	$250,988,000	$204,810,000
Number of Employees	4,396	3,821	2,730

The company made major progress during 1983 in improving asset management through strengthened management systems. Among the results are a $15 million reduction in inventories and a $69 million increase in cash to a year-end cash balance of $94 million. Seen at far left is Lary Evans, vice president of manufacturing, meeting with (from left) Bob Marshall, senior vice president and chief operating officer; Jim Treybig, president and chief executive officer; and Jan Jensen, vice president, human resources.

As we look back in fiscal 1983, we believe that Tandem became a much stronger organization during the course of the year. Despite the fact that the economic recession continued to impact our customers and therefore impact Tandem, our revenues grew 34 percent. More importantly, this was a year when the Company strengthened its management organization, control systems, and asset management, while maintaining our emphasis on product development and marketing.

Shortly after the close of the fiscal year, we announced our innovative new computer system, the NonStop TXP. At the time of the announcement, the new machine was already in production and installed at four customer sites. Early customer response has been enthusiastic.

The NonStop TXP system is the most powerful machine in the world for on-line transaction processing. The 32-bit, multiple processor based TXP system provides users with two to three times the processing power of the NonStop II system, and reduces the cost per transaction by up to 50 percent. The TXP system achieves an unprecedented level of hardware and software compatibility. Our customers can even combine NonStop II processors and TXP processors within the same system. They can also run existing application programs on the TXP system.

With this addition to the product line, in 1984 we offer a full range of price-performance to address the complete spectrum of processing needs for our marketplace.

Strengthening our Operations
Our revenue growth rate exceeded that of most computer companies during this recessionary year; however, it was slower growth than Tandem had experienced in prior years. Tandem used this period of relatively slower growth to focus on internal operations, devoting time and effort to strengthening the organization in order to maximize our growth opportunities in the future. We

believe that we have made Tandem a much stronger organization. Asset management has improved greatly. Better control of capital spending, inventory, and accounts receivable has contributed to a dramatic increase in our cash balance, which will help us fund our growth in the coming year.

Other internal developments during the year included a continuing emphasis on cost control measures instituted in November of 1982. We have programs in place to control hiring and salaries as well as discretionary spending. We initiated a new internal audit function to further identify ways to improve our systems and controls. In addition, we added David Rynne to our management staff as Vice President and Chief Financial Officer. Prior to joining Tandem, Mr. Rynne was with the Burroughs Corporation for 18 years where he held various finance positions, including most recently vice president and corporate controller.

In the manufacturing area, in addition to improving inventory control, we have also invested in automation and productivity. A new facility in Watsonville, California came on-line this year that is a state-of-the-art, fully automated board assembly and test facility. This plant will allow us to produce the majority of our board needs in a highly efficient facility. Our Austin, Texas terminal manufacturing plant uses a computer-aided manufacturing system that has resulted in a truly paperless factory. Manufacturing productivity was further enhanced by the in-house development of tools that use scan logic to improve product testing and reliability.

Our strong commitment to research and development continues. In product development over the past two years, Tandem has invested more than $70 million, greater than two times the amount invested during our entire previous corporate history. The most visible results of that investment are new products such as SNAX software that enables our EXPAND network users to access IBM SNA networks, devices, and applications programs while retaining the reliability and flexibility of NonStop systems; the FOX fiber optic extension that allows the connection of up to 14 closely proximate NonStop systems into a very high-speed information network; and the top-of-the-line NonStop TXP system.

Tandem invested extensively in technology as well. For example, this year we expanded our computer-aided design capability and opened an LSI lab for prototype chip development. Further, throughout the year, about 50 percent of our development people were working on enhancements to existing products, while the other 50 percent were developing new products that will be introduced in coming years.

We have continued to invest in marketing. In 1983 we inaugurated the Tandem Alliance, a new program to enhance our relationship with software houses. We also furthered our emphasis on major account marketing during the year. In addition to beginning some exciting new projects with existing customers, we increased our customer base by 126, with 47 new customers added in the fourth quarter. This has augmented our established position as a leader in the market for on-line transaction processing.

Financial Performance
Some challenges remain. While revenue for the fiscal year ended September 30, 1983 grew 34 percent to $418,282,000 from $312,143,000 a year earlier, operating income increased 22.3 percent to $49,771,000 compared to $40,708,000 in fiscal 1982. Operating margins were under pressure this year due to increased cost of revenue. The combination of excess manufacturing capacity and the Company's successful inventory reduction program, which required lower production levels, resulted in substantially higher overhead costs being applied to products shipped. Earnings per share were $.76 in both years. Earnings per share were flat despite the increase in operating income due to lower net interest income and a higher effective tax rate. Although the Company's cash balances grew markedly during the year, much of this cash build-up occurred in the latter half of the year, so most interest-earning funds were only available part of the year. In addition, the prevailing interest rates were substantially lower than in the prior fiscal year.

Outlook
The people at Tandem worked with dedication and sacrifice to improve our operations while launching exciting new products and expanding our marketing efforts. We will continue to work hard to improve margins while emphasizing customer satisfaction and investing for our future growth. We feel we are in an excellent position to capitalize on improvements in the economy. While European operations continue to experience weak economic conditions and the adverse effects of the strong dollar, we believe we have seen a strengthening of the domestic economy. With the combination of outstanding employees, unique and innovative products, a high-potential marketplace, an impressive customer base, and a strengthened internal organization, we feel optimistic that fiscal 1984 will be a year of improved operating results.

Eugene Kleiner
Eugene Kleiner has decided not to stand for reelection as a director. Gene was instrumental in the formation and initial funding of the Company. He has served as a director since the Company's founding and has been a significant factor in its success. We will miss him.

Thomas J. Perkins
Chairman of the Board

James G. Treybig
President and
Chief Executive Officer

December 1, 1983

TANDEM COMPUTERS INCORPORATED AND SUBSIDIARIES

SELECTED FINANCIAL DATA

For the Five Years Ended September 30, 1983

(In thousands except per share amounts)	1983	1982	1981	1980	1979
Revenue	$418,282	$312,143	$208,397	$108,989	$ 55,974
Cost of revenue	168,708	109,305	75,547	40,831	20,786
Product development	39,168	33,642	17,833	8,786	4,654
Marketing, general and administrative	160,635	128,488	74,626	40,049	20,828
Operating Income	49,771	40,708	40,391	19,323	9,706
Interest income, net	730	6,033	10,707	1,759	398
Provision for income taxes	(19,696)	(16,885)	(24,549)	(10,395)	(5,184)
Net Income	$ 30,805	$ 29,856	$ 26,549	$ 10,687	$ 4,920
Earnings Per Share	$ .76	$ .76	$ .72	$ .35	$ .20
Total assets	$415,525	$337,366	$255,971	$ 95,701	$ 45,947
Long term debt and capitalized lease obligations	23,957	21,102	2,054	1,651	1,144
Stockholders' investment	310,993	250,988	204,810	70,294	31,530

Overview

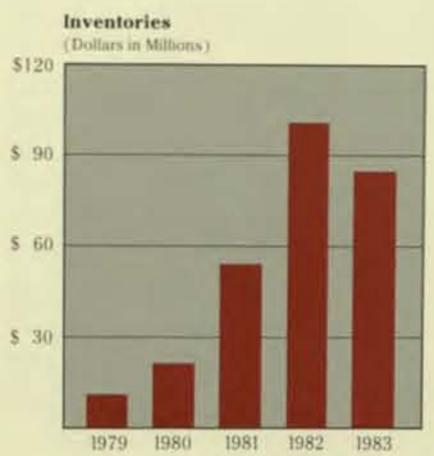
Tandem Computers is committed to being a technological leader in the rapidly growing market for on-line transaction processing systems and networks of on-line systems. Achieving the Company's technological leadership goal involves many factors, including strategic market positioning, an ongoing commitment to product development, and an organizational structure and philosophy that fosters employee productivity and creativity. It is also critical to maintain a financial position and operating record that allow the Company to maximize its performance in an environment of rapid growth.

Financial Condition

Maintaining a sound financial position is a high priority within Tandem. The Company's financial condition improved significantly in 1983 as a result of the emphasis placed on asset management. Inventory levels declined, and accounts receivable grew at a rate substantially below that of revenue growth. Capital spending was held to a conservative level. As a consequence of improved asset management, along with employee purchases of stock and funds generated from operations, cash and cash investments increased by $68,685,000, to $93,501,000 as of September 30, 1983.

An important part of Tandem's corporate philosophy is to provide all employees with the opportunity to share in the Company's financial success by means of stock ownership. As a result of employee participation in the employee stock purchase program and exercises of stock options, the Company generated $25,031,000 in cash in fiscal 1983, $12,249,000 in fiscal 1982, and $9,669,000 in fiscal 1981.

The Company's financial strategy also includes maintaining a sound ratio of current assets to current liabilities and a conservative capital structure. At the end of fiscal 1983, the current ratio was 5.5:1, long term debt and capitalized lease obligations were 7.7 percent of total capital, unused revolving lines of credit totaled $67,117,000, and the Company's equity base was $310,993,000. Tandem believes this strategy provides it with maximum near term and long term flexibility to consider the full range of financing alternatives to fund the capital needs of its projected future growth.



Results of Operations

The table below summarizes the changes in selected operating indicators for the fiscal years presented. The numbers on the left account for the revenue dollar by showing various income and expense items as a percentage of revenue. The numbers on the right measure the yearly percentage increases (decreases) in the same items.

% of Revenues				% Increase (Decrease)		
1983	1982	1981		1983	1982	1981
100	100	100	Revenue	34	50	91
40	35	36	Cost of revenue	54	45	85
9	11	9	Product development	16	89	103
38	41	36	Marketing, general and administrative	25	72	86
12	13	19	Operating income	22	1	109
–	2	5	Interest (net)	(88)	(44)	509
12	15	25	Pretax income	8	(9)	106
5	5	12	Provision for taxes	17	(31)	136
7	10	13	Net income	3	12	148
			Earnings per share	0	6	106
			Weighted average shares outstanding	4	6	22

Numbers may not total due to rounding.

Revenue

Tandem Computers' revenue gains over the last three years have resulted directly from increased shipments of its computer hardware and software products to new and existing customers, and from increases in the number of customers using its support and training services. In both fiscal 1982 and 1983, the Company's revenue growth was affected by economic recession, leading to a slowing of revenue growth in certain geographic regions.

During fiscal 1983, the Company shipped 1,773 processors to 509 customers, compared with 1,542 processors to 483 customers in fiscal 1982, and 1,210 processors to 436 customers in fiscal 1981. The fourth quarter of fiscal 1983 was a particularly strong period for new customer generation, with 47 new customers added. To date, the Company has 5,824 processors installed with 725 customers.

International revenue grew at a slower rate than domestic revenue in fiscal 1983. Foreign revenue accounted for 30.3 percent of total revenue for fiscal 1983, compared to 33.5 percent and 34.3 percent for fiscal 1982 and 1981, respectively.

Operating Income

Operating margins of 12 percent in fiscal 1983 were below the Company's target range of 16 to 20 percent. The principal reason was that cost of revenue as a percent of revenue increased in fiscal 1983, due to higher costs relating to excess capacity, and to the effects of lower production rates resulting from our successful program to reduce inventory levels. Partly offsetting these higher costs was our significant improvement in manufacturing productivity, which enabled the Company to reduce manufacturing employment by six percent.

The Company targets product development expenditures in the range of 9 to 10 percent of revenue. Tandem's product development effort focuses on meeting the needs of computer users who are implementing on-line systems, both at single sites and in geographically distributed on-line information processing networks. The Company believes that the opportunities for technological innovation in this marketplace are enormous. Product development funds are being invested in enhancements to existing products and in important new products that will be introduced in future years.

The Company keys its marketing strategy on selling to users who are implementing major on-line applications. Providing a high level of service and support is essential to meeting the needs of this customer base. To maximize its long-term opportunities in this marketplace, Tandem has built a direct selling and support organization in the United States and, primarily through wholly-owned subsidiaries, in industrial markets throughout the world. The Company's marketing, general and administrative expenditures in fiscal 1983 were lower as a percent of revenue than in fiscal 1982, but were approximately in line on a percentage basis with the pattern of fiscal 1981 and prior years. Looking ahead, the Company believes that it is essential to invest in marketing in order to achieve future growth. A rate of expenditure on marketing and support similar to that experienced in fiscal 1983 and 1981 will be required to compete successfully in its marketplace.

Net Income and Earnings Per Share

Net income growth has differed from operating income growth over the past three fiscal years because of substantial changes in the Company's net interest income and effective tax rate. Operating income grew faster than net income in fiscal 1983 due to a substantial decline in net interest income and a higher tax rate, compared with fiscal 1982. Over the course of fiscal 1983, the Company has increased its cash balances from $24,816,000 at the end of fiscal 1982 to $93,501,000 at the end of the current fiscal year. Interest income has been earned on these balances. Because the majority of the increase in cash and cash investment balances occurred in the latter part of the fiscal year, and because debt obligations are primarily at higher fixed rates, net interest income was modest. Further, the rate at which interest was earned was lower than in the two previous fiscal years.

The Company's effective tax rate was 39 percent in fiscal 1983, compared with 36 percent in 1982 and 48 percent in 1981. The increase in effective tax rate versus 1982 is largely due to the reduced beneficial impact of tax incentives for investment in capital equipment resulting from the Tax Equity and Fiscal Responsibility Act of 1982. The fiscal 1982 tax rate decrease versus fiscal 1981 was attributable primarily to the tax incentives provided by the Economic Recovery Tax Act of 1981 for research and development expenditures and investment in capital equipment.

Earnings per share were flat versus 1982, while net income grew slightly. The difference is due to increases in weighted average shares outstanding. The Company's public offering of common stock in fiscal 1981, combined with sales of stock to employees under the stock purchase plan and grants under option plans, resulted in increases in weighted average shares outstanding of four percent in 1983, six percent in 1982, and 22 percent in 1981. Proceeds from the sale of these additional shares have been used to finance the capital expansion required to support the Company's growth during this period.

Effect of Inflation

See page 39 of this report for a discussion of the effect of changing prices on the Company's operations.

CONSOLIDATED STATEMENT OF INCOME

For the Three Years Ended September 30, 1983

(In thousands except per share amounts)	1983	1982	1981
Revenue			
Product revenue	$360,133	$272,591	$186,897
Service and other revenue	58,149	39,552	21,500
Total Revenue	418,282	312,143	208,397
Costs and Expenses			
Cost of revenue	168,708	109,305	75,547
Product development	39,168	33,642	17,833
Marketing, general and administrative	160,635	128,488	74,626
Total costs and expenses	368,511	271,435	168,006
Operating Income	49,771	40,708	40,391
Interest expense	(2,806)	(967)	(282)
Interest income	3,536	7,000	10,989
Income Before Income Taxes	50,501	46,741	51,098
Provision for income taxes	(19,696)	(16,885)	(24,549)
Net Income	$ 30,805	$ 29,856	$ 26,549
Earnings Per Share	$ .76	$ .76	$ .72
Weighted average shares outstanding	40,784	39,221	37,025

The accompanying notes are an integral part of this statement.

CONSOLIDATED BALANCE SHEET

As of September 30, 1983 and 1982

(In thousands except per share amounts)	1983	1982
Assets		
Current Assets		
Cash and cash investments	$ 93,501	$ 24,816
Accounts receivable, net of allowances of $2,851 in 1983 and $3,000 in 1982	119,558	98,810
Inventories	85,920	101,335
Prepaid expenses and other	11,775	17,013
Total current assets	310,754	241,974
Property, Plant and Equipment, At Cost		
Land	3,127	4,441
Machinery and equipment	35,162	25,767
Computer equipment and spares	59,836	44,274
Leasehold improvements	27,859	21,788
Construction in process	6,788	11,196
	132,772	107,466
Accumulated depreciation and amortization	(33,991)	(18,080)
Net property and equipment	98,781	89,386
Other Assets	5,990	6,006
Total Assets	$415,525	$337,366

Liabilities and Stockholders' Investment

	1983	1982
Current Liabilities		
Current portion of capitalized lease obligations	$ 3,335	$ 2,060
Accounts payable	27,960	22,918
Accrued liabilities:		
Wages, payroll taxes, and employee benefits	14,081	8,913
Income taxes	4,971	7,136
Other accrued liabilities	6,262	6,186
Total current liabilities	56,609	47,213
Capitalized Lease Obligations	15,434	10,378
Long Term Debt	8,523	10,724
Deferred Income Taxes	23,966	18,063
Stockholders' Investment		
Common stock $.025 par value, authorized 60,000,000 shares, outstanding 39,552,963 in 1983 and 37,634,754 in 1982	989	941
Additional paid-in capital	206,911	177,759
Retained earnings	103,093	72,288
Total stockholders' investment	310,993	250,988
Total Liabilities and Stockholders' Investment	$415,525	$337,366

The accompanying notes are an integral part of this balance sheet.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT

For the Three Years Ended September 30, 1983

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1980	30,075	$251	$ 53,555	$ 16,488	$ 70,294
Sale of common stock, net of related expenses	4,500	38	95,995	–	96,033
Sale of common stock under stock option plans	1,692	15	7,381	–	7,396
Sale of common stock under stock purchase plan	143	1	2,272	–	2,273
Capitalization of retained earnings for three-for-one stock split	–	605	–	(605)	–
Tax benefit from employee transactions in common stock	–	–	2,265	–	2,265
Net income	–	–	–	26,549	26,549
Balance September 30, 1981	36,410	910	161,468	42,432	204,810
Sale of common stock under stock option plans	863	22	5,028	–	5,050
Sale of common stock under stock purchase plan	362	9	7,190	–	7,199
Tax benefit from employee transactions in common stock	–	–	4,073	–	4,073
Net income	–	–	–	29,856	29,856
Balance September 30, 1982	37,635	941	177,759	72,288	250,988
Sale of common stock under stock option plans	1,634	41	19,054	–	19,095
Sale of common stock under stock purchase plan	284	7	5,929	–	5,936
Tax benefit from employee transactions in common stock	–	–	4,169	–	4,169
Net income	–	–	–	30,805	30,805
Balance September 30, 1983	39,553	$989	$206,911	$103,093	$310,993

The accompanying notes are an integral part of this statement.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Three Years Ended September 30, 1983

(In thousands)	1983	1982	1981
Funds (Cash and cash investments) at beginning of period	$ 24,816	$ 89,806	$ 16,245
Provided from Operations			
Sources:			
Net income	30,805	29,856	26,549
Depreciation and amortization	18,836	10,196	4,107
Deferred income taxes	5,903	9,920	4,818
Net book value of property, plant and equipment sold or retired	14,408	2,142	1,264
Total sources	69,952	52,114	36,738
Uses:			
Accounts receivable	20,748	28,139	28,119
Inventories	(15,415)	46,792	33,642
Net change in prepaid expenses and non-debt current liabilities	(13,359)	7,096	(17,246)
Investment in property, plant and equipment	42,222	65,819	27,238
Increase in other assets	401	6,006	–
Total uses	34,597	153,852	71,753
Net provided from (used in) operations	35,355	(101,738)	(35,015)
Provided from External Financings			
Net increase in capitalized leases	6,331	9,702	609
Increase (decrease) in long term debt, net	(2,201)	10,724	–
Sale of common stock, net of related expenses	–	–	96,033
Sale of common stock under employee stock option and stock purchase plans	25,031	12,249	9,669
Tax benefit from employee transactions in common stock	4,169	4,073	2,265
Total provided from external financings	33,330	36,748	108,576
Funds (Cash and cash investments) at end of period	$ 93,501	$ 24,816	$ 89,806

The accompanying notes are an integral part of this statement.

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition

The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Exchange Gains and Losses

Foreign exchange and translation gains and losses are not significant and are reflected in the results of operations.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include materials, labor, and manufacturing overhead. The components of inventories as of September 30 were:

(In Thousands)	1983	1982
Purchased parts and subassemblies	$36,887	$ 56,822
Work-in-process	12,519	13,413
Finished goods	36,514	31,100
Total	$85,920	$101,335

Income Taxes

The Company provides for income taxes on total DISC income and accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are realized.

Property, Plant and Equipment

Systems spares ($19,271,000 in 1983 and $15,869,000 in 1982) are depreciated over a five-year period using the double declining balance method. All other property, plant and equipment are depreciated using the straight-line method. The estimated useful lives are:

Machinery and equipment	5-10 years
Computer equipment and spares	5- 7 years
Leasehold improvements	Lease term

Earnings Per Share

Earnings per common share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of stock options outstanding that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

2. Income Taxes

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1983	1982	1981
Current Federal	$ 1,370	$ 5,516	$15,356
Current State	1,532	3,633	3,771
Current Foreign	4,621	2,244	1,401
	7,523	11,393	20,528
Prepaid Federal	4,731	(3,333)	(1,205)
Prepaid State	309	(253)	(180)
Prepaid Foreign	1,230	(842)	588
	6,270	(4,428)	(797)
Deferred Federal	5,843	6,656	4,325
Deferred State	225	239	194
Deferred Foreign	(165)	3,025	299
	5,903	9,920	4,818
Total Provision	$19,696	$16,885	$24,549

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1983	1982	1981
Installment sale method for income tax reporting	$ 8,572	$ 3,657	$ –
Expenses recognized for financial statements, but not for income tax reporting	810	(1,505)	(897)
Effect of intercompany profit eliminations	(4,143)	(2,654)	(2,522)
Other items	1,031	(3,926)	2,622
Total Prepaid	$ 6,270	$(4,428)	$ (797)
DISC income	$ 3,181	$ 3,918	$ 3,230
Accelerated depreciation	2,628	2,799	1,192
Other items	94	3,203	396
Total Deferred	$ 5,903	$ 9,920	$ 4,818

The provision for income taxes differs from the amount obtained by applying the Federal statutory income tax rate to income before taxes as follows:

	1983	1982	1981
Federal statutory tax rate	46%	46%	46%
State taxes, net of Federal income tax benefit	4	4	4
Investment tax credits	(4)	(8)	(3)
Research and development tax credits	(7)	(8)	(1)
Other	–	2	2
Effective Tax Rate	39%	36%	48%

3. Lease and Other Commitments

The Company leases its headquarters, operating facilities, field offices, and automobiles under operating lease agreements. The Company also has capitalized leases for certain equipment. Future lease payments as of September 30, 1983 are as follows:

(In thousands)	Leases	
Fiscal Year	Operating	Capital
1984	$ 29,856	$ 5,764
1985	27,325	5,632
1986	25,448	5,391
1987	22,815	5,140
1988	21,135	3,915
Thereafter	130,840	–
Total minimum lease payments	$257,419	25,842
Less: Amount representing interest (4%-17%)		7,073
Present value of minimum lease payments		$18,769

Capitalized leases totaling $22,038,000 and $12,999,000 are included in the machinery and equipment and computer equipment and spares classification on the Balance Sheet at September 30, 1983 and 1982, respectively.

Rent expenses were $30,458,000 in 1983, $20,895,000 in 1982, and $8,908,000 in 1981.

4. Long Term Debt

Long term debt as of September 30 consists of the following:

(In thousands)	1983	1982
Construction financing	$ 4,203	$ 8,724
Industrial revenue bonds bearing interest of 12% to 12-3/8%, due 1992, collateralized by equipment in Austin, Texas	2,000	2,000
15% promissory note payable in annual installments through 1986	1,640	–
Other, bearing average interest of 8.6%	680	–
	$ 8,523	$10,724

Construction financing at September 30, 1983 is related to a facility in Austin, Texas. During June 1983, the Company retired $7,125,000 of construction financing relating to a facility in Watsonville, California pursuant to a sales/leaseback transaction. The associated lease has been accounted for as an operating lease. Interest costs of $644,000 and $508,000 relating to these construction projects were capitalized during fiscal 1983 and 1982, respectively.

The Company has entered into unsecured credit agreements totaling $72,000,000 with several banks. The agreements provide for revolving borrowings through various dates in 1984 and 1985, at which time outstanding amounts may be converted into term loans repayable in equal quarterly installments through 1987. Domestic borrowings bear interest at or below the banks' prime rates during the revolving period and approximately 1/4% above these rates during the term period. The Company is required to pay a commitment fee of 3/8% per annum. Of these facilities, $22,000,000 have been earmarked by Tandem for the construction referred to above. The remaining $50,000,000 are for working capital purposes and contain provisions for Eurocurrency and foreign local currency borrowings at interest rates prevailing in these markets. There are no compensating balances required under any of these arrangements.

Certain financial covenants and restrictions are included in the loan agreements, including a restriction on payment of cash dividends. The Company was in compliance with all such covenants and restrictions at September 30, 1983.

5. Preferred and Common Stock

Preferred Stock

The Company has 2,400,000 shares of preferred stock authorized.

Stock Option Plans

The Company has employee stock option plans under which permanent employees may be granted options to purchase shares at 100% of fair market value at the time of the grant. Options generally become exercisable six months after the effective date and expire no later than seven years after the effective date. At the discretion of the Company, options granted under the stock option plans may qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981.

As of September 30, 1983 options for 4,516,866 shares were outstanding at prices ranging from $3.92 to $29.13, with an average price of $19.75. Options for 4,169,216 shares were exercisable as of September 30, 1983. Options for 4,521,639 shares are available for future grant. Options were exercised at prices ranging from $.58 to $26.88 in 1983, $.17 to $26.88 in 1982, and $.08 to $22.88 in 1981.

Employee Stock Purchase Plan

As of September 30, 1983 the Company has reserved 2,608,040 shares for future issuance under its employee stock purchase plan. Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of common stock at 85% of fair market value as of the beginning or end of a three-month offering period. Under the second method, the Company may grant to employees the option to purchase common stock at not less than 85% of fair market value at the grant date. As of September 30, 1983 options to purchase 30,800 common shares at $26.90 and 204,500 common shares at $12.43 were outstanding under the second method. Such options are exercisable through January 29, 1984 and through November 15, 1984, respectively.

6. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three years ended September 30, 1983.

	Geographic Area			Adjustments	
(In thousands)	United States	Europe	Other	and Eliminations	Consolidated
1983					
Revenue-Customer	$297,722	$91,100	$29,460	$ –	$418,282
Revenue-Intercompany	68,001	–	–	(68,001)	–
Revenue-Total	365,723	91,100	29,460	(68,001)	418,282
Pre-Tax Income	49,084	11,546	(1,127)	(9,002)	50,501
Identifiable Assets	336,193	73,923	26,058	(20,649)	415,525
1982					
Revenue-Customer	$215,154	$74,958	$22,031	$ –	$312,143
Revenue-Intercompany	60,126	–	–	(60,126)	–
Revenue-Total	275,280	74,958	22,031	(60,126)	312,143
Pre-Tax Income	43,949	9,267	22	(6,497)	46,741
Identifiable Assets	276,886	56,685	15,863	(12,068)	337,366
1981					
Revenue-Customer	$144,392	$47,294	$16,711	$ –	$208,397
Revenue-Intercompany	37,580	–	–	(37,580)	–
Revenue-Total	181,972	47,294	16,711	(37,580)	208,397
Pre-Tax Income	50,297	4,145	2,139	(5,483)	51,098
Identifiable Assets	213,693	34,592	12,471	(4,785)	255,971

Intercompany transfers are made at approximately arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $6,400,000 in 1983; $7,687,000 in 1982; and $7,397,000 in 1981.

7. Unaudited Quarterly Financial Data

(In thousands except per share amounts)	Quarters Ended Dec. 31	Mar. 31	June 30	Sept. 30
Year ended September 30, 1983:				
Revenue	$94,135	$96,006	$110,291	$117,850
Costs and Expenses				
Cost of revenue	37,955	37,856	45,117	47,780
Product development	8,997	9,805	9,961	10,405
Marketing, general and administrative	35,548	37,945	41,561	45,581
Total costs and expenses	82,500	85,606	96,639	103,766
Operating Income	11,635	10,400	13,652	14,084
Interest income, net	47	(184)	251	616
Income Before Income Taxes	11,682	10,216	13,903	14,700
Provision for income taxes	4,556	3,765	5,462	5,913
Net Income	$ 7,126	$ 6,451	$ 8,441	$ 8,787
Earnings Per Share	$ .18	$ .16	$ .21	$ .21
Year ended September 30, 1982:				
Revenue	$70,985	$74,101	$ 79,823	$ 87,234
Costs and Expenses				
Cost of revenue	25,181	26,657	26,968	30,499
Product development	6,816	7,733	9,200	9,893
Marketing, general and administrative	27,636	31,277	33,162	36,413
Total costs and expenses	59,633	65,667	69,330	76,805
Operating Income	11,352	8,434	10,493	10,429
Interest income, net	2,302	1,306	1,489	936
Income Before Income Taxes	13,654	9,740	11,982	11,365
Provision for income taxes	5,866	3,518	4,469	3,032
Net Income	$ 7,788	$ 6,222	$ 7,513	$ 8,333
Earnings Per Share	$ .20	$ .16	$ .19	$ .21

8. Information on the Effects of Inflation
(Unaudited)

The Company has provided an adjusted summary of operations and selected financial data in accordance with the Financial Accounting Standards Board in its Statement No. 33 concerning "Financial Reporting and Changing Prices." This guideline requires that inflation-adjusted information be computed using two methods, "constant dollar" and "current cost." This disclosure requirement is experimental and involves considerably more judgment than traditional financial statements, and therefore should be reviewed with caution.

Under the "constant dollar" method, historical results are restated into dollars having the same purchasing power as measured by the Consumer Price Index for All Urban Consumers (CPI-U). The "current cost" method requires the Company to adjust asset values based on specific indices and appraisals.

Neither method allows for inflation adjustments to operating expenses, revenue or net interest income, nor an adjustment to the tax provision, despite the decrease in pretax income which results from the inflation adjustments of the two methods. Only the cost of revenue and depreciation expense related to assets, which are restated for inflation effects, are adjusted.

For both methods, depreciation is computed on a straight-line basis, rather than the accelerated basis that is used for some assets in the Company's historical financial statements, because the accelerated method already recognizes some of the effects of inflation.

Net income for fiscal 1983 was lower under both methods because of higher depreciation and amortization expense. As a result of higher asset values under the inflation-adjusted methods, depreciation and amortization expenses were also higher. Companies who hold monetary assets during a period of inflation lose purchasing power. Tandem held net monetary assets during the period, and their purchasing power declined.

Of the two methods, the Company believes that the current cost method more accurately reflects the impact of inflation on Tandem. The CPI-U used in the constant dollar method contains items unrelated to the nature of the Company's business, and also does not attempt to measure the impact of inflation on its foreign operations.

CONSOLIDATED STATEMENT OF INCOME ADJUSTED FOR INFLATION
FOR THE YEAR ENDED SEPTEMBER 30, 1983

(In thousands except per share amounts)	In Average 1983 Dollars Historic Cost	Constant Dollar	Current Cost
Total Revenue	$418,282	$418,282	$418,282
Cost of revenue, excluding depreciation and amortization	165,352	169,555	165,352
Other costs and expenses, excluding depreciation and amortization	184,323	184,323	184,323
Depreciation and amortization	18,836	20,852	20,305
Interest (income), net	(730)	(730)	(730)
Provision for income taxes	19,696	19,696	19,696
Net income	$ 30,805	$ 24,586	$ 29,336
Earnings Per Share	$ .76	$ .60	$ .72
Net Assets at Year-end	$310,993	$312,887	$312,434
Decrease in purchasing power of net monetary items		$ 2,816	$ 2,816
Increase in value of inventories, property, plant and equipment held during the year:			
Measured in general prices			$ 5,040
Measured in specific prices			3,889
Excess of increase in general price level (constant dollars) over increase in specific prices			$ 1,151

At September 30, 1983, current cost of inventory was $85,968 and current cost of property, plant and equipment net of accumulated depreciation was $105,628.

FIVE YEAR COMPARISON OF SELECTED FINANCIAL DATA ADJUSTED FOR INFLATION
(Revenue dollars in thousands)

	In Average 1983 Dollars 1983	1982	1981	1980	1979
Total revenue					
Constant dollars	$418,282	$322,948	$231,648	$134,543	$78,496
Market price per share at end of period					
Constant dollar	$ 34.77	$ 22.95	$ 29.13	$ 20.67	$ 7.50
Average CPI (1967=100)	295.9	286.0	266.2	239.7	211.0

AUDITORS' REPORT

To Tandem Computers Incorporated:

We have examined the consolidated balance sheet of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1983 and 1982, and the related consolidated statements of income, stockholders' investment, and changes in financial position for each of the three years in the period ended September 30, 1983. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1983 and 1982, and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1983, all in conformity with generally accepted accounting principles applied on a consistent basis.

San Jose, California
November 9, 1983

Arthur Andersen & Co.

TANDEM STOCK PRICE

Calendar Quarter Price	High	Low
1983 3rd Quarter	36-1/2	26
2nd Quarter	34	25-1/2
1st Quarter	30-1/2	23-5/8
1982 4th Quarter	32-3/4	21-3/4
3rd Quarter	25-3/8	14-1/2
2nd Quarter	29	22
1st Quarter	28-1/2	21
1981 4th Quarter	34	27-1/4
3rd Quarter	32	24
2nd Quarter	34-5/8	24-3/4
1st Quarter	25-1/2	20-1/2

Tandem Computers Incorporated has been traded via the NASDAQ National Market System under the trading symbol TNDM since the second calendar quarter of 1982. Beginning in the second quarter of 1982, the quotations represent the high and low sales prices. Quotations that pertain to earlier periods represent prices between dealers without adjustment for mark-up, markdown, or commissions and may not represent actual transactions. All prices have been adjusted for stock splits. No dividends have been declared on the common stock.

Produced by George E. Browne & Associates ☐ Corporate Liaison: Cacey Tangney ☐ Design: Kay Woon ☐ Principal photography: Larry Keenan ☐ Printed in U.S.A.

Board of Directors

Thomas J. Perkins,
Chairman of the Board; Partner, Kleiner, Perkins, Caufield & Byers

Morton Collins,
Partner, DSV Partners III

Thomas J. Davis, Jr.,
Partner, Mayfield II

Franklin P. Johnson, Jr.,
Chairman, Asset Management Capital Company

Eugene Kleiner,
Partner, Kleiner, Perkins, Caufield & Byers

Robert C. Marshall,
Senior Vice President and Chief Operating Officer, Tandem Computers Incorporated

John B.M. Place,
Chairman of the Board and Chief Executive Officer, Crocker National Corporation

Robert G. Stone, Jr.,
Chairman of the Board, Kirby Exploration Company

James G. Treybig,
President and Chief Executive Officer, Tandem Computers Incorporated

Auditors

Arthur Andersen & Co.,
San Jose, California

Registrar and Transfer Agent

Bank of America N.T.&S.A.,
San Francisco, California

Form 10-K

A copy of the company's Form 10-K, as filed with the Securities and Exchange Commission, is available on written request. Please direct request to:

Treasurer's Office
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Friday, February 10, 1984, at the corporation's headquarters.

Tandem

Corporate Headquarters
19333 Vallco Parkway
Cupertino, California 95014-2599
(408) 725-6000

Trademark

Tandem, NonStop, NonStop II, NonStop TXP, ENCOMPASS, ENFORM, EXPAND, TRANSFER and TXP are trademarks and service marks of Tandem Computers Incorporated. INFOSAT is a joint trademark of Tandem and American Satellite Company.

Officers

James G. Treybig,
President and Chief Executive Officer

Robert C. Marshall,
Senior Vice President and Chief Operating Officer

Michael K. Bateman,
Vice President and Division Manager

Thomas A. Bechler,
Vice President and Division Manager

Jack W. Chapman,
Vice President and Managing Director, European Division

George Eckert,
Vice President and Division Manager

Lary L. Evans,
Vice President, Manufacturing

Jan E. Jensen,
Vice President, Human Resources

Lawrence A. Laurich,
Vice President, Hardware Development

David R. Mackie,
Vice President, U.S. Marketing

Dennis L. McEvoy,
Vice President, Software Development

Michael C. Moore,
Vice President and Division Manager

Henry V. Morgan,
Vice President, Controller and Secretary

Gerald L. Peterson,
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Jerald D. Reaugh,
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David J. Rynne,
Vice President and Chief Financial Officer

Stephen C. Schmidt,
Vice President, Strategic Planning and Product Management

Jeanne D. Wohlers,
Vice President-Finance, Treasurer, and Assistant Secretary

Charles J. Yazel,
Vice President and Division Manager

Domestic Sales and Service Offices

ARIZONA, Phoenix

ARKANSAS, Little Rock

CALIFORNIA, Culver City, Irvine, Long Beach, Los Angeles, Orinda, Riverside, Sacramento, San Diego, San Francisco, Santa Clara, Universal City

COLORADO, Englewood

CONNECTICUT, Hartford, Stamford

FLORIDA, Jacksonville, Miami, Tampa, Winter Park

GEORGIA, Atlanta

HAWAII, Honolulu

ILLINOIS, Chicago, Itasca, Oakbrook, Schaumburg

INDIANA, Indianapolis

IOWA, Cedar Rapids, Des Moines

KANSAS, Overland Park

LOUISIANA, Metairie

MARYLAND, Linthicum

MASSACHUSETTS, Newton

MICHIGAN, Ann Arbor, Grand Rapids, Livonia

MINNESOTA, Minneapolis

MISSOURI, Maryland Heights

NEBRASKA, Omaha

NEVADA, Las Vegas

NEW JERSEY, Cardiff City, Hasbrouck Heights

NEW MEXICO, Albuquerque

NEW YORK, Jericho, New York City, Pittsford

NORTH CAROLINA, Charlotte, Greensboro

OHIO, Cincinnati, Cleveland, Columbus

OKLAHOMA, Oklahoma City, Tulsa

OREGON, Portland

PENNSYLVANIA, Horsham, Pittsburgh

TENNESSEE, Memphis

TEXAS, Austin, Dallas, Fort Worth, Houston

UTAH, Salt Lake City

VIRGINIA, Falls Church, Reston, Richmond

WASHINGTON, Bellevue

WEST VIRGINIA, Charleston

WISCONSIN, Brookfield

International Subsidiaries

AUSTRALIA
Tandem NonStop Pty. Ltd
Adelaide, Brisbane, Melbourne, Perth, Sydney

BELGIUM
Tandem Computers SA/NV
Brussels

CANADA
Tandem Computers Canada LTD
Montreal, Ottawa, Toronto, Vancouver

DENMARK
Tandem Computers A/S
Taastrup

FRANCE
Tandem Computers S.A.
Rungis-Cedex

GERMANY
Tandem Computers GMBH
Dortmund, Duesseldorf, Frankfurt, Hamburg, Mannheim, Munich, Stuttgart

HONG KONG
Tandem Computers Hong Kong LTD.
Kowloon

ITALY
Tandem Computers Italia S.P.A.
Milan, Rome

JAPAN
Tandem Computers Japan LTD
Nagoya, Osaka, Tokyo

THE NETHERLANDS
Tandem Computers BV
The Hague

NEW ZEALAND
Tandem NONSTOP Pty. Ltd.
Wellington

NORWAY
Tandem Computers A/S
Hovik

SINGAPORE
Tandem Computers Int'l Inc.
Singapore

SWEDEN
Tandem Computers AB
Malmoe, Solna

SWITZERLAND
Tandem Computers A.G.
Zurich

UNITED KINGDOM
Tandem Computers LTD
Birmingham, High Wycombe, London, Northolt, Rochdale

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ARGENTINA
BAHRAIN
FINLAND
GREECE
ISRAEL
KOREA
KUWAIT
MEXICO
PHILIPPINES
SAUDI ARABIA
TAIWAN
UNITED ARAB EMIRATES
VENEZUELA

TANDEM COMPUTERS ANNUAL REPORT 1984

Tandem Computers Incorporated designs, develops, manufactures, markets and supports a family of unique computer systems for on-line transaction processing. The Tandem NonStop system concept provides the first on-line, distributed computer architecture for mainstream business applications. Customers' systems are supported from over 100 locations throughout North America, Europe, Asia and the Pacific. The Company operates five manufacturing facilities in the United States and one in Germany.

H I G H L I G H T S

Fiscal Year Ended September 30	1984	1983	1982
Revenue	$532,620,000	$418,282,000	$312,143,000
Operating income	$ 51,101,000	$ 49,771,000	$ 40,708,000
Operating margin	9.6%	11.9%	13.0%
Net income	$ 42,908,000	$ 30,805,000	$ 29,856,000
Earnings per share	$1.04	$.76	$.76
Working capital	$263,403,000	$254,145,000	$194,761,000
Total assets	$501,873,000	$415,525,000	$337,366,000
Stockholders' investment	$375,122,000	$310,993,000	$250,988,000
Number of employees	5,223	4,396	3,821

Toward that end we are emphasizing:

☐ Managing our growth of personnel in line with revenue growth.

☐ Maintaining tight control over our cost structure.

☐ Continuing our successful asset management program.

To help our growth continue, we are:

☐ Aggressively pursuing third-party relationships to enhance the marketability of our products in target industries. During the year we increased by nearly 80% the number of software houses writing application programs to run on NonStop systems. We expect these joint-marketing arrangements to significantly leverage our marketing productivity.

☐ Augmenting our emphasis on software house relationships through new alliances with select equipment remarketers. These companies, which independently market value-added Tandem systems, will expand our presence in market segments where we do not concentrate our own marketing resources.

☐ Enlarging our sales force and bringing in salespeople experienced in providing total business solutions.

☐ Emphasizing low-end products to complement the high-performance TXP system, thereby extending our ability to penetrate new accounts and expand existing accounts. As a first step, we repriced the NonStop 1+ and NonStop II systems at aggressive levels. In 1985 new products will strengthen our low-end offerings further.

☐ Introducing a series of new products designed to widen our lead in high-performance transaction processing and to open new opportunities in the area of professional support products. ■

The market for on-line, distributed data processing systems is the fastest growing segment of the commercial computer industry.

FEDERAL EXPRESS INTRODUCES ZAPMAIL. THE TWO-HOUR DOOR-TO-DOOR DUPLICATE.

Federal Express introduced its ZapMail℠ service based on Tandem systems with this advertisement in 1984.

The market for on-line systems is huge and rapidly growing. It spans all industries and a vast array of applications.

A number of business needs drive this growth. To remain competitive in dynamic markets, businesses are moving on-line to:

☐ Offer new and better services to attract and retain customers.
☐ Improve profitability by lowering the cost of delivering services and producing products.
☐ Gain greater control over business information to make better business decisions, and make them more rapidly.

To achieve these critical objectives, businesses are converting from batch to on-line information processing. As a result, the marketplace for commercial computers is in rapid transition.

Entirely new applications are also fueling market growth. The combination of less costly, better-performing hardware and the growing availability of on-line applications software opens up new business opportunities for users.

And success breeds success. Successful applications in one area of a business can create potential in other operational areas. Half of our revenue comes from new applications–not only from new customers, but from new applications with existing customers. The remainder of our revenue comes from customers ▶

users must purchase excess capacity to accommodate change.

Add incremental capacity when needed without reprogramming, thereby protecting their investments in hardware and software.

Maintain consistent cost per transaction as the application grows and capacity is added.

High performance
The Tandem multiple-processor architecture and high-performance data base products provide users with fast and accurate information. And our distributed relational data base capabilities let customers put information where it is most needed and used.

Whether customers' data bases are large or small, simple or complex, Tandem systems provide outstanding performance at economical cost. We deliver high performance using our standard, general-purpose software.

Even in the most demanding environments, customers achieve high performance. Our users can:

☐ Accommodate large numbers of users simultaneously accessing a data base.

☐ Handle the largest data bases with fast transaction rates and short response time.

In a benchmark test conducted by a major U.S. business during 1984, for example, a TXP system – configured to only *one-seventh* of the maximum system size – outperformed one of the industry's most powerful mainframes.

Tandem systems are price/performance leaders across a broad performance range.

Networking and communications
The growing trend toward distributed data bases and application processing, and the proliferation of information-generating devices within a single organization, have clearly created a need for integration of all this information into a cohesive resource.

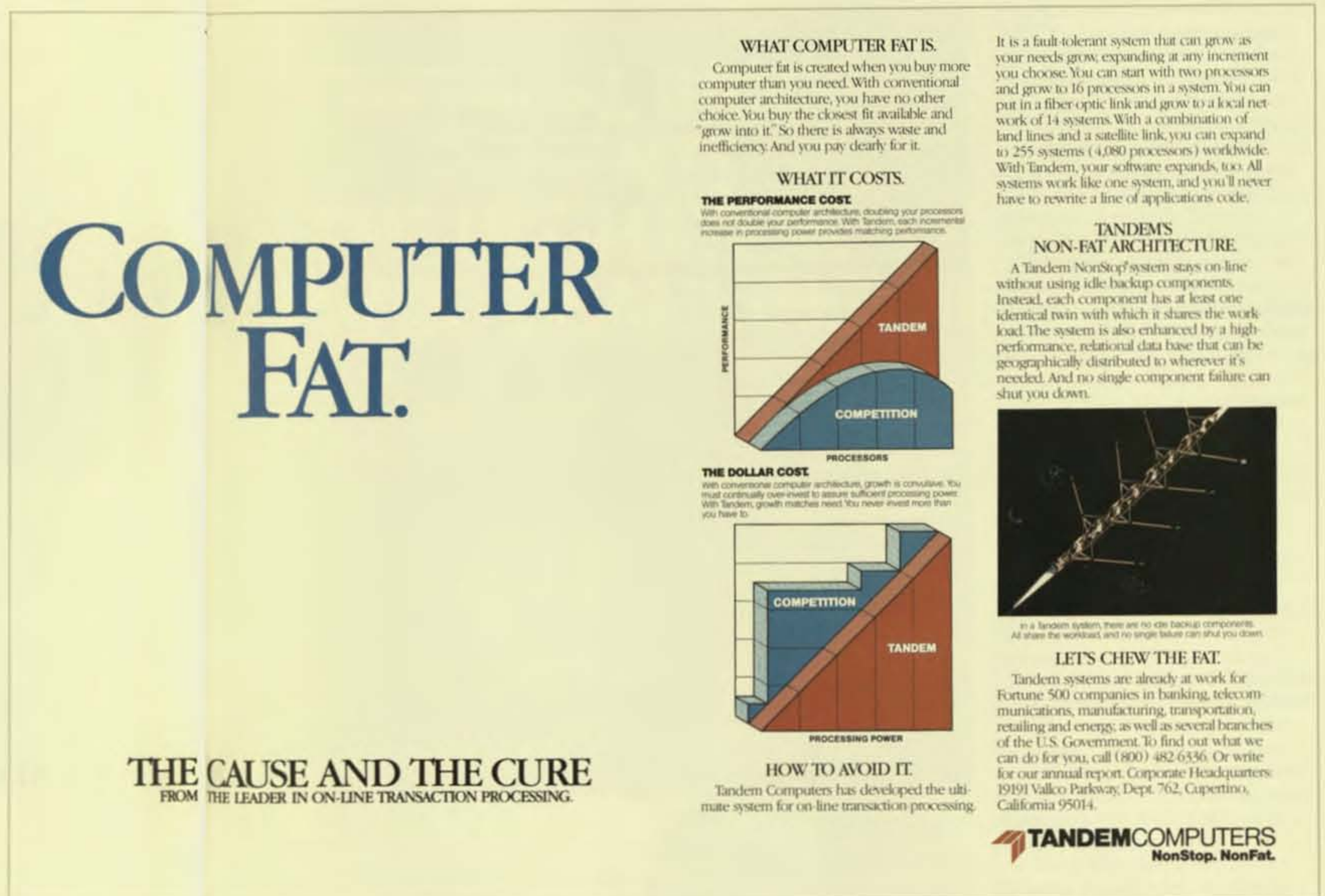
Tandem's network-oriented architecture is ideally suited to the integration task. Even a basic two-processor system operates like a network within a system. Using our EXPAND software and sophisticated communications offerings, customers can:

☐ Establish networks of up to 4,080 Tandem processors without rewriting applications software. And they can easily reconfigure the network as needs change.

☐ Distribute the data base to the points of greatest use, without increasing programming complexity.

☐ Leverage investments in other technologies. We provide highly functional links to other systems and devices, and to networks such as IBM System Network Architecture (SNA). According to industry analysts, Tandem's SNAX software is the most powerful SNA interface in the industry.

Tandem multifunction networks bring the highest level of flexibility, performance, functionality and economy to our customers' applications. ■



Tandem launched a new advertising campaign in the first quarter of fiscal 1985 to create greater awareness of NonStop systems' unique linear expandability.

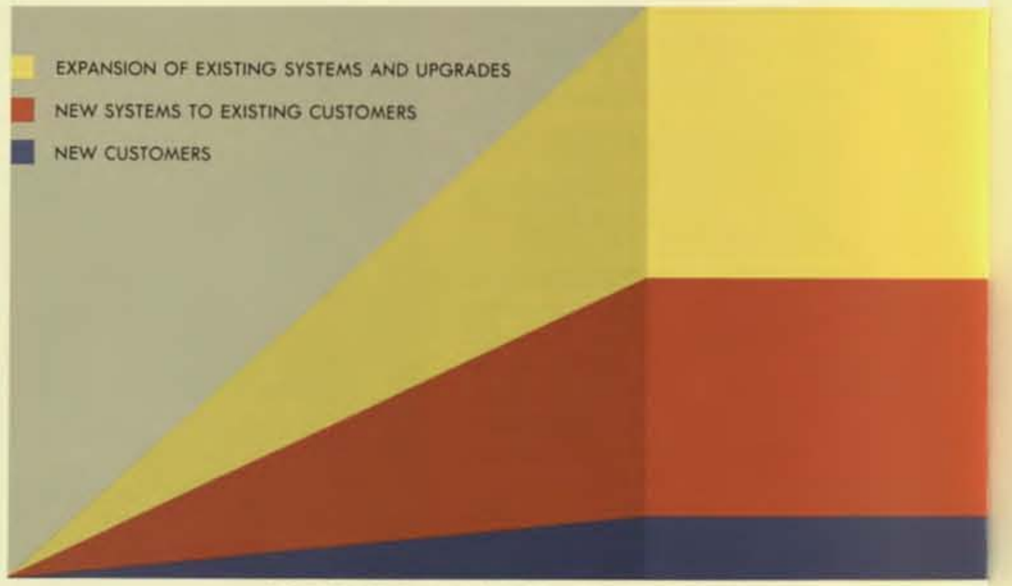
who are expanding existing applications or upgrading their systems.

Users evaluate on-line systems in a markedly different way from that of batch-processing systems. Tandem is a major supplier of systems to the on-line marketplace because we designed our system architecture to meet the new criteria:

Adaptability to constantly changing requirements. By definition, the user's on-line environment is more volatile, more unpredictable, than that of batch processing. The expandability of our NonStop systems makes it easy and economical for customers to enlarge existing applications, add new ones, and link them all together.

Competitive price/performance. The new on-line applications are either central to business operations or to customer services. In both cases, the cost per transaction directly affects profitability. The Tandem family of compatible systems brings price/performance leadership to a full range of application sizes.

Quality systems and applications software. On-line users are demanding innovative and often complex on-line applications. We provide advanced programming tools that simplify program development. In addition, our customers have access to a library of proven, economical application programs developed by Tandem Alliance software houses.



SOURCE OF TANDEM'S 1984 PRODUCT SALES

High-performance data base. Many of today's applications require on-line data bases that will support hundreds of transactions per second. Tandem's unique distributed data base architecture allows growth to very high transaction rates with manageable communication costs and assured data integrity.

Networking and communications capabilities. In order to exploit their new on-line applications efficiently, large organizations often need to distribute data bases and application processing, and to integrate existing information resources. Our architecture and systems software offer outstanding data communications and networking capabilities.

Reliable and available systems. Companies using computers to run their businesses cannot afford system failures or lost data. Tandem's fault-tolerant features are a fundamental strength that assures that all the other product benefits are constantly productive. ■

Tandem is widely recognized as the originator and premier supplier of general-purpose, fault-tolerant systems. But fault tolerance is only the beginning.

We designed our system architecture specifically for on-line applications and distributed data processing. It is singularly well suited to the on-line environment because it is based on independent, parallel processors with separate memory and high-speed interconnections, running a unique message-based operating system that optimizes the movement of transaction-like events throughout the system.

What this means for users is:

Fault tolerance is only part of the Tandem architectural contribution, and only the beginning of user benefits.

Easy, economical application growth

Tandem users can expand a system incrementally from the power of a large minicomputer to many times that of IBM's largest mainframe. Users with growing applications can enlarge each Tandem system modularly from 2 to 16 processors, or to as many as 224 processors in a local cluster using FOX, Tandem's fiber optic link. NonStop systems economically address application demands ranging from a few transactions per second to hundreds of transactions per second. As a result, Tandem users can:

Increase power linearly. When users double the number of Tandem processors, they get double the power.

Buy only as much capacity as they need. With conventional systems, ▶

HOW TANDEM SYSTEMS ARE USED

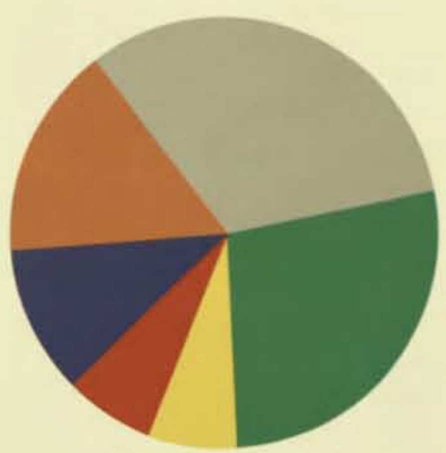
Our customer list spans many industries and reflects a rich variety of applications. Tandem systems are used in large and small applications, both centralized and decentralized, from the more classical to the most innovative.

Chances are you used a Tandem system today. You may have used a Tandem system if you purchased securities traded on one of the world's major stock exchanges; used an automated teller machine; made a long distance telephone call; used a debit card at a gasoline pump; read a newspaper; filed a medical insurance claim; telegraphed a money order; checked into a hospital; shopped or banked at home using home information services; purchased merchandise from a number of large retail establishments; or had a credit card purchase authorized.

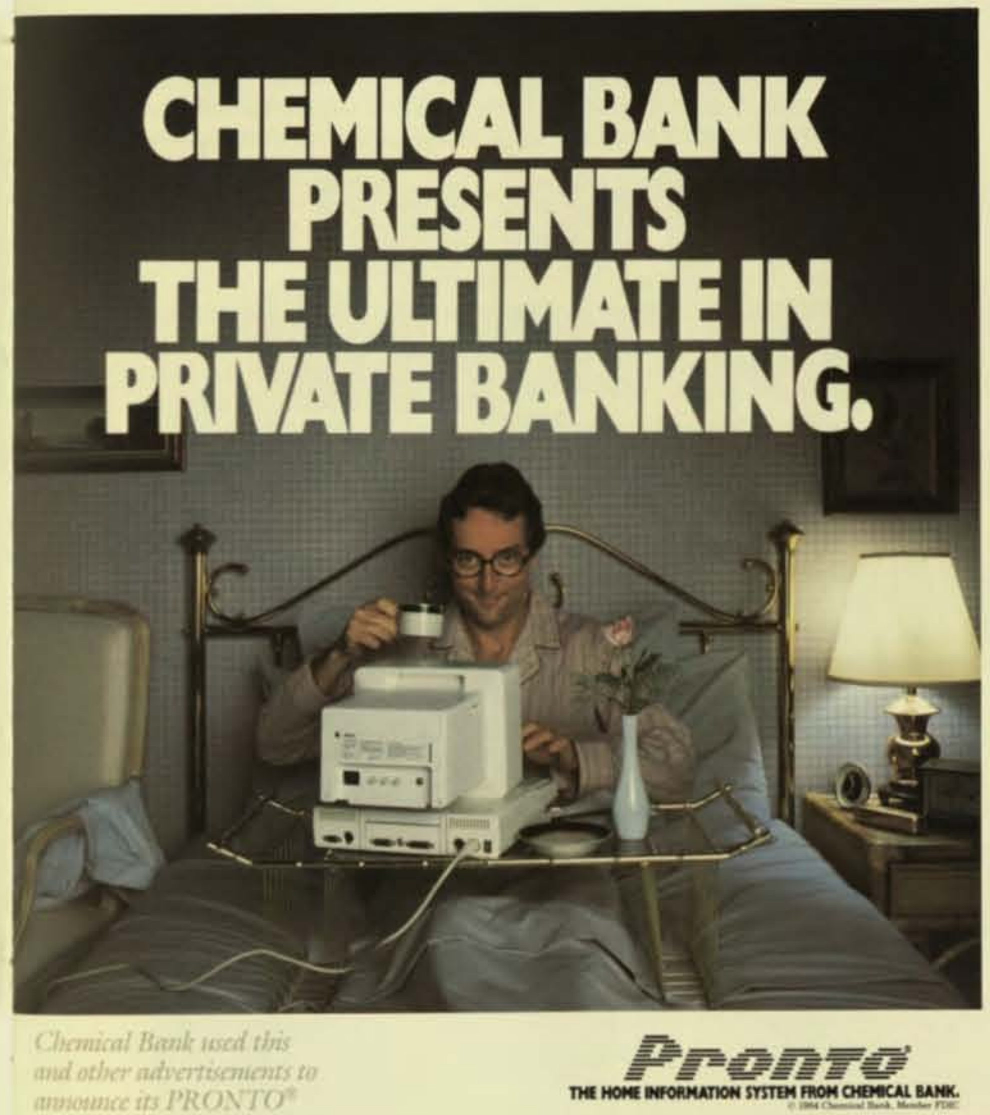
Because of the flexibility of the Tandem architecture and our broad-based price/performance competitiveness, Tandem systems are used in a wide variety of application types:

Beecham Cosmetics, whose product labels include such names as Jōvan, Yardley of London and

The modularity and performance continuum of our systems provides users with ideally sized products for all their needs.



1984 INDUSTRY SHIPMENTS



Chemical Bank used this and other advertisements to announce its PRONTO® home banking and information system in 1984, and by the end of the year had over 10,000 PRONTO customers in the metropolitan New York area. PRONTO is based on Tandem systems.

Vitabath, went from *batch* to *on-line* in 1979 to automate order processing and distribution for their rapidly growing business. NonStop system expandability has enabled Beecham to add major new applications easily.

Thyssen, Germany's multibillion-dollar steel producer, is an example of a *stand-alone application* that has grown into a *network*. Thyssen ordered its first Tandem system in 1977 to automate its factories, and now runs its dispersed plants with a 10-node network of Tandem systems.

According to Thyssen, modular expandability of Tandem systems was a key reason for selecting Tandem: "With Tandem it has not been necessary to define the entire, complex distributed data processing problem before taking action. We are doing it one area at a time, and then integrating that system into the EXPAND network."

Union Bank of Finland has an *expanded system* of 50 processors linked by Tandem's FOX fiber optic extension to handle all of its retail banking services on-line with over 2,300 teller terminals and 140 ATMs at 560 locations throughout Finland.

The May Department Stores Company, one of the largest U.S. retailers, has a *large distributed data base* with more than 35 billion bytes of business information shared in a 12-node Tandem *network*.

The reservation system of Deutsche Bundesbahn, the German national railroad, is a *high-performance data base* application managing ▶

all train seats in six European countries. The yearly reservation volume is about 20 million seats—as many as 100,000 in a single day—booked via 3,500 terminals in Germany and 11 other European countries. FOX linked systems also handle the *communications switching*.

On-line users, as evident in the above examples, commonly need a spectrum of applications. Tandem systems are often used for many different applications within the same organization.

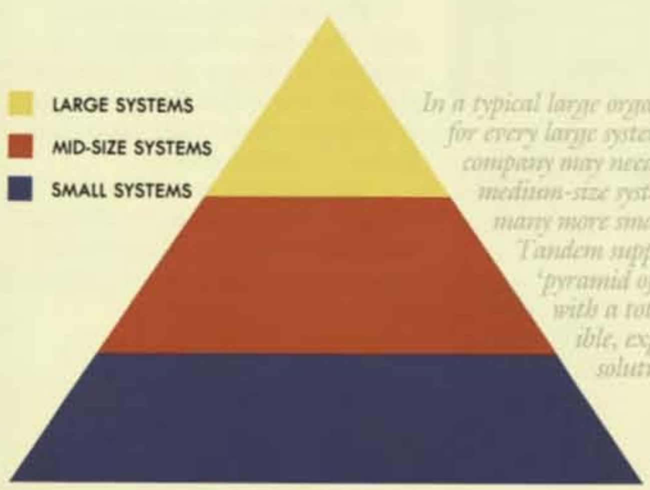
GTE, for example, uses Tandem systems in their separate SPRINT™ long distance telephone and TELEMAIL™ electronic message services.

A large organization also requires systems of varying capacity, often within the same application. It is not uncommon for a single large corporation to use the full range of Tandem system sizes to achieve optimum efficiency.

Extending the GTE example, that company administers its SPRINT subsidiary with a nationwide, 43-node network of low cost, small Tandem systems. Larger Tandem systems are used elsewhere in the SPRINT organization for such applications as on-line unit message billing. And an even larger Tandem system is used at SPRINT headquarters to integrate information from those and other related applications.

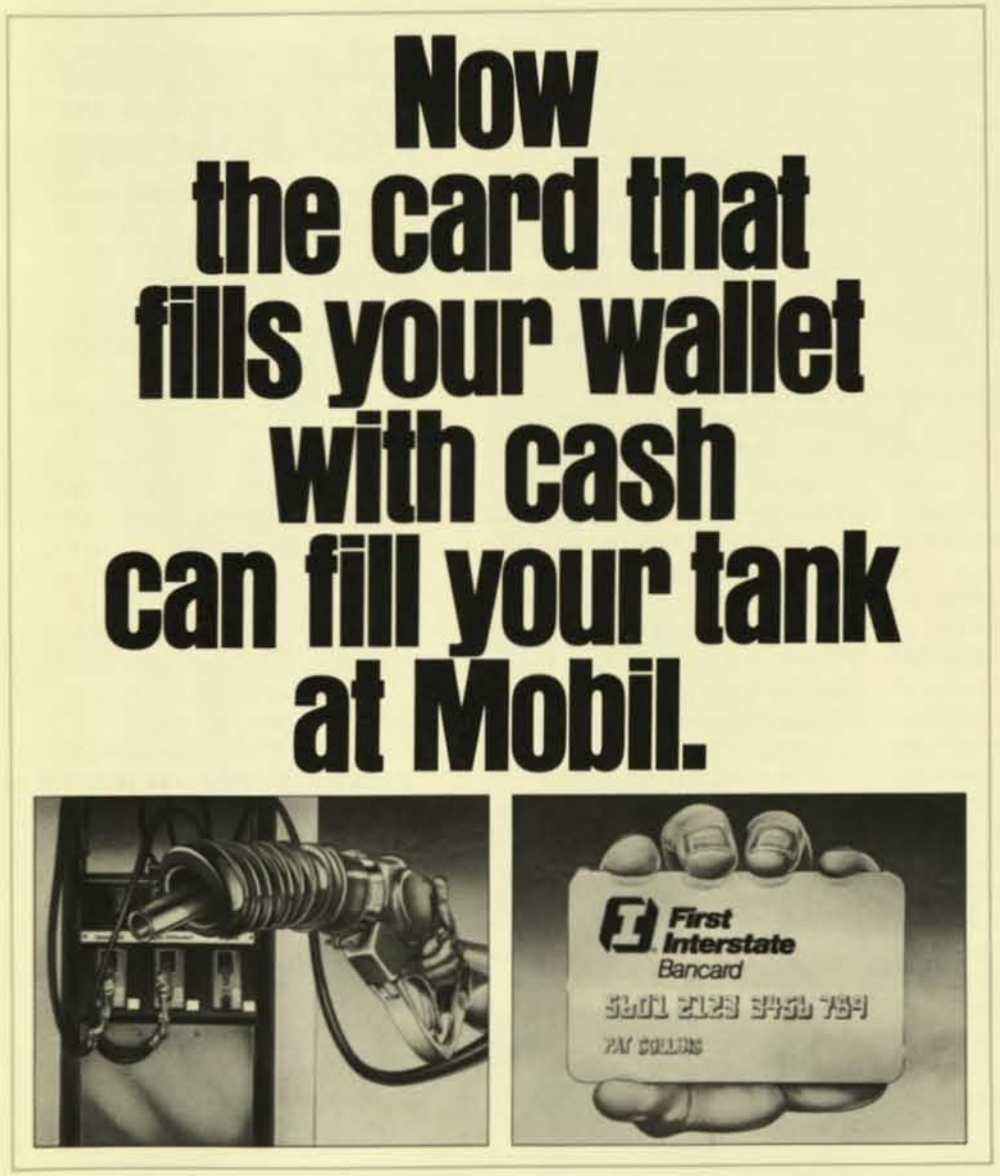
In a typical large organization, for every large system, a company may need several medium-size systems and many more small systems.

The modularity and performance continuum of our systems provides users with ideally sized offerings for all their needs. Tandem supplies this 'pyramid of needs' with a totally compatible, expandable solution. We benefit, too, because we can penetrate an account at the low, middle or high end of the user's performance and price needs. We can then share in the success of the application by expanding it, winning other applications, and extending our presence to other of the user's locations.



In a typical large organization, for every large system, a company may need several medium-size systems and many more small systems. Tandem supplies this 'pyramid of needs' with a totally compatible, expandable solution.

PYRAMID OF NEEDS



With advertisements such as this one, Mobil Oil and a number of U.S. banks began jointly promoting an automated system for using credit cards and ATM (automated teller machine) cards at Mobil stations. The Mobil application runs on Tandem systems.

TANDEM ALLIANCE

A top marketing priority at Tandem is to expand the availability of quality applications software designed for NonStop systems.

We created the Tandem Alliance program in late 1983 to develop relationships with key software houses and expand the presence of our existing software houses in order to broaden our marketing opportunities and effectiveness. By joining forces with applications software developers, we can:

☐ Provide total business solutions to attract new customers and create opportunities for additional business within existing accounts.
☐ Enhance the productivity of our sales force and accelerate the stream of revenues.
☐ Benefit customers by speeding their application development.

Software houses that joined the Tandem Alliance in 1984 will develop or adapt applications software in target industries that include manufacturing, telecommunications, transportation, and finance, as well as for the Federal government. We have also targeted point-of-sale for cross-industry applications. When these applications programs are completed, we and our Alliance members will jointly market powerful solutions for our customers' business needs.

Our approach is not limited to traditional software houses. Our customers, too, develop applications with significant commercial value. We have begun to form alliances with some of them to cooperatively market their proven applications to others in their industries.

As an example, we have joined with Michigan Bell, formerly an operating company within the ATT/Bell system and now a member of the Ameritech telephone companies. Together, we are marketing their application for collecting delinquent bills to other, newly independent telephone companies. Similarly, we and Indiana Bell will jointly market its on-line service order entry package.

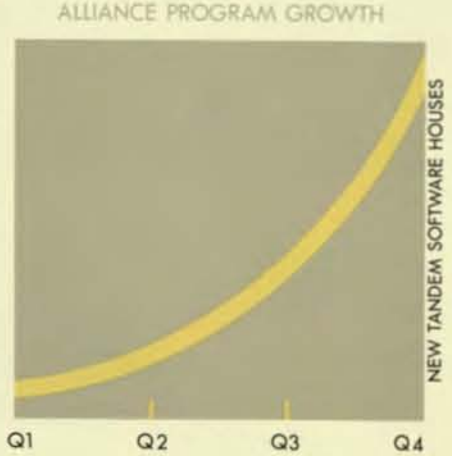
We have also joined with two Scandinavian Airlines System subsidiaries, Linjeflyg AB and Scanator AB, and with U.S.-based Bedford Associates to market an airline reservation system and a series of advanced software packages for airline management.

In the first full year of the program, our Alliance software developers participated in nearly half of our new account sales. During the year, we added 23 new Alliance software houses, expanding the total by nearly 80%. In the fourth quarter of 1984, more software houses committed to Tandem solutions than in any quarter in our history.

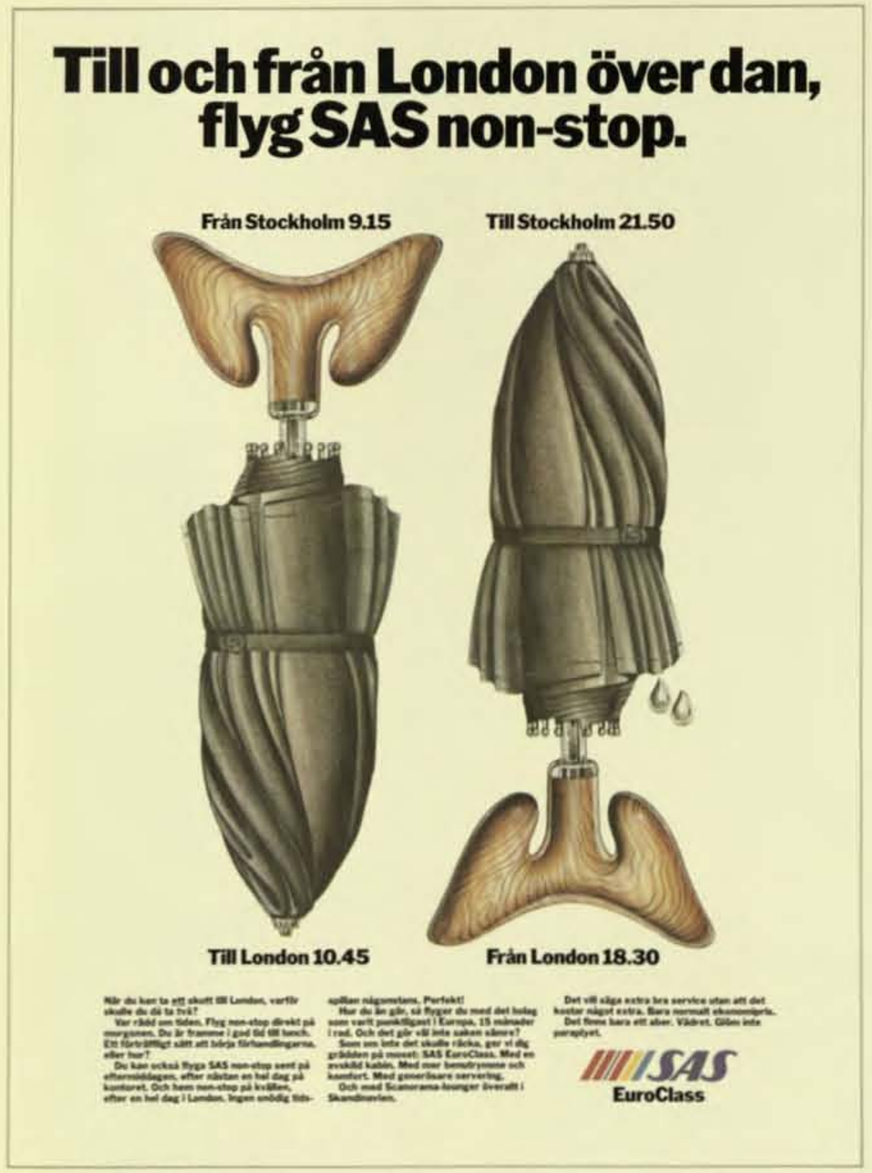
The Tandem Alliance attracts software houses because:

Our strong product features and price/performance advantage make their software more attractive to customers.

ALLIANCE PROGRAM GROWTH



A top marketing priority at Tandem is to increase sales through alliances with key applications software firms.



Scandinavian Airlines System (SAS) uses Tandem systems for a variety of applications, and is also a team member in a Tandem Alliance project that will market to the airline industry a reservation system and a series of advanced software packages for airline management.

Our systems' compatibility and modular growth capability let software houses develop an application only once and it will run on small, medium or large systems.

Our extensive program of support includes representatives in all sales regions dedicated to software houses. These Tandem employees communicate the strengths of our software houses and foster relationships with the rest of the Tandem sales force.

Alliance software houses also have access to many Tandem resources.

☐ Our worldwide sales organization expands Alliance members' marketing opportunities.
☐ Alliance software houses participate in some of Tandem's closed-circuit satellite television programs to make marketing presentations to our sales force and customers.
☐ Alliance software houses can take advantage of our training programs – both as student and teacher.

We also join in cooperative promotional activities.

In 1985 we will broaden the Tandem Alliance program to include new types of equipment remarketers. A select group of remarketers will contribute products or expertise to help us address specialized market opportunities.

T H E F U T U R E

Tandem serves a rapidly growing market with leading edge, much-needed products. We have a large base of prestigious, satisfied customers who count on our products to help make them more competitive. We are confident in the future of the marketplace and in our ability to share in its growth.

Every time Tandem sells to a new customer, you can expect to see the initial sale yield a stream of revenues over the years because of the ease and economy of Tandem system expandability. The unique modular expandability and linear performance continuum of our systems also serves us in developing new business, as well as expanding applications within existing accounts.

We are investing in the future of our marketplace. In the past two years alone, we have invested over $90 million in product development programs. Our development efforts have a magnified impact because our flexible architecture spreads the enhancements over our entire product line. In all of our programs, we maintain our commitment to our architecture, which provides the only computer systems offering fault tolerance as well as linear expandability.

In 1985 we have focused our new product programs on these areas:

High-performance data base. In 1985 we intend to widen our already strong leadership in delivering capabilities for high-performance, distributed data bases. We will introduce software and hardware products that provide significant improvements in price/performance, reliability and serviceability for on-line data base applications.

Low-end systems. Tandem's strategy is to provide a family of

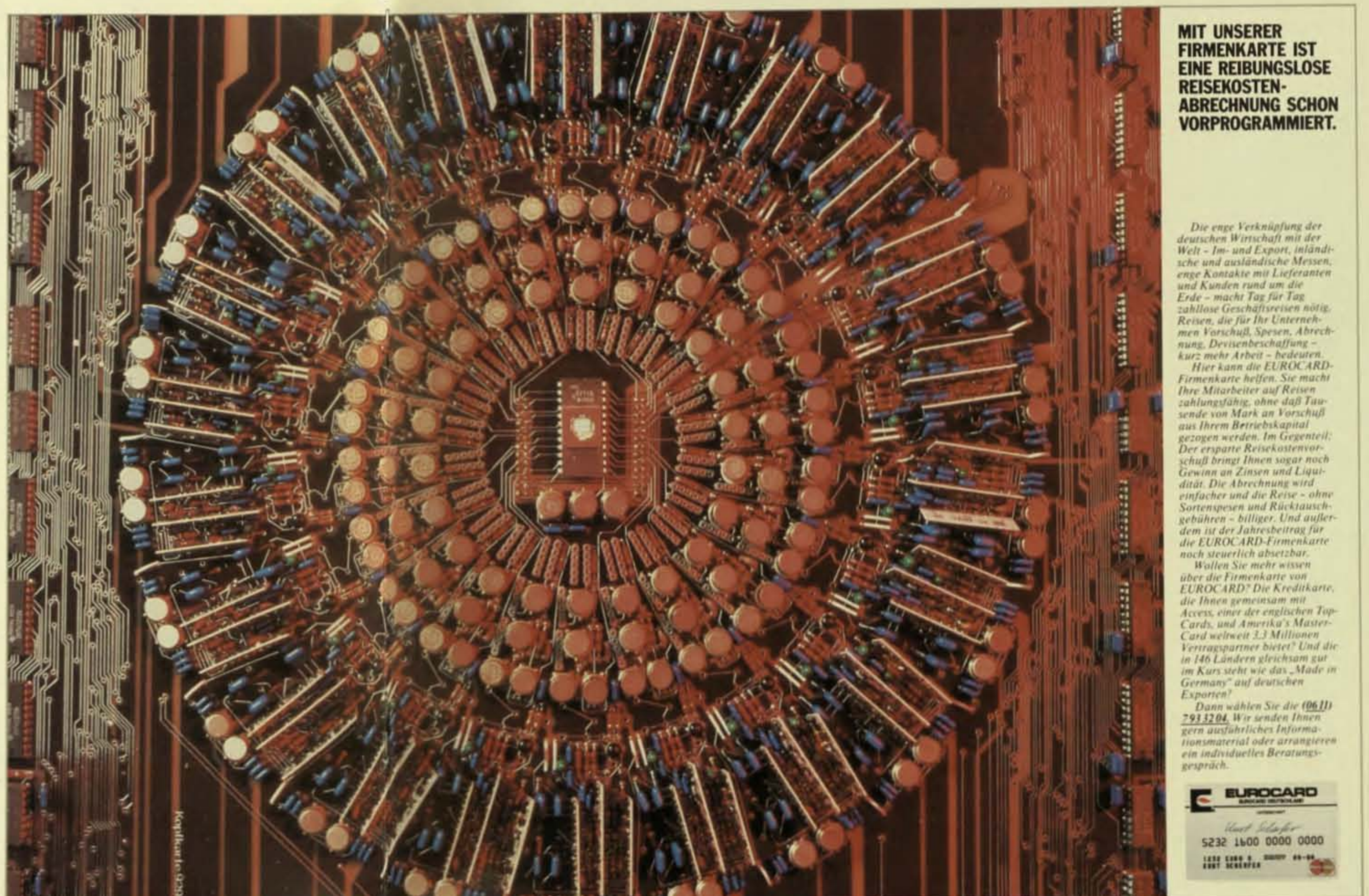
We are in the right market with leading edge products, and we are investing in the future of our marketplace.

compatible systems to serve a wider range of capacity needs with greater functionality than any other vendor. In 1984 we moved into very high performance applications with the TXP system. In 1985 we will wage a new offensive at the low end.

Networking and communications. We will build on our strength in this technology. In the first quarter of fiscal 1985, we added a major programming productivity enhancement to our SNAX product, already considered the premier SNA interface capability in the industry.

Professional support products. In 1985 Tandem will introduce products aimed at increasing business productivity across our entire customer base. In the first month of the 1985 fiscal year, we introduced our DYNAMITE multifunction workstation. DYNAMITE provides the flexibility of a personal computer with the functionality of a Tandem terminal in a single desk-top device. DYNAMITE gives users access to a wealth of decision support tools while accessing their company's data base on-line.

The new product introductions planned for 1985 are designed to provide more solutions to our customers' business needs, thereby enhancing our competitiveness and ability to grow.



Germany's Eurocard introduced in 1984 a pilot program to authorize credit card purchases automatically at point-of-sale locations. The Eurocard organization, comprising a pool of banks, runs its business on Tandem systems.

T O   O U R   S T O C K H O L D E R S:

Tandem has just marked its tenth anniversary. Since its founding in November, 1974, the Company has grown to more than a half billion dollars in revenue. Our customer list includes more than 850 outstanding corporations and government agencies throughout the world. Our own organization has expanded from the first site in California to over 80 locations in the United States and to 18 other countries, employing more than 5,000 people. And, during this tenth anniversary year, Tandem joined the ranks of the *Fortune* 500 largest U.S. industrial concerns.

Developments

Early in the fiscal year, Tandem introduced the high-performance NonStop TXP system. TXP processor shipments ramped up rapidly during the year, so that the TXP product accounted for the majority of our fiscal 1984 revenue. We believe this result demonstrates the strong customer acceptance of the powerful TXP system. This system should be a major contributor to our financial performance in 1985.

Tandem continues to place high priority on product development. In addition to the TXP system, we introduced a new, sophisticated 6100 communications subsystem. A new 264 megabyte Winchester disc drive brings even better mean-time-between-failure and price/performance to our line of disc drives. The 6530 terminal product was enhanced with the inclusion of two smaller, modular terminals as well as additional functions. The 653X family of terminals offers IBM 3270 emulation and can use a variety of alternate input methods including voice. In 1985 we plan to have an active schedule of new product introductions.

There were a number of developments in our marketing programs this year. Tandem identified the newly deregulated telephone companies as an area of opportunity. In 1984 we established a telecommunications industry marketing program to further penetrate that rapidly growing marketing sector. Telecommunications proved to be Tandem's fastest growing market this year. In addition, through the Tandem Alliance program, we signed Michigan Bell and Indiana Bell as new software houses offering applications programs to the telephone companies.

The Tandem Alliance, established late last year to attract software houses to develop application programs on Tandem systems, had other successes as well. For example, to help us in the recently deregulated airline market, we added new Alliance members that are developing application packages for this industry.

We implemented programs to enhance our competitive position across our entire product line. By repositioning the NonStop 1+ and NonStop II systems with pricing that is extremely attractive for the lower end of our marketplace, we believe that our entire family of NonStop systems offers the best price/performance for on-line transaction processing in the industry.

We are very pleased to have a new member on our Board of Directors this year. Mr. Andrew Knight, editor of *The Economist*, was elected to Tandem's Board at the annual meeting of stockholders last February.

Financial Performance

Revenues grew 27%, reaching $532,620,000 at the end of fiscal 1984. Earnings per share grew nearly 37% to $1.04, which included a one-time tax benefit amounting to $.24 per share. Our financial performance improved in the second half of the year compared with the first half. However, we are not satisfied with our level of profitability. The Company's first priority for fiscal 1985 is increasing profitability while meeting our product and marketing objectives. We have taken a number of steps to lay the groundwork for improved profitability in 1985.

Tandem is working hard to improve our cost structure through conservative spending and very limited hiring. Through much of 1984, the growth in employment exceeded the growth in revenue. To counter that trend, we have implemented a program designed to hold employment approximately level. Despite this plan, we intend to continue to add salespeople. We achieved this goal in the fourth quarter of fiscal 1984: Total employment declined slightly while the number of salespeople grew by nine percent.

Asset management continued to improve this year. As a result, Tandem's balance sheet is the strongest it has ever been. This year ended with the highest level of cash in our history, nearly $107 million. In addition, inventory turns increased and receivables collections improved.

Litigation

Just after the close of the fiscal year, Tandem reached an agreement with the Securities and Exchange Commission (SEC) that terminated an investigation relating to Tandem's December, 1982 restatement of revenue and earnings. Without admitting or denying the allegations of the complaint filed by the SEC, which related to the second, third and fourth quarters of fiscal 1982, we consented to the entry of a judgment enjoining the Company against any future violations of the Federal securities laws and requiring Tandem's auditors to conduct annual reviews of certain of the Company's internal controls for this year and an additional two years. Tandem consented to the entry of judgment in order to avoid the extensive commitment of financial resources that would have been required to contest the allegations in court.

Outlook for 1985

As the business section of this annual report notes, Tandem has established several areas of emphasis for 1985. The first priority is better profitability. By improving our cost structure, our goal is to provide a better return to our stockholders while continuing to offer aggressive price/performance for customers. We will continue to form business relationships through the Tandem Alliance. These alliances leverage Tandem's direct selling efforts and give customers the benefit of faster application development. Importantly, our new product program for the year has been designed to provide contributions in three major areas: high-performance data base, low-end systems and personal productivity tools, all key to success in on-line transaction processing.

Nineteen eighty-five is off to a good start. In the first month of the new fiscal year, we announced three new products. DYNAMITE, Tandem's multifunction personal workstation, provides the features of Tandem's 653X family of on-line terminals plus the convenience and local processing capability of a stand-alone personal computer. As a stand-alone workstation, it can run most software written for the IBM PC. Further, using Tandem's micro-mainframe integration software, DYNAMITE users can access the corporate data base and manipulate that information using off-the-shelf software packages. In addition, the Company added a more powerful version of the ENABLE automatic computer program generation tool, and a major programming productivity enhancement for SNAX, Tandem's System Network Architecture Access Method.

Commemorating Tandem's tenth anniversary, Jim Treybig, at left, and Tom Perkins were among the hosts of a special closed-circuit television broadcast to Tandem facilities in November 1984.

Tandem believes ours is the most attractive market in the computer industry, and that our unique architecture has enabled us to develop the best products for that market. These advantages are leveraged by our foremost asset – our people. Through the continued hard work and commitment of our people, we look forward to achieving our goals for 1985.

James G. Treybig
President and
Chief Executive Officer

Thomas J. Perkins
Chairman of the Board

November 29, 1984

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview
Tandem Computers is committed to being a technological leader in the rapidly growing market for on-line transaction processing systems and networks of on-line systems. The Company believes that its computer architecture uniquely satisfies the fundamental requirements of fault tolerance and linear power expandability for such applications. Achieving the Company's technological leadership goal involves many factors, including strategic market positioning, a commitment to product development, and an organizational structure and philosophy that foster employee productivity and creativity. It is also critical to maintain a strong financial position and operating record to allow the Company to maximize its performance in an environment of rapid growth.

Financial Condition
Maintaining a sound financial position is a high priority within Tandem. The Company's financial condition further strengthened in fiscal 1984. The year ended with the highest cash and cash investments balance in the Company's history. Cash increased to $106,862,000 at fiscal year end, from $93,501,000 a year earlier, reflecting income from operations, employee purchases of stock, and improved asset management. As a result of Tandem's continuing emphasis on asset management, inventory levels increased modestly, while days of inventory declined. In addition, accounts receivable increased at a rate slower than the rate of growth in revenues, and days of accounts receivable declined. Capital spending increased during the year to $71,519,000. This amount was substantially above the fiscal 1983 capital spending level, and was slightly higher than in fiscal 1982.

An important part of Tandem's corporate philosophy is to provide all employees with the opportunity to share in the Company's financial success by means of stock ownership. As a result of employee participation in the employee stock purchase program and exercises of stock options, the Company generated $16,991,000 in cash in fiscal 1984, $25,031,000 in fiscal 1983, and $12,249,000 in fiscal 1982.

The Company's financial strategy also includes maintaining a sound ratio of current assets to current liabilities and a conservative capital structure. At the end of fiscal 1984, the current ratio was 4:1, long term debt and capitalized lease obligations were 4.4 percent of total capital, and the Company's equity base was $375,122,000. Unused lines of credit total $70,000,000. Tandem believes this strategy provides it with the maximum near-term and long-term flexibility to consider the full range of financing alternatives to fund the capital needs of its projected growth.

Results of Operations
The table below summarizes the changes in selected operating indicators for the fiscal years presented. The numbers on the left account for the revenue dollar by showing various income and expense items as a percentage of revenue. The numbers on the right measure the yearly percentage increases (decreases) in the same items.

% of Revenue 1984	1983	1982		% Increase (Decrease) 1984	1983	1982
100	100	100	Revenue	27	34	50
41	40	35	Cost of revenue	30	54	45
10	9	11	Product development	34	16	89
39	38	41	Marketing, general and administrative	31	25	72
10	12	13	Operating income	3	22	1
1	–	2	Interest (net)	610	(88)	(44)
11	12	15	Pretax income	11	8	(9)
4	5	5	Current tax provision	17	17	(31)
(2)	–	–	DISC reversal	N/A	–	–
8	7	10	Net income	39	3	12
			Earnings per share	37	–	6
			Weighted average shares outstanding	2	4	6

Numbers may not total due to rounding.

Revenue
Tandem's revenue gains over the last three years have resulted directly from increased shipments of its computer hardware and software products to new and existing customers, and from increases in the number of customers using its support and training services. The Company's revenue increased by $114,338,000 in fiscal 1984 over fiscal 1983. Comparing geographic segments, international sales outside of Europe experienced the highest rate of growth, advancing 97.5 percent over the fiscal 1983 level. Fiscal 1983 revenue increased $106,139,000 over fiscal 1982 revenue. In that year, the United States was the fastest growing geographical area, posting a 38.4 percent rate of revenue growth. During the past two years, the Company's international revenue has been adversely affected by the strength of the U.S. dollar. International revenue accounted for 32.6 percent of total revenue in fiscal 1984, compared to 30.4 percent in fiscal 1983 and 33.5 percent in fiscal 1982.

Operating Income
Operating margins of 10 percent in fiscal 1984 were below the Company's target range. The principal reason was that operating expenses as a percent of revenue increased in fiscal 1984. During the first half of the year, the Company hired people in anticipation of higher rates of revenue growth. As a result, expenses in relation to revenue exceeded plan. The Company reduced its hiring targets sharply beginning in the fourth fiscal quarter of 1984. In response to this program, total employment declined slightly in the final fiscal 1984 period even though people were added in key functions such as sales. The Company anticipates maintaining this limited hiring program in the near term.

In fiscal 1983, operating margins at 12 percent were also below the Company's target range. The principal reason was that cost of revenue as a percent of revenue rose, due to higher costs relating to excess capacity and to the successful program to reduce inventory levels.

Tandem's product development effort focuses on meeting the needs of computer users who are implementing on-line systems, both at single sites and in geographically distributed on-line information processing networks. The Company believes that the opportunities for technological innovation in this marketplace are substantial. Product development funds are being invested in enhancements to existing products and in important new products that will be introduced in future years. Therefore, the Company has increased its investment in product development each year since its founding. The Company targets product development expenditures in the range of 9 to 10 percent of revenue.

The Company keys its marketing strategy on selling to users who are implementing major on-line applications. Providing a high level of service and support is essential to meeting the needs of this customer base. To maximize its long-term opportunities in this marketplace, Tandem has built a direct selling and support organization in the United States and, primarily through wholly owned subsidiaries, in industrial markets throughout the world. The Company's direct selling efforts are complemented by relationships established with third-party software developers and equipment remarketers. The Company's marketing, general and administrative expenditures in fiscal 1984 were higher as a percent of revenue than in fiscal 1983, but lower than in fiscal 1982. Tandem believes that it is essential to invest in marketing in order to achieve future growth. However, a rate of expenditures on marketing and support lower than that experienced in recent years will be sufficient to compete successfully in its marketplace.

Net Income and Earnings Per Share
Net income growth has differed from operating income growth over the past three fiscal years because of substantial changes in the Company's net interest income and effective tax rate. In fiscal 1984 net interest income was significantly above the level of fiscal 1983, although lower than in fiscal 1982. The Company maintained strong cash balances throughout fiscal 1984, thereby earning substantially more interest income compared with fiscal 1983. Fiscal 1982 interest income benefitted from higher prevailing interest rates.

The primary reason net income grew faster than operating income in fiscal 1984 was a one-time reversal of taxes that had been accrued on earnings of the Company's Domestic International Sales Corporation (DISC). The effective tax rate in fiscal 1984 was 24 percent, reflecting a $9,700,000 one-time DISC benefit. In comparison, the effective tax rates in 1983 and 1982 were 39 percent and 36 percent, respectively. In both fiscal 1984 and 1983, relative to fiscal 1982, there were reduced beneficial impacts of tax incentives for investment in capital equipment resulting from the Tax Equity and Fiscal Responsibility Act of 1982. Earnings per share were $1.04 in fiscal 1984. Without the DISC tax reversal, fiscal 1984 earnings per share were $.80, compared with $.76 in each of the two prior fiscal years. Earnings in 1984 were higher because of the DISC tax reversal and because of higher operating earnings.

Effect of Inflation
Please see page 27 of this report for a discussion of the effect of changing prices on the Company's operations.

TANDEM COMPUTERS INCORPORATED AND SUBSIDIARIES

SELECTED FINANCIAL DATA *For the Five Years Ended September 30, 1984*

(In thousands except per share amounts)	1984	1983	1982	1981	1980
Revenue	$532,620	$418,282	$312,143	$208,397	$108,989
Cost of revenue	218,810	168,708	109,305	75,547	40,831
Product development	52,514	39,168	33,642	17,833	8,786
Marketing, general and administrative	210,195	160,635	128,488	74,626	40,049
Operating Income	51,101	49,771	40,708	40,391	19,323
Interest income, net	5,183	730	6,033	10,707	1,759
Provision for income taxes					
Current period	(23,076)	(19,696)	(16,885)	(24,549)	(10,395)
Benefit of DISC tax reversal	9,700	–	–	–	–
Net Income	$ 42,908	$ 30,805	$ 29,856	$ 26,549	$ 10,687
Earnings Per Share	$ 1.04	$ .76	$ .76	$ .72	$ .35
Total assets	$501,873	$415,525	$337,366	$255,971	$ 95,701
Long term debt and capitalized lease obligations	17,155	23,957	21,102	2,054	1,651
Stockholders' investment	375,122	310,993	250,988	204,810	70,294

CONSOLIDATED STATEMENT OF INCOME

For the Three Years Ended September 30, 1984

(In thousands except per share amounts)	1984	1983	1982
Revenue			
Product revenue	$448,611	$360,133	$272,591
Service and other revenue	84,009	58,149	39,552
Total revenue	532,620	418,282	312,143
Costs and Expenses			
Cost of revenue	218,810	168,708	109,305
Product development	52,514	39,168	33,642
Marketing, general and administrative	210,195	160,635	128,488
Total costs and expenses	481,519	368,511	271,435
Operating Income	51,101	49,771	40,708
Interest expense	(2,642)	(2,806)	(967)
Interest income	7,825	3,536	7,000
Income Before Income Taxes	56,284	50,501	46,741
Provision for Income Taxes			
Current period	(23,076)	(19,696)	(16,885)
Benefit of DISC tax reversal	9,700	–	–
Total provision for income taxes	(13,376)	(19,696)	(16,885)
Net Income	$ 42,908	$ 30,805	$ 29,856
Earnings Per Share	$ 1.04	$ .76	$ .76
Weighted average shares outstanding	41,399	40,784	39,221

Because of the Company's method of operation, it is not practical or meaningful to report the cost of service and other revenue as a separate line item.

The accompanying notes are an integral part of this statement.

CONSOLIDATED BALANCE SHEET

As of September 30, 1984 and 1983

(In thousands except share data)	1984	1983
Assets		
Current Assets		
Cash and cash investments	$106,862	$ 93,501
Accounts receivable, net of allowances of $1,708 in 1984 and $2,851 in 1983	146,342	119,558
Inventories	92,375	85,920
Prepaid expenses and other	6,998	11,775
Total current assets	352,577	310,754
Property, Plant and Equipment, At Cost		
Land	8,782	3,127
Machinery and equipment	46,642	35,162
Computer equipment and spares	85,002	59,836
Leasehold improvements	31,320	27,859
Construction in process	20,009	6,788
	191,755	132,772
Accumulated depreciation and amortization	(50,253)	(33,991)
Net property, plant and equipment	141,502	98,781
Other Assets	7,794	5,990
Total Assets	$501,873	$415,525
Liabilities and Stockholders' Investment		
Current Liabilities		
Current portion of long term debt and capitalized lease obligations	$ 15,025	$ 3,335
Accounts payable	36,350	27,960
Accrued liabilities		
Wages, payroll taxes and employee benefits	22,527	14,081
Income taxes	4,440	4,971
Other accrued liabilities	10,832	6,262
Total current liabilities	89,174	56,609
Capitalized Lease Obligations	11,744	15,434
Long Term Debt	5,411	8,523
Deferred Income Taxes	20,422	23,966
Stockholders' Investment		
Common stock $.025 par value, authorized 60,000,000 shares, outstanding 40,616,638 in 1984 and 39,552,963 in 1983	1,015	989
Additional paid-in capital	228,106	206,911
Retained earnings	146,001	103,093
Total stockholders' investment	375,122	310,993
Total Liabilities and Stockholders' Investment	$501,873	$415,525

The accompanying notes are an integral part of this balance sheet.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT

For the Three Years Ended September 30, 1984

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1981	36,410	$ 910	$161,468	$ 42,432	$204,810
Sale of common stock under stock option plans	863	22	5,028	–	5,050
Sale of common stock under stock purchase plan	362	9	7,190	–	7,199
Tax benefit from employee transactions in common stock	–	–	4,073	–	4,073
Net income	–	–	–	29,856	29,856
Balance September 30, 1982	37,635	941	177,759	72,288	250,988
Sale of common stock under stock option plans	1,634	41	19,054	–	19,095
Sale of common stock under stock purchase plan	284	7	5,929	–	5,936
Tax benefit from employee transactions in common stock	–	–	4,169	–	4,169
Net income	–	–	–	30,805	30,805
Balance September 30, 1983	39,553	989	206,911	103,093	310,993
Sale of common stock under stock option plans	779	19	9,983	–	10,002
Sale of common stock under stock purchase plan	285	7	6,982	–	6,989
Tax benefit from employee transactions in common stock	–	–	4,230	–	4,230
Net income	–	–	–	42,908	42,908
Balance September 30, 1984	40,617	$1,015	$228,106	$146,001	$375,122

The accompanying notes are an integral part of this statement.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Three Years Ended September 30, 1984

(In thousands)	1984	1983	1982
Funds (cash and cash investments) at beginning of period	$ 93,501	$ 24,816	$ 89,806
Provided from Operations			
Sources:			
Net income	42,908	30,805	29,856
Depreciation and amortization	22,741	18,836	10,196
Deferred income taxes	(3,544)	5,903	9,920
Net book value of property, plant and equipment sold or retired	6,614	14,408	2,142
Total sources	68,719	69,952	52,114
Uses:			
Accounts receivable	26,784	20,748	28,139
Inventories	6,455	(15,415)	46,792
Net change in prepaid expenses and non-debt current liabilities	(25,652)	(13,359)	7,096
Investment in property, plant and equipment	71,519	42,222	65,819
Increase in other assets	2,361	401	6,006
Total uses	81,467	34,597	153,852
Net provided from (used in) operations	(12,748)	35,355	(101,738)
Provided from External Financings			
Increase (decrease) in capitalized leases, net	(3,442)	6,331	9,702
Increase (decrease) in long term debt, net	8,330	(2,201)	10,724
Sale of common stock under employee stock option and stock purchase plans	16,991	25,031	12,249
Tax benefit from employee transactions in common stock	4,230	4,169	4,073
Total provided from external financings	26,109	33,330	36,748
Funds (cash and cash investments) at end of period	$106,862	$ 93,501	$ 24,816

The accompanying notes are an integral part of this statement.

1. Summary of Significant Accounting Policies

Consolidation
The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition
The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Exchange Gains and Losses
During fiscal year 1984 the Company adopted FASB Statement No. 52 which concerns accounting for foreign currency transactions. Using guidelines established in the Statement, the Company has selected the U.S. dollar as its worldwide functional currency. Adoption of the standard did not have a material effect on the Company's consolidated financial position or results of operations for the three fiscal years ending September 30, 1984.

Inventories
Inventories are stated at the lower of cost (first-in, first-out) or market and include materials, labor and manufacturing overhead. The components of inventories as of September 30 were:

(In thousands)	1984	1983
Purchased parts and subassemblies	$ 45,259	$ 36,887
Work-in-process	12,400	12,519
Finished goods	34,716	36,514
Total	$ 92,375	$ 85,920

Income Taxes
The Company accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are realized.

In accordance with the Tax Reduction Act of 1984, the accumulated income taxes provided for the Company's Domestic International Sales Corporation (DISC) have been reflected as a reduction to the provision for income taxes. Through June 30, 1984, the Company provided deferred taxes on total DISC earnings (see Note 2), the reversal of which has been reflected as a reduction in the provision in the fourth quarter of fiscal 1984.

Property, Plant and Equipment
Systems spares ($25,863,000 in 1984 and $19,271,000 in 1983) are depreciated over a five-year period using the double declining balance method. All other property, plant and equipment are depreciated using the straight-line method. The estimated useful lives are:

Machinery and equipment	5-10 years
Computer equipment and spares	5- 7 years
Leasehold improvements	Lease term

Earnings Per Share
Earnings per common share have been computed based on the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of stock options outstanding that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

2. Income Taxes

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1984	1983	1982
Federal:			
Current	$ 13,882	$ 1,370	$ 5,516
Deferred (prepaid)	(10,550)	10,574	3,323
	3,332	11,944	8,839
State:			
Current	4,800	1,532	3,633
Deferred (prepaid)	(297)	534	(14)
	4,503	2,066	3,619
Foreign:			
Current	6,197	4,621	2,244
Deferred (prepaid)	(656)	1,065	2,183
	5,541	5,686	4,427
Total provision	$ 13,376	$ 19,696	$ 16,885

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1984	1983	1982
Installment sale method for income tax reporting	$ (1,950)	$ 8,572	$ 3,657
DISC income	(6,084)	3,181	3,918
Accelerated depreciation	2,950	2,628	2,799
Expenses recognized for financial statements, but not for income tax reporting	(4,943)	810	(1,505)
Effect of intercompany profit eliminations	(2,178)	(4,143)	(2,654)
Other items	702	1,125	(723)
Total deferred (prepaid)	$(11,503)	$ 12,173	$ 5,492

The provision for income taxes differs from the amount obtained by applying the Federal statutory income tax rate to income before taxes as follows:

	1984	1983	1982
Federal statutory tax rate	46%	46%	46%
State taxes, net of Federal income tax benefit	4	4	4
Investment tax credits	(3)	(4)	(8)
Research and development tax credits	(7)	(7)	(8)
Other	1	–	2
	41	39	36
Benefit of DISC tax reversal	(17)	–	–
Effective tax rate	24%	39%	36%

The DISC tax benefit shown above is attributable to the reversal of deferred taxes previously provided on DISC earnings accumulated through June 30, 1984 in accordance with the Tax Reduction Act of 1984, and has been reflected as a reduction in the provision for taxes in the fourth quarter of fiscal 1984. Included in this benefit are $7.4 million attributable to earnings accumulated in years prior to fiscal 1984.

3. Lease and Other Commitments

The Company leases its headquarters, operating facilities, field offices and automobiles under operating lease agreements. The Company also has capitalized leases for certain equipment. Future lease payments as of September 30, 1984 are as follows:

(In thousands)	Leases	
Fiscal year	Operating	Capital
1985	$ 30,637	$ 5,518
1986	28,528	5,377
1987	24,481	5,078
1988	22,258	3,701
1989	21,503	180
Thereafter	112,019	–
Total minimum lease payments	$ 239,426	19,854
Less: Amount representing interest (4%-17%)		4,527
Present value of minimum lease payments		$ 15,327

Assets relating to capitalized leases totaling $21,605,000 and $22,038,000 are included in the machinery and equipment and computer equipment and spares classifications on the Balance Sheet at September 30, 1984 and 1983, respectively.

Rent expenses were $36,726,000 in 1984, $30,458,000 in 1983, and $20,895,000 in 1982.

4. Long Term Debt

Long term debt as of September 30 consists of the following:

(In thousands)	1984	1983
Construction financing	$ 11,250	$ 4,203
Industrial revenue bonds bearing interest of 12% to 12-3/8%, due 1992, collateralized by equipment in Austin, Texas	2,000	2,000
6-7/8% unsecured promissory note payable in Japanese yen, due October 1985	2,327	–
15% promissory note due January 1986	800	1,640
Other	476	680
	16,853	8,523
Less current portion	(11,442)	–
Long term debt	$ 5,411	$ 8,523

Interest costs of $1,606,000, $644,000, and $508,000 relating to construction projects were capitalized during fiscal 1984, 1983 and 1982, respectively.

The Company has entered into unsecured credit agreements totaling $82,000,000 with several banks. The agreements provide for revolving borrowings through 1988, at which time outstanding amounts are to be repaid. Domestic borrowings bear interest at or below the banks' prime rates through 1985 and approximately 1/4% above these rates through 1988. The Company is required to pay a commitment fee of 5/16% per annum. Of these facilities, $12,000,000 have been earmarked by Tandem for construction financing. The remaining $70,000,000 are for working capital purposes and contain provisions for Eurocurrency and foreign local currency borrowings at interest rates prevailing in these markets. There are no compensating balances required under any of these arrangements.

Certain financial covenants and restrictions are included in the loan agreements. The Company was in compliance with all such covenants and restrictions at September 30, 1984.

The Company has guaranteed payment of bank loans made to two officers comprising $550,000 at September 30, 1984.

5. Capital Stock

The Company's authorized capital stock consists of 2,400,000 shares of Preferred Stock and 60,000,000 shares of Common Stock consisting of 56,000,000 shares of "Common Stock" and 4,000,000 shares of "Junior Common Stock." At September 30, 1984, there were no shares of Preferred Stock or Junior Common Stock outstanding.

Stock Option Plans
The Company has employee stock option plans under which permanent employees may be granted options to purchase shares at 100% of fair market value at the time of the grant. Options generally become exercisable six months after the effective date and expire no

later than seven years after the effective date. At the discretion of the Company, options granted under the stock option plans may qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981.

As of September 30, 1984, options for 6,119,873 shares were outstanding at prices ranging from $3.96 to $34.88, with an average price of $22.07. Options for 4,602,047 shares were exercisable as of September 30, 1984. Options for 2,232,619 shares are available for future grant. Options were exercised at prices ranging from $3.92 to $26.88 in 1984, $.58 to $26.88 in 1983, and $.17 to $26.88 in 1982.

Employee Stock Purchase Plan

As of September 30, 1984, the Company has reserved 2,189,328 shares for future issuance under its employee stock purchase plan. Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of common stock at 85% of fair market value as of the beginning or end of a three-month offering period. Under the second method, the Company may grant to employees the option to purchase common stock at not less than 85% of fair market value at the grant date. As of September 30, 1984, options to purchase 94,100 shares at $12.43 and 28,800 shares at $29.00 were outstanding under the second method. Such options are exercisable through November 15, 1984 and through January 20, 1986, respectively.

6. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three years ended September 30, 1984.

	Geographic Area			Adjustments	
(In thousands)	United States	Europe	Other	and Eliminations	Consolidated
1984					
Revenue-Customer	$364,873	$109,562	$58,185	$ –	$532,620
Revenue-Intercompany	90,850	–	–	(90,850)	–
Revenue-Total	455,723	109,562	58,185	(90,850)	532,620
Pretax Income	46,977	10,842	5,261	(6,796)	56,284
Identifiable Assets	421,974	79,747	31,732	(31,580)	501,873
1983					
Revenue-Customer	$297,722	$ 91,100	$29,460	$ –	$418,282
Revenue-Intercompany	68,001	–	–	(68,001)	–
Revenue-Total	365,723	91,100	29,460	(68,001)	418,282
Pretax Income	49,084	11,546	(1,127)	(9,002)	50,501
Identifiable Assets	336,193	73,923	26,058	(20,649)	415,525
1982					
Revenue-Customer	$215,154	$ 74,958	$22,031	$ –	$312,143
Revenue-Intercompany	60,126	–	–	(60,126)	–
Revenue-Total	275,280	74,958	22,031	(60,126)	312,143
Pretax Income	43,949	9,267	22	(6,497)	46,741
Identifiable Assets	276,886	56,685	15,863	(12,068)	337,366

Intercompany transfers are made at arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $5,989,000 in 1984; $6,400,000 in 1983; and $7,687,000 in 1982.

7. Unaudited Quarterly Financial Data

(In thousands except per share amounts)	Quarters Ended Dec. 31	March 31	June 30	Sept. 30
Year Ended September 30, 1984:				
Revenue	$126,369	$111,236	$141,925	$153,090
Costs and Expenses				
Cost of revenue	50,437	47,245	57,787	63,341
Product development	10,849	12,853	13,514	15,298
Marketing, general and administrative	48,205	49,132	56,282	56,576
Total costs and expenses	109,491	109,230	127,583	135,215
Operating Income	16,878	2,006	14,342	17,875
Interest income, net	1,076	1,142	1,243	1,722
Income Before Income Taxes	17,954	3,148	15,585	19,597
Provision for income taxes				
Current period	(7,900)	(1,174)	(6,335)	(7,667)
Benefit of DISC tax reversal	–	–	–	9,700
Total provision for income taxes	(7,900)	(1,174)	(6,335)	2,033
Net Income	$ 10,054	$ 1,974	$ 9,250	$ 21,630
Earnings Per Share	$ .24	$ .05	$ .23	$ .53
Year Ended September 30, 1983:				
Revenue	$ 94,135	$ 96,006	$110,291	$117,850
Costs and Expenses				
Cost of revenue	37,955	37,856	45,117	47,780
Product development	8,997	9,805	9,961	10,405
Marketing, general and administrative	35,548	37,945	41,561	45,581
Total costs and expenses	82,500	85,606	96,639	103,766
Operating Income	11,635	10,400	13,652	14,084
Interest income, net	47	(184)	251	616
Income Before Income Taxes	11,682	10,216	13,903	14,700
Provision for income taxes	(4,556)	(3,765)	(5,462)	(5,913)
Net Income	$ 7,126	$ 6,451	$ 8,441	$ 8,787
Earnings Per Share	$ .18	$ .16	$ .21	$ .21

8. Commitments and Contingencies

The Company, along with three present or former principal officers, has been named as a defendant in a single class action complaint filed on October 23, 1984 purporting to state claims for alleged violations of Federal securities laws and pendent state claims arising out of the Company's December 1982 restatement of revenue and earnings for fiscal 1982. The action purports to be brought on behalf of all persons who purchased the common stock of the Company from April 28, 1982 through December 8, 1982. The complaint seeks damages in an unspecified amount. No provision has been made in the accompanying financial statements for possible liability because, in the opinion of management, it is unlikely that the ultimate disposition of the suit would have a material effect on the Company's financial position.

9. Information on the Effects of Inflation (Unaudited)

The Company has provided an adjusted summary of operations and selected financial data in accordance with the Financial Accounting Standards Board in its Statement No. 33 concerning "Financial Reporting and Changing Prices." This disclosure requirement is experimental and involves considerably more judgment than traditional financial statements, and therefore should be reviewed with caution.

Inflation-adjusted information is computed using the "current cost" method, which requires the Company to adjust asset values based on specific indices and appraisals.

The method does not allow for inflation adjustments to operating expenses, revenue or net interest income, nor an adjustment to the tax provision, despite the decrease in pretax income which results from the inflation adjustments. Only the cost of revenue and depreciation expense related to the assets, which are restated for inflation effects, are adjusted.

Depreciation is computed on a straight-line basis, rather than the accelerated basis that is used for some assets in the Company's historical financial statements, because the accelerated method already recognizes some of the effects of inflation.

Net income for fiscal 1984 was lower under the current cost method because of higher depreciation and amortization expense resulting from higher asset values. Companies that hold monetary assets during a period of inflation lose purchasing power. Tandem held net monetary assets during the period, and their purchasing power declined.

Consolidated Statement of Income Adjusted for Inflation

For the Year Ended September 30, 1984

(In thousands except per share amounts)

	In Average 1984 Dollars Historic Cost	Current Cost
Total Revenue	$ 532,620	$532,620
Cost of revenue, excluding depreciation and amortization	214,603	214,603
Other costs and expenses, excluding depreciation and amortization	244,175	244,175
Depreciation and amortization	22,741	23,437
Interest (income), net	(5,183)	(5,183)
Provision for income taxes	13,376	13,376
Net Income	$ 42,908	$ 42,212
Increase in value of inventories, property, plant and equipment held during the year:		
Measured in general prices		$ 8,900
Measured in specific prices		8,118
Excess of increase in general price level (constant dollars) over increase in specific prices		$ 782

At September 30, 1984, current cost of inventory was $92,418 and current cost of property, plant and equipment, net of accumulated depreciation, was $155,776.

Five Year Comparison of Selected Financial Data Adjusted for Inflation

(In thousands except per share amounts)

	In Average 1984 Dollars 1984	1983	1982	1981	1980
Total revenue					
Constant dollars	$532,620	$435,386	$336,154	$241,120	$140,044
Current cost information					
Net income	$ 42,212	$ 30,536			
Earnings per share	$ 1.02	$ .75			
Net assets at year end	$382,305	$319,594			
Excess of increase in general price level (constant dollars) over increase in specific prices	$ 782	$ 1,198			
Other information					
Decrease in purchasing power of net monetary items	$ 5,471	$ 2,931			
Market price per share at end of period	$ 15.83	$ 36.31	$ 23.89	$ 30.33	$ 21.51
Average CPI (1967=100)	308.0	295.9	286.0	266.2	239.7

AUDITORS' REPORT

To Tandem Computers Incorporated:

We have examined the consolidated balance sheet of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1984 and 1983 and the related consolidated statements of income, stockholders' investment, and changes in financial position for each of the three years in the period ended September 30, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1984 and 1983 and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

San Jose, California
November 6, 1984

Arthur Andersen & Co.

TANDEM STOCK PRICE

Calendar Quarter Price		High	Low
1984	3rd Quarter	24¾	13
	2nd Quarter	30⅝	16¼
	1st Quarter	40¼	30
1983	4th Quarter	39½	30
	3rd Quarter	36½	26
	2nd Quarter	34	25½
	1st Quarter	30½	23⅝
1982	4th Quarter	32¾	21¾
	3rd Quarter	25⅜	14½
	2nd Quarter	29	22
	1st Quarter	28½	21

Tandem Computers Incorporated has been traded via the NASDAQ National Market System under the trading symbol TNDM since the second calendar quarter of 1982. All quotations shown represent the high and low prices. Quotations that pertain to earlier periods represent prices between dealers without adjustment for mark-up, markdown, or commissions and may not represent actual transactions. No dividends have been declared on the common stock.

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Former Chairman of the Board and Chief Executive Officer, Crocker National Corporation

Robert G. Stone, Jr.,
Chairman of the Board, Kirby Exploration Company

James G. Treybig,
President and Chief Executive Officer, Tandem Computers Incorporated

Auditors

Arthur Andersen & Co.
San Jose, California

Registrar and Transfer Agent
Bank of America N.T. & S.A.
San Francisco, California

Form 10-K
A copy of the Company's Report on Form 10-K for the 1984 fiscal year, as filed with the Securities and Exchange Commission, is available on written request. Please direct your request to:

Treasurer's Office
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting
The annual meeting of stockholders will be held at 10:00 a.m. on Friday, February 22, 1985, at the Company's headquarters.

Corporate Headquarters
19333 Vallco Parkway
Cupertino, California 95014-2599
(408) 725-6000

Trademark
Tandem, NonStop, NonStop II, NonStop TXP, DYNABUS, DYNAMITE, ENABLE, ENCOMPASS, ENFORM, EXPAND, GUARDIAN, TRANSFER, and TXP are trademarks and service marks of Tandem Computers Incorporated.

Officers

James G. Treybig,
President and Chief Executive Officer

Robert C. Marshall,
Senior Vice President and Chief Operating Officer

Michael K. Bateman,
Vice President and Division Manager

Thomas A. Bechler,
Vice President and Division Manager

Jack W. Chapman,
Vice President and Managing Director, European Division

Thomas L. Chun,
Vice President-Legal Affairs and Secretary

George C. Eckert,
Vice President and Division Manager

Jan E. Jensen,
Vice President-Human Resources

Richard A. Lamb,
Treasurer

Lawrence A. Laurich,
Vice President-Hardware Development

David R. Mackie,
Vice President-U.S. Marketing

Dennis L. McEvoy,
Vice President-Software Development

Lawrence W. McGraw,
Vice President-Marketing and Service Support

Michael C. Moore,
Vice President and Division Manager

Gerald L. Peterson,
Vice President-International Marketing and Product Management

Jerald D. Reaugh,
Vice President-MIS

David J. Rynne,
Vice President and Chief Financial Officer

Stephen C. Schmidt,
Vice President-Operations

Jeanne D. Wohlers,
Vice President and Corporate Controller

Charles J. Yazel,
Vice President and Division Manager

Domestic Sales and Service Offices

ALASKA, Anchorage
ALABAMA, Birmingham
ARIZONA, Phoenix
ARKANSAS, Little Rock
CALIFORNIA, Culver City, Irvine, Long Beach, Los Angeles, Orinda, Riverside, Sacramento, San Diego, San Francisco, Santa Clara, Universal City
COLORADO, Englewood
CONNECTICUT, Hartford, Stamford
FLORIDA, Jacksonville, Miami, Orlando, Tampa
GEORGIA, Atlanta
HAWAII, Honolulu
IDAHO, Coeur D'Alene
ILLINOIS, Arlington Heights, Chicago, Itasca, Oakbrook, Schaumburg
INDIANA, Huntington, Indianapolis
IOWA, Cedar Rapids, Des Moines
KANSAS, Overland Park
LOUISIANA, Metairie
MARYLAND, Linthicum
MASSACHUSETTS, Newton
MICHIGAN, Ann Arbor, Lansing, Livonia
MINNESOTA, Minneapolis
MISSOURI, Creve Coeur, St. Louis
MISSISSIPPI, Jackson
NEBRASKA, Omaha
NEVADA, Las Vegas
NEW JERSEY, Cardiff City, Cherry Heights, Hasbrouck Heights, Mt. Laurell
NEW MEXICO, Albuquerque
NEW YORK, Buffalo, Fairport, Jericho, New York City
NORTH CAROLINA, Charlotte, Greensboro
OHIO, Cincinnati, Cleveland, Columbus, Dayton
OKLAHOMA, Oklahoma City, Tulsa
OREGON, Portland
PENNSYLVANIA, Duncannon, Horsham, Pittsburgh
TENNESSEE, Memphis, Nashville
TEXAS, Austin, Dallas, Fort Worth, Houston, Irving, San Antonio
UTAH, Salt Lake City
VIRGINIA, Falls Church, Reston, Richmond, Virginia Beach
WASHINGTON, Bellevue
WEST VIRGINIA, Charleston
WISCONSIN, Brookfield

International Subsidiaries

AUSTRALIA
Tandem NonStop Pty. Ltd
Adelaide, Brisbane, Melbourne Perth, Sydney

BELGIUM
Tandem Computers SA/NV
Brussels

CANADA
Tandem Computers Canada Ltd
Edmonton, Markham, Ottawa, St. Laurent, Toronto, Vancouver, Victoria, Windsor, Winnipeg

DENMARK
Tandem Computers A/S
Taastrup

FRANCE
Tandem Computers S.A.
Paris

GERMANY
Tandem Computers GMBH
Dortmund, Düsseldorf, Frankfurt, Hamburg, Hilden, Mannheim, Munich, Neufahrn, Stuttgart

HONG KONG
Tandem Computers (Hong Kong) Ltd
Kowloon

ITALY
Tandem Computers Italia S.P.A.
Milan, Rome

JAPAN
Tandem Computers Japan, Ltd
Nagoya, Osaka, Tokyo

THE NETHERLANDS
Tandem Computers BV
The Hague

NEW ZEALAND
Tandem NonStop Pty. Ltd
Wellington

NORWAY
Tandem Computers (Norway) A/S
Hovik

REPUBLIC OF IRELAND
Tandem Computers Ltd
Dublin

SINGAPORE
Tandem Computers Int'l Inc.
Singapore

SPAIN
Tandem Computers Iberica S.A.
Madrid

SWEDEN
Tandem Computers A.B.
Malmo, Stockholm

SWITZERLAND
Tandem Computers A.G.
Zurich

UNITED KINGDOM
Tandem Computers Ltd
Birmingham, Glasgow, High Wycombe, Kirkliston Lothian, London, Northolt, Rochdale

International Distributors

ARGENTINA
BAHRAIN
COLOMBIA
FINLAND
ISRAEL
KUWAIT
MEXICO
PHILIPPINES
REPUBLIC OF CHINA
SAUDI ARABIA
SOUTH KOREA
UNITED ARAB EMIRATES
VENEZUELA

TANDEM

January 2, 1985

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders which will be held on Friday, February 22, 1985 at 10:00 A.M. at the offices of the Company at 19333 Vallco Parkway, Cupertino, California.

The formal notice of the Annual Meeting and the Proxy Statement have been made a part of this invitation.

After reading the Proxy Statement, please mark, sign and return, at an early date, the enclosed proxy in the prepaid envelope addressed to the Bank of America, our agent, to assure that your shares will be represented. YOUR SHARES CANNOT BE VOTED UNLESS YOU SIGN AND RETURN THE ENCLOSED PROXY OR ATTEND THE ANNUAL MEETING IN PERSON.

A copy of the Company's Annual Report to Stockholders is also enclosed.

The Board of Directors and Management look forward to seeing you at the meeting.

Sincerely yours,

Thomas J. Perkins
Chairman of the Board

James G. Treybig
President and Chief Executive Officer

TANDEM COMPUTERS INCORPORATED

19333 Vallco Parkway • Cupertino, CA 95014 • (408) 725-6000

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders
to be held February 22, 1985

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on February 22, 1985 at 10:00 A.M. for the following purposes:

1. To elect three Class II Directors to hold office until 1988.

2. To consider and vote upon a proposal to amend the Company's Certificate of Incorporation to provide for the authorized number of directors to range from nine (9) to fifteen (15) and to authorize the Board of Directors to designate the exact number of directors within such limits and to restate the Certificate and all amendments as a single document.

3. To consider and vote upon a proposal to amend the Tandem Computers Incorporated 1981 Stock Option Plan to increase the number of shares of Common Stock available for issuance under the Plan.

4. To ratify the selection of Arthur Andersen & Co. as the Company's independent auditors.

5. To transact such other business as may properly come before the Meeting and any adjournment of the Meeting.

The Board of Directors has fixed the close of business on December 24, 1984 as the record date for determining the stockholders entitled to notice of and to vote at the Meeting and any adjournment of the Meeting. A complete list of stockholders entitled to vote will be available at the Company's headquarters, 19333 Vallco Parkway, Cupertino, California, for ten days before the meeting.

IF YOU DO NOT EXPECT TO ATTEND IN PERSON, PLEASE PROMPTLY MARK, SIGN AND RETURN THE ENCLOSED PROXY.

THOMAS LYMAN CHUN
Secretary

January 2, 1985

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders
to be held February 22, 1985

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on February 22, 1985 at 10:00 A.M., for the following purposes:

1. To elect three Class II Directors to hold office until 1988.

2. To consider and vote upon a proposal to amend the Company's Certificate of Incorporation to provide for the authorized number of directors to range from nine (9) to fifteen (15) and to authorize the Board of Directors to designate the exact number of directors within such limits and to restate the Certificate and all amendments as a single document.

3. To consider and vote upon a proposal to amend the Tandem Computers Incorporated 1981 Stock Option Plan to increase the number of shares of Common Stock available for issuance under the Plan.

4. To ratify the selection of Arthur Andersen & Co. as the Company's independent auditors.

5. To transact such other business as may properly come before the Meeting and any adjournment of the Meeting.

The Board of Directors has fixed the close of business on December 28, 1984 as the record date for determining the stockholders entitled to notice of and to vote at the Meeting and any adjournment of the Meeting. A complete list of stockholders entitled to vote will be available at the Company's headquarters, 19333 Vallco Parkway, Cupertino, California, for ten days before the meeting.

IF YOU DO NOT EXPECT TO ATTEND IN PERSON, PLEASE PROMPTLY MARK, SIGN AND RETURN THE ENCLOSED PROXY.

Thomas Lyman Cronin
Secretary

January 22, 1985

TANDEM COMPUTERS INCORPORATED

PROXY STATEMENT

This Proxy Statement is furnished in connection with the solicitation by the Board of Directors of Tandem Computers Incorporated, a Delaware corporation (the "Company"), with principal executive offices at 19333 Vallco Parkway, Cupertino, California 95014, of proxies in the accompanying form to be used at the Annual Meeting of Stockholders to be held on February 22, 1985 and any adjournment of the Annual Meeting. The shares represented by the proxies received in response to this solicitation and not revoked will be voted at the Annual Meeting. A proxy may be revoked at any time before it is exercised by submitting a later-dated proxy or by voting in person at the Annual Meeting. On the matters coming before the Meeting for which a choice has been specified by a stockholder by means of the ballot on the proxy, the shares will be voted accordingly. If no choice is specified, the shares will be voted FOR the election of the three nominees for director listed in this Proxy Statement and FOR approval of proposals 2, 3 and 4 described in the Notice of Annual Meeting and in this Proxy Statement.

Stockholders of record at the close of business on December 24, 1984 are entitled to notice of and to vote at the Annual Meeting. On November 20, 1984, the Company had 40,879,085 shares of Common Stock outstanding. Each holder of Common Stock is entitled to one vote for each share held as of the record date, except that, in voting for directors, each stockholder is entitled to cumulate votes for the election of directors whose names have been placed in nomination; that is, a stockholder may cast as many votes as there are directors to be elected multiplied by the number of shares which the stockholder holds. All such votes may be cast for one candidate or distributed among the nominees for director as the stockholder sees fit. The persons authorized to vote shares represented by executed proxies in the enclosed form (if authority to vote for the election of directors is not withheld) will have full discretion and authority to vote cumulatively and to allocate votes among any or all of the nominees for election to the Board of Directors as they may determine or, if authority to vote for a specified candidate or candidates has been withheld, among those nominees for whom authority to vote has not been withheld.

The expense of printing and mailing proxy materials will be borne by the Company. In addition to the solicitation of proxies by mail, solicitation may be made by certain directors, officers and other employees of the Company by personal interview, telephone or telegraph; no additional compensation will be paid to such persons for such solicitation. The Company has also engaged Corporate Investor Communications, Inc. to assist in the solicitation of proxies and will pay this firm a fee of approximately $5,000 plus expenses. The Company will reimburse brokerage firms and others for their reasonable expenses in forwarding solicitation materials to beneficial owners of the Company's Common Stock.

This Proxy Statement and a form of proxy are being mailed to stockholders on or about January 2, 1985.

IMPORTANT

Please mark, date and sign the enclosed proxy and return it at your earliest convenience in the enclosed postage-prepaid return envelope so that, if you are unable to attend the Annual Meeting, your shares may be voted.

ELECTION OF DIRECTORS

The Company has three classes of directors serving staggered three-year terms. Each class consists of three directors. Three Class II directors are to be elected at the Annual Meeting for three-year terms expiring on the date of the Annual Meeting in 1988 or until each such director's successor shall have been duly elected or appointed.

Unless authority to vote for directors is withheld, it is intended that the shares represented by the enclosed proxy will be voted for the election of Messrs. Franklin P. Johnson, Jr., Thomas J. Perkins and Thomas I. Unterberg as Class II directors. Messrs. Johnson and Perkins are currently members of the Board of Directors of the Company. Mr. John B. M. Place, currently a Class II director, has decided not to stand for reelection. Upon the recommendation of the Nominating Committee, the Board of Directors has nominated Mr. Unterberg for election as a Class II director. In the event any of such nominees becomes unable or unwilling to serve, the shares represented by the enclosed proxy will be voted for the election of the balance of those named and such other person as the Board of Directors may select. The Board of Directors has no reason to believe that any such nominee will be unable to serve.

Set forth below are the names and ages of the nominees and directors, the class to which each has been elected or nominated for election, their principal occupations at present and for the past five years, certain directorships held by each and the year in which each became a director of the Company. Information with respect to the Company includes the Company's predecessor California corporation.

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Class I		
Morton Collins (1)	1975	48
General Partner of DSV Associates and DSV Partners III, Princeton, New Jersey private investment partnerships, since 1974 and 1981, respectively.		
Andrew Knight	1984	45
Editor, *The Economist,* Economist Newspaper Ltd., since 1974; Member of Council of Chatham House (The Royal Institute of International Affairs); Governor of Imperial College of Science and Technology, University of London; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University; Trustee of the Victoria and Albert Museum, London.		
Robert C. Marshall	1980	53
Senior Vice President and Chief Operating Officer of the Company since July 1980; Vice President and Chief Operating Officer from 1979 to 1980; Vice President from 1975 to 1979.		
Class II		
Franklin P. Johnson, Jr. (2)	1975	56
General Partner since 1982 of Asset Management Partners, a Palo Alto, California private investment partnership; Owner from 1967 to 1984 of Asset Management Company, a Palo Alto, California private investment proprietorship; Director of Amgen, Boole & Babbage, California Microwave, Inc., Coherent, Inc., SBE, Inc. and Teradyne, Inc.		

(See footnotes on following page)

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Thomas J. Perkins (2) (3)	1974	52
Chairman of the Board of the Company since 1974; General Partner since 1972, 1978, 1980 and 1982 of Kleiner & Perkins, Kleiner, Perkins, Caufield & Byers, Kleiner, Perkins, Caufield & Byers II and Kleiner, Perkins, Caufield & Byers III, respectively, San Francisco, California private investment partnerships; Director of Corning Glass Works, Genentech, Inc., Hybritech Incorporated, LSI Logic Corporation and Spectra-Physics, Inc.		
Thomas I. Unterberg	—	53
Chairman and Senior Managing Director of L. F. Rothschild, Unterberg, Towbin, an investment banking firm, since 1983; Managing Senior Partner of such firm from 1981 to 1982; General Partner of such firm from 1977 to 1980; Director of Applied Energy Services, Inc., ASK Computer Systems, Inc., LIN Broadcasting Corporation, Scitex Corporation Ltd., Systems & Computer Technology Corporation and Thermo Electron Corporation.		
Class III		
Thomas J. Davis, Jr. (1) (3)	1976	72
General Partner since 1973, 1979, 1981 and 1983 of Mayfield II, Mayfield III, Mayfield IV and Mayfield V, respectively, Menlo Park, California private investment partnerships; Director of Businessland, Inc., Compression Labs, Inc. and Equatorial Communications Co.		
Robert G. Stone, Jr. (2)	1978	61
Chairman of the Board of Kirby Exploration Company, an oil and gas exploration company, and its predecessor, General Energy Corporation, since 1971; Chairman of the Board of West India Shipping Company, Inc. from 1974 to 1983; Director of The Chubb Corporation, Combustion Engineering, Inc., Core Industries, Inc., Corning Glass Works, Great Northern Nekoosa Corp., Hamilton Brothers Petroleum Corp., The Japan Fund, Inc., The Pittston Company, R. H. Macy & Co., Inc. and Western Pacific Industries, Inc.		
James G. Treybig (3)	1974	44
President and Chief Executive Officer of the Company since 1974.		

(1) Member of Audit Committee.

(2) Member of Nominating Committee.

(3) Member of Compensation/Option Committee.

STOCK OWNERSHIP OF DIRECTORS AND OFFICERS

The following table sets forth information as of November 20, 1984 as to shares of Common Stock beneficially owned by the directors and nominees named under "Election of Directors" and the directors and officers of the Company as a group. Except as otherwise indicated, each person has sole investment and voting power with respect to the shares shown. Ownership information is based upon information furnished by the respective individuals.

	Beneficial Ownership of Common Stock	
	Number of Shares(1)	Percent of Class
Thomas J. Perkins	510,468	1.2%
James G. Treybig(2)	296,447	0.7
Franklin P. Johnson, Jr.(3)	259,998	0.6
Robert C. Marshall(4)	182,000	0.4
Robert G. Stone, Jr.(5)	107,725	0.3
Thomas J. Davis, Jr.	82,644	0.2
Morton Collins(6)	31,704	0.1
John B. M. Place	14,000	(7)
Thomas I. Unterberg	10,000	(7)
Andrew Knight	12,000	(7)
All officers and directors as a group (26 persons including the nine directors named above)	2,133,630	5.2

(1) Includes shares which may be acquired within 60 days pursuant to the exercise of options as follows: Mr. Treybig, 82,088 shares; Mr. Marshall, 83,800 shares; Mr. Place, 12,000 shares; Mr. Knight, 12,000 shares; and all officers and directors as a group, 483,001 shares.

(2) Includes 1,800 shares held by trusts, of which Mr. Treybig is the trustee.

(3) All such shares are held by Asset Management Partners, a partnership of which Mr. Johnson is general partner.

(4) Includes 2,755 shares held in a trust for the benefit of a minor child of Mr. Marshall, of which the trustee is Mr. Marshall's wife, and as to which Mr. Marshall disclaims any beneficial interest.

(5) Includes 23,143 shares held by trusts, of which Mr. Stone is a trustee, and 45,982 shares beneficially owned by Mr. Stone's wife and children, as to all but 600 of which shares Mr. Stone disclaims any beneficial interest.

(6) Includes 400 shares held in a trust for the benefit of Mr. Collins' children and as to which Mr. Collins disclaims any beneficial interest.

(7) Less than one-tenth of one percent.

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Information is set forth below as to the cash compensation paid during the 1984 fiscal year by the Company and its subsidiaries to each of the five most highly compensated executive officers of the Company individually, to all executive officers as a group and to directors. Information is given only for the period each served as an executive officer or director of the Company. Information for the past five fiscal years as to stock options granted and amounts allocated to such persons, to all officers and directors as a group and to employees under the Company's employee benefit plans is set forth under "Stock Options" on page 6 or the description of each plan under "Description of Other Plans" commencing on page 11 of this Proxy Statement.

Cash Compensation of Executive Officers for Fiscal 1984

Name of Individual or Number in Group and Capacities in Which Served	Amount
James G. Treybig — President, Chief Executive Officer and Director	$ 290,051
Robert C. Marshall — Senior Vice President, Chief Operating Officer and Director	$ 242,968
David R. Mackie — Vice President — U.S. Marketing	$ 194,223
Dennis L. McEvoy — Vice President — Software Development	$ 194,218
Lawrence A. Laurich — Vice President — Hardware Development	$ 192,445
All executive officers as a group (19 persons including the five named above)	$2,895,173

Directors who are not officers of the Company are paid an annual retainer of $13,000 plus expenses, payable quarterly. Directors who are members of one or more of the Executive, Compensation/Option, Nominating, Conflicts of Interest or Audit Committees are paid an additional annual retainer of $1,000 for each such committee of which they are a member. The Chairman of the Board is paid an additional annual retainer of $2,000 per year. Mr. Knight has chosen to serve without an annual retainer.

During August 1984, the Company made a short-term loan to Mr. Marshall in the amount of $100,000 to enable him to maintain his ownership position in the Company's Common Stock. The annual interest rate on the loan was a variable rate equal to the lesser of (i) the Bank of America's prime rate plus one percent or (ii) 14 percent. The largest amount outstanding under the loan was $102,782. Mr. Marshall has paid the loan in full.

From time to time, the Company has guaranteed bank loans to officers. During the 1984 fiscal year the Company guaranteed bank loans to Messrs. Laurich and Mackie in the principal amounts of $300,000 and $250,000, respectively, plus interest. The Company has not had to perform under the guarantees.

STOCK OPTIONS

With respect to options to purchase shares of the Company's Common Stock granted to certain executive officers, all executive officers as a group and all directors as a group during the period October 1, 1979 to November 20, 1984, the following table sets forth (i) the aggregate amount of Common Stock subject to options granted (net of cancellations) during the specified period, (ii) the weighted average per share option exercise price of such options, (iii) the net value of shares (market value less any exercise price) realized during the specified period upon the exercise of such options during the specified period and (iv) the numbers of shares of Common Stock sold by the named persons and by all executive officers as a group and by all directors as a group during the specified period. Information is given only for the period each served as an executive officer or director of the Company.

Common Stock(1)	James G. Treybig	Robert C. Marshall	David R. Mackie(2)	Dennis L. McEvoy(2)	Lawrence A. Laurich(2)	All Executive Officers as a Group(2)	All Directors as a Group(3)
Granted—October 1, 1979 to November 20, 1984:							
Number of shares	90,000	99,000	63,600	20,200	55,600	509,300	24,000
Weighted average per share exercise price	$15.95	$14.48	$15.36	$21.21	$15.53	$17.26	$23.86
Exercised—October 1, 1979 to November 20, 1984:							
Net value realized in shares (market value less exercise price)	$405,274	$474,789	$677,435	$165,166	$1,161,812	$3,990,684	$266,508
Sales—October 1, 1979 to November 20, 1984:							
Number of shares(4)	133,000	74,500	63,800	23,000	28,000	346,562	202,868

(1) Adjusted for stock splits.

(2) Includes options granted under the Stock Option Grant Program of the Company's Employee Stock Purchase Plan, all of which have an exercise price of 85% of the market value of the shares on the date of grant. The numbers of options granted under such Plan to Messrs. Mackie, McEvoy, Laurich and all executive officers as a group are 500, 100, 500 and 1,800, respectively, and the weighted average per share exercise price of such options and the market price of the Common Stock on the date of grant are $18.06 and $21.25, respectively.

(3) Excludes directors who are also executive officers.

(4) Shares sold were not necessarily acquired by the exercise of options. May include shares disposed of by gift.

During the period from October 1, 1979 to November 20, 1984, employees (excluding officers) were granted options under the Company's stock option plans and the Stock Option Grant Program of the Employee Stock Purchase Plan to purchase a total of 10,269,804 shares (net of cancellations) at a weighted average exercise price of $18.64 per share (adjusted to reflect stock splits). Of these, 3,514,152 were not "qualified" stock options, incentive stock options or options granted pursuant to an "employee stock purchase plan," as the quoted terms are defined in Sections 422 through 423 of the Internal Revenue Code of 1954, as amended. The weighted average per share exercise price for such options is $17.47. Of the total number of options granted, 931,900 were granted under the Stock Option Grant Program of the Company's Employee Stock Purchase Plan at 85% of the market price of the Common Stock on the date of grant. The weighted average per share market price of the Common Stock on the dates of grant is $19.60.

As of November 20, 1984 there were outstanding options under the Company's 1981 Stock Option Plan, 1979 Stock Option Plan, Non-Qualified Stock Option Plan and Qualified Stock Option Plan to purchase 5,417,491 shares held by approximately 4,300 participants and there were approximately 5,200 employees eligible to participate in such plans. The expiration dates of all such options range from October 10, 1986 to September 20, 1991 and the weighted average exercise price per share is $22.49.

RECENT EVENTS

On October 2, 1984 the Securities and Exchange Commission (the "Commission") filed a civil action for injunctive and other equitable relief in the United States District Court for the Northern District of California against the Company, Messrs. Treybig and Marshall and a former officer of the Company. The Commission's complaint alleged that during fiscal 1982, the Company, aided and abetted by the named persons, engaged in certain conduct which resulted in improper recognition of revenue. This conduct was alleged to have resulted in the violation by the Company of certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act") through the filing with the Commission of reports which overstated the Company's revenue and net income for the second and third fiscal quarters of 1982 and the issuance of a press release which overstated the Company's revenue and net income for the fourth fiscal quarter of 1982 and fiscal 1982 as a whole. The complaint further alleged that during fiscal 1982, the Company, aided and abetted by the named persons, violated certain accounting provisions of the Exchange Act relating to record keeping and internal accounting controls. The Company had restated its fiscal 1982 financial statements in December 1982 and the Commission did not seek a further restatement.

In order to avoid the time and expense of protracted litigation, without admitting or denying the allegations in the complaint, on October 2, 1984 the Company and the named persons consented to the entry of a final judgment permanently enjoining them from violating various provisions of the Exchange Act and requiring certain ancillary relief, including an annual review and report for three years by the Company's independent accountants of the Company's system of accounting and internal controls in specified areas, including revenue recognition.

Subsequent to October 2, 1984, a stockholder class action suit was filed against the Company and the persons named in the Commission's complaint alleging violations of the antifraud provisions of the Exchange Act and certain state fraud and misrepresentation laws. This suit is based primarily upon the allegations of the Commission's complaint and seeks damages in an unspecified amount. The Company and the individuals named in this suit believe they have meritorious defenses to the allegations in this action and will vigorously defend the litigation. In addition, a stockholder derivative suit based upon the same events was filed by an individual against the Company, certain of its present and former directors and a former officer alleging waste of corporate assets under Delaware law.

APPROVAL OF PROPOSED AMENDMENT AND RESTATEMENT OF THE CERTIFICATE OF INCORPORATION

The proposed amendment to Article V of the Company's Certificate of Incorporation would change the authorized number of directors from nine to an indefinite number ranging from nine to 15. If the stockholders approve the proposed amendment, the Board of Directors will, from time to time, designate the exact number of directors within this range. The Board would continue to be divided into three classes of directors serving staggered three-year terms. The amendment would also expressly delegate to incumbent directors the power to elect additional directors to fill any vacancies on the Board resulting from an increase in its size. If the size of the Board were increased, the additional directors would be apportioned among the three classes so as to make all classes as nearly equal in number as possible. The additional directors would hold office until the completion of their respective classes' terms and until their successors were elected and qualified.

The proposed restatement of the Company's Certificate of Incorporation would integrate into a single document the Company's original Certificate and all amendments, including the proposed amendment to Article V. The proposed restatement would also reflect the new address of the Company's registered office in Delaware and delete obsolete provisions designating the incorporator of the Company and the now-expired initial terms of office of the various classes of the Company's directors. Delaware law does not require such changes to be approved by the stockholders.

The proposed amendment and restatement is set forth in full in Exhibit A to this Proxy Statement. Please refer to that Exhibit for a full statement of the proposed amendment to Article V.

The Board of Directors has no present intention of increasing the size of the Board but believes that the proposed amendment would benefit the Company and its stockholders by allowing the Company the flexibility to increase the size of the Board if qualified candidates for director become available.

The adoption of the amendment and restatement of the Certificate of Incorporation requires the affirmative vote of not less than a majority of the issued and outstanding shares of Common Stock entitled to vote.

The Board of Directors recommends a vote FOR the amendment and restatement of the Certificate of Incorporation.

APPROVAL OF AMENDMENT TO THE TANDEM COMPUTERS INCORPORATED 1981 STOCK OPTION PLAN

The Board of Directors believes that stock options are an invaluable tool for the recruitment, retention and motivation of qualified employees, including officers, who can materially contribute to the Company's success. The Board of Directors believes that availability of stock options for employees will continue to be essential in the future and is therefore requesting stockholder approval of an increase in the number of shares of the Company's Common Stock reserved for issuance under the Tandem Computers Incorporated 1981 Stock Option Plan (the "1981 Plan") from 5,000,000 to 9,000,000 shares. As of November 20, 1984, options to purchase 3,581,091 shares (some of which have been cancelled due to employee terminations) had been granted under the 1981 Plan, of which options to purchase 15,554 shares had been exercised, and only 1,640,290 shares remained available for additional option grants. See "Description of Other Plans" below for a discussion of the Company's other benefit plans.

Description of the Plan

The 1981 Plan was approved by the stockholders at the Company's 1982 Annual Meeting of Stockholders. A general summary of the principal provisions of the 1981 Plan is set forth below.

The 1981 Plan is administered by the Compensation/Option Committee, which has the authority to select the employees to be granted options, determine the number of shares for each option, fix the terms and conditions of options, designate certain options as Incentive Stock Options (ISOs) for the purpose of qualifying under Section 422A of the Internal Revenue Code, and interpret the 1981 Plan and any option granted under the Plan. Grants of options under the 1981 Plan to employees who are also directors are administered by the Directors' Option Committee, a committee consisting of four directors who do not hold outstanding options and who are not eligible to be granted options. All employees of the Company and its 50% or more owned subsidiaries, including officers and directors who are also employees, are eligible to receive options under the 1981 Plan. The maximum value of ISO grants is limited to $100,000 per year for each employee, subject to certain carryover provisions.

Options granted under the 1981 Plan are required to have an option price of not less than 100% of the market value of the Company's Common Stock on the date of grant. Options may be made exercisable at such time or times as determined by the administering Committee and provided in the option agreement entered into between the Company and the employee. However, except when the optionee's employment terminates because of death or permanent disability, an option may not be exercisable before six months following its effective date. In addition, an ISO may not be exercised while there is outstanding any ISO previously granted to the same employee.

An employee may exercise an option only while employed by the Company or one of its subsidiaries, or, subject to certain limitations, within 30 days following the termination of such employment (three months, if termination is due to permanent disability). If an optionee dies while in the employ of the Company or a subsidiary, subject to certain limitations, the optionee's legal representative may exercise the option within one year following the optionee's death. Options may not be transferred except by will or the laws of descent and distribution. In no event may an option be exercised more than seven years after the date of grant. Shares purchased upon the exercise of an option must be paid for in full at the time of exercise, except that, with the consent of the Company, an optionee may deliver a full recourse, interest-bearing promissory note to the Company, calling for periodic repayments over a period not to exceed 10 years from the date of exercise.

The administering Committee may determine that an option to be granted under the 1981 Plan will provide that the shares to be issued upon exercise of the option shall be subject to a right of repurchase by the Company at the option price. In such case, the option agreement will provide that if the optionee's employment terminates, the Company may repurchase a specified percentage of the shares.

Any shares subject to options which lapse or terminate become available for the grant of options. In the event of any change in the outstanding shares of Common Stock resulting from a stock dividend, stock split, reorganization or the like, the administering Committee may proportionately adjust the number of shares reserved for issuance under the 1981 Plan and the number of shares and per share exercise prices of outstanding options.

The Board of Directors may at any time amend, suspend or discontinue the 1981 Plan, subject to the requirement that certain amendments be approved by the stockholders. If not earlier terminated by action of the Board of Directors, the 1981 Plan will terminate automatically on October 29, 1991.

Federal Income Tax Effects

When a nonstatutory option is granted, the optionee realizes no taxable income as the result of the grant. Upon the exercise of a nonstatutory stock option, the optionee must recognize ordinary income in the amount of the difference between the option price and the fair market value on the date of exercise. Upon the subsequent sale of stock acquired by the exercise of a nonstatutory stock option, any gain or loss, based on the fair market value of the stock on the date of recognition of ordinary income, will be taxed as short-term or long-term capital gain or loss, depending on the length of time the optionee has held the stock from the date of recognition of income.

In general, the Internal Revenue Code makes certain tax advantages available to the holders of ISOs. As to such options, the optionee realizes no taxable income upon either the grant or the exercise of the option. If the optionee makes a disposition of the stock acquired by the exercise of the option within two years from the date of grant or within one year from the date of exercise (a disqualifying disposition), the difference between the option price and the fair market value on the date of exercise (not to exceed the gain recognized on the sale) will be taxed as ordinary income and any gain in excess of such amount will be treated as a long-term or short-term capital gain, depending on the length of time the stock was held by the optionee. If the optionee sells the stock acquired by the exercise of the option more than one year after the date of exercise and more than two years after the date of grant, the difference between the option price and sales price will be taxed as a long-term capital gain or loss.

In the case of an ISO, the spread between the option price and the fair market value of the stock on the date of exercise will be classified as an item of tax preference. Special rules apply to optionees who exercise a stock option when subject to the "short swing" trading restrictions of Section 16(b) of the Securities Exchange Act of 1934.

The Company will have no tax deduction with respect to the grant or exercise of an ISO or the sale of stock acquired by such exercise, except to the extent that an employee recognizes ordinary income upon a disqualifying disposition of such stock. The Company will have no tax deduction with respect to the grant of a nonstatutory stock option or the sale of stock acquired by such exercise. The Company will have a deduction equal to the amount of ordinary income that the optionee is required to recognize as a result of the exercise of a nonstatutory stock option.

Required Vote

The amendment of the 1981 Stock Option Plan requires the affirmative vote of not less than a majority of the shares of Common Stock present and voting at the meeting in person or by proxy.

The Board of Directors recommends a vote FOR the amendment to the Tandem Computers Incorporated 1981 Stock Option Plan.

DESCRIPTION OF OTHER PLANS

Other Stock Option Plans

Tandem Computers Incorporated 1979 Stock Option Plan. The Tandem Computers Incorporated 1979 Stock Option Plan (the "1979 Plan") was approved by the stockholders at the Company's 1980 Annual Meeting of Stockholders. The 1979 Plan is administered in the same manner as the 1981 Plan. The provisions of the 1979 Plan and the terms of the options granted under the 1979 Plan are substantially similar to those of the 1981 Plan, except as follows. Only employees of the Company and employees and directors of its 80% or more owned subsidiaries are eligible to receive options. Certain options outstanding on January 1, 1981 could not be designated as Incentive Stock Options.

Tandem Computers Incorporated Non-Qualified Stock Option Plan. The Tandem Computers Incorporated Non-Qualified Stock Option Plan was approved by the stockholders at the Company's 1978 Annual Meeting of Stockholders and, as amended, at the 1979 Annual Meeting of Stockholders. The terms of the options granted under this Plan are substantially similar to those of the 1981 Plan, except that only employees of the Company and employees and directors of its wholly owned subsidiaries are eligible to receive options.

Tandem Computers Incorporated Qualified Stock Option Plan. The Tandem Computers Incorporated Qualified Stock Option Plan was approved by the stockholders in 1976 and is administered in the same manner as the 1981 Plan. The provisions of the Qualified Stock Option Plan and the terms of the options granted pursuant thereto are substantially similar to those of the 1981 Plan described above, except as follows. Only key employees of the Company and its subsidiaries may be granted options. Options may not be exercised after five years from the date of grant. All shares issued pursuant to the exercise of options are subject to certain rights of repurchase by the Company. Under certain circumstances, options may not be exercised while the optionee holds another option previously granted at a higher option price. The Qualified Stock Option Plan will expire on November 12, 1985. Under certain amendments of the Internal Revenue Code, no option granted under the Qualified Stock Option Plan which is exercised after May 20, 1981 will be afforded the special tax treatment formerly available to "qualified" stock options under the Internal Revenue Code.

Individual Stock Option Agreements. In addition to the 1981 Plan, the 1979 Plan and the Non-Qualified and Qualified Stock Option Plans, the Company has entered into two separate Non-Qualified Stock Option Plans and Agreements with Mr. John B. M. Place who is a director of the Company. Under these Plans, Mr. Place was granted options to purchase 2,000 and 10,000 shares of the Company's Common Stock, respectively. The exercise prices of the options are $26.75 and $29.125, respectively, which equal 100% of the market value of the Company's Common Stock on the dates of grant. The provisions of these Plans are substantially similar to those described in the description of the Non-Qualified Stock Option Plan except that no further grants are permitted under any of these Plans and the options granted to Mr. Place may be exercised for 36 months after the end of his term as a director. Mr. Andrew Knight, also a director of the Company, has similarly been granted an option to purchase 12,000 shares of the Company's Common Stock at $19 per share.

Tandem Computers Incorporated Employee Stock Purchase Plan

Since 1978, the Company has had in effect the Tandem Computers Incorporated Employee Stock Purchase Plan (the "Stock Purchase Plan"). The Stock Purchase Plan has two segments, a Payroll Withholding Accumulation Program and a Stock Option Grant Program, and is administered by the Compensation/Option Committee.

All employees of the Company and its 50% or more owned subsidiaries, including officers, who customarily work more than five months in a calendar year are eligible to purchase shares under the Stock Purchase Plan. Non-employee directors of the Company may not participate. As of November 20, 1984, approximately 5,200 employees were eligible to participate in the Stock Purchase Plan, of whom 1,980 were participating, and 1,979,639 shares remained available for purchase.

Under the Payroll Withholding Accumulation Program, an eligible employee may authorize the Company to withhold from 1% to 10% of his or her compensation to be applied to the purchase of the maximum number of whole shares (up to 1,500) of the Company's Common Stock which can be purchased with the amount withheld during a participation period (calendar quarter). The purchase price for each participation period is the lesser of (i) 85% of the market value of a share of Common Stock on the last trading day before the participation period commences or (ii) 85% of the market value of a share of Common Stock on the last trading day of the participation period.

During the period from October 1, 1979 through November 20, 1984, the aggregate difference between the purchase price and the fair market value on the date of purchase of shares acquired pursuant to the Payroll Withholding Accumulation Program by Mr. Mackie (the only participant among the persons named in the table under the caption "Compensation of Executive Officers and Directors"), all executive officers as a group and all employees (including officers) was $2,647, $14,021 and $5,815,167, respectively.

Under the Stock Option Grant Program, options for an identical number of shares are granted periodically at the discretion of the Compensation/Option Committee to every person who is eligible to participate in the program on the date of grant. The exercise price, determined by the Compensation/Option Committee, cannot be less than 85% of the market value of the Common Stock on the date of grant. Options expire no later than 27 months after the date of grant. Shares purchased upon the exercise of an option must be paid for in full at the time of exercise or, with the Compensation/Option Committee's approval, may be purchased by delivery of a full-recourse, interest-bearing promissory note.

As of November 20, 1984, four grants had been made under the Stock Option Grant Program of the Stock Purchase Plan. A grant of 100 shares was made to each employee in 1980, 1981, 1982 and 1983 (without giving effect to a stock split in 1981). As of November 20, 1984, there were outstanding options under the Stock Option Grant Program to purchase 25,000 shares held by 250 employees at a weighted average exercise price of $29 per share. The expiration date of these options is January 20, 1986.

Incentive Cash Bonus Plan

The Company has in the past had an incentive cash bonus plan (the "Bonus Plan") in which the executive officers of the Company were eligible to participate. Awards under the Bonus Plan were made if certain target increases in revenues, operating profits and asset management ratios (established by the Board in its discretion) were attained by the Company. No awards were made under the Bonus Plan during fiscal 1984 and any amounts paid since October 1, 1979 have been included in the disclosure of management remuneration for such years. The Bonus Plan is not currently in effect.

1984 401(k) Investment Plan

Employees of the Company, including directors who are employees of the Company, are eligible to participate in the Company's 1984 401(k) Investment Plan (the "Investment Plan"). Each participant may elect to contribute from 2% to 10% of his or her compensation, and the Company matches 25% of the first 6% of the employee's compensation contributed to the Investment Plan, subject to a maximum Company matching contribution of $1,200 per employee per plan year ending September 30. An employee's contributions are made by deferring that portion of his or her compensation, thereby enabling such contributions to be made on a before-tax basis. A participant is at all times fully vested in his or her contributions and becomes fully vested in Company contributions upon the last day of the fourth calendar quarter following the quarter for which such contributions were made. Contributions are held and invested by the Investment Plan trustee in three different funds. A participant may designate, within certain limitations, in which funds his or her accounts are to be invested. The Investment Plan permits participants to make withdrawals and to borrow from their accounts at market rates under certain conditions. In general, the vested portion of a participant's accounts is distributed upon termination of employment.

Between July 1, 1984 (the inception of the Investment Plan) and November 30, 1984, the Company made matching contributions under the Investment Plan for the accounts of Messrs. Marshall, Mackie, McEvoy and Laurich, all executive officers as a group and all employees as a group in the amounts of $1,406, $1,125, $1,125, $1,012, $14,330 and $590,321, respectively. These amounts include contributions made during the first plan year, which ended September 30, 1984, and during the first quarter of the current plan year.

RATIFICATION OF INDEPENDENT AUDITORS

Upon the recommendation of the Audit Committee, the Board of Directors has reappointed the firm of Arthur Andersen & Co. as the Company's independent auditors for the 1985 fiscal year, subject to ratification by the stockholders. Representatives of Arthur Andersen & Co. are expected to be present at the Company's Annual Meeting. They will have an opportunity to make a statement, if they desire to do so, and will be available to respond to appropriate questions.

The Board of Directors recommends a vote FOR ratification of the appointment of Arthur Andersen & Co.

BOARD OF DIRECTORS MEETINGS AND COMMITTEES

The Company's Board of Directors held four meetings during the 1984 fiscal year. All directors except Mr. Place attended at least 75% of the aggregate number of meetings of the Board and of the committees on which such directors serve.

The Board of Directors of the Company has appointed an Audit Committee, Nominating Committee, Compensation/Option Committee and a Directors' Option Committee of the Board.

The members of the Audit Committee are Messrs. Morton Collins, John B. M. Place and Thomas J. Davis, Jr. The Audit Committee held five meetings during the 1984 fiscal year. Its functions are to monitor the effectiveness of the audit effort, to supervise the Company's financial and accounting organization and financial reporting and to select a firm of certified public accountants, whose duty it is to audit the books and accounts of the Company for the fiscal year for which they are appointed.

The members of the Nominating Committee are Messrs. Franklin P. Johnson, Jr., Thomas J. Perkins and Robert G. Stone, Jr. The Nominating Committee held one meeting during the 1984 fiscal year. The Nominating Committee's function is to select nominees for election as directors. The Nominating Committee will consider nominees recommended by stockholders. Such recommendations should be submitted in writing to the Nominating Committee in care of the Secretary of the Company at its address set forth on the front page of this Proxy Statement.

The members of the Compensation/Option Committee are Messrs. Thomas J. Perkins, James G. Treybig and Thomas J. Davis, Jr. The Compensation/Option Committee held four meetings during the 1984 fiscal year. The Compensation/Option Committee's functions are to determine and supervise compensation to be paid to officers and directors of the Company and to supervise and manage the Company's Stock Purchase Plan and stock option plans (except with respect to options granted to directors).

The members of the Directors' Option Committee are Messrs. Thomas J. Perkins, Thomas J. Davis, Jr., Franklin P. Johnson, Jr. and Morton Collins. The Directors' Option Committee held no meetings during the 1984 fiscal year. The Directors' Option Committee's function is to supervise and manage the Company's stock option plans as to directors of the Company.

CERTAIN BENEFICIAL OWNERS

The following table sets forth information as of November 20, 1984 as to stockholders that have advised the Company that each is the beneficial owner of more than 5% of the Company's Common Stock.

	Beneficial Ownership of Common Stock	
	Number of Shares	Percent of Class
Jennison Associates Capital Corp. 466 Lexington Avenue New York, NY 10017	3,803,770(1)	9.3%
Sanford C. Bernstein & Co., Inc. 767 Fifth Avenue New York, NY 10153	3,779,000(2)	9.2%

(1) In its Schedule 13G dated April 5, 1984, Jennison Associates Capital Corp. stated that it has sole voting and investment power with regard to 3,526,870 and 3,803,770 of such shares, respectively.

(2) The Company has no direct information as to the number of such shares as to which Sanford C. Bernstein & Co., Inc. has voting or investment power.

STOCKHOLDER PROPOSALS

To be considered for presentation at the Annual Meeting of Stockholders to be held in 1986, a stockholder proposal must be received at the offices of the Company, 19333 Vallco Parkway, Cupertino, California 95014, not later than October 25, 1985.

OTHER MATTERS

The Board of Directors knows of no other business which will be presented to the Annual Meeting. If any other business is properly brought before the Annual Meeting, it is intended that proxies in the enclosed form will be voted in accordance with the judgment of the persons voting the proxies.

Whether you intend to be present at the Annual Meeting or not, we urge you to return your signed proxy promptly.

By order of the Board of Directors,

THOMAS LYMAN CHUN
Secretary

EXHIBIT A

RESTATED CERTIFICATE OF INCORPORATION
OF
TANDEM COMPUTERS INCORPORATED

ARTICLE I

The name of the corporation is Tandem Computers Incorporated.

ARTICLE II

The address of its registered office in the State of Delaware is Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.

ARTICLE III

The nature of the business or purposes to be conducted or promoted is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

ARTICLE IV

The total number of shares of stock which the corporation shall have authority to issue is sixty-two million four hundred thousand (62,400,000) shares, of which two million four hundred thousand (2,400,000) shares of the par value of ten hundredths dollars ($.10) each, amounting in the aggregate to two hundred forty thousand dollars ($240,000), shall be preferred stock and sixty million (60,000,000) shares of the par value of twenty-five thousandths dollars ($.025) each, amounting in the aggregate to one million five hundred thousand dollars ($1,500,000), shall be common stock.

The preferred stock may be issued from time to time in one or more series. The Board of Directors is hereby expressly vested with authority to fix by resolution or resolutions the designations and the powers, preferences and relative, participating, optional or other special rights, and the qualifications, limitations or restrictions thereof (including, without limitation, the voting powers, if any, the dividend rate, conversion rights, redemption price, or liquidation preference of any series of preferred stock), to fix the number of shares constituting any such series, and to increase or decrease the number of shares of any such series (but not below the number of shares thereof then outstanding). In case the number of shares of any such series shall be so decreased, the shares constituting such decrease shall resume the status which they had prior to the adoption of the resolution or resolutions originally fixing the number of shares of such series.

Fifty-six million (56,000,000) shares of the common stock authorized hereinabove are designated "Common Stock" and four million (4,000,000) shares of the common stock authorized hereinabove are designated "Junior Common Stock," such Junior Common Stock to be issuable from time to time in one or more series. The Board of Directors is hereby expressly vested with authority to fix by resolution or resolutions the designations and the powers, preferences and relative, participating, optional or other special rights, and the qualifications, limitations or restrictions (including, without limitation, the voting powers, if any, the dividend rate, conversion rights, redemption price, or liquidation preference) of any series of Junior Common Stock, to fix the number of shares constituting any such series of Junior Common Stock, and to increase or decrease the number of shares of any such series of Junior Common Stock (but not below the number of shares thereof then outstanding). In case the number of shares of any such series of Junior Common Stock shall be so decreased, the shares constituting such decrease shall resume that status which they had prior to the adoption of the resolution or resolutions originally fixing the number of shares of such series.

The number of authorized shares of any class or classes of stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the stock of the corporation entitled to vote in the election of directors.

ARTICLE V

The number of directors which shall constitute the whole Board of Directors of this corporation shall be not less than nine (9) nor more than fifteen (15). The Board of Directors of this corporation may, within the limits specified by this Article V, increase or decrease the exact number of directors from time to time by resolution adopted by the affirmative vote of a majority of the entire Board of Directors. The exact number of directors shall be nine (9) until changed pursuant to this Article V. No decrease in the number of directors shall shorten the term of any incumbent director.

The directors shall be divided into three classes: Class I, Class II and Class III. The number of directors in each class shall be as nearly equal in number as possible. Directors of each class shall serve for a term ending on the third annual meeting of stockholders following the annual meeting at which such class was elected. The foregoing notwithstanding, each director shall serve until his successor shall have been duly elected and qualified, unless he shall die, resign or be removed.

At each annual election the directors chosen to succeed those whose terms then expire shall be identified as being of the same class as the directors they succeed. If for any reason the number of directors in the various classes shall not conform with the formula set forth in the preceding paragraph, the Board of Directors may redesignate any director into a different class in order that the balance of directors in such classes shall conform thereto.

At all elections of directors of this corporation, each holder of Common Stock shall be entitled to as many votes as shall equal the number of votes which, except for this provision as to cumulative voting, he would be entitled to cast for the election of directors with respect to his shares of Common Stock, multiplied by the number of directors to be elected, and he may cast all of such votes for a single nominee for director or may distribute them among the number to be voted for, or for any two or more of them as he may see fit.

In case of any increase in the number of directors, the additional directors may be elected by the Board of Directors to hold office until the next election of the class for which such directors have been chosen and until their successors are elected and qualified.

ARTICLE VI

In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized, by resolution passed by a majority of the whole board, to make, amend, alter or repeal the by-laws of this corporation.

ARTICLE VII

This corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation in any manner now or hereafter prescribed by law, and all rights herein conferred upon the stockholders are granted subject to this reservation.

ARTICLE VIII

Whenever a compromise or arrangement is proposed between this corporation and its creditors or any class of them and/or between this corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of this corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this corporation under the provisions of Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for this corporation under the provisions of Section 279 of Title 8 of the Delaware Code, order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this corporation as a consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this corporation, as the case may be, and also on this corporation.

ARTICLE IX

This corporation is to have perpetual existence.

ARTICLE X

Meetings of stockholders may be held outside the State of Delaware, if the by-laws so provide. The books of this corporation may be kept (subject to any provision of law) outside of the State of Delaware. Elections of directors need not be by ballot unless the by-laws of this corporation shall so provide.

[illegible] in the number of [illegible], the additional directors may be elected by the [illegible] directors have been [illegible]

ARTICLE VI

[illegible] the Board of Directors [illegible] whole board [illegible]

ARTICLE VII

[illegible] any provisions contained in this Certificate of Incorporation [illegible] by law, and all rights conferred upon the stockholders [illegible]

ARTICLE VIII

Whenever a compromise or arrangement is proposed between this corporation and its creditors or any class of them and/or between this corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of this corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this corporation under the provisions of Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for this corporation under the provisions of Section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this corporation, as the case may be, and also on this corporation.

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TANDEM COMPUTERS ANNUAL REPORT

1985

Leading the Way in On-line Transaction Processing

TANDEMCOMPUTERS

Tandem Computers Incorporated designs, develops, manufactures, markets and supports a family of unique computer systems for online transaction processing. The Tandem NonStop system concept provides the first online, distributed computer architecture for mainstream business applications. Customers' systems are supported from over 100 locations throughout North America, Europe, Asia and the Pacific. The Company operates manufacturing facilities in the United States and in West Germany.

***T**andem earns the highest marks for customer loyalty.*

Outstanding products are a big part of customer satisfaction. But knowing that Tandem will lead the way is equally important.

We delivered our unique computer architecture in 1976 to a data processing community that was just beginning to understand that information technology would create vast changes in business and society.

Businesses began the transition from the first generation of manual handling of transactions to the second generation of centralized, batch-processing computers in the 1950s.

Tandem was founded in response to the need for a third generation, on-line system to fully automate transaction processing. To meet this need, Tandem offered the added values of constant availability through fault tolerance and modular growth with proportional increases in power.

Many of the biggest, most sophisticated organizations in business recognized that Tandem offered the resource they needed to revolutionize the way they did business.

In this decade, the need has developed for a fourth generation of transaction processing, one where business can distribute processing and data where they are needed and can access the information through networks. In this era, advantages of Tandem's architecture and systems software products have become even more important.

And now, we lead the way into the fifth generation with solutions for integrating previously incompatible information resources to give our customers a powerful tool to help take them to the forefront of their industries.

HIGHLIGHTS

Fiscal Year Ended September 30	1985	1984	1983
Revenue	$624,138,000	$532,620,000	$418,282,000
Operating income	$ 50,081,000	$ 51,101,000	$ 49,771,000
Operating margin	8.0%	9.6%	11.9%
Net income	$ 34,374,000	$ 42,908,000	$ 30,805,000
Earnings per share	$.82	$1.04	$.76
Working capital	$298,611,000	$263,403,000	$254,145,000
Total assets	$552,344,000	$501,873,000	$415,525,000
Stockholders' investment	$420,408,000	$375,122,000	$310,993,000
Number of employees	5,494	5,223	4,396

> **"The potential market is large and growing, with very limited direct competition (for Tandem)."**
>
> *– Drexel Burnham Lambert*

Market direction:

ACCELERATING TRANSACTION RATES

The on-line transaction processing (OLTP) marketplace that Tandem pioneered 11 years ago is still the most attractive segment of the market for commercial data processing systems.

Three major, fundamental sets of forces drive the growth of transaction volumes and the demand for OLTP systems.

Deregulation and competition. The deregulation of industries and worldwide competitive pressures are spawning new, automated procedures and services to control costs or attract new customers. An increasingly automation-dependent world demands computers that can deal with vastly increased transaction rates and volumes.

Technology. Transaction volumes are also increasing as a result of advances in computer processor, memory and communications technologies. Costs of transactions have decreased, inspiring some applications that could not have been considered before. At the same time, business applications are delivering more value for the dollars spent.

Microprocessor technology, too, is feeding transaction volume growth. Microprocessors are bringing intelligence to such devices as automated tellers, retail checkout terminals and wands, facsimile machines, copiers, personal computers, factory data collection terminals, industrial robots and even gasoline pumps. These previously "dumb" devices are now generating transactions at a rapid rate, creating demand for systems to capture and process those transactions.

Integration. As automated procedures multiply, businesses increasingly need to tie together separate batch and on-line applications, usually running on different vendors' systems and networks, into a single information processing resource. This need creates additional demand for systems that can effectively and efficiently perform this integration function.

Most of the growth in OLTP is yet to come. The impact on transaction volumes created by these three forces in the marketplace is just beginning to unfold. Fully 75% of the independent software houses participating in Tandem's Alliance program, according to an independent survey, believe that their Tandem based applications have penetrated less than 10% of their market.

Forces driving up transaction volumes
-Deregulation and competition
-Technology
-Integration

Tandem Revenue ($ Millions)

TANDEM LEADS THE WAY:

Dedicated solely to filling the needs of on-line transaction processing for over a decade, Tandem's computer architecture accommodates the full range of OLTP requirements.

In evidence is the strong Tandem presence among leading-edge applications.

Marketplace innovators look to Tandem for success of new applications, many of which can only be achieved through the unique capabilities and flexibility of the Tandem architecture.

The cornerstone of OLTP requirements and a fundamental benefit of the Tandem architecture is fault tolerance, which significantly increases the productivity of the computer resource. Equally important, however, are programmer productivity, data integrity and security, fast response time, low cost per transaction, ability to distribute data bases, networking and modular system growth from mini to mainframe power without performance degradation and without loss of full functionality.

We believe no other supplier fulfills all of those requirements as well as Tandem. No OLTP application that is subject to growth or modification should be without this critical portfolio of capabilities if it is to enjoy long-term efficiencies and success.

We expect major corporations to continue to rely on Tandem to reduce the risks of automation. Our customers in this rapidly growing, rapidly changing marketplace understand that they can commit to Tandem with confidence. Tandem's technology and focus on OLTP anticipate the direction of the market in the 1990s.

Industry focus:

POINT-OF-SALE:

Mobil Oil's leading-edge project to automate transactions at the point of sale (POS) is an excellent example of the use of on-line processing to gain cost and competitive advantages, as well as an illustration of microprocessor-based technology accelerating the growth of transaction processing volumes.

The POS application automates authorization and data capture of credit card sales (Mobil or bank cards) and debit card sales at service stations, and dramatically reduces Mobil's cost of carrying those sales.

Microprocessor-equipped on-line terminals at high-volume Mobil stations now automatically and instantly update customers' accounts (at Mobil or a specific bank). This replaces the manual handling of charge receipts that previously delayed account updating and collection by some ten days.

Mobil is also able to negotiate more favorable bank-card discount rates because the on-line, paperless POS system also reduces banks' handling costs. Mobil can pass on to customers the company's discount for cash by allowing them to use bank automated teller cards in lieu of cash.

Mobil began the project in 1983, and the 3,600 highest-volume stations of the company's 12,000 outlets will be POS-automated by early 1986, generating transactions at the rate of approximately 7,000,000 per month.

Tandem is a leading supplier of computer systems for point-of-sale applications in many industries, including some of the largest retailers, banks and petroleum companies. Five of the seven major North American petroleum companies developing POS applications chose Tandem systems.

"Software houses have chosen Tandem as a superior technical solution for their specific applications."

– Prudential-Bache

Market direction:

DEMAND FOR APPLICATION SOFTWARE

Customers are no longer just interested in hardware and systems software. Today they demand total systems solutions to business problems and the ability to pursue business opportunities.

Organizations of all sizes are generating strong demand for proven, readily-available application software packages. These packages help to speed implementation of applications and cost less than custom-developed systems. They enable users to respond quickly to market changes and competitive pressures. And, because these packaged solutions are running and demonstrable, they offer users a low-risk path to automation.

TANDEM LEADS THE WAY:

Through the Tandem Alliance program, the expertise of the independent software house combines with Tandem's knowledge of the needs of industry to deliver powerful hardware and application software solutions.

Our philosophy is to work closely with software houses and other third parties as development partners. Our objective is to do all we can to help our third-party allies be successful.

Advantages of the Tandem hardware and software architecture complement the capabilities of application software produced by independent software houses. Virtually all Alliance software houses, according to an independent survey, consider Tandem systems to be an advantage in developing and marketing their application software. Among major strengths cited are:

☐ Reliability of NonStop systems.

☐ Modularity, compatibility and linear performance growth of Tandem systems, enabling an application to be developed only once to run on small, medium or large systems.

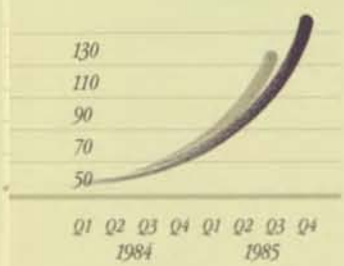
☐ Power and throughput of the NonStop TXP system.

☐ An ideal entry-level system, the self-contained NonStop EXT that needs no specially modified computer room.

☐ Superior networking, communications and distributed data base capabilities.

☐ Growth potential: over 70% of Alliance software houses have products aimed at Fortune 1000 customers where Tandem has a strong market presence.

The Alliance program continues to be extremely successful in establishing new customers for Tandem in target industries, including banking, financial services, manufacturing and telecommunications. During 1985, the number of Alliance members expanded by 80%.



Alliance Program Growth (Cumulative members)

Alliance software houses that believe markets for their products are less than 10% penetrated.

Source: Prudential-Bache

Industry focus:
BANKING

The Tandem Alliance program is successful internationally.

In France, for example, Groupe Francais d'Informatique (GFI) recently helped Tandem win two new accounts in the banking industry. GFI is a major French software house with over 1,000 employees. The company is a subsidiary of SCICON International Limited which is a member of the British Petroleum Group. Other SCICON software houses operate in the United Kingdom, West Germany and the U.S.

The new French banking applications are at Caisse Regionale de Credit Agricole Mutuel (CRCAM) de l'Ile de France and BANQUE SOFINCO. The former, with 800,000 accounts in Paris, is the largest of the CRCAM group which ranks second among French banks ($92 billion in assets). SOFINCO has 80 offices in France and is its second largest provider of consumer credit.

CRCAM de l'Ile de France is using a GFI videotex application for home banking. Its customers can conduct their banking through French MINITEL terminals, distributed free to all telephone subscribers by the French telephone authority.

SOFINCO is also using a GFI videotex application to connect some 2,000 terminals at retailers for instantaneous credit authorization for installment loans.

Tandem has a strong presence in worldwide banking. Over 240 banks use Tandem systems, including 22 of the top 25 U.S. bank holding companies and 15 of Europe's 25 largest banks.

"We expect Tandem to build upon key strengths, including a leadership position in large-scale transaction processing networks and a substantial customer base in over 800 corporations worldwide."

– Merrill Lynch

Market direction:

RAPIDLY EXPANDING APPLICATIONS

The forces driving OLTP growth create a dilemma for users: conventional computer architectures force users to choose between higher performance and functionality. But users need both.

As performance requirements grow, applications that run on conventional computers typically trade-off such functions as programming ease, data integrity and the ability to manipulate the data base for analytical queries.

The performance versus functionality impasse will undoubtedly amplify in the near future. Maximum OLTP performance requirements today, with the exception of the largest airline reservation systems, rarely exceed 90 transactions per second (tps). Many are still under five tps. Industry expects tps rates to increase to 200-500 in the next few years. And that in the Nineties users will need systems capable of performing in the 1,000 tps range – over ten times that of most of today's highest performing applications.

TANDEM LEADS THE WAY:

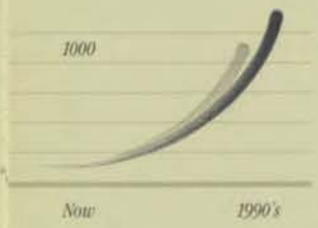
Other vendors may promise full functions at high transaction rates, but Tandem delivers. Tandem users get the same capabilities on large NonStop systems delivering the industry's highest transaction rates that they get on smaller NonStop systems handling lower throughput demands. Functionality is preserved with virtually no degradation of performance.

Tandem can deliver consistent functionality and performance for our systems because of the unique hardware and software architecture of Tandem's product line.

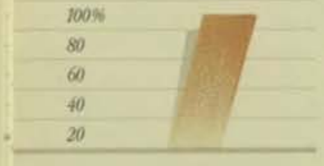
Applications can be implemented on Tandem's entry-level NonStop EXT system and directly moved to a NonStop II or a higher-power TXP system giving increased performance without rewriting application software. In addition, the NonStop II and TXP systems can be expanded modularly to mainframe levels of power – with linear gains in performance while retaining full functions and without reprogramming.

Data bases can be distributed to any size Tandem system using ENCOMPASS software, the industry's only high-performance, distributed relational data base management system. And applications can be linked together transparently with EXPAND networking software, also common to all Tandem systems.

Applications implemented today on Tandem systems will continue to deliver function and value as future transaction rates multiply – even with growth in transaction requirements to 1,000 tps and beyond.

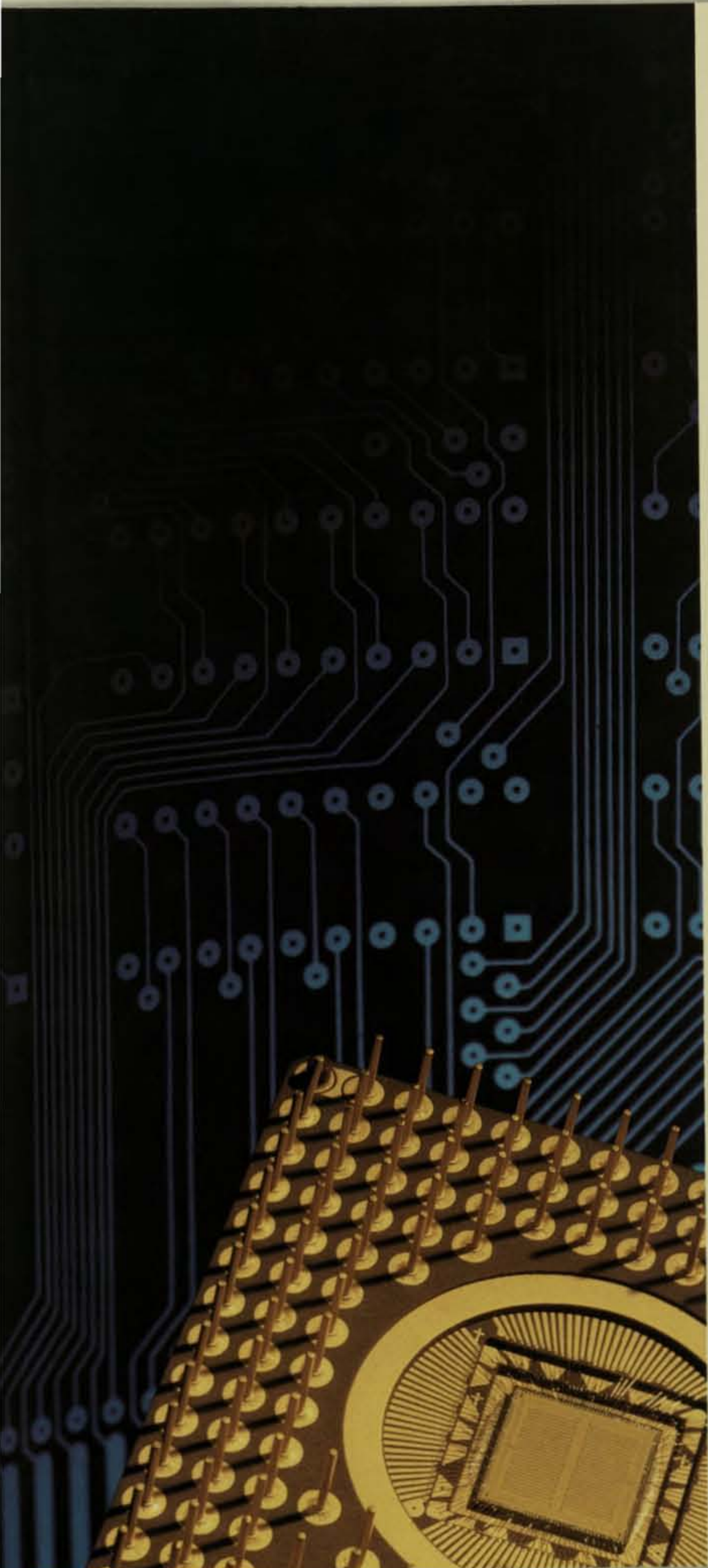


Performance Trend (Maximum transactions per second)



Alliance software houses that consider Tandem NonStop TXP power and throughput a major strength.

Source: Prudential-Bache



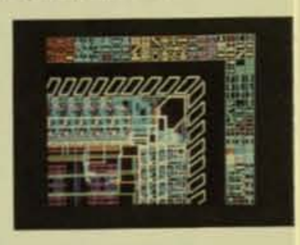
Technical focus:
STATE-OF-THE-ART PRODUCTS

Very large-scale integration (VLSI) circuitry applied in Tandem products helps meet the need for reliability, functionality and performance at lower costs. Tandem's strategy is to develop leading-edge VLSI devices jointly with semiconductor manufacturers. Tandem designs its own VLSI prototype devices, then buys production devices from leading semiconductor suppliers, to shorten product development leadtimes and to build the knowledge that enables us to apply the right technology for the right job.

Currently we have established close relationships for the utilization of high-performance bi-polar technology as well as low-power, lower performance CMOS technology.

With the strategic investment that we made in building our own VLSI prototype fabrication laboratory and computer-aided design system, we are able to improve our development engineers' productivity and deliver competitive products rapidly to the market. These resources enable us to produce prototypes three to four times faster than the industry standard.

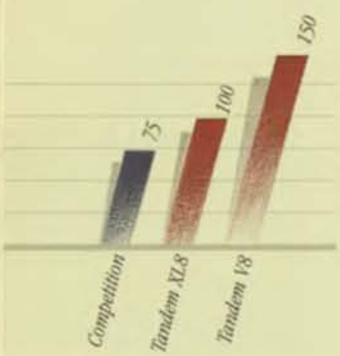
During 1985 we began introducing products that incorporate Tandem designed VLSI gate arrays. For example, subsystems such as our new 3207 tape controller and 5130-31 tape drive employ state-of-the-art, Tandem designed 2,000- and 4,000-gate gate arrays. The 3207 provides significant price and functionality advantages in a single circuit board, compared with competitive devices that are many times larger in size.



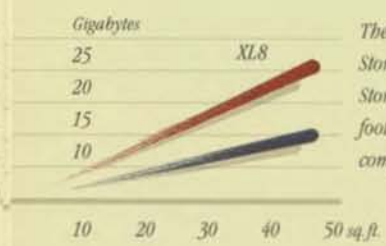
We are now poised for a stream of products at all levels of our system employing VLSI technology.

"Tandem has tremendous value-added in its technology for on-line transaction processing."

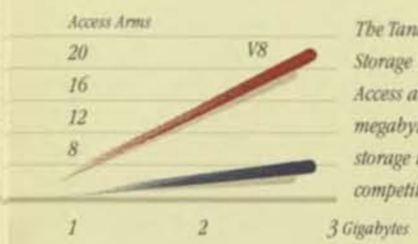
– Prudential-Bache



Accesses per second (per $100,000)



The Tandem XL8 Disc Storage Facility. Storage per square foot vs. leading competitor.



The Tandem V8 Disc Storage Facility. Access arms per megabyte of storage vs. leading competitor.

Market direction:

LOWEST COST PER TRANSACTION

With organizations in all industries becoming dependent on on-line transaction processing to run their businesses, the cost of a transaction has become central to the total cost of doing business. In many cases, the information system *is* the business. The long-term, total cost of delivering OLTP services can be crucial to the profitability of all information-based businesses.

Businesses are, therefore, beginning to make systems purchasing decisions based on total cost per transaction. The many factors that can affect transaction costs over the life of the system must be included in the pre-purchase analysis.

TANDEM LEADS THE WAY:

Tandem focuses on providing products and services that help our customers reduce the total cost of their transaction processing applications. Initial system price and the relationship of price to performance are only part of the total cost picture.

Tandem helps cut programming costs by making the programmer's OLTP task as simple as writing batch processing applications. Tandem users typically implement applications at a fraction of the time and cost – and begin enjoying cost-saving benefits much sooner – than do users of conventional systems.

Users of conventional systems pay for "computer fat" – the over-investment in larger-than-needed systems to accommodate future growth. Tandem eliminates the cost of computer fat. NonStop systems can be appropriately sized to an application environment and then expanded modularly. With each growth increment – all the way to the power of a mainframe – Tandem users get proportional performance gains and retain functionality.

Another major cost of system growth with other vendors is the rewriting of programs and retraining of people at each growth stage. Tandem software is compatible across the widest range of performance in the industry. That means that the Tandem system can grow to a very large distributed environment without reprogramming or retraining.

Using our distributed relational data base management software, Tandem users can cut communications costs by distributing applications and data to remote locations while assuring data integrity.

Tandem systems are easy to use and highly productive. They handle large data bases with large numbers of simultaneous users, yet deliver both high transaction rates and fast response time.

Productivity also comes from the availability of the system provided by the fault-tolerant NonStop architecture.

The ease of networking and of changing network configurations with Tandem systems can yield huge cost savings.

And cost per transaction on Tandem systems is continually improving. A new software product released in 1985, for example, gave Tandem users the ability to reduce transaction cost substantially. GUARDIAN 90XF software, a more powerful version of the Tandem operating system software, increases performance 50-70% for customers using all the facilities of ENCOMPASS data base management software, at no additional cost.

Technical focus:
ADVANCED DISC SYSTEMS

Another major cause of "computer fat" and performance bottlenecks is conventional disc access and storage. Users of conventional devices may waste as much as 70% of disc space to achieve the rapid response rates needed for OLTP applications.

Tandem has radically improved OLTP disc performance and cost through the parallel data access architecture of the new V8 and XL8 Disc Storage Facilities.

Up to eight drives are packaged in a single, compact cabinet. The V8 facility is designed to be extremely cost-effective for high activity on-line data bases. Response time is the fastest in the industry. And 100% of the disc space is used. The complementary XL8 facility is designed for maximum data storage in the minimum space.

These new Tandem products also dramatically reduce the high cost of computer room space. The V8 and XL8 disc systems concentrate much more capacity per square foot than any conventional disc device: 1.3 and 4.2 gigabytes (billions of bytes), respectively, in just six square feet of floor space. In one large application, five V8 drives provide 700 accesses per second in one-fifth the space and with $100,000 less in equipment than the nearest competitor.

Like the NonStop architecture, the V8 and XL8 Disc Storage Facilities are fault tolerant and expand modularly. Users can start with four drives per cabinet and expand up to eight as applications grow.

> **"Tandem, through its architectural approach, its GUARDIAN operating system with DYNABUS, its software facilities, and its extensive networking facilities, is a vendor with proven experience that has met and addressed the five basic requirements for on-line transaction processing."**
>
> – Yankee Group Research, Inc.

Remote Networks
(% of customer sites)

Source:
DATAMATION/Cowen & Co.
1985/86 Survey

Market direction:

INTERCONNECTION OF APPLICATIONS

With the proliferation of automated applications has come the need to tie together isolated applications into powerful networks. Interconnected applications provide a more complete business picture, reduce costs and increase competitive advantages.

But the networking and communications task can be formidable.

With conventional computers, there are normally long lead times and high costs associated with programming networks.

Performance can deteriorate significantly when linking systems not specifically designed for networking.

Lack of a single communications standard requires complex interfaces.

And businesses in dynamic environments encounter difficulty in forecasting computer size requirements at each of many network nodes. It can be even more difficult, with conventional computers, to alter the network configuration quickly and inexpensively if business is better than expected or if requirements change.

TANDEM LEADS THE WAY:

Tandem's networking and communications offerings are comprehensive, easily implemented and cost effective.

Building a network of Tandem systems is a relatively simple matter because the message-based operating system means that even a single Tandem system operates as a network. Hence, a network is no more complex than a single system.

The integration of EXPAND networking software into the operating system creates a high-performance, fully transparent network of systems. Programming applications across a network is the same as programming a stand-alone application. Users need not know where data resides in the network to complete a transaction. And EXPAND networks provide high performance because the networking software is not grafted on as it is in most systems.

To preserve customers' investments in their various incompatible systems, Tandem got an early start in supporting communications standards to provide the necessary interfaces. Tandem's communications products simplify interconnecting with systems and networks of other vendors.

Tandem's SNAX software, for example, is recognized as the best software for integrating IBM systems and IBM's SNA networks outside of SNA itself. More than 130 Tandem customers have licensed SNAX software.

Tandem was one of the first vendors to support the X.25 European Open Systems Interconnection (OSI) standard, and we continue to work to support emerging OSI standards.

Tandem was the first vendor independently certified for conformance to MAP Level 2.1, the General Motors protocol for interconnection of incompatible devices and systems. MAP is evolving as an important communications standard for manufacturing.

Tandem's communications products add the values of fault tolerance, transparent distribution, data integrity and high performance.

We also lead the way with value-added network security in support of the U.S. National Bureau of Standards Data Encryption Standard. Data is protected from unauthorized access while on the system, in transmission and in storage with Tandem's new SAFEGUARD system protection software and SAFE-T-NET data encryption subsystem.

Industry focus:
FINANCIAL

Bunker Ramo, a major supplier of real-time investment information services, significantly changed its way of doing business and its competitive posture with the introduction in 1985 of its SuperNet™ brokerage network.

SuperNet transforms Bunker Ramo from a terminal manufacturer and information provider to a leading-edge supplier of integrated network services. Bunker Ramo's installed base of over 30,000 brokerage subscribers now can have access to expanded services on either an existing Bunker Ramo terminal, an IBM PC-based brokerage automation system or the broker's own personal computer.

A Tandem 6-node EXPAND backbone network will integrate and transmit up-to-the-second information between previously incompatible terminals and host computers. The new network can reduce broker's communications costs, provide access to a greater volume of timely information and increase productivity.

Tandem's networking architecture is a key part of the SuperNet strategy to preserve customers' investment in Bunker Ramo systems and, at the same time, provide them with the flexibility to access the network with other office equipment.

Tandem's corporate network organization will work closely with Bunker Ramo to help assure the success of SuperNet. And Bunker Ramo has joined the Tandem Alliance program to market its proprietary, Tandem driven applications to large financial institutions.

The financial services industry is an important part of Tandem's business. Fifteen major stock exchanges worldwide use Tandem systems, as do 17 of the largest brokerage firms.

> "Tandem Computers' proven record of user acceptance for the concept of multiprocessing will give strength to the trend of distributing transaction work loads."
>
> -COMPUTERWORLD

Market direction:

DISTRIBUTED APPLICATIONS

The success of an application at one location in a large organization provides a great incentive to introduce the application companywide.

To do so, companies typically begin by installing terminals at the remote locations that communicate with the central location's computer. But, as transactions multiply, communicating over long distances can drive costs up sharply.

Long distance communication also slows transaction response times which reduces productivity, further eroding the value of the transaction.

The ideal, therefore, is to distribute all or part of the application's data base to systems located at the sites where the transactions occur, while preserving access by all locations.

TANDEM LEADS THE WAY:

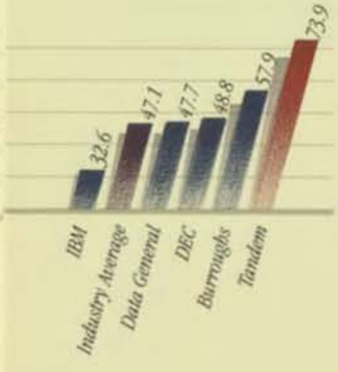
Although for many years there has been a need to distribute data, the capability was rarely implemented until Tandem, five years ago, began delivering the industry's first high-performance, distributed relational data base (DDB) system, ENCOMPASS.

Two fundamental problems of distributing data bases–the distribution itself and data integrity–have been successfully addressed by Tandem.

The distribution task on Tandem systems is relatively simple because the data base management function in a Tandem system is already distributed across all processors. The architecture has no single point of control and no common memory. With the integration of ENCOMPASS relational data base management software, programming and use are no more difficult than with a centralized data base: neither the programmer nor the user need know where the data resides.

Data integrity across a DDB must be assured before an application can be distributed or a user risks contaminating the data base. With Tandem's Transaction Monitoring Facility (TMF), transactions automatically update records in multiple nodes of the DDB. In the event of a communications or system failure anywhere in the DDB, TMF assures that there are no incomplete transactions, assuring the consistency of the information regardless of location. No other computer manufacturer offers this level of logical data integrity across a distributed data base.

TMF also gives Tandem fast data base recovery. In the event of a failure anywhere in the DDB, recovery is automatic.



Data Base Management Software Users (% of customer sites)

Source: DATAMATION/Cowen & Co. 1985/86 Survey.

Industry focus:
MANUFACTURING

Societa Pneumatici Pirelli SpA, one of the largest industrial companies in Italy and maker of the world-respected Pirelli tires, has distributed its manufacturing data bases on Tandem systems throughout Italy.

The data bases are distributed to three plants in northern and central Italy and one in Sicily. They are interconnected by a Tandem EXPAND network that enables users at the four plants to access data transparently from any one of the nodes as well as from a host mainframe in Milan. The network also integrates Tandem terminals and those of other computer suppliers.

Pirelli's Tandem driven applications in Italy, Germany and the United Kingdom are used for production planning and step-by-step manufacturing control, stock control, scheduling of equipment maintenance, attendance records, defect analysis and final inspection.

Pirelli has manufacturing facilities in eight countries and began using Tandem systems in 1981. In addition to tires, the company produces electrical cables, fiber optics and automotive rubber components.

Tandem systems are at work at over 200 manufacturing companies worldwide.

> **"The highest incidence of advanced systems software usage is at Tandem installed sites."**
>
> –DATAMATION/Cowen & Co. 1985/1986 Survey

Market direction:

INTEGRATED APPLICATIONS & RESOURCES

In almost every industry, the challenge of the Sixties and Seventies was to automate. In the Eighties and Nineties, the challenge expands to integration of multiple applications, systems, devices and networks into a single information resource.

Integration multiplies the cost-effectiveness and competitiveness of the individual information assets. It has become essential to preserve customers' huge investments in an array of incompatible applications, terminals and mainframe computers while distributing information to more users.

The challenge is not limited to organizations integrating their own resources. There are increasing opportunities for interaction with incompatible data bases and networks of other organizations (retail point-of-sale with banks, for example) to accomplish more efficient transactions and provide new, competitive services.

Nor is the challenge limited to integration of computer systems and networks. An evolving need must be met to integrate information from other devices (such as facsimile and copying machines, smart terminals and wands) that are becoming increasingly sophisticated data capturers and transmitters.

TANDEM LEADS THE WAY:

The Tandem architecture suits the integration task. We have invested heavily to produce superior products that are fundamental to integration.

Integration is impossible without networking to interconnect multiple systems at different locations. Broad communications products are essential to tie into a variety of incompatible systems and networks. Distributed data base capabilities are key because applications may be in multiple locations. Fault tolerance is crucial because integration concentrates all of the information needed to run a business into in a single resource. And modular expandability with linear performance is fundamental to handling cost-effectively the increased transaction workloads generated by integration.

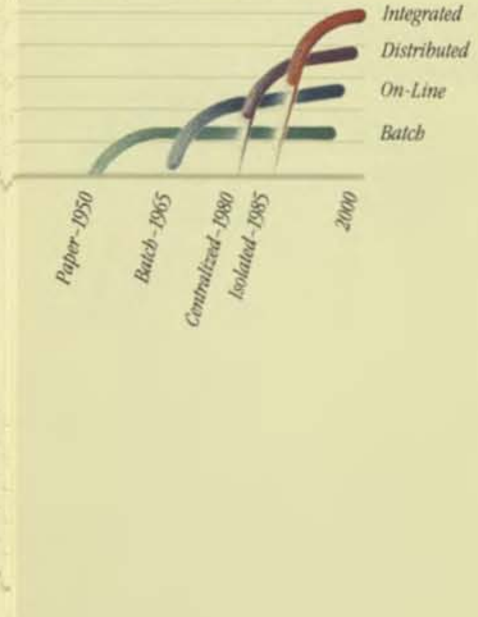
Tandem provides all of those integration capabilities. And more.

Tandem has a family of leading-edge integration products collectively called Information Management Technology (IMT). Its foundation is TRANSFER software which merges and moves information between individuals or application programs regardless of the source, format or location of the information.

IMT products, running under TRANSFER software, move combinations of text, data and images from a wide variety of devices through a Tandem network as a single package. Using PS MAIL electronic mail software in combination with FAXLINK and PC LINK facilities, a user can, for example, transmit a drawing with an electronic message and also "attach" a copy of a personal computer file.

The integration function is natural to the Tandem NonStop architecture. Because integration solutions with Tandem systems can be developed with comparative ease–and because Tandem views integration as an extension of on-line transaction processing–Tandem intends to continue to lead the way in this important market direction.

Movement to Integration



Industry focus:
TELECOMMUNICATIONS

At General Telephone Company of the Northwest (GTNW,) as elsewhere within the GTE organization, integration of various applications, devices, systems and networks is actively underway.

One example is GTNW's 6-node Tandem EXPAND network called LEADS (Line Equipment Assignment and Display System) that links some 1,500 terminals in Oregon, Washington and Idaho. This application, which replaces a manual, paper system to allocate telephone numbers, switch equipment and cable pairs, has cut the previous people-intensive, two or three day process to minutes. The system has also been exported to Canada.

GTNW is a Tandem Alliance member. By leveraging its LEADS experience, GTNW will be able to offer an integrated network management package which consists of facilities management, service order entry, billing, repair and directory assistance packages. These systems, designed to execute on Tandem hardware, are sized and scoped for both telephone companies and private network operations.

Tandem has a growing presence in the telecommunications industry. Forty telecommunications companies in the U.S., Canada, United Kingdom, Europe and Australia use Tandem systems. And many enhanced services, such as Federal Express ZapMail™ and Western Union Easylink,™ are delivered on Tandem systems.

Tandem made major progress this year in the areas critical for long-term success.

TO OUR STOCKHOLDERS

This year Tandem did well strategically and became stronger as a company. By augmenting support and introducing many new products, we maintained a high level of customer satisfaction. Our future position strengthened through the continued commitment to our product programs and through the enhancement of our support of third parties that develop application solutions for Tandem systems. Asset management improved, increasing our financial strength. Tandem made major progress this year in the areas critical for long-term success.

Tandem grew despite the weak demand environment in the United States, yet growth was not equal to the rates of prior years. The strength of the U.S. dollar compared with last year adversely affected both revenue and earnings.

We did not hold expenses as well as we would have liked. We added needed people in customer-related areas and in development. We also invested in third-party relationships essential for future market penetration. Pretax income was slightly ahead of the fiscal 1984 level. Nonetheless, we missed our goal of achieving profitability improvement this year.

The Foundation for 1986

In fiscal 1986, we will continue our focus on strategic areas while we improve expense control so we can grow with very limited increases in employment. We have taken steps to control expenses to position Tandem for improved profitability if capital spending in our market improves. We currently are holding employment levels approximately flat until our marketplace strengthens. Total employment at the end of fiscal 1985 was down slightly from the prior quarter's level. We implemented a number of short-term measures to reduce operating expenses. We also consolidated some manufacturing operations, which should help to continue the improvement in manufacturing efficiency.

We have achieved significant efficiencies in manufacturing over the past two years as a result of major changes we made in our manufacturing operations. Inventory levels have been reduced and the gross profit margin has increased. We believe we can achieve similar efficiencies in marketing.

At the beginning of the 1986 fiscal year, we restructured our marketing organization. Tandem's market is changing, and we saw the opportunity to change our organization in order to build on our successes in this market.

For example, we have made significant penetration of major accounts, and many of these accounts are nationally and internationally distributed. We have defined better ways to support and sell to these accounts throughout their locations. As our customers undertake projects to develop important applications on Tandem systems that are critical to their business operations, Tandem increasingly is asked to participate in the development of the project. We have created a new organization that will provide professional management of such projects.

These two examples represent the ways we intend to leverage our successes and increase efficiency in marketing while maintaining quality. We believe the opportunities are greater than ever, and the new organization will increase our ability to win and win efficiently.

Market Strength

This year we enhanced our strong leadership position in on-line transaction processing, networking, distributed data base and integration of applications and resources in anticipation of emerging competition. The foundation for this leadership is Tandem's multiprocessor architecture.

Tandem has an established position in a number of industries where on-line transaction processing applications are growing rapidly. This year, for example, we strengthened our position in retail point-of-sale and in manufacturing control applications. We increased our penetration of telephone companies, a new target market for Tandem.

We added many important new accounts such as Daimler-Benz and Toshiba in manufacturing; Hoare Govett, Bunker Ramo Information Systems and the Chicago Mercantile Exchange in financial services; Bank of Tokyo, Amro Bank and Standard Chartered Bank in banking; and Shell Canada, J.C. Penney and Ross Stores in point-of-sale retailing.

This past year we offered our customers a wide range of new products, many with strategic importance. The V8 Disc Storage Facility set a new standard for performance in on-line transaction processing applications through a proprietary packaging design. The low-priced EXT system extended Tandem's system family into non-computer room environments. We announced the first products under our Information Management Technology (IMT) strategy. IMT is a multi-vendor system integration strategy to allow our customers to use their Tandem networks to provide company-wide information sharing between users of a variety of incompatible electronic office devices and networks.

Perhaps most importantly, the new, high-performance GUARDIAN 90 operating system software gives us the foundation for the applications of the 1990s. GUARDIAN 90, which represents a significant revision and extension of the original GUARDIAN operating system, was developed with a view to the requirements of the next decade. We are proud of the significant performance improvements our customers report from using this new operating system software.

Tandem introduced numerous other products as well, such as enhancements to SNAX, our IBM System Network Architecture interface, support for General Motors' Manufacturing Automation Protocol (MAP) standard, programmer productivity tools, workstation products and new languages.

Outlook

Fiscal 1986 will continue the rapid pace of product introductions. In the first weeks of the new fiscal year, Tandem introduced system security tools, three new ergonomic terminals, as well as high-end disc and tape storage subsystems that incorporate the latest in disc, tape and VLSI-based controller technologies.

We are working to make fiscal 1986 a more profitable year as well. Although the weak demand environment may persist for some months, we are taking actions to position the company for stronger performance. We have created a new organization for leverage, efficiency and quality. We will limit hiring and continue expense control so that an improvement in the selling environment will result in better earnings for our stockholders.

Thomas J. Perkins
Chairman of the Board

James G. Treybig
President and
Chief Executive Officer

December 16, 1985


Thomas J. Perkins


James G. Treybig

Overview

Tandem Computers is committed to being a technological leader in the expanding market for on-line transaction processing systems and networks. The Company believes that its computer architecture uniquely satisfies the fundamental requirements for such applications. Achieving this technological leadership goal involves many factors, including strategic market positioning, a commitment to product development and an organizational structure and philosophy that foster employee productivity and creativity. Further, Tandem believes it is essential to maintain a strong financial position and operating record to allow the Company to maximize its opportunities within this dynamic market.

Results of Operations

The following table summarizes the changes in selected operating indicators for the years presented. The percentages on the left show the relationship of the revenue dollar to various income and expense items. The percentages on the right measure the year-to-year percentage increases or decreases.

% of Revenue				% Increase (Decrease)		
1985	1984	1983		1985	1984	1983
100	100	100	Revenue	17	27	34
38	40	42	Cost of revenue	11	23	46
12	10	9	Product development	36	34	16
42	40	37	Marketing, general and administrative	23	39	31
8	10	12	Operating income	(2)	3	22
1	1	–	Interest income, net	21	610	(88)
9	11	12	Pretax income	–	11	8
4	4	5	Current tax provision	(5)	17	17
–	(2)	–	DISC reversal	–	–	–
6	6	7	Net income excluding DISC reversal	4	8	3
6	8	7	Net income	(20)	39	3
			Earnings per share excluding DISC reversal	3	5	–
			Earnings per share	(21)	37	–

Amounts may not total due to rounding.

Revenue

The rate of revenue growth has slowed over the past three years as the Company has undergone a transition to a major supplier in the on-line transaction processing marketplace. The Company's product line has broadened and its customers' needs have expanded, leading to changes in Tandem's market. Further, demand for computers in the U.S. weakened significantly during fiscal 1985, while the strength of the U.S. dollar negatively affected international revenue and profits.

Tandem's revenue gains over the last three years result directly from increased shipments of its hardware and software products to new and existing customers and from increases in the number of customers using its support and training services. The Company's total revenue increased $92 million in fiscal 1985 over fiscal 1984. Nearly three-quarters of the increase came from higher product shipment levels, while the remainder was due to greater service and other revenue. International business, led by Europe, grew more rapidly than domestic, despite the adverse effects of the strong U.S. dollar. International operations contributed 33% of total revenue in fiscal 1985, compared with 31% in the prior year.

In fiscal 1984, revenue increased $114 million over fiscal 1983. Over three-quarters of the increase resulted from higher product shipment levels, while the remainder was due to greater service and other revenue. The growth in international business was considerably stronger than in domestic business. The percentage of total revenue contributed from international operations grew to 31% from 29% in fiscal 1983.

Operating Income

Operating income as a percent of revenue has declined in the past two years because improved gross profit margins were offset by increased product development and marketing, general and administrative expenses. In part, the increase in operating expenses as a percent of revenue resulted from the Company's anticipation of a stronger demand environment than the industry experienced during fiscal 1985.

The Company increased its product development expenditures in fiscal 1985 in support of a more aggressive product introduction schedule. The large number of product introductions in 1985 resulted in increased marketing costs to bring the products to market and to train new and existing sales, service and support personnel.

Tandem's product development effort focuses on meeting the needs of computer users who are implementing on-line systems at single sites and in geographically distributed information processing networks. The Company believes that the opportunities for technological innovation in this marketplace are substantial and, therefore, has increased its investment in product development each year since its founding. The Company expects to increase expenditures on product development in fiscal 1986. However, certain software development expenditures will be capitalized in fiscal 1986, rather than expensed as in the past, due to the implementation of Financial Accounting Standards Board Statement No. 86 which requires capitalization of certain software development expenses. The effect of this accounting change cannot be quantified at this time, however, the Company does expect some positive impact on earnings.

The Company keys its marketing strategy on selling to users who are implementing major on-line transaction processing applications. Providing a high level of service and support is essential to meeting the needs of this customer base. To maximize its long-term opportunities in this marketplace, Tandem has built a direct selling and support organization in industrial markets throughout the world. The Company's direct selling efforts are complemented by relationships established with third-party application software developers, equipment remarketers and distributors.

Marketing, general and administrative expenses have increased as a percent of revenue since fiscal 1983 as the Company has continued to build its marketing organization to meet future needs. In addition to factors noted above, these expenses increased during fiscal 1985 due to further development of Tandem third-party marketing relationships.

In response to the changing needs of the marketplace, the Company slowed the growth in employment during 1985 and has recently restructured the marketing organization with the goal of improving efficiency and countering the industry trend toward lower operating margins. In addition, cost savings measures were implemented during the year to reduce total payroll, travel and entertainment and energy costs. The Company expects to reduce the employment growth rate further during fiscal 1986.

Cost of revenue as a percent of revenue continued to decline in fiscal 1985. The Company attributes the improvement primarily to the success of its programs to increase efficiency in manufacturing operations. Given a reasonable level of demand, the Company expects to maintain a strong gross profit margin in fiscal 1986.

Net Income and Earnings Per Share

The rate of change in net income has differed from that of operating income over the past three years because of changes in the Company's net interest income and effective tax rate. This year, net interest income was more than $1 million higher than in fiscal 1984 and more than $5 million higher than in fiscal 1983. The effect of lower prevailing interest rates in fiscal 1985 was offset by continuing declines in interest expense and by higher levels of short-term investments throughout the year than in the previous two years.

Net interest income in fiscal 1984 was substantially higher than that of fiscal 1983 because the Company maintained much higher levels of interest-earning short-term investments.

Net income comparisions for the three years are distorted by a one-time tax benefit recorded in fiscal 1984. In that year, there was a reversal of taxes that had been accrued on earnings of the Company's Domestic International Sales Corporation (DISC). The effective tax rate in fiscal 1984 was 24 percent, reflecting a $10 million DISC benefit. In comparison, the effective tax rate was 39 percent in both fiscal 1985 and 1983.

Earnings per share in fiscal 1985 were $.82, compared with earnings per share in 1984 of $.80 (net of the $.24 benefit from the DISC tax reversal) and $.76 in 1983.

Financial Condition

Tandem's financial condition continued to be strong and improved throughout fiscal 1985. For the third consecutive year, the cash and cash investments balance grew. Cash reached an all-time high, rising to $129 million at September 30, 1985, from $107 million at the end of fiscal 1984. Key factors contributing to record cash levels were income from operations, improved asset management and employee purchases of stock. Compared to the prior year, inventories declined by more than $13 million despite an expanded product line and a 15% increase in product shipments. Factors contributing to the decline in inventories were stronger than expected demand in the final fiscal quarter of the year, improved management of the manufacturing process, improved planning of materials purchasing and reductions in component costs.

An important part of Tandem's corporate philosophy is to provide all employees with the opportunity to participate in the Company's ownership through employee stock purchase and option programs. As a result of employee participation in these programs, the Company received $10 million in fiscal 1985 and $17 million in fiscal 1984.

The Company's financial strategy also includes maintaining a sound ratio of current assets to current liabilities and a conservative capital structure. At the end of fiscal 1985, the current ratio was 4.4:1, long term debt and capitalized lease obligations were 2.9% of total capital, unused lines of credit totaled $70 million and the equity base was $420 million. Tandem believes this strategy provides the maximum near-term and long-term flexibility to utilize a full range of financing alternatives to fund the Company's future business needs.

Effect of Inflation

Please see page 27 of this report for a discussion of the effect of changing prices on the Company's operations.

SELECTED FINANCIAL DATA

TANDEM COMPUTERS INCORPORATED AND SUBSIDIARIES

For the Five Years Ended September 30, 1985

(In thousands except per share amounts)	1985	1984	1983	1982	1981
Revenue	$624,138	$532,620	$418,282	$312,143	$208,397
Cost of revenue	240,148	215,692	175,646	120,390	84,868
Product development	71,577	52,514	39,168	33,642	17,833
Marketing, general and administrative	262,332	213,313	153,697	117,403	65,305
Operating Income	50,081	51,101	49,771	40,708	40,391
Interest income, net	6,269	5,183	730	6,033	10,707
Provision for income taxes					
Current period	(21,976)	(23,076)	(19,696)	(16,885)	(24,549)
Benefit of DISC tax reversal	–	9,700	–	–	–
Net Income	$ 34,374	$ 42,908	$ 30,805	$ 29,856	$ 26,549
Earnings Per Share	$ .82	$ 1.04	$ .76	$ .76	$ .72
Total assets	$552,344	$501,873	$415,525	$337,366	$255,971
Long term debt and capitalized lease obligations	$ 12,412	$ 17,155	$ 23,957	$ 21,102	$ 2,054
Stockholders' investment	$420,408	$375,122	$310,993	$250,988	$204,810

CONSOLIDATED STATEMENT OF INCOME

For the Three Years Ended September 30, 1985

(In thousands except per share amounts)	1985	1984	1983
Revenue			
Product revenue	$515,109	$448,611	$360,133
Service and other revenue	109,029	84,009	58,149
Total revenue	624,138	532,620	418,282
Costs and Expenses			
Cost of revenue	240,148	215,692	175,646
Product development	71,577	52,514	39,168
Marketing, general and administrative	262,332	213,313	153,697
Total costs and expenses	574,057	481,519	368,511
Operating Income	50,081	51,101	49,771
Interest expense	(2,407)	(2,642)	(2,806)
Interest income	8,676	7,825	3,536
Income Before Income Taxes	56,350	56,284	50,501
Provision For Income Taxes			
Current period	(21,976)	(23,076)	(19,696)
Benefit of DISC tax reversal	–	9,700	–
Total provision for income taxes	(21,976)	(13,376)	(19,696)
Net Income	$ 34,374	$ 42,908	$ 30,805
Earnings Per Share	$ .82	$ 1.04	$ .76
Weighted average shares outstanding	41,765	41,399	40,784

Because of the Company's method of operation, it is not practical or meaningful to report the cost of service and other revenue as a separate line item.

The accompanying notes are an integral part of this statement.

CONSOLIDATED BALANCE SHEET

As of September 30, 1985 and 1984

(In thousands except share amounts)	1985	1984
Assets		
Current Assets		
Cash and cash investments	$128,676	$106,862
Accounts receivable, net of allowances of $3,479 in 1985 and $1,708 in 1984	163,378	146,342
Inventories	78,962	92,375
Prepaid expenses and other	10,746	6,998
Prepaid income taxes	3,655	–
Total current assets	385,417	352,577
Property, Plant and Equipment, at cost		
Land and Building	25,398	8,782
Machinery and equipment	55,669	46,642
Computer equipment and spares	119,982	85,002
Leasehold improvements	32,363	31,320
Construction in process	7,932	20,009
	241,344	191,755
Accumulated depreciation and amortization	(80,746)	(50,253)
Net property, plant and equipment	160,598	141,502
Other Assets	6,329	7,794
Total Assets	$552,344	$501,873

Liabilities and Stockholders' Investment		
Current Liabilities		
Current portion of long term debt and capitalized lease obligations	$ 7,049	$ 15,025
Accounts payable	33,377	36,350
Accrued liabilities		
Wages, payroll taxes and employee benefits	28,196	22,527
Income taxes	–	4,440
Other accrued liabilities	18,184	10,832
Total current liabilities	86,806	89,174
Capitalized Lease Obligations	7,969	11,744
Long Term Debt	4,443	5,411
Deferred Income Taxes	32,718	20,422
Stockholders' Investment		
Common stock $.025 par value, authorized 60,000,000 shares, outstanding 41,386,572 in 1985 and 40,616,638 in 1984	1,035	1,015
Additional paid-in capital	238,998	228,106
Retained earnings	180,375	146,001
Total stockholders' investment	420,408	375,122
Total Liabilities and Stockholders' Investment	$552,344	$501,873

The accompanying notes are an integral part of this balance sheet.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT

For the Three Years Ended September 30, 1985

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1982	37,635	$ 941	$177,759	$ 72,288	$250,988
Sale of common stock under stock option plans	1,634	41	19,054	–	19,095
Sale of common stock under stock purchase plan	284	7	5,929	–	5,936
Tax benefit from employee transactions in common stock	–	–	4,169	–	4,169
Net income	–	–	–	30,805	30,805
Balance September 30, 1983	39,553	989	206,911	103,093	310,993
Sale of common stock under stock option plans	779	19	9,983	–	10,002
Sale of common stock under stock purchase plan	285	7	6,982	–	6,989
Tax benefit from employee transactions in common stock	–	–	4,230	–	4,230
Net income	–	–	–	42,908	42,908
Balance September 30, 1984	40,617	1,015	228,106	146,001	375,122
Sale of common stock under stock option plans	352	10	3,873	–	3,883
Sale of common stock under stock purchase plan	418	10	6,184	–	6,194
Tax benefit from employee transactions in common stock	–	–	835	–	835
Net income	–	–	–	34,374	34,374
Balance September 30, 1985	41,387	$1,035	$238,998	$180,375	$420,408

The accompanying notes are an integral part of this statement.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Three Years Ended September 30, 1985

(In thousands)	1985	1984	1983
Funds (Cash and cash investments) at beginning of period	$106,862	$ 93,501	$24,816
Provided from (Used in) Operations			
Sources:			
Net income	34,374	42,908	30,805
Depreciation and amortization	35,616	22,741	18,836
Deferred income taxes	12,296	(3,544)	5,903
Net book value of property, plant and equipment sold or retired	13,810	6,614	14,408
Total sources	96,096	68,719	69,952
Uses:			
Increase in accounts receivable	17,036	26,784	20,748
Increase (decrease) in inventories	(13,413)	6,455	(15,415)
Net change in prepaid expenses and non-debt current liabilities	1,795	(25,652)	(13,359)
Investment in property, plant and equipment	67,568	71,519	42,222
Increase (decrease) in other assets, net	(511)	2,361	401
Total uses	72,475	81,467	34,597
Net provided from (used in) operations	23,621	(12,748)	35,355
Provided from (Repayment of) External Financings			
Increase (decrease) in capitalized leases, net	(3,552)	(3,442)	6,331
Increase (decrease) in long term debt, net	(9,167)	8,330	(2,201)
Sale of common stock under employee stock option and stock purchase plans	10,077	16,991	25,031
Tax benefit from employee transactions in common stock	835	4,230	4,169
Total provided from (repayment of) external financings	(1,807)	26,109	33,330
Funds (Cash and cash investments) at end of period	$128,676	$106,862	$93,501

The accompanying notes are an integral part of this statement.

1. Summary of Significant Accounting Policies

Consolidation
The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly-owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition
The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Translation of Non-U.S. Currency Amounts
Assets and liabilities of the Company's subsidiaries which are denominated in the local currency of the subsidiary are translated into U.S. dollars (the functional currency) at year-end exchange rates, except for inventories and property, plant and equipment, which are translated at approximate rates prevailing when the assets were acquired. Income and expense items are translated at average rates of exchange prevailing during the year, except that cost of goods sold and depreciation are translated at historical rates. Exchange gains and losses, which are not material for each of the periods presented, are included in earnings currently.

Inventories
Inventories are stated at the lower of cost (first-in, first-out) or market and include materials, labor and manufacturing overhead. The components of inventories as of September 30 were:

(In thousands)	1985	1984
Purchased parts and subassemblies	$41,434	$45,259
Work-in-process	11,176	12,400
Finished goods	26,352	34,716
Total	$78,962	$92,375

Income Taxes
The Company accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are generated.

Property, Plant and Equipment
Systems spares ($35,420,000 in 1985 and $25,863,000 in 1984) are depreciated over a five-year period using an accelerated depreciation method. All other property, plant and equipment are depreciated using the straight-line method. The estimated useful lives are:

Buildings	30 years
Machinery and equipment	5-10 years
Computer equipment and spares	5- 7 years
Leasehold improvements	Lease term

Earnings Per Share
Earnings per common share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of stock options outstanding that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

Reclassifications
Prior period amounts associated with cost of service and other revenue have been reclassified in order to conform to the current period presentation.

2. Income Taxes

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1985	1984	1983
Federal:			
Current	$ 2,950	$13,882	$ 1,370
Deferred (Prepaid)	4,610	(10,550)	10,574
	7,560	3,332	11,944
State:			
Current	3,522	4,800	1,532
Deferred (Prepaid)	423	(297)	534
	3,945	4,503	2,066
Foreign:			
Current	12,005	6,197	4,621
Deferred (Prepaid)	(1,534)	(656)	1,065
	10,471	5,541	5,686
Total Provision	$21,976	$13,376	$19,696

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1985	1984	1983
Installment sale method for income tax reporting	$9,752	$ (1,950)	$ 8,572
DISC income	(6,117)	(6,084)	3,181
Accelerated depreciation	2,586	2,950	2,628
Expenses recognized for financial statements, but not for income tax reporting	(2,632)	(4,943)	810
Effect of intercompany profit eliminations	(90)	(2,178)	(4,143)
Other	–	702	1,125
Total Deferred (Prepaid)	$3,499	$(11,503)	$12,173

The provision for income taxes differs from the amount obtained by applying the federal statutory income tax rate to income before taxes as follows:

	1985	1984	1983
Federal statutory tax rate	46%	46%	46%
State taxes, net of federal income tax benefit	4	4	4
Investment tax credits	(3)	(3)	(4)
Research and development tax credits	(8)	(7)	(7)
Tax exempt DISC and FSC income	(4)	(1)	–
Other	4	2	–
	39	41	39
Benefit of DISC tax reversal	–	(17)	–
Effective Tax Rate	39%	24%	39%

The 1984 benefit of Domestic International Sales Corporation (DISC) tax reversal represents the benefit of deferred taxes previously provided on DISC earnings accumulated prior to the enactment of the Tax Reduction Act of 1984.

The Company established a Foreign Sales Corporation (FSC) effective January 1, 1985.

3. Lease and Other Commitments

The Company leases its headquarters, field offices, certain equipment, automobiles and most of its operating facilities under operating lease agreements. The Company also has capitalized leases for certain equipment. Future minimum lease payments as of September 30, 1985 are as follows:

(In thousands)	Leases	
Fiscal Year	Operating	Capital
1986	$ 29,900	$ 5,349
1987	24,467	5,104
1988	21,280	3,730
1989	19,897	210
1990	18,988	30
Thereafter	79,749	–
Total minimum lease payments	$194,281	14,423
Less amount representing interest (4% - 17%)		2,648
Present value of minimum lease payments		$11,775

The cost of assets held under capitalized leases totaled $20,504,000 and $21,605,000 at September 30, 1985 and 1984, respectively, and are included in the machinery and equipment and computer equipment and spares classifications in the accompanying Balance Sheet. The accumulated depreciation associated with these assets totaled $11,928,000 and $8,686,000 at September 30, 1985 and 1984, respectively.

Rent expenses were $38,213,000 in 1985, $36,726,000 in 1984 and $30,458,000 in 1983.

4. Long Term Debt

Long term debt as of September 30 consists of the following:

(In thousands)	1985	1984
6.9% and 8.2% promissory notes payable to a bank, in Japanese yen, due January 1986 and March 1987	$2,573	$ 2,327
Convertible subordinated debenture, payable to an officer of the Company, bearing interest at 9.5% and due September 1989	1,667	–
Industrial revenue bond, bearing interest at 12%, due July 1992	1,000	1,000
Industrial revenue bond, bearing interest at 12.4%, due July 1992 and collateralized by certain equipment	1,000	1,000
Construction financing	–	11,250
Other	1,446	1,276
	7,686	16,853
Less current portion	3,243	11,442
Long term debt	$4,443	$ 5,411

The $1,667,500 convertible subordinated debenture is convertible into 100,000 shares of Common Stock at a price of $16.675. The debenture becomes convertible as to 25,000 shares each year beginning in September 1986 and is subject to conversion acceleration in the event of certain occurrences.

Interest costs of $594,000, $1,606,000 and $644,000 relating to construction projects were capitalized during fiscal 1985, 1984 and 1983, respectively.

The Company has entered into unsecured credit agreements totaling $70,000,000 with several banks for working capital purposes. The agreements provide for revolving borrowings through December 1985, at which time outstanding amounts may be converted to term loans to be amortized through 1988. Domestic borrowings bear interest at or below the banks' prime rates through December 1985 and approximately 1/4% above these rates through 1988. The Company is required to pay a commitment fee of 5/16% per annum. There are no compensating balances required under any of these arrangements.

Certain financial covenants and restrictions are included in the loan agreements. The Company was in compliance with all such covenants and restrictions at September 30, 1985.

The Company has guaranteed payment of loans made to officers totalling $837,000 at September 30, 1985 under a $2,000,000 bank line of credit. In addition, the Company has a $1,667,500 note receivable from an officer included in Other Assets which matures in September 1989 and bears interest at an annual rate of 10%.

5. Capital Stock

The Company's authorized capital stock consists of 2,400,000 shares of preferred stock, 4,000,000 shares of Junior Common Stock and 56,000,000 shares of Common Stock. At September 30, 1985, 13,794,393 shares of Common Stock were reserved for future issuance under stock option plans, the employee stock purchase plan and a convertible subordinated debenture. There were no shares of preferred stock or Junior Common Stock outstanding at September 30, 1985.

Preferred Stock Rights

During 1985, the Company declared a dividend of one preferred share purchase right for each then outstanding share of Common Stock. In addition, one right will be issued with each share of Common Stock issued by the Company before the date the rights become exercisable, are redeemed by the Company or expire on May 17, 1990. The rights will not be exercisable, or transferable apart from the Common Stock, until 10 days after another person or group of persons acquires 20% of the Common Stock or commences, or announces its intention to commence, a tender or exchange offer for 30% of the Common Stock. Each right entitles its holder to buy one one-hundredth of a share of a newly created series of preferred stock of the Company, par value $.10 per share, designated as Series A Participating Preferred Stock, at an exercise price of $80.00. In certain circumstances, the right will entitle its holder to purchase a larger amount of preferred stock or stock in an acquiring company.

Stock Option Plans

The Company has employee stock option plans under which permanent employees may be granted options to purchase shares of Common Stock at 100% of fair market value at the time of the grant. Options generally become exercisable six months after the effective date and expire no later than seven years after the effective date. At the discretion of the Board of Directors, options granted under the stock option plans may qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981.

As of September 30, 1985 options for 6,438,989 shares were outstanding at prices ranging from $3.96 to $34.88, with an average price of $21.56. Options for 5,831,459 shares were exercisable as of September 30, 1985. Options for 5,709,069 shares are available for future grant. Options were exercised at prices ranging from $3.96 to $26.88 in 1985, $3.92 to $26.88 in 1984, and $.58 to $26.88 in 1983.

Employee Stock Purchase Plan

As of September 30, 1985 the Company has reserved 1,051,935 shares of Common Stock for future issuance under its employee stock purchase plan. Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of Common Stock at 85% of fair market value as of the last trading day before or the last trading day of the participation period. Under the second method, the Company may grant to all employees the option to purchase the same number of shares of Common Stock at not less than 85% of fair market value at the grant date. As of September 30, 1985 options to purchase 22,400 common shares at $29.00 and 472,000 common shares at $15.73 were outstanding under the second method. Such options are exercisable through January 20, 1986 and through February 28, 1987, respectively.

6. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three years ended September 30, 1985.

	Geographic Area				
(In thousands)	United States	Europe	Other	Eliminations	Consolidated
1985					
Revenue-Customer	$417,460	$136,307	$ 70,371	$ –	$624,138
Revenue-Intercompany	111,742	–	–	(111,742)	–
Revenue-Total	529,202	136,307	70,371	(111,742)	624,138
Pretax Income	34,586	15,496	6,555	(287)	56,350
Identifiable Assets	436,835	101,836	47,386	(33,713)	552,344
1984					
Revenue-Customer	$364,873	$109,562	$ 58,185	$ –	$532,620
Revenue-Intercompany	90,850	–	–	(90,850)	–
Revenue-Total	455,723	109,562	58,185	(90,850)	532,620
Pretax Income	46,977	10,842	5,261	(6,796)	56,284
Identifiable Assets	421,974	79,747	31,732	(31,580)	501,873
1983					
Revenue-Customer	$297,722	$ 91,100	$ 29,460	$ –	$418,282
Revenue-Intercompany	68,001	–	–	(68,001)	–
Revenue-Total	365,723	91,100	29,460	(68,001)	418,282
Pretax Income	49,084	11,546	(1,127)	(9,002)	50,501
Identifiable Assets	336,193	73,923	26,058	(20,649)	415,525

Intercompany transfers are made at arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $7,053,000 in 1985, $5,989,000 in 1984 and $6,400,000 in 1983.

7. Commitments and Contingencies

The Company, along with three present or former principal officers, was named as a defendant in a class action complaint filed in the United States District Court for the Northern District of California on October 23, 1984 purporting to state claims for alleged violations of federal securities laws and pendent state claims arising out of the Company's December 1982 restatement of revenue and earnings for fiscal 1982. The court dismissed the complaint as to the individual defendants in March 1985 with leave to amend. Subsequently, the court granted the defendant's motion for summary judgment and dismissed the suit in September 1985. The plaintiff filed a notice of appeal in October 1985. No provision has been made in the accompanying financial statements for possible liability because, in the opinion of management, it is unlikely that the ultimate disposition of the suit would have a material effect on the Company's financial position.

In addition, there are various actions or claims which have been brought or asserted against the Company. Management does not consider them to be material to the Company's financial position.

8. Unaudited Quarterly Financial Data

(In thousands except per share amounts)				
Quarters Ended	Dec. 31	March 31	June 30	Sept. 30
Year ended September 30, 1985				
Revenue	$159,653	$146,489	$144,165	$173,831
Costs and Expenses				
Cost of revenue	62,021	57,713	56,116	64,298
Product development	15,127	17,075	18,027	21,348
Marketing, general and administrative	59,996	61,998	69,482	70,856
Total costs and expenses	137,144	136,786	143,625	156,502
Operating Income	22,509	9,703	540	17,329
Interest income, net	1,888	1,573	1,298	1,510
Income Before Income Taxes	24,397	11,276	1,838	18,839
Provision for Income Taxes	(10,369)	(4,435)	550	(7,722)
Net Income	$ 14,028	$ 6,841	$ 2,388	$ 11,117
Earnings Per Share	$ .34	$ .16	$ .06	$ .27
Year ended September 30, 1984				
Revenue	$126,369	$111,236	$141,925	$153,090
Costs and Expenses				
Cost of revenue	51,360	47,826	56,563	59,943
Product development	10,849	12,853	13,514	15,298
Marketing, general and administrative	47,282	48,551	57,506	57,974
Total costs and expenses	109,491	109,230	127,583	135,215
Operating Income	16,878	2,006	14,342	17,875
Interest income, net	1,076	1,142	1,243	1,722
Income Before Income Taxes	17,954	3,148	15,585	19,597
Provision for Income Taxes				
Current period	(7,900)	(1,174)	(6,335)	(7,667)
Benefit of DISC tax reversal	–	–	–	9,700
Total provision for income taxes	(7,900)	(1,174)	(6,335)	2,033
Net Income	$ 10,054	$ 1,974	$ 9,250	$ 21,630
Earnings Per Share	$ .24	$ .05	$ .23	$ .53

9. Information on the Effects of Inflation (Unaudited)

The Company has provided an adjusted summary of operations and selected financial data in accordance with the Financial Accounting Standards Board Statement No. 33, as amended, concerning "Financial Reporting and Changing Prices." This disclosure requirement is experimental and involves considerably more judgment than traditional financial statements and, therefore, should be reviewed with caution.

Inflation-adjusted information was completed using the "current cost" method which requires the Company to adjust asset values based on specific indices and appraisals.

The method does not allow for inflation adjustments to operating expenses, revenue or net interest income, nor an adjustment to the tax provision, despite the decrease in pretax income which results from the inflation adjustments. Only the cost of revenue and depreciation expense related to the assets, which are restated for inflation effects, are adjusted.

Depreciation is computed on a straight-line basis, rather than the accelerated basis that is used for some assets in the Company's historical financial statements, because the accelerated method already recognizes some of the effects of inflation.

Net income for fiscal 1985 was lower under the current cost method because of higher depreciation and amortization expense resulting from higher asset values. Companies that hold monetary assets during a period of inflation lose purchasing power. Tandem held net monetary assets during the period, and their purchasing power declined.

CONSOLIDATED STATEMENT OF INCOME ADJUSTED FOR INFLATION

For the Year Ended September 30, 1985

	In Average 1985 Dollars	
(In thousands except per share amounts)	Historic Cost	Current Cost
Total Revenue	$624,138	$624,138
Cost of revenue, excluding depreciation and amortization	225,550	225,550
Other costs and expenses, excluding depreciation and amortization	312,891	312,891
Depreciation and amortization	35,616	38,534
Interest (income), net	(6,269)	(6,269)
Provision for income taxes	21,976	21,976
Net Income	$ 34,374	$ 31,456
Increase in value of inventories, property, plant and equipment held during the year:		
Measured in general prices		$ 8,428
Measured in specific prices		8,367
Excess of increase in general price level (constant dollars) over increase in specific prices		$ 61

At September 30, 1985, current cost of inventory was $79,133,000 and current cost of property, plant and equipment, net of accumulated depreciation, was $180,193,000.

FIVE YEAR COMPARISON OF SELECTED FINANCIAL DATA ADJUSTED FOR INFLATION

(Dollars in thousands except per share amounts)

	In Average 1985 Dollars				
	1985	1984	1983	1982	1981
Total revenue					
Constant dollars	$624,138	$552,234	$451,501	$348,596	$250,045
Current cost information					
Net income	$ 31,456	$ 43,774	$ 31,666		
Earnings per share	$ .75	$ 1.06	$ .78		
Net assets at year-end	$433,546	$396,455	$337,247		
Excess of increase in general price level (constant dollars) over increase in specific prices	$ 61	$ 811	$ 1,242		
Other information					
Decrease in purchasing power of net monetary items	$ 5,334	$ 5,673	$ 3,040		
Market price per share at end of period	$ 14.38	$ 16.72	$ 38.32	$ 25.41	$ 33.00
Average CPI (1967=100)	319.4	308.0	295.9	286.0	266.2

AUDITORS' REPORT

To Tandem Computers Incorporated:

We have examined the consolidated balance sheet of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1985 and 1984 and the related consolidated statements of income, stockholders' investment and changes in financial position for each of the three years in the period ended September 30, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1985 and 1984, and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

San Jose, California,
November 1, 1985.

Arthur Andersen & Co.

TANDEM STOCK PRICE

Calendar Quarter Price	High	Low
1985 3rd Quarter	18 5/8	13 1/8
2nd Quarter	23 7/8	14 1/2
1st Quarter	28 5/8	17 5/8
1984 4th Quarter	20 1/8	14 3/4
3rd Quarter	24 3/4	13
2nd Quarter	30 5/8	16 1/4
1st Quarter	40 1/4	30
1983 4th Quarter	39 1/2	30
3rd Quarter	36 1/2	26
2nd Quarter	34	25 1/2
1st Quarter	30 1/2	23 5/8

Tandem Computers Incorporated is traded via the NASDAQ National Market System under the trading symbol TNDM. All quotations shown represent the high and low sale prices. No cash dividends have been declared on the Common Stock.

Board of Directors

Thomas J. Perkins,
Chairman of the Board; General Partner,
Kleiner, Perkins, Caufield & Byers

Morton Collins,
General Partner, DSV Associates

Thomas J. Davis, Jr.,
General Partner, Mayfield Fund

Franklin P. Johnson, Jr.,
Chairman, Asset Management Company

Andrew Knight,
Editor, *The Economist*,
Economist Newspaper Ltd.

Robert C. Marshall,
Senior Vice President and Chief
Operating Officer, Tandem
Computers Incorporated

Robert G. Stone, Jr.,
Chairman of the Board,
Kirby Exploration Company

James G. Treybig,
President and Chief Executive Officer,
Tandem Computers Incorporated

Thomas I. Unterberg,
Chairman and Senior Managing Director,
L. F. Rothschild, Unterberg, Towbin

Auditors

Arthur Andersen & Co.
San Jose, California

Registrar and Transfer Agent

Bank of America N.T. & S.A.
San Francisco, California

Form 10-K

A copy of the Company's Report on Form 10-K for the 1985 fiscal year, as filed with the Securities and Exchange Commission, is available on written request. Please direct your request to:

Director of Investor Relations
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Monday, February 3, 1986, at the Company's headquarters.

Corporate Headquarters

19333 Vallco Parkway
Cupertino, California 95014-2599
(408) 725-6000

Trademark

Tandem, NonStop, NonStop II, NonStop EXT, NonStop TXP, DYNABUS, ENCOMPASS, EXPAND, FAXLINK, GUARDIAN, GUARDIAN 90, GUARDIAN 90XF, SAFEGUARD, SAFE-T-NET, TRANSFER, TXP and XL8 are trademarks and service marks of Tandem Computers Incorporated.

Officers

James G. Treybig,
President and Chief Executive Officer

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer

Michael K. Bateman,
Vice President – Third Party Marketing

Thomas A. Bechler,
Vice President and Division Manager

Jack W. Chapman,
Vice President and Managing Director,
Europe

Thomas L. Chun,
Vice President – Corporate Projects

George C. Eckert,
Vice President – Major Projects Management

Jan E. Jensen,
Vice President – Human Resources

Thomas J. Klitgaard,
Vice President – Corporate Counsel

Richard A. Lamb,
Treasurer

Lawrence A. Laurich,
Vice President – Engineering

Dennis L. McEvoy,
Vice President – Software

Lawrence W. McGraw,
Vice President – U.S. Sales Operations

Michael C. Moore,
Vice President and General Manager,
Intercontinental Division

Gerald L. Peterson,
Vice President – Marketing

Jerald D. Reaugh,
Vice President – MIS

David J. Rynne,
Vice President and Chief Financial Officer

Stephen C. Schmidt,
Vice President – Operations

Jeanne D. Wohlers,
Vice President and Corporate Controller

Domestic Sales and Service Offices

ALASKA, Anchorage

ARIZONA, Phoenix

ARKANSAS, Little Rock

CALIFORNIA, Culver City, Irvine, Long Beach, Los Angeles, Orinda, Riverside, Sacramento, San Diego, San Francisco, Santa Clara

COLORADO, Englewood

CONNECTICUT, Hartford, Stamford

FLORIDA, Jacksonville, Miami, Orlando, Tampa

GEORGIA, Atlanta

HAWAII, Honolulu

ILLINOIS, Chicago, Oakbrook

INDIANA, Indianapolis

IOWA, Cedar Rapids, Des Moines

KANSAS, Overland Park

LOUISIANA, Metairie

MARYLAND, Linthicum

MASSACHUSETTS, Newton

MICHIGAN, Ann Arbor, Lansing, Livonia

MINNESOTA, Edina

MISSISSIPPI, Jackson

MISSOURI, Creve Coeur, St. Louis

NEBRASKA, Omaha

NEVADA, Las Vegas

NEW JERSEY, Cherry Hill, Hasbrouck Heights

NEW MEXICO, Albuquerque

NEW YORK, Amherst, Fairport, Jericho, New York City

NORTH CAROLINA, Charlotte, Greensboro

OHIO, Cincinnati, Cleveland, Columbus, Dayton

OKLAHOMA, Oklahoma City, Tulsa

OREGON, Portland

PENNSYLVANIA, Allentown, Philadelphia, Pittsburgh

SOUTH CAROLINA, North Charleston

TENNESSEE, Memphis, Nashville

TEXAS, Austin, Dallas, Fort Worth, Harrisberg, Houston, Irving, San Antonio

UTAH, Salt Lake City

VIRGINIA, Reston, Richmond, Virginia Beach

WASHINGTON, Bellevue, Bremerton

WISCONSIN, Brookfield

International Subsidiaries

AUSTRALIA
Tandem NonStop Pty. Ltd
Adelaide, Brisbane, Melbourne, Perth, Sydney

AUSTRIA
Tandem Computer Ges.m.b.H.
Vienna

BELGIUM
Tandem Computers SA/NV
Brussels

CANADA
Tandem Computers Canada Ltd
Montreal, Ottawa, Toronto, Vancouver, Winnipeg

DENMARK
Tandem Computers A/S
Copenhagen

FRANCE
Tandem Computers S.A.
Paris

HONG KONG
Tandem Computers Hong Kong Ltd
Kowloon

ITALY
Tandem Computers Italia S.p.A.
Milan

JAPAN
Tandem Computers Japan Ltd
Osaka, Tokyo

THE NETHERLANDS
Tandem Computers BV
Amsterdam

NEW ZEALAND
Tandem NonStop Pty. Ltd
Wellington

NORWAY
Tandem Computers A/S
Oslo

SINGAPORE
Tandem Computers Int'l Inc.
Singapore

SPAIN
Tandem Computers Iberica S.A.
Madrid

SWEDEN
Tandem Computers A.B.
Stockholm

SWITZERLAND
Tandem Computers A.G.
Zurich

UNITED KINGDOM
Tandem Computers Ltd
Birmingham, Glascow, High Wycombe, London, Northolt, Rochdale

WEST GERMANY
Tandem Computers GmbH
Bonn, Dortmund, Duesseldorf, Frankfurt, Hamburg, Mannheim, Munich, Neufahrn, Stuttgart

International Distributors

ARGENTINA

COLOMBIA

FINLAND

MALAYSIA

MEXICO

MIDDLE EAST

SOUTH KOREA

TAIWAN

THAILAND

VENEZUELA

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TANDEM
COMPUTERS

January 2, 1986

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders which will be held on Monday, February 3, 1986 at 10:00 A.M. at the offices of the Company at 19333 Vallco Parkway, Cupertino, California.

The formal notice of the Annual Meeting and the Proxy Statement have been made a part of this invitation.

After reading the Proxy Statement, please mark, sign and return, at an early date, the enclosed proxy in the prepaid envelope addressed to the Bank of America, our agent, to assure that your shares will be represented. YOUR SHARES CANNOT BE VOTED UNLESS YOU SIGN AND RETURN THE ENCLOSED PROXY OR ATTEND THE ANNUAL MEETING IN PERSON.

A copy of the Company's Annual Report to Stockholders is also enclosed.

The Board of Directors and Management look forward to seeing you at the meeting.

Sincerely yours,

Thomas J. Perkins
Chairman of the Board

James G. Treybig
President and Chief Executive Officer

TANDEM COMPUTERS INCORPORATED

19333 Vallco Parkway • Cupertino, CA 95014 • (408) 725-6000

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders
to be Held February 3, 1986

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on February 3, 1986 at 10:00 A.M. for the following purposes:

1. To elect three Class III Directors to hold office until 1989.

2. To consider and vote upon a proposal to amend the Company's Restated Certificate of Incorporation to increase the authorized number of shares of common stock from 60,000,000 to 200,000,000 shares.

3. To consider and vote upon a proposal to amend the Tandem Computers Incorporated Employee Stock Purchase Plan to increase the number of shares of Common Stock available for issuance under the Plan.

4. To ratify the selection of Arthur Andersen & Co. as the Company's independent auditors.

5. To transact such other business as may properly come before the Meeting and any adjournment of the Meeting.

The Board of Directors has fixed the close of business on December 17, 1985 as the record date for determining the stockholders entitled to notice of and to vote at the Meeting and any adjournment of the Meeting. A complete list of stockholders entitled to vote will be available at the Company's headquarters, 19333 Vallco Parkway, Cupertino, California, for ten days before the meeting.

IF YOU DO NOT EXPECT TO ATTEND IN PERSON, PLEASE PROMPTLY MARK, SIGN AND RETURN THE ENCLOSED PROXY.

THOMAS J. KLITGAARD
Secretary

January 2, 1986

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders
to be Held February 3, 1986

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on February 3, 1986 at 10:00 A.M. for the following purposes:

1. To elect three Class III Directors to hold office until 1989.

2. To consider and vote upon a proposal to amend the Company's Restated Certificate of Incorporation to increase the authorized number of shares of common stock from 70,000,000 to 200,000,000 shares.

3. To consider and vote upon a proposal to amend the Tandem Computers Incorporated Employee Stock Purchase Plan to increase the number of shares of Common Stock available for issuance under the Plan.

4. To ratify the selection of Arthur Andersen & Co. as the Company's independent auditors.

5. To transact such other business as may properly come before the Meeting and any adjournment of the Meeting.

The Board of Directors has fixed the close of business on December 12, 1985 as the record date for determining the stockholders entitled to notice of and to vote at the Meeting and any adjournment of the Meeting. A complete list of stockholders entitled to vote will be available at the Company's headquarters, 19333 Vallco Parkway, Cupertino, California, for ten days before the Meeting.

IF YOU DO NOT EXPECT TO ATTEND IN PERSON, PLEASE PROMPTLY MARK, SIGN AND RETURN THE ENCLOSED PROXY.

Thomas J. Klitgaard
Secretary

January 7, 1986

TANDEM COMPUTERS INCORPORATED

PROXY STATEMENT

This Proxy Statement is furnished in connection with the solicitation by the Board of Directors of Tandem Computers Incorporated, a Delaware corporation (the "Company"), with principal executive offices at 19333 Vallco Parkway, Cupertino, California 95014, of proxies in the accompanying form to be used at the Annual Meeting of Stockholders to be held on February 3, 1986 and any adjournment of the Annual Meeting. The shares represented by the proxies received in response to this solicitation and not revoked will be voted at the Annual Meeting. A proxy may be revoked at any time before it is exercised by submitting a later-dated proxy or by voting in person at the Annual Meeting. On the matters coming before the Meeting for which a choice has been specified by a stockholder by means of the ballot on the proxy, the shares will be voted accordingly. If no choice is specified, the shares will be voted FOR the election of the three nominees for director listed in this Proxy Statement and FOR approval of proposals 2, 3 and 4 described in the Notice of Annual Meeting and in this Proxy Statement.

Stockholders of record at the close of business on December 17, 1985 are entitled to notice of and to vote at the Annual Meeting. On November 20, 1985, the Company had 41,526,844 shares of Common Stock outstanding. Each holder of Common Stock is entitled to one vote for each share held as of the record date, except that, in voting for directors, each stockholder is entitled to cumulate votes for the election of directors whose names have been placed in nomination; that is, a stockholder may cast as many votes as there are directors to be elected multiplied by the number of shares which the stockholder holds. All such votes may be cast for one candidate or distributed among the nominees for director as the stockholder sees fit. The persons authorized to vote shares represented by executed proxies in the enclosed form (if authority to vote for the election of directors is not withheld) will have full discretion and authority to vote cumulatively and to allocate votes among any or all of the nominees for election to the Board of Directors as they may determine or, if authority to vote for a specified candidate or candidates has been withheld, among those nominees for whom authority to vote has not been withheld.

The expense of printing and mailing proxy materials will be borne by the Company. In addition to the solicitation of proxies by mail, solicitation may be made by certain directors, officers and other employees of the Company by personal interview, telephone or telegraph. No additional compensation will be paid to such persons for such solicitation. The Company has also engaged Corporate Investor Communications, Inc. to assist in the solicitation of proxies and will pay this firm a fee of approximately $5,500 plus expenses. The Company will reimburse brokerage firms and others for their reasonable expenses in forwarding solicitation materials to beneficial owners of the Company's Common Stock.

This Proxy Statement and a form of proxy are being mailed to stockholders on or about January 2, 1986.

IMPORTANT

Please mark, date and sign the enclosed proxy and return it at your earliest convenience in the enclosed postage-prepaid return envelope so that, if you are unable to attend the Annual Meeting, your shares may be voted.

ELECTION OF DIRECTORS

The Company has three classes of directors serving staggered three-year terms. Each class consists of three directors. Three Class III directors are to be elected at the Annual Meeting for three-year terms expiring on the date of the Annual Meeting in 1989 or until each such director's successor shall have been duly elected or appointed.

Unless authority to vote for directors is withheld, it is intended that the shares represented by the enclosed proxy will be voted for the election of Messrs. Thomas J. Davis, Jr., Robert G. Stone, Jr., and James G. Treybig as Class III directors, each of whom is currently a member of the Board of Directors of the Company. In the event any of such nominees becomes unable or unwilling to serve, the shares represented by the enclosed proxy will be voted for the election of the balance of those named and such other person as the Board of Directors may select. The Board of Directors has no reason to believe that any such nominee will be unable to serve.

Set forth below are the names and ages of the nominees and directors, the class to which each has been elected or nominated for election, their principal occupations at present and for the past five years, certain directorships held by each and the year in which each became a director of the Company. Information with respect to the Company includes the Company's predecessor California corporation.

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Class I		
Morton Collins (1)	1975	49
General Partner of DSV Associates, DSV Partners III and DSV Partners IV, Princeton, New Jersey private investment partnerships, since 1974, 1981 and 1985, respectively.		
Andrew Knight	1984	46
Editor, *The Economist*, Economist Newspaper Ltd., since 1974; Governor of Imperial College of Science and Technology, University of London; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University; Trustee of the Victoria and Albert Museum, London.		
Robert C. Marshall (2)	1980	54
Senior Vice President and Chief Operating Officer of the Company since July 1980; Vice President and Chief Operating Officer from 1979 to 1980; Vice President from 1975 to 1979.		
Class II		
Franklin P. Johnson, Jr. (3)	1975	57
General Partner since 1982 of Asset Management Partners, a Palo Alto, California private investment partnership; Owner since 1967 of Asset Management Company, a Palo Alto, California investment management proprietorship; Director of Amgen, Boole & Babbage, California Microwave, Inc., Coherent, Inc., Ross Stores, Inc., SBE, Inc. and Teradyne, Inc.; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University.		

(See footnotes on following page)

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Thomas J. Perkins (3) (4)	1974	53
Chairman of the Board of the Company since 1974; General Partner since 1972, 1978, 1980 and 1982 of Kleiner & Perkins, Kleiner, Perkins, Caufield & Byers, Kleiner, Perkins, Caufield & Byers II, and Kleiner, Perkins, Caufield & Byers III, respectively, San Francisco, California private investment partnerships; Director of Corning Glass Works, Genentech, Inc., Hybritech Incorporated, LSI Logic Corporation and Spectra-Physics, Inc.		
Thomas I. Unterberg (1) (5)	1985	54
Chairman and Senior Managing Director of L.F. Rothschild, Unterberg, Towbin, an investment banking firm, since 1983; Managing Partner of such firm from 1981 to 1982; General Partner of such firm from 1977 to 1980; Director of Applied Energy Services, Inc., ASK Computer Systems, Inc., J. Rothschild Holdings plc, LIN Broadcasting Corporation, Scitex Corporation Ltd. and Systems & Computer Technology Corporation.		
Class III		
Thomas J. Davis, Jr. (1) (4)	1976	73
General Partner since 1973, 1979, 1981 and 1983 of Mayfield II, Mayfield III, Mayfield IV and Mayfield V, respectively, Menlo Park, California private investment partnerships; Director of Compression Labs, Inc. and Equatorial Communications Co.		
Robert G. Stone, Jr. (3)	1978	62
Chairman of the Board of Kirby Exploration Company, an oil and gas exploration company, and its predecessor, General Energy Corporation, since 1971; Chairman of the Board of West India Shipping Company, Inc. from 1974 to 1983; Director of The Chubb Corporation, Combustion Engineering, Inc., Core Industries, Inc., Corning Glass Works, Great Northern Nekoosa Corp., Hamilton Brothers Petroleum Corp., The Japan Fund, Inc., The Pittston Company, R. H. Macy & Co., Inc. and Western Pacific Industries, Inc.		
James G. Treybig (2) (4)	1974	45
President and Chief Executive Officer of the Company since 1974.		

(1) Member of Audit Committee.

(2) On October 2, 1984 the Securities and Exchange Commission (the "Commission") filed a civil action for injunctive and other equitable relief in the United States District Court for the Northern District of California against the Company, Messrs. Treybig and Marshall and a former officer of the Company. The Commission's complaint alleged that during fiscal 1982, the Company, aided and abetted by the named persons, engaged in certain conduct which resulted in improper recognition of revenue. This conduct was alleged to have resulted in the violation by the Company of certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act") through the filing with the Commission of reports which overstated the Company's revenue and net income for the second and third fiscal quarters of 1982 and the issuance of a press release which overstated the Company's revenue and net income for the fourth fiscal quarter of 1982 and fiscal 1982 as a whole. The complaint further alleged

that during fiscal 1982, the Company, aided and abetted by the named persons, violated certain accounting provisions of the Exchange Act relating to record keeping and internal accounting controls. The Company had restated its fiscal 1982 financial statements in December 1982, and the Commission did not seek a further restatement.

In order to avoid the time and expense of protracted litigation, without admitting or denying the allegations in the complaint, on October 2, 1984 the Company and the named persons consented to the entry of a final judgment permanently enjoining them from violating various provisions of the Exchange Act and requiring certain ancillary relief, including an annual review and report for three years by the Company's independent accountants of the Company's system of accounting and internal controls in specified areas, including revenue recognition.

(3) Member of Nominating Committee.

(4) Member of Compensation/Option Committee.

(5) From time to time, L.F. Rothschild, Unterberg, Towbin advises the Company with respect to investment banking matters.

STOCK OWNERSHIP OF DIRECTORS AND OFFICERS

The following table sets forth information as of November 20, 1985 as to shares of Common Stock beneficially owned by the directors and nominees named under "Election of Directors" and the directors and officers of the Company as a group. Except as otherwise indicated, each person has sole investment and voting power with respect to the shares shown. Ownership information is based upon information furnished by the respective individuals.

	Beneficial Ownership of Common Stock	
	Number of Shares(1)	Percent of Class
Thomas J. Perkins	500,468	1.2
James G. Treybig (2)	309,444	0.7
Franklin P. Johnson, Jr. (3)	200,000	0.5
Robert C. Marshall (4)	184,000	0.4
Robert G. Stone, Jr. (5)	95,086	0.2
Thomas J. Davis, Jr.	38,572	0.1
Andrew Knight	12,000	(6)
Morton Collins (7)	11,304	(6)
Thomas I. Unterberg	10,000	(6)
All officers and directors as a group (28 persons including the nine directors named above)	2,141,856	5.1

(1) Includes shares which may be acquired within 60 days pursuant to the exercise of options as follows: Mr. Treybig, 82,333 shares; Mr. Marshall, 75,800 shares; Mr. Knight, 12,000 shares and all officers and directors as a group, 615,271 shares.

(2) Includes 1,800 shares held by trusts, of which Mr. Treybig is the trustee.

(3) All such shares are held by Asset Management Partners, a partnership of which Mr. Johnson is general partner.

(4) Includes 2,755 shares held in a trust for the benefit of a minor child of Mr. Marshall, of which the trustee is Mr. Marshall's wife and as to which Mr. Marshall disclaims any beneficial interest.

(5) Includes 19,100 shares held by trusts, of which Mr. Stone is a trustee, and 39,186 shares beneficially owned by Mr. Stone's wife and children, as to all but 1,000 of which shares Mr. Stone disclaims any beneficial interest.

(6) Less than one-tenth of one percent.

(7) Includes 1,400 shares held in a trust for the benefit of Mr. Collins' children and as to which Mr. Collins disclaims any beneficial interest.

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Information is set forth below as to the cash compensation paid during the 1985 fiscal year by the Company and its subsidiaries to each of the five most highly compensated executive officers of the Company individually, to all executive officers as a group and to directors. Information is given only for the period each served as an executive officer or director of the Company. Information for the past five fiscal years as to stock options granted and amounts allocated to such persons, to all officers and directors as a group and to employees under the Company's employee benefit plans is set forth under "Stock Options" on pages 7 and 8 or the description of each plan under "Approval of Amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan" and "Description of Other Plans" which commence on page 9 of this Proxy Statement.

Cash Compensation of Executive Officers for Fiscal 1985

Name of Individual or Number in Group and Capacities in Which Served	Amount
James G. Treybig — President, Chief Executive Officer and Director	\$ 320,056
Robert C. Marshall — Senior Vice President, Chief Operating Officer and Director	\$ 266,723
David J. Rynne — Vice President and Chief Financial Officer	\$ 257,499
Dennis L. McEvoy — Vice President—Software	\$ 213,390
Lawrence A. Laurich — Vice President—Engineering	\$ 200,092
All executive officers as a group (21 persons including the five named above)	\$3,572,729

Directors who are not officers of the Company are paid an annual retainer of \$13,000, plus expenses, payable quarterly. Directors who are members of one or more of the Executive, Compensation/Option, Nominating, Conflicts of Interest or Audit Committees are paid an additional annual retainer of \$1,000 for each such committee of which they are a member. The Chairman of the Board is paid an additional annual retainer of \$2,000.

From time to time, the Company has guaranteed bank loans to officers. During the 1985 fiscal year the Company guaranteed bank loans under a \$2,000,000 bank line of credit to Lawrence A. Laurich, David R. Mackie (a former officer), Dennis L. McEvoy and Gerald L. Peterson (Vice President —Marketing) in the principal amounts of \$430,000, \$200,000, \$100,000 and \$150,000, respectively, plus interest. The Company has not had to perform under the guarantees.

During August 1984, the Company made a short-term loan to Mr. Marshall in the amount of \$100,000 to enable him to maintain his ownership position in the Company's Common Stock. The annual interest rate on the loan was a variable rate equal to the lesser of (i) the Bank of America's prime rate plus one percent or (ii) 14 percent. The largest amount outstanding under the loan was \$102,782. On November 6, 1984, Mr. Marshall paid the loan in full.

Since May 9, 1983, the Company has made loans to Jan E. Jensen, Vice President—Human Resources, to enable him to purchase a residence. The interest rates on the loans are adjustable semi-annually and are variable rates equal to the lesser of (i) the Bank of America's prime rate plus one percent or (ii) five percent above the Federal Reserve Bank of San Francisco's discount rate. The loans are due on dates ranging from March 3, 1986 to June 30, 1988. The largest aggregate principal amount outstanding under the loans was $212,811.40, all of which is currently outstanding.

On September 26, 1985, the Company loaned Mr. Treybig $1,667,500 in consideration of his promissory note in that amount. The principal amount of the note is due September 26, 1989 and bears interest at 10% per annum payable quarterly. The note is fully secured. See "Description of Other Plans—Convertible Debenture Issuance."

STOCK OPTIONS

With respect to options to purchase shares of the Company's Common Stock granted to certain executive officers, all executive officers as a group and all directors as a group during the period October 1, 1980 to November 20, 1985, the following table sets forth (i) the aggregate amount of Common Stock subject to options granted (net of cancellations) during the specified period, (ii) the weighted average per share option exercise price of such options, (iii) the net value of shares (market value less any exercise price) realized during the specified period upon the exercise of such options during the specified period and (iv) the numbers of shares of Common Stock sold by the named persons and by all executive officers as a group and by all directors as a group during the specified period. Information is given only for the period each served as an executive officer or director of the Company.

Common Stock(1)	James G. Treybig	Robert C. Marshall	David J. Rynne(2)	Dennis L. McEvoy(2)	Lawrence A. Laurich(2)	All Executive Officers as a Group(2)	All Directors as a Group(3)
Granted—October 1, 1980 to November 20, 1985:							
Number of shares	148,000	63,000	50,300	38,400	49,800	671,000	24,000
Weighted average per share exercise price	$19.12	$22.60	$22.87	$20.14	$21.13	$20.36	$23.86
Exercised—October 1, 1980 to November 20, 1985:							
Net value realized in shares (market value less exercise price)(4)	$539,481	$711,286	$ -0-	$165,166	$1,115,564	$4,434,681	$266,508
Sales—October 1, 1980 to November 20, 1985:							
Number of shares(5)	40,000	40,250	-0-	27,500	30,000	216,951	251,384

(1) Adjusted for stock splits.

(2) Includes options granted under the Stock Option Grant Program of the Company's Employee Stock Purchase Plan, all of which have an exercise price of 85% of the market value of the shares on the date of grant. The numbers of options granted under such Plan to Messrs. Rynne, McEvoy, Laurich and all executive officers as a group are 200, 300, 700 and 5,300, respectively, and the weighted average per share exercise price of such options and the market price of the Common Stock on the date of grant are $16.62 and $19.54, respectively.

(3) Excludes directors who are also executive officers.
(4) Represents the difference between the exercise price and the fair market value of the Company's Common Stock on the date or dates of exercise of stock options for the specified individual or group. These amounts do not reflect, and may or may not bear any relationship to, the net realized value when or if the shares are sold. Pursuant to rules of the Securities and Exchange Commission, no executive officer or director of the Company may sell shares of the Company's Common Stock within six months prior to or after exercising an option without the possible imposition of a severe penalty.
(5) Shares sold were not necessarily acquired by the exercise of options. May include shares disposed of by gift.

During the period from October 1, 1980 to November 20, 1985, employees (excluding officers) were granted options under the Company's stock option plans and the Stock Option Grant Program of the Employee Stock Purchase Plan to purchase a total of 10,352,284 shares (net of cancellations) at a weighted average exercise price of $21.12 per share (adjusted to reflect stock splits). Of these, 3,707,894 were not "qualified" stock options, incentive stock options or options granted pursuant to an "employee stock purchase plan," as the quoted terms are defined in Sections 422 through 423 of the Internal Revenue Code of 1954, as amended. The weighted average per share exercise price for such options is $20.10. Of the total number of options granted, 2,001,900 were granted under the Stock Option Grant Program of the Company's Employee Stock Purchase Plan at 85% of the market price of the Common Stock on the date of grant. The weighted average per share market price of the Common Stock on the dates of grant is $19.15.

As of November 20, 1985 there were outstanding options under the Company's 1981 Stock Option Plan, 1979 Stock Option Plan and Non-Qualified Stock Option Plan to purchase 6,153,040 shares held by approximately 4,800 participants, and there were approximately 5,500 employees eligible to participate in such plans. The expiration dates of all such options range from January 23, 1986 to November 10, 1992, and the weighted average exercise price per share is $21.51.

APPROVAL OF AMENDMENT TO THE COMPANY'S RESTATED CERTIFICATE OF INCORPORATION

The Board of Directors has unanimously approved an amendment of Article IV of the Company's Restated Certificate of Incorporation to increase the number of shares of presently authorized common stock from 60,000,000 to 200,000,000 and recommends such amendment to the Company's stockholders for adoption. At November 20, 1985, 41,526,844 shares of Common Stock were outstanding. The text of Article IV, as proposed to be amended, is set forth in Exhibit A to this Proxy Statement.

Management of the Company has no arrangements, agreements, understandings or plans at the present time for the issuance or use of shares of common stock, except for the addition of 2,000,000 shares to the Tandem Computers Incorporated Employee Stock Purchase Plan as proposed for stockholder approval at the Annual Meeting. The Board of Directors believes, however, that the availability of additional shares of common stock will provide the Company with the flexibility required to meet business needs as they arise.

The amendment of the Restated Certificate of Incorporation requires the affirmative vote of not less than a majority of the outstanding shares of Common Stock.

The Board of Directors recommends a vote FOR the Amendment to the Company's Restated Certificate of Incorporation.

APPROVAL OF AMENDMENT TO THE TANDEM COMPUTERS INCORPORATED EMPLOYEE STOCK PURCHASE PLAN

On November 10, 1985, the Board of Directors adopted an amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan (the "Plan") to increase the number of shares of Common Stock available for purchase under the Plan from 4,100,000 to 6,100,000 shares. As of November 20, 1985, 1,538,945 shares remained available for purchase under the Plan, before giving effect to the amendment, and a total of 2,561,055 shares had been purchased under the Plan. Of the shares remaining available for purchase, 1,003,500 are reserved for issuance upon the future exercise of options granted under the Stock Option Grant Program of the Plan described below.

The purpose of the Plan is to attract, retain and motivate qualified employees by providing them with the opportunity to subscribe for and purchase Common Stock from the Company at a price lower than its market value at the time of purchase and to pay for such stock through payroll deductions. The Board of Directors believes that employee stock ownership is an effective means of securing to the Company and its stockholders the advantages of the incentive inherent in stock ownership by participating employees, upon whose judgment, initiative and efforts the Company is largely dependent for the successful conduct of its business. Consequently, the Board of Directors believes that the use of the Plan as a supplement to other forms of compensation paid by the Company is desirable. The following is a general summary of the principal provisions of the Plan, as amended.

Administration

The Plan is administered by the Board of Directors. The Board of Directors may interpret the Plan, adopt rules and regulations for its administration, prescribe additional terms and limitations on the options and delegate administration of the Plan to a committee consisting of not less than three members of the Board of Directors. The Board of Directors has delegated administration of the Plan to the Compensation/Option Committee (the "Committee").

Eligibility

All employees of the Company and its 50% or more owned subsidiaries, including officers, who customarily work more than five months in a calendar year are eligible to purchase shares under the Plan. Directors of the Company are not eligible to participate in the Plan. As of November 20, 1985, approximately 5,500 employees were eligible to participate in the Plan. No employee may be granted a right or an option to purchase Common Stock under the Plan which if exercised would result in (i) his or her owning stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or any subsidiary, or (ii) his or her ability to purchase stock under the Plan or similar plans of the Company in any one calendar year with a fair market value in excess of $25,000 (determined as of the time such right or option is granted).

Purchase Price and Terms

The Plan has two segments, a Payroll Withholding Accumulation Program and a Stock Option Grant Program.

Under the Payroll Withholding Accumulation Program, an eligible employee may authorize the Company to withhold any whole percentage from 1 to 10% of his or her compensation. "Compensation" means, for this purpose, a participant's total annual compensation including bonuses and commissions but excluding special payments (such as moving expenses) and income with respect to stock options or other stock purchases. A participant is deemed to have elected to purchase the maximum number of whole shares of the Company's Common Stock which can be purchased with the amount withheld during a participation period (calendar quarters commencing on each July 1, October 1, January 1 and April 1 while the Plan is in effect). A participant may not purchase more than 1,500 shares in any one participation period. At the end of each participation period the participant's accumulated payroll withholdings are divided by the purchase price for that participation period, which is the lesser of (i) 85% of the fair market value of a share of Common Stock on the last trading day before the participation period commences or (ii) 85% of the fair market value of a share of Common Stock on the last trading day during the participation period.

If a participant's employment terminates for any reason (including death), his or her participation in the Payroll Withholding Accumulation Program will terminate immediately and the entire amount credited to his or her Plan account will be refunded to the participant in cash, without interest.

During the period from October 1, 1980 through November 20, 1985, the aggregate difference between the purchase price and the fair market value on the date of purchase of shares acquired pursuant to the Payroll Withholding Accumulation Program by all executive officers as a group and all employees (including officers) was $41,918.38 and $6,644,007.88, respectively.

Under the Stock Option Grant Program, options for an identical number of shares of Common Stock are granted periodically at the discretion of the Committee to every participant who is eligible on the date of grant. The exercise price must not be less than 85% of the fair market value of a share of Common Stock on the date of grant. Options expire no later than 27 months after the date of grant. Shares purchased upon the exercise of an option must be paid for in full at the time of exercise. Payment may be by personal check or by delivery of an irrevocable direction to a securities broker, approved by the Company, to sell shares and deliver all or a portion of the proceeds to the Company in payment for the shares. In addition, with the Committee's approval given at the time the option is granted, payment may be by delivery of a full recourse, interest-bearing promissory note.

Upon termination of employment, an optionee may exercise an outstanding option granted under the Stock Option Grant Program (to the extent it was exercisable on the date of termination) within 30 days following the date of termination (but in no event later than the expiration date of such option), unless termination of employment is because of permanent disability, in which case the option may be exercised within three months following the date of termination. In the case of the death of an optionee while an eligible employee, the optionee's heirs or legal representative may exercise the option within one year after the date of death.

Adjustment Upon Recapitalization

The Plan provides for appropriate adjustment by the Board of Directors of the number and price of shares subject to outstanding rights and the number of shares and option price of any outstanding options and of the aggregate number of shares available for issuance under the Plan in the event of a reorganization, stock split, combination of shares, stock dividend or other recapitalization of the Company.

Term of the Plan, Amendment and Termination

The Board of Directors may at any time amend, modify or terminate the Plan. Any increase in the aggregate number of shares to be issued under the Plan will not be effective until approved by the stockholders of the Company. Unless earlier terminated by the Board of Directors, the Plan will be in effect until June 30, 1988.

Transferability

A participant may not assign his or her rights or interest in the Plan, in any option granted under the Plan or in any Common Stock or moneys to which he or she may become entitled under the Plan during a present or future participation period to any other person. Any such attempted assignment other than by will shall be treated as an election by the participant to withdraw from the Plan.

Federal Income Tax Information

The Plan is intended to qualify as an "employee stock purchase plan" under the provisions of Section 423 of the Internal Revenue Code of 1954, as amended. No taxable income is recognized by a participant either at the time a right or an option is granted to purchase Common Stock under the Plan or at the time the shares are purchased thereunder.

If a participant does not dispose of shares acquired under the Plan before two years after the date of grant (which under the Payroll Withholding Accumulation Program is the first day of each participation period and the Stock Option Grant Program is the date an option is granted) nor in the case of shares acquired under the Stock Option Grant Program, before six months after the date the shares are transferred to him or her (12 months for shares acquired prior to June 23, 1984), then upon such disposition the United States federal income tax consequences will be as follows: (1) the lesser of (a) the excess of the fair market value of the Common Stock on the date of disposition over the purchase price or (b) 15% of the fair market value of the shares on the date of grant will be taxed to the participant as ordinary income, but the Company will not be entitled to any deduction with respect thereto, and (2) the excess, if any, of the fair market value of the shares on the date of disposition over the sum of the purchase price and the amount of ordinary income recognized upon disposition will be taxed as long-term capital gain. If such taxable disposition produces a loss (i.e., the value of the shares on the date of disposition is less than the purchase price) and the disposition involves certain unrelated parties, the loss will be a long-term capital loss.

If a participant disposes of the shares earlier than two years after the date of grant, or in the case of shares acquired under the Stock Option Grant Program, earlier than six months after the date the shares are transferred to him or her (12 months for shares acquired prior to June 23, 1984), then upon such disposition the United States federal income tax consequences will be as follows: (1) the difference between the purchase price and the fair market value of the Common Stock on the date of purchase will be taxed to the participant as ordinary income in the year of disposition and will be deductible by the

Company, and (2) the excess, if any, of the fair market value of the shares on the date of disposition over their fair market value on the date of purchase will be taxed as capital gain (long-term or short-term, depending upon the holding period). If the value of the shares on the date of disposition is less than the sum of the purchase price and the amount of ordinary income recognized upon disposition, then such difference will result in a capital loss (long-term or short-term, depending upon the holding period), provided the disposition is between certain unrelated parties. Any such loss will not affect the ordinary income realized upon the disposition.

Generally, a transfer of shares to a decedent's estate or to an heir by bequest or inheritance or to any transferee pursuant to certain tax-free exchanges is not considered a disposition by the participant for purposes of the foregoing rules. Also, a pledge of the shares is not considered a disposition unless the shares are actually disposed of pursuant to the pledge.

If a participant dies after purchasing shares under the Plan, then upon the participant's death he or she will realize ordinary income equal to the amount he or she would have recognized as ordinary income if he or she had made a qualifying disposition of the shares on the date of his or her death. The basis of the shares in the hands of the estate or legatee will be determined without regard to the realization of such ordinary income, and the Company will receive no deduction with respect thereto.

The deductible portion of a participant's long-term capital gain may constitute an item of tax preference subject to the alternative minimum tax which was enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982. The alternative minimum tax, which imposes a 20% tax on certain items of tax preference in excess of an exemption amount, is payable if it exceeds the amount of the regular United States federal income tax for the same taxable year.

Required Vote

The amendment of the Plan requires the affirmative vote of not less than a majority of the outstanding shares of Common Stock.

The Board of Directors recommends a vote FOR the amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan.

DESCRIPTION OF OTHER PLANS

Stock Option Plans

Tandem Computers Incorporated 1981 Stock Option Plan. The Tandem Computers Incorporated 1981 Stock Option Plan (the "1981 Plan") was approved by the stockholders at the Company's 1982 Annual Meeting of Stockholders and, as amended, at the 1985 Annual Meeting of Stockholders. The 1981 Plan is administered by the Compensation/Option Committee, except that the Directors' Option Committee administers grants of options to employees who are also directors. All employees of the Company and its 50% or more owned subsidiaries, including officers and directors who are also employees, are eligible to receive options. Options may be either non-statutory stock options or incentive stock options ("ISOs"). The maximum value of ISO grants is limited to $100,000 per year for each employee, subject to certain carryover provisions. Options granted must have an option price of not less than 100% of the fair market value of the Company's Common Stock on the date of grant. Options may be made exercisable at such times as determined by the administering committee, provided that an ISO may not be exercised while there is outstanding any ISO previously granted to the same employee and, except when an optionee's employment terminates because of death or permanent disability, an option may not be exercisable before six months following its effective date. Shares purchased upon exercise of an option must be paid for in full at the time of exercise. Payment may be by personal check or, with the consent of the Company, by delivery of an irrevocable direction to a securities broker, approved by the Company, to sell shares and deliver all or a portion of the proceeds to the Company in payment for the shares. In addition, with the Company's consent, payment may be by delivery of a full recourse, interest-bearing promissory note. Options may not be exercised after seven years from the date of grant and are not transferable except by will or the laws of descent and distribution. In the event of a reorganization, stock split, combination of shares, stock dividend or other recapitalization, the Board of Directors may make appropriate adjustments in the number and kind of shares available for issuance under the 1981 Plan, in the number and kind of shares as to which outstanding options will be exercisable and in the exercise price specified in any agreement with respect to any unpurchased shares. The administering committee may determine that an option will provide that the shares to be issued upon exercise of the option shall be subject to certain rights of repurchase by the Company at the option price. In such case, the option agreement will provide that if the optionee's employment terminates, the Company may repurchase a specified percentage of the shares.

Tandem Computers Incorporated 1979 Stock Option Plan. The Tandem Computers Incorporated 1979 Stock Option Plan (the "1979 Plan") was approved by the stockholders at the Company's 1980 Annual Meeting of Stockholders. The 1979 Plan is administered in the same manner as the 1981 Plan. The provisions of the 1979 Plan and the terms of the options granted under the 1979 Plan are substantially similar to those of the 1981 Plan, except as follows. Only employees of the Company, including officers, and employees and directors of its 80% or more owned subsidiaries, are eligible to receive options. Certain options outstanding on January 1, 1981 could not be designated as incentive stock options.

Tandem Computers Incorporated Non-Qualified Stock Option Plan. The Tandem Computers Incorporated Non-Qualified Stock Option Plan was approved by the stockholders at the Company's 1978 Annual Meeting of Stockholders and, as amended, at the 1979 Annual Meeting of Stockholders. The terms of the options granted under this plan are substantially similar to those of the 1981 Plan, except as follows. Only employees of the Company, including officers and directors, and employees and directors of its wholly owned subsidiaries, are eligible to receive options. Payment for shares purchased upon the exercise of an option may be by personal check or, with the consent of the Company, by delivery of a full recourse, interest-bearing promissory note. The Non-Qualified Stock Option Plan expired on November 12, 1985.

Tandem Computers Incorporated Qualified Stock Option Plan. The Tandem Computers Incorporated Qualified Stock Option Plan was approved by the stockholders in 1976 and is administered in the same manner as the 1981 Plan. The provisions of the Qualified Stock Option Plan and the terms of the options granted pursuant thereto are substantially similar to those of the 1981 Plan, except as follows. Only key employees of the Company, including officers and directors, and its subsidiaries may be granted options. Options may not be exercised after five years from the date of grant. Under certain circumstances, options may not be exercised while the optionee holds another option previously granted at a higher option price. Payment for shares purchased upon the exercise of an option is to be by personal check. The Qualified Stock Option Plan expired on November 12, 1985.

Individual Stock Option Agreements. In addition to the 1981 Plan, the 1979 Plan and the Non-Qualified and Qualified Stock Option Plans, the Company has entered into a Non-Qualified Stock Option Plan and Agreement with Mr. Andrew Knight who is a director of the Company. Under this Plan, Mr. Knight was granted an option to purchase 12,000 shares of the Company's Common Stock. The exercise price of the option is $19.00 per share, which equals 100% of the market value of the Company's Common Stock on the date of grant. The provisions of this Plan are substantially similar to those described in the description of the Non-Qualified Stock Option Plan except that no further grants are permitted under this Plan. Mr. John B. M. Place, a former director of the Company, was similarly granted, during his term as director, two options to purchase 2,000 and 10,000 shares of the Company's Common Stock at $26.75 and $29.125, respectively, per share. The options granted to Mr. Place may be exercised on or before February 22, 1988.

Incentive Cash Bonus Plan

The Company has in the past had an incentive cash bonus plan (the "Bonus Plan") in which the executive officers of the Company were eligible to participate. Awards under the Bonus Plan were made if certain target increases in revenue, operating profits and asset management ratios (established by the Board of Directors in its discretion) were attained by the Company. No awards were made under the Bonus Plan during fiscal 1985 and any amounts paid since October 1, 1980 have been included in the disclosure of management remuneration for such years. The Bonus Plan is not currently in effect.

1984 401(k) Investment Plan

All non-union employees of the Company who are on its United States payroll, including directors who are employees of the Company, and the employees of certain participating subsidiaries, are eligible to participate in the Company's 1984 401(k) Investment Plan (the "Investment Plan"). The Investment Plan was amended and restated on November 7, 1985 to comply with the Tax Reform Act of 1984 and the Retirement Equity Act of 1984, and to make certain additional changes, including, but not limited to, an increase in participant contributions from 10% to 12% of compensation.

Each participant may elect to contribute from 2% to 12% of his or her compensation, and the Company matches 25% of the first 6% of the employee's compensation contributed to the Investment Plan, subject to a maximum Company matching contribution of $1,200 per employee per plan year ending September 30. An employee's contributions are made by deferring that portion of his or her compensation, thereby enabling such contributions to be made on a before-tax basis. A participant is at all times fully vested in his or her contributions and becomes fully vested in Company contributions upon the last day of the fourth calendar quarter following the quarter for which such contributions were made. Contributions are held and invested by the Investment Plan trustee in three different funds. A participant may designate, within certain limitations, in which funds his or her accounts are to be invested. The Investment Plan permits participants to make withdrawals and to borrow from their accounts at market rates under certain conditions. In general, the vested portion of a participant's accounts is distributed in a single-sum cash payment upon his or her termination of employment.

Between July 1, 1984 (the inception of the Investment Plan) and November 30, 1985, the Company made matching contributions under the Investment Plan for the accounts of Messrs. Marshall, Rynne, McEvoy and Laurich, all executive officers as a group, and all employees as a group in the amounts of $2,957, $2,497, $2,621, $2,541, $39,346 and $2,161,502, respectively.

Convertible Debenture Issuance

On September 26, 1985, the Company issued a 9.5% Convertible Subordinated Debenture Due September 26, 1989 (the "Debenture") in the principal amount of $1,667,500 to Mr. Treybig. The Company may redeem the Debenture in whole or in part beginning September 26, 1986. The Debenture is convertible into shares of the Company's Common Stock at $16.675 per share, which was 115% of the closing sale price of the Common Stock on the date of issuance of the Debenture. The principal amount which may be converted at any time is limited to the greater of (i) the amount which has been called for redemption but not yet redeemed or (ii) 25% of the aggregate principal amount commencing September 26, 1986 and an additional 25% each September 26 thereafter through 1989; unless Mr. Treybig is disabled or dies or a "change in control," as defined, occurs in which case the entire amount then outstanding is convertible. The Debenture may not be transferred by Mr. Treybig except upon his death.

RATIFICATION OF INDEPENDENT AUDITORS

Upon the recommendation of the Audit Committee, the Board of Directors has reappointed the firm of Arthur Andersen & Co. as the Company's independent auditors for the 1986 fiscal year, subject to ratification by the stockholders. Representatives of Arthur Andersen & Co. are expected to be present at the Company's Annual Meeting. They will have an opportunity to make a statement, if they desire to do so, and will be available to respond to appropriate questions.

The Board of Directors recommends a vote FOR ratification of the appointment of Arthur Andersen & Co.

BOARD OF DIRECTORS MEETINGS AND COMMITTEES

The Company's Board of Directors held four meetings during the 1985 fiscal year. All directors attended at least 75% of the aggregate number of meetings of the Board and of the committees on which such directors serve.

The Board of Directors of the Company has appointed an Audit Committee, Nominating Committee, Compensation/Option Committee and a Directors' Option Committee of the Board.

The members of the Audit Committee are Messrs. Morton Collins, Thomas I. Unterberg and Thomas J. Davis, Jr. The Audit Committee held five meetings during the 1985 fiscal year. Its functions are to monitor the effectiveness of the audit effort, to supervise the Company's financial and accounting organization and financial reporting and to select a firm of certified public accountants, whose duty it is to audit the books and accounts of the Company for the fiscal year for which they are appointed.

The members of the Nominating Committee are Messrs. Franklin P. Johnson, Jr., Thomas J. Perkins and Robert G. Stone, Jr. The Nominating Committee held one meeting during the 1985 fiscal year. The Nominating Committee's function is to select nominees for election as directors. The Nominating Committee will consider nominees recommended by stockholders. Such recommendations should be submitted in writing to the Nominating Committee in care of the Secretary of the Company at its address set forth on the front page of this Proxy Statement.

The members of the Compensation/Option Committee are Messrs. Thomas J. Perkins, James G. Treybig and Thomas J. Davis, Jr. The Compensation/Option Committee held ten meetings during the

1985 fiscal year. The Compensation/Option Committee's functions are to determine and supervise compensation to be paid to officers and directors of the Company and to supervise and manage the Company's Employee Stock Purchase Plan and stock option plans (except with respect to options granted to directors).

The members of the Directors' Option Committee are Messrs. Thomas J. Perkins, Thomas J. Davis, Jr., Franklin P. Johnson, Jr. and Morton Collins. The Directors' Option Committee held one meeting during the 1985 fiscal year. The Directors' Option Committee's function is to supervise and manage the Company's stock option plans as to directors of the Company.

CERTAIN BENEFICIAL OWNERS

The following table sets forth information as of November 20, 1985 as to stockholders that have advised the Company that each is the beneficial owner of more than 5% of the Company's Common Stock.

	Beneficial Ownership of Common Stock	
	Number of Shares	Percent of Class
Sanford C. Bernstein & Co., Inc. 767 Fifth Avenue New York, NY 10153	3,777,105(1)	9.1%
The Capital Group, Inc. 333 South Hope Street Los Angeles, CA 90071	2,580,500(2)	6.2
T. Rowe Price Associates, Inc. 100 East Pratt Street Baltimore, MD 21202	2,178,300(3)	5.2

(1) In its Schedule 13G dated February 15, 1985, Sanford C. Bernstein & Co., Inc. stated that it has sole voting and investment power with regard to 1,039,100 and 3,777,105 of such shares, respectively.

(2) The Capital Group, Inc. advised the Company on February 13, 1985 that the shares are held by two of its operating subsidiaries for various institutional investors. The subsidiaries have sole investment power with regard to 2,580,500 shares and one subsidiary has sole voting power with regard to 1,074,500 of such shares. The Capital Group, Inc. disclaims beneficial ownership of the shares.

(3) The shares are owned by various individual and institutional investors for which T. Rowe Price Associates, Inc. serves as investment adviser with sole investment power with regard to 2,178,300 shares and shared voting power with regard to 442,800 of such shares. T. Rowe Price Associates, Inc. disclaims beneficial ownership of the shares.

STOCKHOLDER PROPOSALS

To be considered for presentation at the Annual Meeting of Stockholders to be held in 1987, a stockholder proposal must be received at the offices of the Company, 19333 Vallco Parkway, Cupertino, California 95014, not later than September 5, 1986.

OTHER MATTERS

The Board of Directors knows of no other business which will be presented to the Annual Meeting. If any other business is properly brought before the Annual Meeting, it is intended that proxies in the enclosed form will be voted in accordance with the judgment of the persons voting the proxies.

Whether you intend to be present at the Annual Meeting or not, we urge you to return your signed proxy promptly.

By order of the Board of Directors,

THOMAS J. KLITGAARD
Secretary

EXHIBIT A

RESTATED CERTIFICATE OF INCORPORATION
OF
TANDEM COMPUTERS INCORPORATED

ARTICLE IV

The total number of shares of stock which the corporation shall have authority to issue is two hundred two million four hundred thousand (202,400,000) shares, of which two million four hundred thousand (2,400,000) shares of the par value of ten hundredths dollars ($.10) each, amounting in the aggregate to two hundred forty thousand dollars ($240,000), shall be preferred stock and two hundred million (200,000,000) shares of the par value of twenty-five thousandths dollars ($.025) each, amounting in the aggregate to five million dollars ($5,000,000), shall be common stock.

The preferred stock may be issued from time to time in one or more series. The Board of Directors is hereby expressly vested with authority to fix by resolution or resolutions the designations and the powers, preferences and relative, participating, optional or other special rights, and the qualifications, limitations or restrictions thereof (including, without limitation, the voting powers, if any, the dividend rate, conversion rights, redemption price, or liquidation preference of any series of preferred stock), to fix the number of shares constituting any such series, and to increase or decrease the number of shares of any such series (but not below the number of shares thereof then outstanding). In case the number of shares of any such series shall be so decreased, the shares constituting such decrease shall resume the status which they had prior to the adoption of the resolution or resolutions originally fixing the number of shares of such series.

One hundred ninety-six million (196,000,000) shares of the common stock authorized hereinabove are designated "Common Stock" and four million (4,000,000) shares of the common stock authorized hereinabove are designated "Junior Common Stock," such Junior Common Stock to be issuable from time to time in one or more series. The Board of Directors is hereby expressly vested with authority to fix by resolution or resolutions the designations and the powers, preferences and relative, participating, optional or other special rights, and the qualifications, limitations or restrictions (including, without limitation, the voting powers, if any, the dividend rate, conversion rights, redemption price, or liquidation preference) of any series of Junior Common Stock, to fix the number of shares constituting any such series of Junior Common Stock, and to increase or decrease the number of shares of any such series of Junior Common Stock (but not below the number of shares thereof then outstanding). In case the number of shares of any such series of Junior Common Stock shall be so decreased, the shares constituting such decrease shall resume that status which they had prior to the adoption of the resolution or resolutions originally fixing the number of shares of such series.

The number of authorized shares of any class or classes of stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the stock of the corporation entitled to vote in the election of directors.

"Companies worldwide have discovered that Tandem's architecture for on-line transaction processing frees them to solve the more difficult and important computing problems now. This has led to Tandem's outstanding financial performance in 1986 and represents the company's fundamental strength. Tandem's solution brings the future to its customers today."

Carol E. Muratore
Vice President
Morgan Stanley & Co. Incorporated
December, 1986[1]

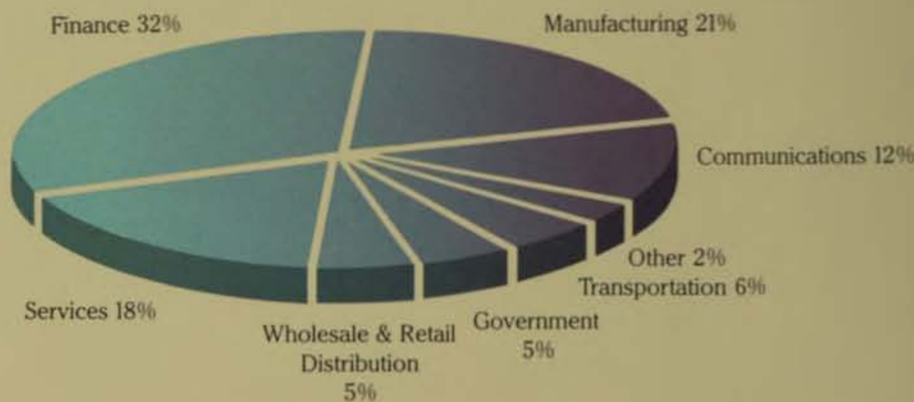
Tandem Computers Incorporated, founded 12 years ago, today ranks as a Fortune 500 company and employs over 5,700 people worldwide. It is a leading supplier of computer systems and networks for on-line transaction processing. Tandem systems are used widely to run ATM and point-of-sale networks, stock exchanges, factories, and other enterprises where hundreds of business transactions must be processed each second and recorded instantly. Tandem provides a fully compatible family of systems that spans the range of performance requirements for on-line transaction processing applications. The systems can run the same applications and can be networked with each other and with equipment from many other vendors to provide a single computing resource for an organization. Tandem supports its customers from over 130 locations worldwide and manufactures its products in the United States, Mexico, and West Germany.

Highlights

Fiscal Year Ended September 30	1986	1985	1984
Revenue	$767,793,000	$624,138,000	$532,620,000
Operating income	$105,978,000	$ 50,081,000	$ 51,101,000
Operating margin	13.8%	8.0%	9.6%
Net income	$ 63,766,000	$ 34,374,000	$ 42,908,000
Earnings per share	$1.44	$ .82	$1.04
Working capital	$385,220,000	$298,611,000	$263,403,000
Total assets	$705,025,000	$552,344,000	$501,873,000
Stockholders' investment	$534,680,000	$420,408,000	$375,122,000
Number of employees	5,719	5,494	5,223

Revenue by Industry

(Fiscal 1986; amounts may not total due to rounding.)



Tandem Computers "is a true original in a world of look-alikes. Though all computer makers strive mightily for product differentiation, they tend to come up with variations on a very few themes. Tandem has parlayed a unique computer architecture into an almost unmatchable position in the specialized world of transaction processing."

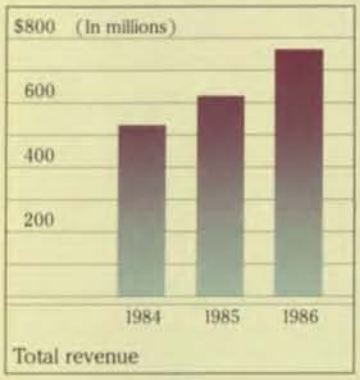
Electronics
April 14, 1986 [2]

To Our Stockholders:

Fiscal 1986 was a good year for Tandem. Despite a difficult environment for the computer industry, our year-end results set records in both revenue and earnings. Compared to fiscal year 1985, revenue grew 23 percent to $768 million and earnings per share grew 76 percent to $1.44. We ended the year with a record cash balance of $240 million. ■ Our strong financial performance is the result of strengthening our marketing organization; introducing many products based on new, leading-edge technology; and improving productivity throughout the company, particularly in manufacturing. ■ *Marketing Focus:* Early in fiscal 1986, we reorganized and strengthened our marketing organization, and we have begun to see positive results. Productivity in our U.S. sales organization has improved. Our revenue growth rate increased over fiscal 1985. We are adding customers and increasing penetration of existing accounts. In addition, many customers have begun to build strategic networks using Tandem products. ■ During 1986, we broadened our emphasis on strategic relationships with other companies to leverage our internal resources and bring solutions to market faster. For example, to reach smaller businesses outside of our traditional customer base, we began to develop value-added reseller distribution channels. We worked with independent software companies to increase the quantity and quality of third-party software. More than 200 companies now provide software solutions for Tandem system users. ■ We made equity investments in two companies that support our long-term industry strategies, one in telecommunications and the other in manufacturing. To broaden markets in specific geographic areas, we formed a joint venture company in Japan and entered into

Thomas J. Perkins (left), Chairman of the Board; James G. Treybig, President and Chief Executive Officer.

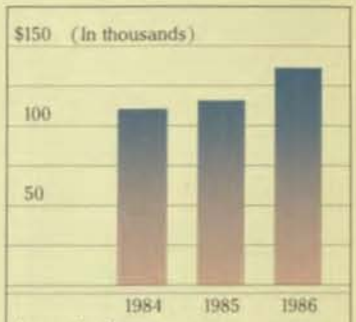
(*Includes $.24 benefit from DISC tax reversal.)



negotiations to establish joint venture companies in the Netherlands and Australia. We also entered into several strategic joint development agreements to leverage the technologies of other companies. ■ *New Products, Advanced Technology:* The unique architecture of Tandem systems has given the company a fundamental advantage in the marketplace. During 1986, we significantly strengthened this advantage with the introduction of new technology. We began investing in the development of semi-custom bipolar and CMOS gate array technology six years ago. This investment not only produced important new products during 1986, but it also provided Tandem with the automated design tools and facilities necessary to reduce development time for future products. ■ The successful introduction of our new high-end NonStop VLX system in April marked the first of several Tandem processors that will be based on gate array technology. The VLX system processes more transactions per second than many of the industry's largest mainframe computers. Its bipolar gate array technology and expert-system based diagnostic capability reduce service costs by two-thirds on a per-transaction basis for customers who select our remote support option. ■ *Management Focus:* In 1986, we achieved substantial productivity improvements in manufacturing as part of our long-term strategic plan. We also initiated new budgeting, asset management, and review processes that have improved revenue forecasting and expense control. These new processes, combined with increased employee efforts, enabled us to achieve a 23 percent revenue gain with only a 4 percent increase in hiring. ■ We strengthened Tandem's management team and board of directors. Walter B. Wriston, Chairman of the President's Economic

Tandem designs and develops gate array technology for use in many new products.

Policy Advisory Board, joined our board of directors. Mr. Wriston retired in 1984 from Citicorp, where he was Chairman and Chief Executive Officer. His experience in managing a multibillion-dollar corporation, plus his extraordinary grasp of the benefits that technology can bring to large organizations, will be of tremendous value to Tandem as we go forward. ■ Three senior individuals joined Tandem as vice presidents for strategic planning, management information systems, and Austin Operations. In recognition of the growing importance of international sales, third-party marketing, and new ventures, three individuals were promoted to newly created vice presidential positions. ■ *Outlook:* Fiscal 1987 will be another year of important product introductions. We plan to announce systems with low entry prices to extend the Tandem network to the individual store, to the branch bank, to the manufacturing cell, and to the departments of large corporations. One of these new systems will be based on custom CMOS technology and also will feature semi-custom CMOS gate arrays and 680X0 microprocessors in input/output controllers. In addition to new systems, we plan to announce new storage products, communications products, and printers. ■ Fiscal 1987 will be a significant year for software. Products in development build on the unique capabilities of the GUARDIAN 90 operating system and we believe they will establish a new standard in software technology for on-line transaction processing. Tandem believes it will advance the state of the art in database technology with the announcement of a relational database that implements the emerging industry-standard interface, SQL. This new product will be optimized for high-performance, distributed on-line transaction processing, and we believe it will



Annualized revenue per average employee


The Tandem NonStop VLX system improves performance and reduces service costs.

be the industry's first SQL database to allow on-line updates with transaction integrity for data distributed across networks. We also plan to announce products for network and system management that are implemented within a common architecture. ■ Strategic relationships will become more important as we target new opportunities with lower cost, departmental systems. We will continue to develop value-added reseller distribution channels to reach smaller businesses outside of our traditional customer base. Through strategic third-party relationships, we plan to increase the quality and quantity of application solutions. ■ We will continue our efforts to improve productivity throughout the company. In addition, we plan to strengthen our systems analyst organization, as well as our capabilities in management information systems, human resources, and project management. ■ We believe that the fundamental trends in the marketplace favor Tandem. With the planning and review programs that are in place, we anticipate another good year.

The Tandem XL8 disk storage facility (right) won the prestigious Hannover Faire "Good Industrial Design" award during 1986. The V8 disk storage facility (left) won the "Industrial Design Magazine 1985 Design Review Award" for excellence in industrial design.

Sincerely,

James G. Treybig
President and Chief Executive Officer

Thomas J. Perkins
Chairman of the Board

December 9, 1986

The powerful Tandem 6AX workstation, introduced in fiscal 1986, can operate as a stand-alone workstation or as a fully integrated system terminal.


ALBERTA

"We believe that Tandem will displace many traditional computer vendors and become one of the major, surviving computer companies. Although Tandem has historically been associated with a limited market niche – fault-tolerant systems – we think that Tandem's unique computer architecture makes it better suited for the broad, mainstream commercial market."

Jonathan Fram
Bear, Stearns & Co. Inc.
June 11, 1986 [3]

▲ In Ottawa (from left): Bjorn B. Ahlblad, President of Tandem Computers Canada Limited, with Alan Walter, Vice President of Bell Canada, and Robert Radcliffe, Ottawa Branch Manager of Tandem Computers Canada Limited.

◀ In the large photo is the National Network Operations Center of Telecom Canada.

Bell Canada runs its iNet ("intelligent network") and other networks, including Envoy electronic mail and a nationwide credit authorization system, on Tandem systems because "these are public networks and we demand the same degree of availability as we expect from our central office exchanges." Bell Canada's iNet offers significant growth opportunities for the company beyond its traditional role of simply transmitting voice and data information. The value-added public network, inaugurated in 1982 and offered nationally through all other members of Telecom Canada, provides business users easy access to a variety of interactive databases.

Dynamic Marketplace

Tandem's marketplace, on-line transaction processing (OLTP), is one of the fastest growing marketplaces in commercial data processing. In businesses and financial institutions worldwide, OLTP systems and networks are being used as competitive weapons to deliver new customer services electronically, to collect and process business transactions, and to run operations profitably.

"Increasingly, the very viability of retail stores, banks, brokerage houses, airline reservation offices, and manufacturing plants – in short, vast segments of the U.S. economy – depends on machines that

Tandem's "fault-tolerant design is now offering a new payoff: a powerful role in distributed computing and networking, two of the high-growth markets of the 1980s."

Electronics, *April 14, 1986* [4]

conduct rapid-fire transactions as they occur, not overnight in a windowless back office," wrote *Business Week* on July 14, 1986. "If on-line machines didn't exist, banks would have to hire more tellers, the stock markets couldn't handle anywhere near their current volume, and lines at airline ticket counters might stretch around the corner." [5]

The market demand is for networks of on-line transaction processing systems that can collect and process transactions generated by hundreds of devices, and that can speed up and ensure the delivery of money, stocks, bonds, news, messages, and many other goods and services. Tandem was first to recognize and fulfill this market demand.

Today, Tandem systems offer a unique blend of features that enable them to process growing numbers of transactions across networks, integrate devices from other vendors, provide data accuracy, expand modularly, minimize downtime, deliver up-to-the-minute reports, and allow users to interact with a network as easily as if it were a single, centralized system.

Tandem Is an Industry Leader

According to a Merrill Lynch investment research report dated May 5, 1986, Tandem "is the leading supplier of high availability transaction processing systems. Tandem's NonStop systems have met excellent user acceptance, building a substantial customer base in over 1,000 major enterprises worldwide.... The company has important strengths in its large user base and expertise in large-scale computer networking. In our view, these strengths ensure a continued leadership role for Tandem." [6]

In the view of the Gartner Group, a respected market research company, "Tandem Computers is the leading player, behind IBM, in the on-line transaction processing (OLTP) market, one of the fastest

Chances are, you have used a Tandem computer if you...

...read a major city newspaper

growing markets in the information processing industry.... Tandem has successfully challenged IBM in the financial services OLTP business, which is an extremely dynamic business as a result of bank deregulation, brokerage consolidations, and [a] rash of mergers and acquisitions." [7]

OLTP Is Mainstream

Unlike traditional mainframe data processing, where data is stored at a central computing facility and is processed only at specific times, OLTP updates data to reflect changes as they occur. The power of this concept is that it matches the flow of business operations, transaction by transaction.

According to Omri Serlin, a prominent computer industry analyst, "OLTP applications are in the mainstream of the business they serve. Sometimes they are the business. More often than not, they are the major tool the business uses to offer revenue-generating services to customers, or to run day-to-day operations." [8]

OLTP Market Grows

"Since 1981, when on-line transaction processing accounted for less than one-third of new sales, the market has grown in size and importance to more than $17 billion in worldwide revenue in 1985. As the effective cost per transaction continues to shrink, this market will grow to more than 70 percent of new business computer system revenue (not necessarily unit replacements), or $35 billion in 1990," according to a 1986 report from Dataquest, a leading market research company.

Commenting on the forces for growth, Dataquest observed, "The service sector of the economy is growing much faster than the manufacturing sector,

> *"Tandem is very focused, dedicated to providing high-value-added products to the transaction-processing marketplace.... This focus, plus Tandem's product breadth, should keep it one of the industry's bright spots during the next three to five years."*
>
> *Goldman, Sachs & Co., October 13, 1986* [9]

and on-line transaction processing lends itself to service businesses such as telemarketing, insurance, and banking. Service companies see OLTP as a way to gain a competitive advantage. Typical applications include automated teller machines, electronic funds transfer, credit authorization, directory assistance, manufacturing shop floor control, and reservation systems." The report concluded, "The on-line transaction processing market will continue to grow as more applications are developed and more batch applications are converted to on-line." [10]

...run a business or a factory


ROSS

"With Tandem, we now have a strategic network foundation in place to support our growth and help us capture market share."

Peter C. M. Hart
Vice President of Management
Information Systems
Ross Stores, Inc.
1986

▲ In California: Peter C.M. Hart (left), Vice President of Management Information Systems, Ross Stores, Inc., with Ross's President and Chief Executive Officer Donald E. Rowlett.

◀ At Ross Stores, Inc., a point-of-sale network from Tandem links 1,400 cash registers in 147 stores to inventory and distribution systems and to credit authorizers throughout the United States. The network supports Ross's aggressive plans for growth, helps Ross enhance customer service, and allows Ross to communicate electronically with stores, while preserving its significant investment in point-of-sale devices and in-store controllers.

Customer Highlight

Retailing, like many industries, is highly competitive and cost-conscious. It is an industry where on-line transaction processing (OLTP) and point-of-sale networks are becoming key strategic tools for success.

At Ross Stores, Inc., of Newark, California, OLTP is a key ingredient in the company's plans for future growth. In less than five years, Ross has become the third largest off-price fashion retailer in the U.S., and it has one of the lowest operating costs as a percentage of sales in the industry.

The point-of-sale networking solution Ross uses is from Tandem. It links 1,400 cash registers in 147 stores to inventory and distribution systems and to credit authorizers throughout the U.S. On-line access to the latest sales and inventory information gives Ross a competitive edge in controlling its business, says Peter C. M. Hart, Ross's Vice President of Management Information Systems.

"From the beginning, we have taken a different view of computer technology. To us, computer technology–particularly on-line transaction processing–is a strategic business weapon. Indeed, certain parts of our growth plan and corporate philosophy could not exist without the help of OLTP," Hart said.

Technology Is Critical to Success

"Our business is off-price fashion retailing. We provide the same quality name-brand and designer merchandise as the big department store chains, but at 20 percent to 60 percent less cost to the customer.

"We operate on very low margins, so profitability and growth in our business depend on how well we serve our customers and how well we manage merchandising. Our corporate motto, 'Dress for Less,' attracts new customers, but to keep them coming back, we have to provide great service and continue to offer quality and value.

"Now that the Tandem network is in place, we are planning new ways to use it that will cut some of our operating expenses and make communications with our stores much more efficient and timely."

Peter C. M. Hart
Ross Stores, Inc.

"Not long ago, we faced a dilemma in our processing that illustrates the critical role that technology plays in our success.

"We were using six NCR [Corporation] minicomputers to provide credit authorization and to collect the point-of-sale information we need to drive our merchandising process.

"The problem was that we had reached a point where we needed to add more minicomputers to support our growth. But that created a larger problem because the minicomputers couldn't talk to each other or to our inventory and distribution system.

Chances are, you have used a Tandem computer if you...

...purchase gasoline with a credit card or bank ATM card

Instead, each minicomputer generated a tape at the end of each day, which we would mount onto another computer and reformat the data. That process took about 45 minutes per tape, and then we still had to run the batch applications using the new data.

"There simply wasn't enough time to do all that before the next morning, when our buyers need the data – especially during the Christmas season with extended shopping hours.

Network Helps Ross Provide Convenient Shopping

"At that point, we turned to Tandem and one of its independent application software vendors, Signorum [Inc., Fremont, Calif.], for a solution.

"Without replacing any cash registers or in-store controllers, we now have an on-line, point-of-sale transaction processing network from Tandem with StoreLink software that supports 1,400 cash registers in over 140 stores. Not only does it eliminate tapes and feed sales data directly into our host, but it gives us numerous competitive advantages by helping us provide better customer service.

"For instance, we are dedicated to providing 'hassle-free' shopping. When there are three people in a checkout line, we open another register – we don't want our customers to wait. Likewise, they shouldn't be made to wait for credit authorization when they are making a purchase.

"So one of the things our Tandem network allows us to do is monitor the performance of our check and credit card authorizers. I use a terminal to get up-to-the-minute reports about how many authorizations they completed in under five seconds, two seconds, and so on. If the performance of an authorizer is falling below an acceptable level, I contact them immediately and begin fixing the problem. That's just one example of how we use technology to serve our customers better.

"Not only that: for the first time, we can link into multiple credit authorizers. That means we can shop for the best discount rates and support as many different credit cards as we choose. It also means we can make it easy to write checks – even out-of-state checks. We request only a driver's license. That's what 'hassle-free' is all about.

Tandem Provides a Foundation for the Future

"Now that the Tandem network is in place, we are planning new ways to use it that will cut some of our operating expenses and make communications with our stores much more efficient and timely. For instance, we frequently send information via courier to each of our stores. We'll eliminate most of those courier packages in the near future by using the Tandem network to send that same information electronically on a daily basis.

"With Tandem, we now have a strategic network foundation in place to support our growth and help us capture market share," Hart said. "With creativity and a clear sense of what we want our business to be five years from now, we can use our network as a very powerful tool to help us be successful."

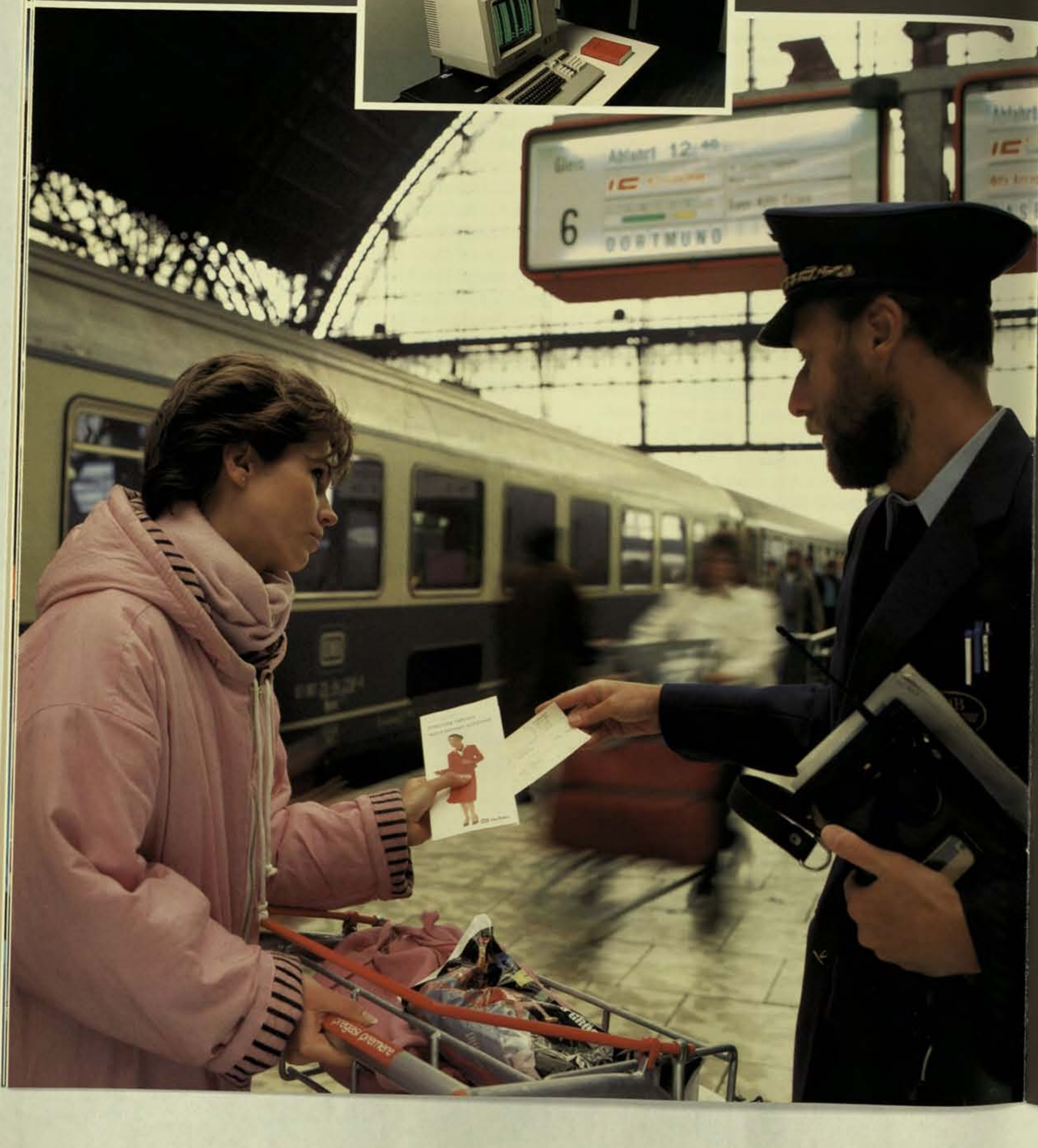
...use an automated teller machine

"The company's emphasis on communications has intensified in recent years, with Tandem scoring significant competitive wins of large-scale networks in banking, retail point of sale and electronic mail."

Merrill Lynch,
Pierce, Fenner & Smith Inc.
April 30, 1986 [11]

Frankfurt: Dr.-Ing. Fritz Timm (left), oject Manager, Seat Reservation Sys-m, Deutsche Bundesbahn, with Rich-d Glück, Project Manager for Tandem mputers GmbH.

e Deutsche Bundesbahn, Germany's tional railway, runs its international servation system on Tandem comput-s to maximize its rolling stock and arantee seats to all passengers. The stem books up to 170,000 reserva-ns daily from 4,500 railway and trav-agent terminals in Western Europe. The avily traveled railway chose Tandem mputers for rapid response time, liability, and modular expandability.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6
DORTMUND

"The company's emphasis on communications has intensified in recent years, with Tandem scoring significant competitive wins of large-scale networks in banking, retail point of sale and electronic mail."

Merrill Lynch,
Pierce, Fenner & Smith Inc.
April 30, 1986"

In Frankfurt: Dr.-Ing. Fritz Timm (left), Project Manager, Seat Reservation System, Deutsche Bundesbahn, with Richard Glück, Project Manager for Tandem Computers GmbH.

The Deutsche Bundesbahn, Germany's national railway, runs its international reservation system on Tandem computers to maximize its rolling stock and guarantee seats to all passengers. The system books up to 170,000 reservations daily from 4,500 railway and travel agent terminals in Western Europe. The heavily traveled railway chose Tandem computers for rapid response time, reliability, and modular expandability.

Unique Parallel Architecture

In the battle for a competitive edge in emerging markets, corporations are using computers to create new computer-based products and services that will generate revenue. But they are finding that their traditional, centralized computers do not provide the distributed networking foundation they need. As a result, many are investing in networks for on-line transaction processing–networks that will deliver new services, move information between incompatible systems, and support unpredictable transaction volumes in the future.

During 1986, Tandem was awarded several contracts to install strategic, large-scale networks for retailers, financial institutions, and other businesses. A key element of Tandem's success in applications such as these is its system architecture.

Tandem's Strength: The System Is a Network

"Others build networks on top of individual processors. Our lowest-level operating system is a network," explained James G. Treybig, President and Chief Executive Officer of Tandem, in the April 14, 1986, issue of *Electronics*. In that same article, *Electronics* described the essence of Tandem's uniqueness:

"The location of a data base or a peripheral is immaterial in a Tandem system, which makes it well-suited for networking. One process communicates with another through packet-switched messages without regard for physical location. The process of creating a network is therefore straightforward." [12]

In a June 11, 1986 investment research report, Bear, Stearns & Co. Inc. described the advantages of Tandem's architecture. Following are excerpts from that report.

"[Tandem's] architecture enables users to: 1) physically and geographically distribute processors and data throughout their organization, yet perceive a single system image; [and] 2) expand the performance of their systems in a much wider range than found in traditional computer designs....

Distributing Programs and Data

"... With Tandem computers, users can physically distribute data and programs throughout their organization. Yet, the user perceives the image of a single system–transparent to the user, the operating system fetches and stores data at remote sites if needed. The user perceives the data to be local....

"The importance of being able to physically distribute processors and data becomes apparent when one realizes that businesses and their employees are geographically dispersed, yet it is desirable to maintain only a single copy of important data. Consider the problem of allocating airline seats from any of 20,000 travel agent locations. While it is imperative not to allocate the same seat at different locations, it is desirable to alter the data from any location. In older systems, each travel agent and ticket counter was tied into where the data resides (at the airline's central computer). We think that the airline industry represents one of the biggest opportunities for Tandem over the next few years....

Chances are, you have used a Tandem computer if you...

...send messages over a public electronic mail network

Expandability Without Degradation

"Unlike today's mainframes, Tandem's machines do not experience performance degradation when multiple processors are strung together.... A Tandem user can achieve a *linear* growth in performance by adding processor modules to the system. [For example, an 8-processor NonStop VLX system processes 80 to 100 transactions per second (TPS), while a 16-processor VLX processes twice as many–160 to 200 TPS.]....

"... In a sense, Tandem's systems are really a form of *parallel processing* for the commercial world.

"The importance of linear performance expandability is better understood by realizing that on-line transaction processing systems tend to grow as the customers' business grows. This stems from the fact that interactive/transaction processing systems generally form the core of the customers' own product offering–the computer becomes part of the customers' competitive repertoire. For example, major stock exchanges use Tandem systems for order execution and reconciliation.... With the burgeoning transaction volumes of recent years, such expandability was a necessary requirement....

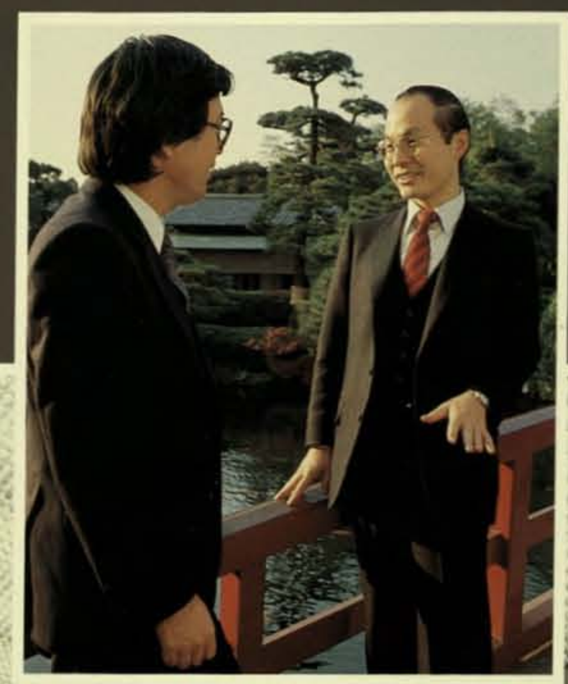
"Finally, the President of the Tandem Users' Group, an independent association, informed us that customers are now purchasing Tandem systems more for their expandability than for fault tolerance....

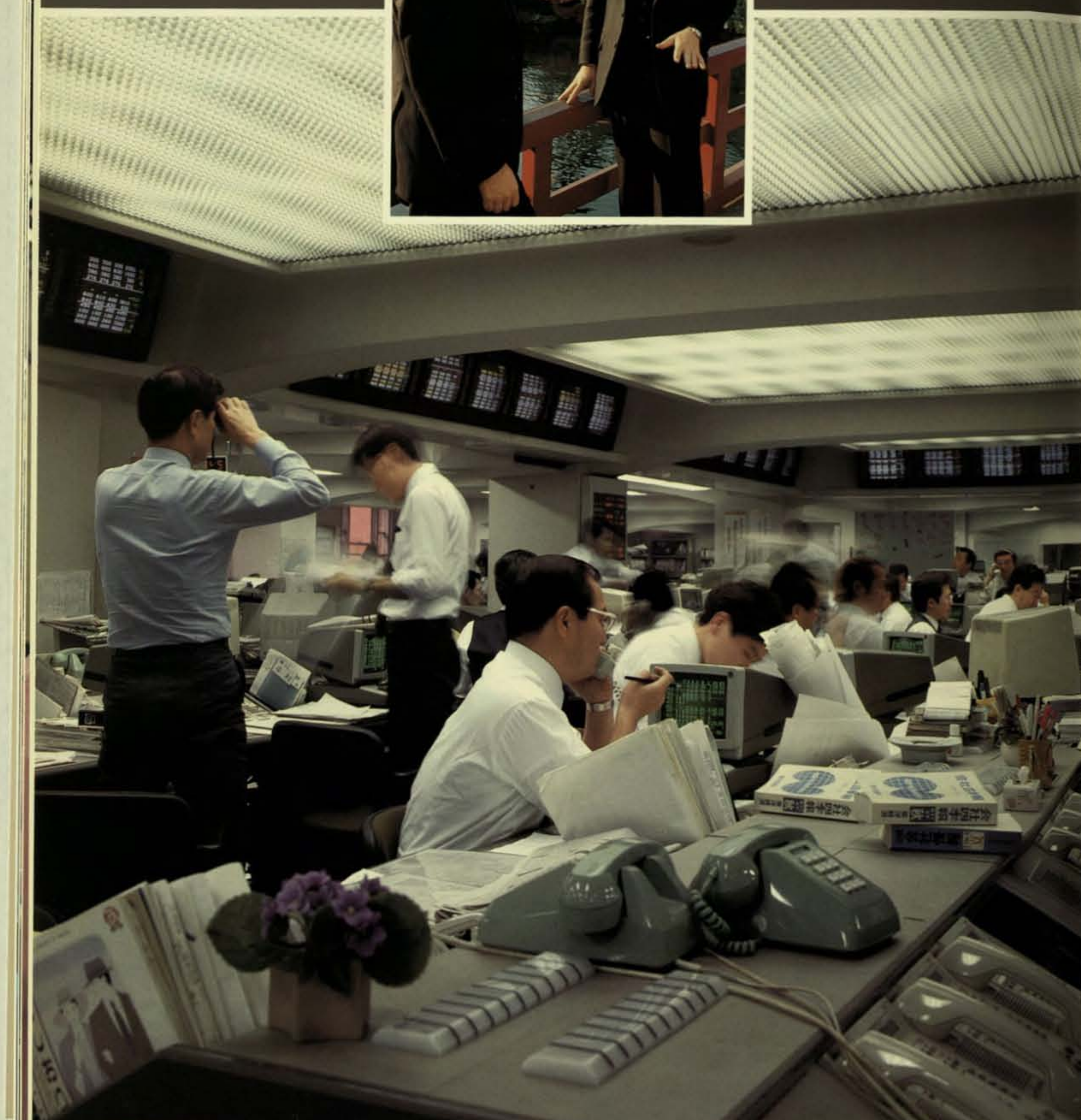
> *"While fault tolerance is certainly a key feature of Tandem's machines, it is only one of many architectural advantages that makes Tandem's systems more suitable than traditional mainframes and minicomputers in the commercial marketplace."*
>
> *Bear, Stearns & Co. Inc., June 11, 1986* [13]

Application Software Solutions

"... When we queried the [Tandem third-party] software houses as to why they chose Tandem, they said that Tandem's architecture allowed the software houses to develop an application that could not be conceived on a conventional mainframe. Over time we believe that Tandem will be able to attract more third-party software vendors than other computer companies because of this unique architecture. [Tandem currently works with over 200 third-party companies.] ... Attracting third-party software vendors who add value to a vendor's machine has become the key to success in the computer industry...." [14]

...make retail purchases with a credit card





"We are dedicated to reducing system maintenance costs by using new technologies to increase product reliability and to offer the highest quality of service to our customers."

James G. Treybig
President and Chief Executive Officer
Tandem Computers Incorporated

▲ In Tokyo: Norio Izumi (left), Country Sales Manager for Tandem Computers Japan, Ltd., with Teiichi Aruga, Deputy General Manager, Network Services Department, Nomura Computer Systems Co., Ltd.

◀ Nomura Securities' main stock trading room is seen in the accompanying photo.

Nomura Securities, Japan's largest brokerage firm and the first Japanese company to use computers, is expanding its competitive advantage with a state-of-the-art value-added network (VAN) that runs on Tandem systems and provides a variety of services to cross-industry clients nationwide through Nomura Computer Systems Co., Ltd. (NCC). More than 30,000 terminals of 60 different types were on-line by the end of 1986, and significant expansion is planned. In its annual report, NCC told its customers it uses Tandem products for the network for enhanced reliability and efficiency. Japan is the world's second largest market for computers.

Comprehensive Support and Service

Tandem's support and service mission has a single goal: to provide the highest quality, most comprehensive assistance available in the industry. At Tandem, this means supplying much more than traditional installation and maintenance.

It means helping customers to design their applications. It means understanding customers' business objectives and configuring networks that will support their goals.

As a result, Tandem staffs its service and support organization with highly experienced people and provides training to keep them informed about the latest technologies. In addition, Tandem sponsors programs to assist customers with application and network design, capacity planning, and benchmarking. Customers who participate in these programs can reduce system costs by fine-tuning system configurations before they are installed.

Education

A key element of Tandem's support philosophy is education. Courses cover everything from daily system operation to application design and development. Instruction is available worldwide through classes, teletraining, computer-assisted learning, or self-paced tutorials.

Supporting Large Networks

Assisting customers with large-scale network design is an important part of Tandem's support strategy. The company recently expanded its Performance Center in Sunnyvale, California, to include a Network Environment Studies Facility for testing customer applications in large networking environments. In addition, Tandem offers consulting and benchmark testing to help customers design applications and networks that are optimized for peak performance and lowest possible cost.

Ongoing Research: High-Performance Systems

Research also is a significant element in Tandem's support philosophy. In Frankfurt, Germany, Tandem operates its High-Performance Research Center, where architectural research is done by studying system requirements for very high-volume transaction processing applications. The knowledge generated is shared with customers to help maximize throughput of their Tandem systems. The knowledge also is shared with Tandem development groups, where it contributes to the design of future high-performance systems.

Support Centers

Located in Austin, Texas; Frankfurt, Germany; and High Wycombe, England are support centers that provide a combination of remote hardware and software support to Tandem customers. All centers are connected electronically via Tandem's worldwide network, allowing customers to call on the expertise of Tandem's support people located around the world.

Chances are, you have used a Tandem computer if you...




...make long distance telephone calls

Through Customer Information Services, Tandem customers worldwide can dial into a Tandem system for up-to-date technical information that is stored on-line.

Flexible, Cost-Effective Service

Tandem's service organization has over 130 locations worldwide to support customers. *Computer/Electronic Service News*, in its August 1986 issue, wrote, "Tandem products span the full range from micros to large mainframes, with all of the associated peripherals. And Tandem has made a name for itself in servicing those products.

Assisting customers with large-scale network design is an important part of Tandem's support strategy.

"Tandem has been servicing its own equipment for more than 12 years. From disk drives to mainframes, from power supplies to operating systems, Tandem has provided maintenance and repair on over 360 products. And now, they have moved into complete networks....

"Large installations have dedicated field service engineers on site. A standard service package usually calls for full coverage from eight a.m. to five p.m., five days per week. This can be extended to include second and third shifts. Total on-site service (requiring seven day, 24-hour coverage) is available. Or, the plan may include full coverage on a specified shift only, with second shift and/or third shift on-call service....

"[A number of products are]... supported with remote diagnostics. No on-site visits are required to troubleshoot either the hardware or software; a CE [customer engineer] goes to the site only when a part replacement or system adjustment is required....

Service Philosophy

"Speaking on the subject of service, James G. Treybig, Tandem President and Chief Executive Officer, stated, 'We are dedicated to reducing system maintenance costs by using new technologies to increase product reliability and to offer the highest quality of service to our customers.' He went on to say that Tandem's use of new technologies in the VLX mainframes, including VLSI circuits, expert system-based diagnostics, and remote support, directly led to... [reduced] maintenance pricing.

"Tandem constantly initiates customer surveys to judge the effectiveness and efficiency of field service. It also regularly gauges customer satisfaction levels with these polls, asking their customers what they want and what they expect from field service....

"The newer VLSI technology used in VLX mainframes has more than doubled system reliability compared to similar Tandem configurations using previous technologies. This has reduced service time, and the cost of service by more than 50 percent– making field service better and better...."[15]




... send money via a public telegraphic service

"OLTP systems can play an important strategic role in keeping a company ahead of its competition."

Computerworld
September 29, 1986[16]

▲ In Melbourne: Grahame Bennett (left), Managing Director for Tandem NonStop Pty. Ltd., with Derek W. Gall, General Manager, Electronic Network Services, Australia and New Zealand Banking Group Limited.

◀ In the large photo is one of the bank's downtown Melbourne branches.

Australia and New Zealand Banking Group Limited (ANZ), Australia's second largest bank, is building a massive, nationwide Electronic Funds Transfer/Point-of-Sale and credit authorization network on Tandem systems as a strategic weapon to combat competition from foreign banks as deregulation changes the financial industry in Australia. ANZ, which chose Tandem for its system's superior growth and networking capabilities, also runs its nationwide ATM network on Tandem systems. All of the four national banks in Australia have Tandem systems at the heart of their operations.

A Strategic Foundation

Today's business environment is undergoing fundamental and dramatic change. Competition is intensifying and industries are being restructured because deregulation and technology are enabling companies to enter new markets. For instance, insurance will be available through banks. Convenience stores will distribute tickets for entertainment and travel. News distribution companies will offer home shopping. And a new class of service companies will emerge and create more competition.

To be successful in this new environment, businesses are beginning to offer computer-based services and products that will change where and how consumers shop, and how they pay for merchandise.

The Future Demands OLTP Networking

New computer uses such as these demand the rapid response and competitive advantages of on-line transaction processing (OLTP). Many computer vendors now market systems for use in OLTP. Most of their offerings are traditional, single-processor or single-memory architectures.

But corporations that want to be competitive in the 1990s are planning for the long term. They are reviewing their technology strategies and are discovering many market-driven reasons why single, centralized computers will not help them compete in the future. First, they must respond to market changes quickly by offering new services faster than the competition. They also must have a low-cost, wide-area distribution system to market products and services in many locations. In short, information delivery networks are becoming vital strategic tools in long-term business strategies.

Tandem Delivers a Competitive Edge

Many businesses with a long-term view are selecting Tandem based solutions. With Tandem, corporations gain easy-to-use tools for developing new computer-based services rapidly–services that are distributed, networked, and on-line. With Tandem systems, corporations can add new customers easily. Modular expansion lets them support growing transaction volumes without rewriting software. In addition, Tandem networking lets corporations open new markets and add users in remote locations quickly. The Tandem architecture lets people interact with data and services on the network as easily as if the network were a single, centralized system.

> *"Tandem's architecture enables customers to do things that cannot be done effectively on other vendors' systems."*
>
> *Bear, Stearns & Co. Inc., June 11, 1986* [17]

Chances are, you have used a Tandem computer if you…





…make stock market transactions

Businesses are uncertain about the future: Does it include changes such as mergers or acquisitions? What new technology will have to be integrated to remain competitive? Because of this uncertainty, corporations want flexibility to merge new technology and business operations into their existing systems. Tandem provides this flexibility. Tandem systems today process transactions generated by hundreds of different electronic devices: mainframes, cash registers, gas pumps, ATMs, facsimile devices, robots on the factory floor, personal computers, ticketing devices, and many others.

Tandem Integrates and Preserves Investments

Over 200 independent companies provide application software and other solutions for Tandem systems. Software companies and Tandem customers can migrate their applications to the next generation of Tandem equipment without reprogramming because Tandem systems are software compatible.

Tandem's support for a wide variety of industry-specific, incompatible devices preserves customers' existing investments in automation.

Many Businesses Select Tandem

Tandem is hard at work in 21 of the top 25 U.S. banks (by assets as of June 30, 1986) and 46 of the top banks outside of the U.S. In Australia, 80 percent of retail electronic funds transfer transactions go through Tandem systems. Over 60 percent of the top U.S. regional automated teller machine interchanges use Tandem systems to switch consumer electronic funds transfer transactions between financial institutions. Nine U.S. and 12 international retailers automate merchandising or distribution functions with Tandem equipment, or have Tandem point-of-sale networks installed. Five major European and several major U.S. automobile manufacturers are using Tandem solutions. Two of the three leading stock exchanges in the world–and 17 others–automate trading or other functions with Tandem equipment.

Businesses are making technology decisions today that will influence their future market positions. Today's decisions will have a critical and strategic impact in the long term. Many businesses select Tandem because Tandem's system architecture meets today's on-line business requirements and establishes a strategic foundation for the future.

> *"Increasingly, the information stored in OLTP systems is not only vital to the corporation itself, it is the corporation's business."*
>
> Computerworld
> *September 29, 1986* [18]





…drive a car manufactured by any of several major automobile companies

"Fiscal 1986 ended on a superlative note for Tandem."

Frederic H. Cohen
L. F. Rothschild,
Unterberg, Towbin, Inc.
November 4, 1986 [19]

▲ In California: Robert E. Berry, Jr., Senior Marketing Representative for Tandem Computers Incorporated, with Deborah A. Coleman, Vice President of Worldwide Operations, Apple Computer, Inc.

◀ Completed Macintosh computers are being readied for shipment in the large picture.

Apple Computer runs its automated domestic manufacturing operations on Tandem systems and is implementing a worldwide Tandem network that will link Tandem processors and Apple Macintosh workstations at manufacturing facilities in Europe, Asia, and the U.S. Apple believes that "information technology in manufacturing is as important to our competitive advantage as is our automated process." Apple selected Tandem primarily for its systems' unique expandability to accommodate growth without impacting operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Tandem Computers is committed to being a technological leader in the expanding market for on-line transaction processing systems and networks. The Company believes that its computer architecture uniquely satisfies the fundamental requirements for such applications. Achieving its goal of technological leadership involves many factors, including strategic market positioning, a commitment to product development, and an organizational structure and philosophy that foster employee productivity and creativity. Further, Tandem believes it is essential to maintain a strong financial position and operating record to allow the Company to maximize its opportunities within this growing market.

Financial Condition

Tandem's already strong financial condition continued to improve throughout fiscal 1986. For the fourth consecutive year, the cash and cash investments balance grew. Cash reached an all-time high of $240 million at September 30, 1986, up from $129 million at the end of fiscal 1985. Key factors contributing to the record cash levels were income from operations, employee purchases of stock, and improved asset management. Net income increased 86 percent over the fiscal 1985 level.

An important part of Tandem's corporate philosophy is to provide all employees with the opportunity to participate in the Company's ownership through employee stock purchase and option programs. As a result of employee participation in these programs, the Company received $45 million in fiscal 1986 and $10 million in fiscal 1985.

Asset management improved as the Company reduced its inventory levels and improved its collection of receivables. Inventories declined 19 percent from the fiscal 1985 year-end level. Inventory days improved to 86 days at fiscal year-end, down from 123 days at the end of fiscal 1985. Accounts receivable days improved to 82 days at fiscal year-end, down from 86 days at the end of fiscal 1985.

From left: Lawrence A. Laurich, Vice President–Engineering; Dennis L. McEvoy, Vice President–Software; Barry E. Young, Vice President–Austin Operations.

From left: Gerald L. Peterson, Vice President–Marketing; Lawrence W. McGraw, Vice President–U.S. Sales Operations.

The Company's financial strategy includes maintaining a sound ratio of current assets to current liabilities and a conservative capital structure. At the end of fiscal 1986, the current ratio was 3.9:1, long-term debt and capital lease obligations were 1.2 percent of total capital, unused lines of credit totaled $65 million, and the equity base was $535 million. Tandem believes this financial strategy provides the maximum near-term and long-term flexibility to utilize a full range of financing alternatives to enable the Company to invest for future growth.

Results of Operations

The following table summarizes the changes in selected operating indicators for the years presented. The percentages on the left show the relationship of various income and expense items to revenue. The percentages on the right measure the year-to-year percentage increases or decreases.

Percent of Revenue				Percent Increase (Decrease)		
1986	1985	1984		1986	1985	1984
100	100	100	Revenue	23	17	27
32	38	40	Cost of revenue	3	11	23
11	12	10	Research and development	21	36	34
43	42	40	Marketing, general and administrative	25	23	39
14	8	10	Operating income	112	(2)	3
1	1	1	Interest income, net	36	21	610
15	9	11	Pretax income	103	—	11
7	4	4	Current tax provision	131	(5)	17
		(2)	DISC reversal			
8	6	6	Net income excluding DISC reversal	86	4	8
8	6	8	Net income	86	(20)	39
			Earnings per share excluding DISC reversal	76	3	5
			Earnings per share	76	(21)	37

Amounts may not total due to rounding.

Revenue

The rate of revenue growth in fiscal 1986 surpassed that of fiscal 1985, although it was lower than that of fiscal 1984. The rate of revenue growth in fiscal 1986 improved as the Company strengthened its position as a major supplier in the on-line transaction processing marketplace. Significant new products introduced during the fiscal year had a positive influence on revenue growth. While demand in the United States was relatively weak, international demand was strong.

Tandem's revenue gains over the past three years result from increased shipments of its hardware and software products to new and existing customers and from increases in the number of customers using its support and training services. The Company's total revenue in fiscal 1986 increased $144 million, or 23 percent, over fiscal 1985. Revenue in fiscal 1985 increased $92 million, or 17 percent, over fiscal 1984. International business, led

From left: Stephen C. Schmidt, Vice President–Operations; Michael K. Bateman, Vice President–Third-Party Marketing; Robert C. Marshall, Senior Vice President and Chief Operating Officer.

by Europe, continued to grow more rapidly than domestic business in fiscal 1986. The percentage of total revenue contributed from international operations reached 40 percent, compared with 33 percent in fiscal 1985 and 31 percent in fiscal 1984.

Operating Income

Operating income as a percentage of revenue increased significantly in fiscal 1986 compared with the prior two fiscal years. The improving trend in operating income is primarily attributable to higher gross profit margins. Cost of revenue as a percentage of total revenue declined sharply. Research and development expenditures as a percentage of total revenue declined slightly compared to fiscal 1985, largely because certain software development expenses were capitalized in fiscal 1986 (see Notes to Consolidated Financial Statements). Marketing, general, and administrative expenditures increased modestly as a percentage of total revenue.

From left: Alois J. Strnad, Vice President–Management Information Systems; David J. Rynne, Vice President and Chief Financial Officer; Jeanne D. Wohlers, Vice President and Corporate Controller; Richard A. Lamb, Treasurer.

The Company increased its research and development expenditures to support an active product introduction schedule. Tandem's product development activities focus on meeting the needs of computer users who are implementing on-line systems at single sites and in geographically distributed information processing networks. The Company believes that the opportunities for technological innovation in this marketplace are substantial and, therefore, has increased its investment in research and development each year since its founding. The Company expects to increase expenditures on research and development in fiscal 1987.

The Company's marketing strategy focuses on selling to large organizations that are implementing major on-line transaction processing applications. Providing a high level of service and support is essential to meeting the needs of this customer base. To maximize its long-term opportunities in this marketplace, Tandem has built a direct selling and support organization in industrial markets throughout the world. The Company's direct sales activities are comple-

From left: Thomas J. Klitgaard, Vice President, General Counsel and Secretary; Jan E. Jensen, Vice President–Human Resources; Gerald D. Held, Vice President–New Ventures; Donald E. Fowler, Vice President–Strategy and Corporate Development.

mented by relationships established with third-party application software developers, equipment remarketers, and distributors.

Marketing, general, and administrative expenses have increased as a percentage of revenue over the past three fiscal years as the Company has continued to build its marketing organization and to develop marketing relationships with third parties to foster future growth. The products introduced during this period resulted in increased marketing costs to bring the products to market and to train new and existing sales, service, and support personnel.

The improvement in the ratio of cost of revenue to total revenue is attributable to a number of factors: Tandem continued its successful programs to increase the efficiency of its manufacturing and service operations. The Company sold a favorable mix of products, including a high ratio of newer products. These products incorporate new technology that provides greater performance at lower cost. The weakness of the U.S. dollar against European currencies had a favorable impact on the cost of revenue ratio.

The 23 percent increase in revenue for fiscal 1986 was achieved with only a four percent increase in employment. Total employment at fiscal year-end was 5,719. The Company expects that, in order to support a higher level of revenue, it will be required to add a greater number of new employees in fiscal 1987.

Net Income and Earnings Per Share

The rate of change in net income has differed from that of operating income over the past three years because of the factors discussed above and because of changes in the Company's net interest income and effective tax rate. This year, net interest income was more than $2 million higher than in fiscal 1985 and more than $3 million higher than in fiscal 1984. While prevailing interest rates continued to decline, the effect has been offset by continuing growth in the amount of interest-earning cash investments.

Net income comparisons for the three years are distorted by a one-time tax benefit recorded in fiscal 1984. In that year, $9.7 million of taxes that had been accrued on earnings of the Company's Domestic International Sales Corporation (DISC) were reversed.

The effective tax rate in fiscal 1986 was 44 percent, compared with rates of 39 percent in fiscal 1985 and 24 percent in fiscal 1984. The effective tax rate in fiscal 1986 was higher than that in fiscal 1985 primarily because of higher levels of pretax income and a reduction of the research and development credit. The Company expects

From left: Robert F. Hoogstraten, Vice President and Managing Director – European Division; Michael C. Moore, Vice President and Intercontinental Division Manager; Jack W. Chapman, Vice President – International Sales Operations.

the Tax Reform Act of 1986 to have an immaterial impact on the fiscal 1986 effective tax rate.

The effective tax rate in fiscal 1984 was lower than that in fiscal 1985 primarily because of the $9.7 million DISC benefit.

Earnings per share in fiscal 1986 were $1.44, compared with earnings per share in fiscal 1985 of $.82 and in fiscal 1984 of $.80 (net of the $.24 per share benefit from the DISC tax reversal). In each of the three years, the growth in earnings per share differed from that of net income because of a higher number of weighted average shares outstanding.

Effect of Inflation

Please see page 39 of this report for a discussion of the effect of changing prices on the Company's operations.

From left: Thomas Lyman Chun, Vice President – Corporate Projects; George C. Eckert, Vice President – Major Projects Management.

SELECTED FINANCIAL DATA

For the Five Years Ended September 30, 1986

(In thousands except per share amounts)	1986	1985	1984	1983	1982
Revenue	$767,793	$624,138	$532,620	$418,282	$312,143
Cost of revenue	247,871	240,148	215,692	175,646	120,390
Research and development	86,614	71,577	52,514	39,168	33,642
Marketing, general and administrative	327,330	262,332	213,313	153,697	117,403
Operating Income	105,978	50,081	51,101	49,771	40,708
Interest income, net	8,504	6,269	5,183	730	6,033
Provision for income taxes					
Current period	(50,716)	(21,976)	(23,076)	(19,696)	(16,885)
Benefit of DISC tax reversal	—	—	9,700	—	—
Net Income	$ 63,766	$ 34,374	$ 42,908	$ 30,805	$ 29,856
Earnings Per Share	$ 1.44	$ .82	$ 1.04	$ .76	$ .76
Total Assets	$705,025	$552,344	$501,873	$415,525	$337,366
Long Term Debt and Capital Lease Obligations	$ 6,526	$ 12,412	$ 17,155	$ 23,957	$ 21,102
Stockholders' Investment	$534,680	$420,408	$375,122	$310,993	$250,988

Auditors' Report

To Tandem Computers Incorporated:

We have examined the consolidated balance sheet of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1986 and 1985 and the related consolidated statements of income, stockholders' investment and changes in financial position for each of the three years in the period ended September 30, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1986 and 1985, and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

San Jose, California,
October 28, 1986.

Arthur Andersen & Co.

CONSOLIDATED STATEMENT OF INCOME

For the Three Years Ended September 30, 1986

(In thousands except per share amounts)	1986	1985	1984
Revenue			
Product revenue	$618,357	$515,109	$448,611
Service and other revenue	149,436	109,029	84,009
Total revenue	767,793	624,138	532,620
Costs and Expenses			
Cost of revenue	247,871	240,148	215,692
Research and development	86,614	71,577	52,514
Marketing, general and administrative	327,330	262,332	213,313
Total costs and expenses	661,815	574,057	481,519
Operating Income	105,978	50,081	51,101
Interest expense	(1,979)	(2,407)	(2,642)
Interest income	10,483	8,676	7,825
Income Before Income Taxes	114,482	56,350	56,284
Provision For Income Taxes			
Current period	(50,716)	(21,976)	(23,076)
Benefit of DISC tax reversal	—	—	9,700
Total provision for income taxes	(50,716)	(21,976)	(13,376)
Net Income	$ 63,766	$ 34,374	$ 42,908
Earnings Per Share	$ 1.44	$ .82	$ 1.04
Weighted average shares outstanding	44,201	41,765	41,399

Because of the Company's method of operation, it is not practical or meaningful to report the cost of service and other revenue as a separate line item.

The accompanying notes are an integral part of this statement.

CONSOLIDATED BALANCE SHEET

As of September 30, 1986 and 1985

(In thousands except share amounts)	1986	1985
Assets		
Current Assets		
Cash and cash investments	$239,819	$128,676
Accounts receivable, net of allowances of $7,292 in 1986 and $3,479 in 1985	197,658	163,378
Inventories	64,229	78,962
Prepaid expenses and other	17,505	10,746
Prepaid income taxes	—	3,655
Total current assets	519,211	385,417
Property, Plant and Equipment, at cost		
Land and buildings	38,652	25,398
Machinery and equipment	62,302	55,669
Computer equipment and spares	137,388	119,982
Leasehold improvements	34,270	32,363
Construction in process	9,513	7,932
	282,125	241,344
Accumulated depreciation and amortization	(107,103)	(80,746)
Net property, plant and equipment	175,022	160,598
Other Assets	10,792	6,329
Total Assets	$705,025	$552,344

Liabilities and Stockholders' Investment		
Current Liabilities		
Accounts payable	$ 50,768	$ 33,377
Accrued liabilities		
Wages, payroll taxes and employee benefits	34,132	28,196
Income taxes	21,670	—
Other accrued liabilities	21,452	18,184
Current portion of long term debt and capital lease obligations	5,969	7,049
Total current liabilities	133,991	86,806
Long Term Debt and Capital Lease Obligations	6,526	12,412
Deferred Income Taxes	29,828	32,718
Stockholders' Investment		
Common stock, $.025 par value, authorized 200,000,000 shares, outstanding 43,918,756 in 1986 and 41,386,572 in 1985	1,098	1,035
Additional paid-in capital	289,441	238,998
Retained earnings	244,141	180,375
Total stockholders' investment	534,680	420,408
Total Liabilities and Stockholders' Investment	$705,025	$552,344

The accompanying notes are an integral part of this balance sheet.

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CONSOLIDATED STATEMENT OF STOCKHOLDERS' INVESTMENT

For the Three Years Ended September 30, 1986

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1983	39,553	$ 989	$206,911	$103,093	$310,993
Sale of common stock under stock option plans	779	19	9,983	—	10,002
Sale of common stock under stock purchase plan	285	7	6,982	—	6,989
Tax benefit from employee transactions in common stock	—	—	4,230	—	4,230
Net income	—	—	—	42,908	42,908
Balance September 30, 1984	40,617	1,015	228,106	146,001	375,122
Sale of common stock under stock option plans	352	10	3,873	—	3,883
Sale of common stock under stock purchase plan	418	10	6,184	—	6,194
Tax benefit from employee transactions in common stock	—	—	835	—	835
Net income	—	—	—	34,374	34,374
Balance September 30, 1985	41,387	1,035	238,998	180,375	420,408
Sale of common stock under stock option plans	2,143	53	39,253	—	39,306
Sale of common stock under stock purchase plan	389	10	5,926	—	5,936
Tax benefit from employee transactions in common stock	—	—	5,264	—	5,264
Net income	—	—	—	63,766	63,766
Balance September 30, 1986	43,919	$1,098	$289,441	$244,141	$534,680

The accompanying notes are an integral part of this statement.

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CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Three Years Ended September 30, 1986

(In thousands)	1986	1985	1984
Funds (Cash and cash investments) at beginning of period	$128,676	$106,862	$ 93,501
Funds Provided from Operations			
Net income	63,766	34,374	42,908
Items not requiring current outlay of funds			
Depreciation and amortization	43,242	35,616	22,741
Deferred income taxes	(2,890)	12,296	(3,544)
Net book value of property, plant and equipment sold or retired	8,742	13,810	6,614
Total provided from operations	112,860	96,096	68,719
Funds Used for Operations			
Increase in accounts receivable	34,280	17,036	26,784
Increase (decrease) in inventories	(14,733)	(13,413)	6,455
Net change in prepaid expenses and non-debt current liabilities	(45,161)	1,795	(25,652)
Investment in property, plant and equipment	65,011	67,568	71,519
Increase (decrease) in other assets, net	5,860	(511)	2,361
Total used for operations	45,257	72,475	81,467
Net increase (decrease) in funds from operations	67,603	23,621	(12,748)
Provided from (Repayment of) External Financings			
Increase (decrease) in long term debt and capital lease obligations, net	(6,966)	(12,719)	4,888
Sale of common stock under employee stock option and stock purchase plans	45,242	10,077	16,991
Tax benefit from employee transactions in common stock	5,264	835	4,230
Total provided from (repayment of) external financings	43,540	(1,807)	26,109
Funds (Cash and cash investments) at end of period	$239,819	$128,676	$106,862

The accompanying notes are an integral part of this statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly-owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition

The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Translation of Non-U.S. Currency Amounts

Assets and liabilities of the Company's subsidiaries which are denominated in the local currency of the subsidiary are translated into U.S. dollars (the functional currency) at year-end exchange rates, except for inventories and property, plant, and equipment, which are translated at approximate rates prevailing when the assets were acquired. Income and expense items are translated at average rates of exchange prevailing during the year, except that cost of goods sold and depreciation are translated at historical rates. Exchange gains and losses are included in current earnings as operating expenses and are immaterial in amount.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include materials, labor, and manufacturing overhead. The components of inventories as of September 30 were:

(In thousands)	1986	1985
Purchased parts and subassemblies	$31,191	$41,434
Work-in-process	12,138	11,176
Finished goods	20,900	26,352
Total	$64,229	$78,962

Income Taxes

The Company accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are generated.

Property, Plant and Equipment

Systems spares (original cost of $34,785,000 and $35,420,000 at September 30, 1986 and 1985, respectively) are depreciated over a five-year period using an accelerated depreciation method. All other property, plant, and equipment are depreciated using the straight-line method. The estimated useful lives are:

Buildings	30 years
Machinery and equipment	5-10 years
Computer equipment and spares	3-7 years
Leasehold improvements	Lease term

Included in the Land and buildings and the Construction in process balances at September 30, 1986 and 1985 are approximately $26,575,000 and $12,789,000, respectively, of costs relating to land and land improvements on a parcel held for future development.

Software Development Costs

During fiscal 1986, the Company adopted the Financial Accounting Standards Board Statement No. 86 which requires the capitalization of certain software development costs. The amount of software development costs included in Other Assets as of September 30, 1986 was $2,982,000, net of amortization of $190,000. The Company does not consider the capitalization of these costs to be material to the fiscal 1986 operating results.

Earnings Per Share

Earnings per common share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of outstanding stock options and a convertible debenture that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

2. Income Taxes

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1986	1985	1984
Federal:			
Current	$26,037	$ 2,950	$13,882
Deferred (Prepaid)	(3,923)	4,610	(10,550)
	22,114	7,560	3,332
State:			
Current	6,880	3,522	4,800
Deferred (Prepaid)	89	423	(297)
	6,969	3,945	4,503
Foreign:			
Current	21,686	12,005	6,197
Deferred (Prepaid)	(53)	(1,534)	(656)
	21,633	10,471	5,541
Total Provision	$50,716	$21,976	$13,376

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1986	1985	1984
Installment sale method for income tax reporting	$(8,043)	$9,752	$ (1,950)
DISC income	—	(6,117)	(6,084)
Accelerated depreciation	447	2,586	2,950
Effect of intercompany profit eliminations	2,048	(90)	(2,178)
Other (including expenses recognized for financial statements, but not for income tax reporting)	1,661	(2,632)	(4,241)
Total Deferred (Prepaid)	$(3,887)	$3,499	$(11,503)

The provision for income taxes differs from the amount obtained by applying the federal statutory income tax rate to income before taxes as follows:

	1986	1985	1984
Federal statutory tax rate	46%	46%	46%
State taxes, net of federal income tax benefit	3	4	4
Investment tax credits	(2)	(3)	(3)
Research and development tax credits	(1)	(8)	(7)
Tax exempt DISC and FSC income	(2)	(4)	(1)
Other	—	4	2
	44	39	41
Benefit of DISC tax reversal	—	—	(17)
Effective Tax Rate	44%	39%	24%

The 1984 benefit of DISC (Domestic International Sales Corporation) tax reversal represents the benefit of deferred taxes previously provided on DISC earnings accumulated prior to the enactment of the Tax Reduction Act of 1984.

The Company established a Foreign Sales Corporation (FSC) effective January 1, 1985.

In fiscal 1986, the Company provided taxes pursuant to tax laws in effect on September 30, 1986. The Company expects the subsequent enactment of the Tax Reform Act of 1986 to have an immaterial impact on the fiscal 1986 effective tax rate.

3. Long Term Debt, Capital Lease Obligations and Other Commitments

Long term debt and capital lease obligations as of September 30 consist of the following:

(In thousands)	1986	1985
5.8% and 8.2% promissory notes payable to a bank in Japanese yen, due October 1986 and March 1987, respectively	$ 3,292	$ 2,573
Convertible subordinated debenture payable to an officer of the Company, bearing interest at 9.5% and due September 1989	1,667	1,667
Industrial revenue bond, bearing interest at 12%, due June 1992	1,000	1,000
Industrial revenue bond, bearing interest at 12.4%, due July 1992 and collateralized by certain equipment.	1,000	1,000
Obligations under capital leases, interest ranging from 4% to 17%, net of imputed interest totaling $749 and $2,648, in 1986 and 1985, respectively	4,735	11,775
Other	801	1,446
	12,495	19,461
Less current portion	5,969	7,049
Long Term Debt and Capital Leases	$ 6,526	$12,412

The $1,667,500 convertible subordinated debenture is convertible into 100,000 shares of Common Stock at a price of $16.675. The debenture becomes convertible as to 25,000 shares each year beginning in September 1986 and is subject to conversion acceleration in the event of certain occurrences.

There were no interest costs capitalized during fiscal 1986. Interest costs of $594,000 and $1,606,000 relating to construction projects were capitalized during fiscal 1985 and 1984, respectively.

The Company has entered into unsecured credit agreements totaling $65,000,000 with several banks for working capital purposes. The agreements provide for revolving borrowings through March 1988, at which time outstanding amounts may be converted to term loans to be amortized through 1991. Domestic borrowings bear interest at or below the banks' prime rates through March 1988 and approximately 1/4% above these rates through 1991. The Company is required to pay a commitment fee of 1/4% per annum. There are no compensating balances required under any of these arrangements.

Certain financial covenants and restrictions are included in the loan agreements. The Company was in compliance with all such covenants and restrictions at September 30, 1986.

The Company has guaranteed payment of loans made to officers totaling $250,000 at September 30, 1986 under a $2,000,000 bank line of credit. In addition, the Company has a $1,667,500 note receivable from an officer included in Other Assets which matures in September 1989 and bears interest at an annual rate of 10%.

The Company leases its headquarters, field offices, certain equipment, automobiles, and most of its operating facilities under operating lease agreements. The Company also has capital leases for certain equipment. Future minimum lease payments as of September 30, 1986 are as follows:

(In thousands)	Lease Obligations	
Fiscal Year	Capital	Operating
1987	$3,210	$ 38,647
1988	1,902	33,047
1989	243	29,545
1990	63	26,739
1991	33	23,268
Thereafter	33	83,954
Total minimum lease payments	$5,484	$235,200

The cost of assets held under capital leases totaled $11,981,000 and $20,504,000 at September 30, 1986 and 1985, respectively, and are included in the Machinery and equipment and Computer equipment and spares classifications in the accompanying Balance Sheet. The accumulated depreciation associated with these assets totaled $8,894,000 and $11,928,000 at September 30, 1986 and 1985, respectively.

Rent expenses were $43,092,000 in 1986, $38,213,000 in 1985, and $36,726,000 in 1984.

4. Capital Stock

The Company's authorized capital stock consists of 2,400,000 shares of preferred stock, 4,000,000 shares of Junior Common Stock, and 196,000,000 shares of Common Stock. At September 30, 1986, 13,258,490 shares of Common Stock were reserved for future issuance under stock option plans, the employee stock purchase plan, and a convertible subordinated debenture. There were no shares of preferred stock or Junior Common Stock outstanding at September 30, 1986.

Preferred Stock Rights

During 1985, the Company declared a dividend of one preferred share purchase right for each then outstanding share of Common Stock. In addition, one right will be issued with each share of Common Stock issued by the Company before the date the rights become exercisable, are redeemed by the Company, or expire on May 17, 1990. The rights will not be exercisable, or transferable apart from the Common Stock, until 10 days after another person or group of persons acquires 20% of the Common Stock or commences, or announces its intention to commence, a tender or exchange offer for at least 30% of the Common Stock. Each right entitles the holder to buy one one-hundredth of a share of a newly created series of preferred stock of the Company, par value $.10 per share, designated as Series A Participating Preferred Stock, at an exercise price of $80.00. In certain circumstances, the right will entitle its holder to purchase a larger amount of preferred stock or stock in an acquiring company.

Stock Option Plans

The Company has employee stock option plans under which permanent employees may be granted options to purchase shares of Common Stock at 100% of fair market value at the time of the grant. Options generally become exercisable six months after the effective date and expire no later than seven years after the effective date. At the discretion of the Board of Directors, options granted under the stock option plans may qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981.

As of September 30, 1986 options for 6,008,986 shares were outstanding at prices ranging from $5.23 to $34.88, with an average price of $22.60. Options for 4,860,946 shares were exercisable as of September 30, 1986. Options for 4,653,538 shares are available for future grant. Options were exercised at prices ranging from $3.96 to $34.88 in 1986, $3.96 to $26.88 in 1985, and $3.92 to $26.88 in 1984.

Employee Stock Purchase Plan

As of September 30, 1986 the Company has reserved 1,605,666 shares of Common Stock for future issuance under its employee stock purchase plan. Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of Common Stock at 85% of fair market value as of the last trading day before or the last trading day of the participation period. Under the second method, the Company may grant to all employees the option to purchase the same number of shares of Common Stock at not less than 85% of fair market value at the grant date. As of September 30, 1986 options to purchase 100,600 common shares at $15.73, 225,000 common shares at $16.15, and 564,700 common shares at $23.91 were outstanding under the second method. Such options are exercisable through February 28, 1987, February 10, 1988, and October 10, 1988, respectively.

5. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three years ended September 30, 1986.

	Geographic Area				
(In thousands)	United States	Europe	Other	Eliminations	Consolidated
1986					
Revenue–Customer	$463,705	$207,670	$ 96,418	$ –	$767,793
Revenue–Intercompany	118,989	–	–	(118,989)	–
Revenue–Total	582,694	207,670	96,418	(118,989)	767,793
Pretax Income	73,716	39,821	1,007	(62)	114,482
Identifiable Assets	541,381	131,853	63,701	(31,910)	705,025
1985					
Revenue–Customer	$417,460	$136,307	$ 70,371	$ –	$624,138
Revenue–Intercompany	111,742	–	–	(111,742)	–
Revenue–Total	529,202	136,307	70,371	(111,742)	624,138
Pretax Income	34,586	15,496	6,555	(287)	56,350
Identifiable Assets	436,835	101,836	47,386	(33,713)	552,344
1984					
Revenue–Customer	$364,873	$109,562	$ 58,185	$ –	$532,620
Revenue–Intercompany	90,850	–	–	(90,850)	–
Revenue–Total	455,723	109,562	58,185	(90,850)	532,620
Pretax Income	46,977	10,842	5,261	(6,796)	56,284
Identifiable Assets	421,974	79,747	31,732	(31,580)	501,873

Intercompany transfers are made at arm's length prices, which include manufacturing profits attributable to United States operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $10,048,000 in 1986, $7,053,000 in 1985, and $5,989,000 in 1984.

6. Contingencies

The Company, along with three present or former principal officers, was named as a defendant in a class action complaint filed in the United States District Court for the Northern District of California on October 23, 1984, purporting to state claims for alleged violations of federal securities laws and pendent state claims arising out of the Company's December 1982 restatement of revenue and earnings for fiscal 1982. The court dismissed the complaint as to the individual defendants in March 1985 with leave to amend. Subsequently, the court granted the defendant's motion for summary judgment and dismissed the suit in September 1985. The plaintiff filed a Notice of Appeal in October 1985. No provision has been made in the accompanying financial statements for possible liability because, in the opinion of management, it is unlikely that the ultimate disposition of the suit would have a material effect on the Company's financial position.

In addition, there are various actions or claims which have been brought or asserted against the Company. Management does not consider them to be material to the Company's financial position.

7. Unaudited Quarterly Financial Data

(In thousands except per share amounts)				
Quarters Ended	Dec. 31	March 31	June 30	Sept. 30
Year ended September 30, 1986:				
Revenue	$170,061	$176,327	$200,853	$220,552
Costs and Expenses				
Cost of revenue	58,844	58,025	61,030	69,972
Research and development	19,817	21,318	22,299	23,180
Marketing, general and administrative	72,085	76,986	86,923	91,336
Total costs and expenses	150,746	156,329	170,252	184,488
Operating Income	19,315	19,998	30,601	36,064
Interest income, net	1,673	2,362	2,054	2,415
Income Before Income Taxes	20,988	22,360	32,655	38,479
Provision For Income Taxes	(9,340)	(9,950)	(14,531)	(16,895)
Net Income	$ 11,648	$ 12,410	$ 18,124	$ 21,584
Earnings Per Share	$ .28	$ .29	$ .40	$ .47
Year ended September 30, 1985:				
Revenue	$159,653	$146,489	$144,165	$173,831
Costs and Expenses				
Cost of revenue	62,021	57,713	56,116	64,298
Research and development	15,127	17,075	18,027	21,348
Marketing, general and administrative	59,996	61,998	69,482	70,856
Total costs and expenses	137,144	136,786	143,625	156,502
Operating Income	22,509	9,703	540	17,329
Interest income, net	1,888	1,573	1,298	1,510
Income Before Income Taxes	24,397	11,276	1,838	18,839
Provision For Income Taxes	(10,369)	(4,435)	550	(7,722)
Net Income	$ 14,028	$ 6,841	$ 2,388	$ 11,117
Earnings Per Share	$ .34	$ .16	$ .06	$ .27

8. Information on the Effects of Inflation (Unaudited)

The Company has provided an adjusted summary of operations and selected financial data in accordance with the Financial Accounting Standards Board Statement No.33, as amended, concerning "Financial Reporting and Changing Prices." This disclosure requirement is experimental and involves considerably more judgment than traditional financial statements and, therefore, should be reviewed with caution.

Inflation-adjusted information was completed using the "current cost" method, which requires the Company to adjust asset values based on specific indices and appraisals.

The method does not allow for inflation adjustments to operating expenses, revenue, or net interest income, nor an adjustment to the tax provision, despite the decrease in pretax income which results from the inflation adjustments. Only the cost of revenue and depreciation expense related to the assets, which are restated for inflation effects, are adjusted.

Depreciation is computed on a straight-line basis, rather than the accelerated basis that is used for some assets in the Company's historical financial statements, because the accelerated method already recognizes some of the effects of inflation.

Net income for fiscal 1986 was lower under the current cost method because of higher depreciation and amortization expense resulting from higher asset values. Companies that hold monetary assets during a period of inflation lose purchasing power. Tandem held net monetary assets during the period, and their purchasing power declined.

Consolidated Statement of Income Adjusted for Inflation

For the year ended September 30, 1986

	In Average 1986 Dollars	
(In thousands)	Historic Cost	Current Cost
Total Revenue	$767,793	$767,793
Cost of revenue, excluding depreciation and amortization	232,944	232,944
Other costs and expenses, excluding depreciation and amortization	385,629	385,629
Depreciation and amortization	43,242	46,311
Interest (income), net	(8,504)	(8,504)
Provision for income taxes	$ 50,716	$ 50,716
Net Income	$ 63,766	$ 60,697
Increase in value of inventories, property, plant and equipment held during the year:		
Measured in general prices		$ 4,534
Measured in specific prices		(3,677)
Excess of increase in general price level (constant dollars) over increase in specific prices		$ 8,211

At September 30, 1986, current cost of inventory was $64,343,000 and current cost of property, plant and equipment, net of accumulated depreciation was $183,490,000.

Five Year Comparison of Selected Financial Data Adjusted for Inflation

(In thousands except per share amounts)

	In Average 1986 Dollars				
	1986	1985	1984	1983	1982
Total revenue					
Constant dollars	$767,793	$639,575	$565,995	$462,669	$357,218
Current cost information					
Net income	$ 60,647	$ 32,234	$ 44,761	$ 32,449	–
Earnings per share	$ 1.37	$ .77	$ 1.08	$ .80	–
Net assets at year-end	$538,553	$444,269	$406,261	$345,589	–
Excess of increase in general price level (constant dollars) over increase in specific prices	$ 8,211	$ 4,531	$ 831	$ 1,273	–
Other information					
Decrease in purchasing power of net monetary items	$ 4,191	$ 5,466	$ 5,814	$ 3,115	–
Market price per share at end of period	$ 33.70	$ 14.51	$ 16.82	$ 38.51	$ 25.39
Average CPI (1967=100)	327.3	319.4	308.0	295.9	286.0

Tandem Stock Price

Calendar Quarter Price		High	Low
1986	3rd Quarter	39 1/2	27 3/4
	2nd Quarter	34 1/8	22 5/8
	1st Quarter	26 7/8	19 1/2
1985	4th Quarter	23 7/8	12 7/8
	3rd Quarter	18 5/8	13 1/8
	2nd Quarter	23 7/8	14 1/2
	1st Quarter	28 5/8	17 5/8
1984	4th Quarter	20 1/8	14 3/4
	3rd Quarter	24 3/4	13
	2nd Quarter	30 5/8	16 1/4
	1st Quarter	40 1/4	30

Tandem Computers Incorporated is traded via the NASDAQ National Market System under the trading symbol TNDM. All quotations shown represent the high and low sale prices. The company has not declared or paid any cash dividends on its Common Stock and has no plans to do so in the foreseeable future.

TEXT REFERENCES

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4. See note 2 above.
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7. Gartner Group, Inc., Stamford, Conn., "Tandem Moves Into High Gear," *Inside Gartner Group This Week* (August 20, 1986): 8-9. ©1986 Gartner Group, Inc. Reprinted by permission.
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12. See note 2 above; pp. 39-40.
13. See note 3 above.
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15. Ron Levine, "Tandem Computers, Inc.[orporated] - This Fault Tolerant Computer Maker Concentrates on Advanced Service Technologies As Well," *Computer/Electronic Service News* (August 1986): 61-63. © 1986 CESN Publications, Inc. Reprinted by permission.
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17. See note 3 above; p. 3.
18. See note 16 above.
19. Frederic H. Cohen and Walter J. Winnitzki, L. F. Rothschild, Unterberg, Towbin, Inc. Investment Viewpoint coded T-42 (November 4, 1986): 53. © 1986 L. F. Rothschild, Unterberg, Towbin, Inc. Reprinted by permission.

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Board of Directors

Thomas J. Perkins,
Chairman of the Board;
General Partner,
Kleiner, Perkins, Caufield & Byers

Morton Collins,
General Partner, DSV Associates

Thomas J. Davis, Jr.,
General Partner, Mayfield Fund

Franklin P. Johnson, Jr.,
Chairman, Asset Management Company

Andrew Knight,
Chief Executive, *The Daily Telegraph*

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer,
Tandem Computers Incorporated

Robert G. Stone, Jr.,
Chairman of the Board,
Kirby Exploration Company

James G. Treybig,
President and
Chief Executive Officer,
Tandem Computers Incorporated

Thomas I. Unterberg,
Chairman and
Chief Executive Officer
L.F. Rothschild, Unterberg,
Towbin Holdings, Inc.

Walter B. Wriston
Chairman, President's Economic
Policy Advisory Board

Auditors

Arthur Andersen & Co.
San Jose, California

Registrar and Transfer Agent

Bank of America N.T.&S.A.
San Francisco, California

Form 10-K

A copy of the Company's Report on Form 10-K for the 1986 fiscal year, as filed with the Securities and Exchange Commission, is available on written request. Please direct your request to:

Director of Investor Relations
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Friday, February 20, 1987, at the Company's headquarters.

Corporate Headquarters

19333 Vallco Parkway
Cupertino, California 95014-2599
(408) 725-6000

Officers

James G. Treybig,
President and
Chief Executive Officer

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer

Michael K. Bateman,
Vice President –
Third-Party Marketing

Jack W. Chapman,
Vice President –
International Sales Operations

Thomas Lyman Chun,
Vice President –
Corporate Projects

George C. Eckert,
Vice President –
Major Projects Management

Donald E. Fowler,
Vice President – Strategy and
Corporate Development

Gerald D. Held,
Vice President – New Ventures

Robert F. Hoogstraten,
Vice President and Managing
Director – European Division

Jan E. Jensen,
Vice President – Human Resources

Thomas J. Klitgaard,
Vice President, General Counsel
and Secretary

Richard A. Lamb,
Treasurer

Lawrence A. Laurich,
Vice President – Engineering

Dennis L. McEvoy,
Vice President – Software

Lawrence W. McGraw,
Vice President –
U.S. Sales Operations

Michael C. Moore,
Vice President and Intercontinental
Division Manager

Gerald L. Peterson,
Vice President – Marketing

David J. Rynne,
Vice President and
Chief Financial Officer

Stephen C. Schmidt,
Vice President – Operations

Alois J. Strnad,
Vice President –
Management Information Systems

Jeanne D. Wohlers,
Vice President and
Corporate Controller

Barry E. Young,
Vice President – Austin Operations

Domestic Sales and Service Offices

Alaska, Anchorage

Arizona, Phoenix, Tucson

Arkansas, Little Rock

California, Culver City, Los Angeles, Orinda, Riverside, Sacramento, San Diego, San Francisco, Santa Ana, Santa Clara

Colorado, Englewood

Connecticut, Hartford, Stamford

Florida, Jacksonville, Miami, Orlando, Tampa

Georgia, Atlanta

Hawaii, Honolulu

Illinois, Chicago, Oak Brook, Palatine, Schaumburg

Indiana, Indianapolis, Fort Wayne

Iowa, Bettendorf, Cedar Rapids, Des Moines

Kansas, Overland Park

Kentucky, Louisville

Louisiana, Metairie

Maryland, Linthicum

Massachusetts, Newton

Michigan, Ann Arbor, Flint, Lansing

Minnesota, Minneapolis

Mississippi, Jackson

Missouri, Creve Coeur, St. Louis

Nebraska, Omaha

Nevada, Las Vegas

New Jersey, Cardiff City, Cherry Hill, Hasbrouck Heights

New Mexico, Albuquerque

New York, Amherst, Fairport, Jericho, New York City

North Carolina, Charlotte, Greensboro, Raleigh

Ohio, Cincinnati, Cleveland, Columbus, Dayton

Oklahoma, Oklahoma City, Tulsa

Oregon, Portland

Pennsylvania, Allentown, Harrisburg, Philadelphia, Pittsburgh

Tennessee, Memphis, Nashville

Texas, Austin, Dallas, Fort Worth, Houston, Plano, San Antonio

Utah, Salt Lake City

Virginia, Reston, Richmond, Virginia Beach

Washington, Bellevue, Olympia

Wisconsin, Brookfield

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Finland
Israel
Malaysia
Mexico
Middle East
Peru
Philippines
South Korea
Taiwan
Thailand
Venezuela

International Subsidiaries

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Tandem NonStop Pty. Ltd.
Adelaide, Brisbane, Canberra, Melbourne, Perth, Sydney

Austria
Tandem Computer Ges.m.b.H.
Linz, Vienna

Belgium
Tandem Computers S.A./N.V.
Brussels

Canada
Tandem Computers Canada Ltd.
Edmonton, Halifax, Markham, Montreal, Ottawa, Scarborough, Toronto, Vancouver, Victoria, Winnipeg

Denmark
Tandem Computers A/S
Copenhagen

France
Tandem Computers S.A.
Paris

Hong Kong
Tandem Computers Hong Kong Ltd.
Kowloon

Italy
Tandem Computers Italia S.p.A.
Milan, Rome

Japan
Tandem Computers Japan Ltd.
Nagoya, Osaka, Tokyo

The Netherlands
Tandem Computers B.V.
Hoofddorp (Amsterdam)

New Zealand
Tandem NonStop Pty. Ltd.
Auckland, Christchurch, Wellington

Norway
Tandem Computers (Norway) A/S
Oslo

Singapore
Tandem Computers Int'l Inc.
Singapore

Spain
Tandem Computers Iberica, S.A.
Madrid

Sweden
Tandem Computers AB
Gothenburg, Malmo, Spanga (Stockholm)

Switzerland
Tandem Computers AG
Nyon (Genève), Zurich

United Kingdom
Tandem Computers Ltd.
Birmingham, Glasgow, High Wycombe, London, Northolt, Rochdale

West Germany
Tandem Computers GmbH
Bonn, Dortmund, Frankfurt, Hamburg, Hilden (Düsseldorf), Mannheim, Neufahrn (Munich), Stuttgart

TANDEM COMPUTERS

January 7, 1987

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders which will be held on Friday, February 20, 1987, at 10:00 A.M. at the offices of the Company at 19333 Vallco Parkway, Cupertino, California.

The formal notice of the Annual Meeting and the Proxy Statement have been made a part of this invitation.

After reading the Proxy Statement, please mark, sign, and return, at an early date, the enclosed proxy in the prepaid envelope addressed to the Bank of America, our agent, to assure that your shares will be represented. YOUR SHARES CANNOT BE VOTED UNLESS YOU SIGN AND RETURN THE ENCLOSED PROXY OR ATTEND THE ANNUAL MEETING IN PERSON.

A copy of the Company's Annual Report to Stockholders is also enclosed.

The Board of Directors and Management look forward to seeing you at the meeting.

Sincerely yours,

THOMAS J. PERKINS *Chairman of the Board*	JAMES G. TREYBIG *President and Chief Executive Officer*

TANDEM COMPUTERS INCORPORATED

19333 Vallco Parkway • Cupertino, CA 95014 • (408) 725-6000

ELECTION OF DIRECTORS

The Company has three classes of directors serving staggered three-year terms. Classes I and II consist of three directors and Class III consists of four directors. Three Class I directors are to be elected at the Annual Meeting for three-year terms expiring on the date of the Annual Meeting in 1990 or until such director's successor shall have been duly elected or appointed.

Unless authority to vote for directors is withheld, it is intended that the shares represented by the enclosed proxy will be voted for the election of Messrs. Morton Collins, Andrew Knight, and Robert C. Marshall as Class I directors, each of whom is currently a member of the Board of Directors of the Company. In the event any of such nominees becomes unable or unwilling to serve, the shares represented by the enclosed proxy will be voted for the election of the balance of those named and such other person as the Board of Directors may select. The Board of Directors has no reason to believe that any such nominee will be unable or unwilling to serve.

Set forth below are the names and ages of the nominees and directors, the class to which each has been elected or nominated for election, their principal occupations at present and for the past five years, certain directorships held by each, and the year in which each became a director of the Company. Information with respect to the Company includes the Company's predecessor California corporation.

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Class I		
Morton Collins (1)(2)	1975	50
General Partner of DSV Associates, DSV Partners III, and DSV Partners IV, Princeton, New Jersey, private investment partnerships, since 1974, 1981, and 1985, respectively; Director of The Liposome Company.		
Andrew Knight (3)	1984	47
Chief Executive, The Daily Telegraph plc, since February 1986; Editor, *The Economist*, Economist Newspaper Ltd., from 1974 to 1986; Chairman, Ballet Rambert; Governor of Imperial College of Science and Technology, University of London; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University; Trustee of the Victoria and Albert Museum, London.		
Robert C. Marshall (4)	1980	55
Senior Vice President and Chief Operating Officer of the Company since July 1980; Vice President and Chief Operating Officer from 1979 to 1980; Vice President from 1975 to 1979.		
Class II		
Franklin P. Johnson, Jr. (1)(3)	1975	58
General Partner since 1982 of Asset Management Partners, a Palo Alto, California, private investment partnership; Owner since 1967 of Asset Management-Investments Company, a Palo Alto, California, investment management proprietorship; Director of Amgen, Boole & Babbage, Coherent, Inc., Ross Stores, Inc., SBE, Inc., and Teradyne, Inc.; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University.		

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Thomas J. Perkins (2)(3)	1974	54
Chairman of the Board of the Company since 1974; General Partner since 1972, 1978, 1980, and 1982 of Kleiner & Perkins, Kleiner, Perkins, Caufield & Byers, Kleiner, Perkins, Caufield & Byers II, and Kleiner, Perkins, Caufield & Byers III, respectively, San Francisco, California, private investment partnerships; Director of Acuson Corporation, Alliant Computer Systems Corporation, Genentech, Inc., and LSI Logic Corporation.		
Thomas I. Unterberg (1)(5)	1985	55
Chairman from January 1986 to December 1986 and Chief Executive Officer from March 1986 to December 1986 of L.F. Rothschild, Unterberg, Towbin Holdings, Inc., and Chairman and Senior Managing Director of its predecessor partnership, an investment banking and securities brokerage firm, from 1983 to 1985; Managing Partner of such firm from 1981 to 1982; General Partner of such firm from 1977 to 1980; Director of Applied Energy Services, Inc., ASK Computer Systems, Inc., LIN Broadcasting Corporation, and Systems & Computer Technology Corporation.		
Class III		
Thomas J. Davis, Jr. (1)(2)	1976	74
General Partner since 1973, 1979, 1981, and 1983 of Mayfield II, Mayfield III, Mayfield IV, and Mayfield V, respectively, Menlo Park, California, private investment partnerships; Director of Equatorial Communications Co.		
Robert G. Stone, Jr. (3)	1978	63
Chairman of the Board of Kirby Exploration Company, Inc., an oil and gas exploration company, and its predecessor, General Energy Corporation, since 1971; Chairman of the Board of West India Shipping Company, Inc. from 1974 to 1983; Director of The Chubb Corporation, Combustion Engineering, Inc., Core Industries, Inc., Corning Glass Works, Great Northern Nekoosa Corporation, Hamilton Oil Corporation, The Japan Fund, Inc., The Pittston Company, and Scudder International Fund.		
James G. Treybig (2)(4)	1974	46
President and Chief Executive Officer of the Company since 1974.		
Walter B. Wriston	1986	67
Chairman and Member, President's Economic Policy Advisory Board since 1982 and 1981, respectively; Chairman and Chief Executive Officer of Citicorp and Citibank, N.A., from 1981 to 1984; Director of BRIntec Corporation, The Chubb Corporation, General Electric Company, J.C. Penney Company, Inc., Pan Am Corporation, Pfizer Inc., and Reuters Holdings PLC.		

(1) Member of Audit Committee. Mr. Davis' term ended on February 3, 1986, and Mr. Johnson became a member on the same date.

(2) Member of Compensation/Option Committee. Mr. Davis' term ended on February 3, 1986, and Mr. Collins became a member on the same date.

(3) Member of Nominating Committee. Mr. Knight became a member on February 3, 1986.

(4) On October 2, 1984, the Securities and Exchange Commission (the "Commission") filed a civil action for injunctive and other equitable relief in the United States District Court for the Northern

District of California against the Company, Messrs. Treybig and Marshall, and a former officer of the Company. The Commission's complaint alleged that during fiscal 1982, the Company, aided and abetted by the named persons, engaged in certain conduct which resulted in improper recognition of revenue. This conduct was alleged to have resulted in the violation by the Company of certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act") through the filing with the Commission of reports which overstated the Company's revenue and net income for the second and third fiscal quarters of 1982 and the issuance of a press release which overstated the Company's revenue and net income for the fourth fiscal quarter of 1982 and fiscal 1982 as a whole. The complaint further alleged that during fiscal 1982, the Company, aided and abetted by the named persons, violated certain accounting provisions of the Exchange Act relating to record keeping and internal accounting controls. The Company had restated its fiscal 1982 financial statements in December 1982, and the Commission did not seek a further restatement.

In order to avoid the time and expense of protracted litigation, without admitting or denying the allegations in the complaint, on October 2, 1984, the Company and the named persons consented to the entry of a final judgment permanently enjoining them from violating various provisions of the Exchange Act and requiring certain ancillary relief, including an annual review and report for three years by the Company's independent accountants of the Company's system of accounting and internal controls in specified areas, including revenue recognition.

(5) From time to time, L.F. Rothschild, Unterberg, Towbin, Inc. advises the Company with respect to investment banking matters.

STOCK OWNERSHIP OF DIRECTORS AND OFFICERS

The following table sets forth information as of November 28, 1986, as to shares of Common Stock beneficially owned by the directors and nominees named under "Election of Directors" and the directors and officers of the Company as a group. Except as otherwise indicated, each person has sole investment and voting power with respect to the shares shown. Ownership information is based upon information furnished by the respective individuals.

	Beneficial Ownership of Common Stock	
	Number of Shares(1)	Percent of Class
Thomas J. Perkins	500,468	1.1
James G. Treybig(2)	334,444	0.8
Robert C. Marshall(3)	202,000	0.5
Franklin P. Johnson, Jr.(4)	200,000	0.4
Robert G. Stone, Jr.(5)	95,086	0.2
Thomas I. Unterberg	22,000	(6)
Thomas J. Davis, Jr.	13,572	(6)
Andrew Knight	12,000	(6)
Morton Collins(7)	11,304	(6)
Walter B. Wriston	—	—
All officers and directors as a group (31 persons including the ten directors named above)	2,160,774	4.9

(1) Includes shares which may be acquired within 60 days pursuant to the exercise of options or convertible securities as follows: Mr. Treybig, 107,333 shares; Mr. Marshall, 63,000 shares; Mr.

Unterberg, 12,000 shares; Mr. Knight, 12,000 shares; and all officers and directors as a group, 783,626 shares.

(2) Includes 1,800 shares held by trusts, of which Mr. Treybig is the trustee.

(3) Includes 2,755 shares held in a trust for the benefit of a minor child of Mr. Marshall, of which the trustee is Mr. Marshall's wife, and as to which Mr. Marshall disclaims any beneficial interest.

(4) All such shares are held by Asset Management Partners, a partnership of which Mr. Johnson is general partner.

(5) Includes 19,100 shares held by trusts, of which Mr. Stone is a trustee, and 39,186 shares beneficially owned by Mr. Stone's wife and children, as to all but 1,000 of which shares Mr. Stone disclaims any beneficial interest.

(6) Less than one-tenth of one percent.

(7) Includes 1,400 shares held in a trust for the benefit of Mr. Collins' children, and as to which Mr. Collins disclaims any beneficial interest.

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Information is set forth below as to the cash compensation paid or accrued during the 1986 fiscal year by the Company and its subsidiaries to each of the five most highly compensated executive officers of the Company individually, to all executive officers as a group, and to directors. Information is given only for the period each served as an executive officer or director of the Company. Information for the past five fiscal years as to stock options granted and amounts allocated to such persons, to all officers and directors as a group, and to employees under the Company's employee benefit plans is set forth under "Stock Options" which commences on page 6 or the description of each plan under "Description of Other Plans" which commences on page 18 of this Proxy Statement.

Cash Compensation of Executive Officers for Fiscal 1986

Name of Individual or Number in Group and Capacities in Which Served	Amount
James G. Treybig President, Chief Executive Officer, and Director	$ 347,544
Robert C. Marshall Senior Vice President, Chief Operating Officer, and Director	$ 289,109
David J. Rynne Vice President and Chief Financial Officer	$ 235,096
Dennis L. McEvoy Vice President—Software	$ 234,364
Gerald L. Peterson Vice President—Marketing	$ 222,201
All executive officers as a group (21 persons including the five named above)	$3,956,855

For the 1986 fiscal year, directors who were not officers of the Company were paid an annual retainer of $13,000, plus expenses, paid quarterly. Directors who were members of one or more of the Executive, Compensation/Option, Nominating, Conflicts of Interest, or Audit Committees were paid an additional annual retainer of $1,000 for each such committee of which they were a member. For the same period, the Chairman of the Board was paid an additional annual retainer of $2,000.

For the 1987 fiscal year, directors who are not officers of the Company will receive an annual retainer of $20,000, plus expenses, payable quarterly. The Chairman of the Board will receive an additional annual retainer of $5,000. No additional compensation will be paid to directors who serve as members of any committee of the Board of Directors during the 1987 fiscal year. If the proposal to approve the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated is approved at the Meeting, each non-employee director will receive a ten-year option pursuant to such Plan to purchase 5,000 shares of the Company's Common Stock exercisable at the fair market value of such shares on the date of grant. On the date of each subsequent annual meeting, each non-employee director will receive a similar option to purchase 3,000 shares. See "Approval of the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated" which commences on page 13 of this Proxy Statement.

During the 1985 fiscal year, the Company guaranteed bank loans under a $2,000,000 bank line of credit to Lawrence A. Laurich (Vice President—Engineering), David R. Mackie (a former officer), Dennis L. McEvoy, and Gerald L. Peterson in the principal amounts of $430,000, $200,000, $100,000, and $150,000, respectively, plus interest, which were the largest aggregate amounts outstanding under such guarantees during fiscal 1986. At September 30, 1986, the outstanding balance of Mr. Laurich's bank loan was $150,000. Messrs. Mackie, McEvoy, and Peterson paid their loans in full during the 1986 fiscal year. The Company has not had to perform under the guarantees.

Since May 9, 1983, the Company has made loans to Jan E. Jensen, Vice President—Human Resources. On December 31, 1985, these loans were consolidated into a single loan bearing interest at the fixed rate of 9.5% payable monthly. The principal of the loan is due in full on June 30, 1988. The largest aggregate principal amount outstanding under the loan during fiscal 1986 was $209,157, of which $205,406 is currently outstanding.

On September 26, 1985, the Company loaned Mr. Treybig $1,667,500 in consideration of his promissory note in that amount. The principal amount of the note is due September 26, 1989, and bears interest at 10% per annum payable quarterly. The note is fully secured. See "Description of Other Plans—Convertible Debenture Issuance" on page 20 of this Proxy Statement.

STOCK OPTIONS

With respect to options to purchase shares of the Company's Common Stock granted to certain executive officers, all executive officers as a group, and all directors as a group during the period October 1, 1981, to November 28, 1986, the following table sets forth (i) the aggregate amount of Common Stock subject to options granted (net of cancellations) during the specified period, (ii) the weighted average per share option exercise price of such options, (iii) the net value of shares (market value less any exercise price) realized during the specified period upon the exercise of such options during the period, and (iv) the number of shares of Common Stock sold by the named persons, by all executive officers as a group, and by all directors as a group during the specified period. Information is given only for the period each served as an executive officer or director of the Company.

Common Stock(1)	James G. Treybig	Robert C. Marshall	David J. Rynne(2)	Dennis L. McEvoy(2)	Gerald L. Peterson(2)	All Executive Officers as a Group(2)	All Directors as a Group(3)
Granted—October 1, 1981, to November 28, 1986:							
Number of shares	127,000	42,000	50,400	38,500	38,400	592,300	34,000
Weighted average per share exercise price	$17.88	$20.61	$22.87	$20.15	$19.62	$20.09	$23.71
Exercised—October 1, 1981, to November 28, 1986:							
Net value realized in shares (market value less exercise price)(4)	$539,481	$980,383	$1,187	$165,166	$133,362	$2,596,135	$266,508
Sales—October 1, 1981, to November 28, 1986:							
Number of shares(5)	40,000	25,250	—	37,500	10,000	277,766	208,384

(1) Adjusted for stock splits.

(2) Includes options granted under the Stock Option Grant Program of the Company's Employee Stock Purchase Plan, all of which have an exercise price of 85% of the market value of the shares on the date of grant. The number of shares subject to options granted under such Plan to Messrs. Rynne, McEvoy, Peterson, and all executive officers as a group during the period October 1, 1981, to November 28, 1986, are 300, 400, 400, and 5,600, respectively, and the weighted average per share exercise price of such options and the per share market price of the Common Stock on the date of grant are $18.88 and $22.21, respectively.

(3) Excludes directors who are also executive officers.

(4) Represents the difference between the exercise price and the fair market value of the Company's Common Stock on the date or dates of exercise of stock options for the specified individual or group. These amounts do not reflect, and may or may not bear any relationship to, the net realized value when or if the shares are sold. Pursuant to rules of the Securities and Exchange Commission, no officer or director of the Company may sell shares of the Company's Common Stock within six months prior to or after exercising an option without the possible imposition of a severe penalty.

(5) Shares sold were not necessarily acquired by the exercise of options. May include shares disposed of without consideration.

As of November 28, 1986, there were outstanding options under the Company's stock option plans to purchase 5,321,836 shares held by approximately 4,625 participants, and there were approximately 5,900 employees eligible to participate in such plans. The expiration dates of all such options range from November 30, 1986, to November 4, 1993, and the weighted average exercise price per share is $23.03. As of November 28, 1986, approximately 5,829,655 shares had been issued upon the exercise of options under the Company's stock option plans.

BACKGROUND REGARDING APPROVAL OF THE AMENDMENT TO THE COMPANY'S RESTATED CERTIFICATE OF INCORPORATION AND RATIFICATION OF FORM OF THE INDEMNITY AGREEMENT

The Company is incorporated under the General Corporation Law of the State of Delaware (the "Delaware Law"). For many years, the Delaware Law has permitted a corporation to indemnify its directors and officers against expenses, judgments, settlement payments, and other costs incurred in connection with litigation or similar proceedings, subject to certain limitations. The Delaware Law also permits a corporation to purchase, on behalf of its directors and officers, insurance against liabilities incurred in their capacities as such, regardless of whether the corporation would have the power to indemnify against such liabilities under the Delaware Law.

During the past few years, the market for directors' and officers' liability insurance has changed dramatically. It is becoming increasingly difficult to obtain insurance. To the extent that insurance is available, the scope and amount of coverage is decreasing and the cost is rising significantly. In response to these conditions, the Delaware legislature recently enacted amendments to the Delaware Law that permit a corporation to provide additional protection for its directors and officers.

The Company's Board of Directors believes it is in the best interest of the stockholders to provide liability protection for its directors and officers to the full extent permitted under the Delaware Law. The incidence of claims and litigation against directors and officers of corporations has risen, and the costs of defending such proceedings are enormous. Few individual directors or officers have the personal resources to sustain the legal costs of defending such claims. In addition, recent judicial decisions have created uncertainties as to the standards to which directors and officers must conform. As a result, an individual may conclude that these risks outweigh the potential benefit of becoming a director or officer of the Company, making it difficult for the Company to attract and retain the high caliber of individuals it needs to serve in these capacities. While the Company has not experienced any problems to date in recruiting or retaining qualified persons as directors or officers, the Board of Directors believes that the Company should take every possible step to ensure that it will continue to be able to attract the best possible persons for these positions.

In order to provide the protection considered necessary, the Company is seeking stockholder approval to amend its Restated Certificate of Incorporation (the "Charter Amendment") and stockholder ratification of the Board's adoption of a form of indemnity agreement between the Company and its directors and such officers as the Board may from time to time determine (the "Indemnity Agreement"). These actions are covered by items 2 and 3 on the Proxy accompanying this Proxy Statement and are discussed in detail below. The text of the Amendment to the Restated Certificate of Incorporation and the form of Indemnity Agreement are set out in Exhibits A and B, respectively, to this Proxy Statement.

The Charter Amendment and the Indemnity Agreement are applicable only to claims arising out of events which occur after they become effective. If approved by the stockholders, the Charter Amendment will become effective upon filing with the Secretary of State of Delaware shortly after the Annual Meeting. An Indemnity Agreement will become effective as to any person on the date the Company enters into an Agreement with such person. The Company has not entered into any Indemnity Agreements to date. There are no pending or threatened claims against any director or officer for breach of his or her fiduciary duties under the Delaware Law. Over two years ago, a stockholder derivative action in which certain directors and officers of the Company were involved was dismissed. In addition, there is currently pending a stockholder action relating to the restatement of the Company's 1982 financial statements in which certain directors and officers of the Company are involved. If the Charter Amendment had been in effect at the time the events which gave rise to such actions occurred, it would have been applicable to such actions.

The Board of Directors has unanimously approved the amendment to the Restated Certificate of Incorporation and the form of Indemnity Agreement. The members of the Board recognize that they may in the future personally benefit from these actions but, for the reasons discussed in this Proxy Statement, believe that such actions are in the best interests of the Company and its stockholders and are therefore recommending such actions to the stockholders.

APPROVAL OF THE AMENDMENT TO THE COMPANY'S RESTATED CERTIFICATE OF INCORPORATION

Delaware Law

The Delaware Law provides that the board of directors has the ultimate responsibility for managing the business of the corporation. A director owes fiduciary duties of care and loyalty to the corporation and its stockholders. The duty of care requires that a director inform himself or herself of all material information relating to a matter on which he or she will use business judgment and then exercise due care in using such judgment. Under Delaware judicial decisions, liability for a breach of the duty of care generally requires a finding that the director was grossly negligent. The duty of loyalty requires that a director act in good faith and in the honest belief that an action taken is in the best interests of the corporation.

A recent amendment to the Delaware Law permits a corporation to include in its certificate of incorporation a provision that eliminates or limits a director's liability for monetary damages for breach of the duty of care. The change in the Delaware Law does not affect the availability of injunctive or other equitable relief as a remedy for breach of fiduciary duty.

Description and Effect of the Charter Amendment

The proposed Charter Amendment provides that a director of the Company will not be liable to the corporation or its stockholders for monetary damages for breach of his or her fiduciary duty as a director. Absent the adoption of the Charter Amendment, under Delaware case law, a director may be held liable for negligence or gross negligence in connection with decisions made in the performance of his or her duty of care. Under the Charter Amendment, a director will remain liable for monetary damages for (i) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (ii) breach of the director's duty of loyalty, (iii) an improper payment of a dividend or an improper repurchase of the Company's stock under the Delaware Law, or (iv) any transaction from which a director derives an improper personal benefit. If future changes in the Delaware Law permit either greater or lesser limitation of directors' liability, such new limitation is intended to become effective automatically with respect to the Company's directors.

In addition, the Charter Amendment provides that the Company shall, to the fullest extent permitted by the Delaware Law, indemnify any person who is involved in any proceeding, other than one by or on behalf of (a derivative action) the Company, because the person is or was a director, officer, employee, agent, fiduciary, or other official of the Company or, at the request of the Company, of another entity, against all liabilities actually and reasonably incurred by the person in connection with the proceeding. The Charter Amendment also includes the right of indemnification for, and to receive payment in advance of incurring, expenses in proceedings, including those by or on behalf of the Company, to the extent permitted by the Delaware Law. If the Charter Amendment is approved, many of the permissive indemnification provisions under the Delaware Law will become mandatory. See "Ratification of Adoption of the Form of Indemnity Agreement—Delaware Law and the Company's By-laws."

The Charter Amendment states that the right to indemnification shall be enforceable as a contract right. The Company is permitted to enter into contracts with individuals to provide for indemnification and may enter into arrangements, including letters of credit, to ensure payment of amounts necessary to cover the Company's obligations under the Charter Amendment or any Indemnity Agreement.

The Charter Amendment provides that a person requesting indemnification shall be presumed entitled to such indemnification. The Company shall have the burden of proving otherwise.

The Charter Amendment states that any repeal or modification of its provisions will not adversely affect any right or protection of any director or indemnified party existing at the time of such repeal or modification. The Delaware Law provides that provisions in a corporation's certificate of incorporation may be modified or repealed by a vote of a majority of the outstanding shares, unless the certificate of incorporation sets forth a higher vote requirement. The Charter Amendment requires the approval of at least 80% of the outstanding shares of stock entitled to vote in order to repeal or modify the Charter Amendment. At the Company's annual meetings held in 1984, 1985, and 1986, 63%, 84%, and 74% of the outstanding shares were voted in person or by proxy.

The Charter Amendment limits the rights of stockholders to recover monetary damages when directors are negligent or grossly negligent in making business decisions, including business decisions relating to takeover proposals. It may also deter stockholders from bringing a lawsuit against directors and officers for breaches of their duties to the Company, even though such an action, if successful, would benefit the Company and its stockholders. The Charter Amendment will not prevent a finding of liability under the federal securities laws, if warranted by the evidence, but is intended to provide indemnification to a director for expenses and monetary damages in appropriate circumstances. The Securities and Exchange Commission has advised that indemnification for liability under the federal securities laws is against public policy; however, this matter has not been finally adjudicated.

Reasons for Approving the Charter Amendment

The Board of Directors believes that the Charter Amendment will significantly increase the Company's ability to continue to attract and retain qualified people to serve as directors and officers by providing additional protection for directors and officers in making good faith business decisions. The Board also believes that prospective directors' and officers' liability insurance carriers will view the Charter Amendment favorably, and that it may aid the Company in obtaining adequate directors' and officers' coverage at a reasonable cost.

Required Vote

The Charter Amendment requires the affirmative vote of a majority of the outstanding shares of Common Stock.

The Board of Directors recommends a vote FOR the Amendment to the Company's Restated Certificate of Incorporation.

RATIFICATION OF ADOPTION OF THE FORM OF INDEMNITY AGREEMENT

Delaware Law and the Company's By-laws

The Delaware Law provides that a director, officer, employee, or agent of a corporation (i) shall be indemnified by the corporation for expenses in defense of an action if the person is sued in his or her capacity as such, to the extent that such person has been successful in defense of the action, (ii) may be indemnified by the corporation for expenses (but not judgments or settlements) of an action by or on behalf of the corporation, even if he or she is not successful, provided that such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the corporation, although no indemnification is permitted without court approval if the person was found liable to the corporation, and (iii) may, in any other actions, be indemnified for expenses, judgments, and settlements, even if he or she is not successful on the merits, if such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the corporation (and in a criminal proceeding, if he or she did not have reasonable cause to believe the conduct was unlawful).

The permissive indemnification described in clauses (ii) and (iii) above may be made only upon a determination by (a) a majority of a quorum of disinterested directors, (b) the stockholders, or (c), under certain circumstances, independent legal counsel that indemnification is proper in the circumstances because the applicable standard of conduct has been met. Litigation expenses may be advanced to an indemnified party upon receipt of an undertaking by such party to repay the expenses if it is ultimately determined that he or she is not entitled to indemnification.

A provision in the Company's By-laws requires the Company to indemnify directors, officers, employees, and agents to the extent and under the circumstances permitted by Delaware Law as described above. The By-law provision also states that the indemnification provided for in the By-laws is not exclusive of any other indemnification rights.

Description and Effect of the Indemnity Agreement

The form of Indemnity Agreement adopted by the Board of Directors contains specific substantive and procedural provisions to ensure adequate indemnification for directors and officers. The form of Indemnity Agreement attached to this Proxy Statement as Exhibit B relates to directors, but the Board may from time to time enter into agreements which contain similar provisions with such officers as it deems appropriate. While stockholder approval of the Indemnity Agreement is not required by the Delaware Law, because members of the Board may become beneficiaries of the rights contained in the Indemnity Agreement, the form of Indemnity Agreement is being submitted to the stockholders for ratification. The Company believes that the stockholders will be estopped from challenging the validity of the form of Indemnity Agreement if they vote to ratify it. However, the ultimate determination of the validity of such Agreements or the stockholders' rights to challenge their validity would have to be made by a court of law. The Board of Directors has not determined what action it will take if the form of Indemnity Agreement is not ratified. The following description of the terms of the Indemnity Agreement is only a summary. Stockholders are urged to read the full text of Exhibit B. The major provisions of the Indemnity Agreement are:

1. The Company is required to maintain directors' and officers' liability insurance which provides a reasonable amount of coverage.

2. The Company is required to advance expenses to an indemnified party within 20 days after request if accompanied by, to the extent required by the Delaware Law, an undertaking to repay these amounts if it is ultimately determined that the person is not entitled to indemnification.

3. The Company is required to determine entitlement to indemnification within 90 days after the Company's receipt of a written request for such indemnification, and the person seeking indemnification is permitted to select the forum for such determination.

4. In the event the Company fails to indemnify or advance expenses to a director or officer on a timely basis, the director or officer will be entitled to sue for indemnification or advancement of expenses.

5. If a person acquires 30% or more of the outstanding stock of the Company, the Company is required to obtain a letter of credit of at least $1,000,000 to secure its obligation to an indemnified party.

The terms of the Indemnity Agreement may require the Company to incur expenses it would otherwise not incur. The Company currently maintains a directors' and officers' liability insurance policy which terminates in February 1987. Although the Company has been able to maintain such insurance policies to date, and intends to obtain a new policy when the current policy expires, in February 1986 it experienced a decrease in the number of companies offering such insurance and a ten-fold increase in the cost of such insurance. Accordingly, the coverage of the directors' and officers' liability policy may vary from time to time depending upon the availability and cost of this type of insurance. While the Company believes the adoption of the Charter Amendment will have a positive effect on its ability to secure adequate directors' and officers' liability insurance at reasonable rates, there can be no assurance that the Company's rates will not increase in the future. The Company could also be required to obtain a letter of credit for each person with whom it has an Indemnity Agreement.

The Indemnity Agreement permits an indemnified party to select the forum for determination of indemnification, appeal an adverse determination as to his or her rights to indemnification, and be reimbursed by the Company for such person's actual and reasonable expenses of prosecuting any such claim. The Delaware Law does not specifically provide these rights. The Indemnity Agreement also provides that a person is presumed to be entitled to indemnification, and that the burden is on the Company to prove otherwise. It is not clear under the Delaware Law whether the indemnified party has the burden of proving his conduct entitles him or her to indemnification.

The enforceability of certain provisions of the Indemnity Agreement has not been tested in court and remains subject to considerations of state law and public policy.

Reasons for Ratifying the Adoption of the Indemnity Contract

The Board of Directors believes that it is in the best interest of the Company and its stockholders to provide broad and clear indemnification, not only in order to attract and retain a high caliber of directors and officers, but also to ensure that such persons are not unduly fettered by the increasing incidence of litigation when conducting the business of the Company.

The Indemnity Agreement, being a contractual obligation of the Company, also provides assurance that a subsequent board of directors or controlling stockholders will not disavow or retroactively change the conditions under which indemnification is available by amending the

Company's By-laws or Restated Certificate of Incorporation. This assurance is particularly important in today's climate of hostile takeovers.

The Board of Directors recommends a vote FOR the ratification of the adoption of the form of Indemnity Agreement.

APPROVAL OF THE STOCK OPTION PLAN FOR NON-EMPLOYEE DIRECTORS OF TANDEM COMPUTERS INCORPORATED

The Company believes it is important to encourage the Company's non-employee directors to acquire a proprietary interest in the Company and to continue their association with the Company or its subsidiaries. To accomplish this goal, Tandem has over the past several years granted an option to each new non-employee director of the Company through individual stock option plans and agreements. While the Company plans to continue using such option grants for new non-employee directors, the Board of Directors has determined that adopting a plan that provides for specified annual option grants would provide on-going incentives to its non-employee directors. The Board of Directors therefore adopted the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated (the "Directors' Plan") on November 3, 1986, to be effective February 20, 1987, subject to the approval of the Company's stockholders.

An explanation of the Directors' Plan and a summary of its significant provisions is set forth below. A copy of the full plan may be reviewed by stockholders upon request to Patricia E. Garvey at the offices of the Company at 19333 Vallco Parkway, Cupertino, California 95014, during normal business hours. The following summary is qualified in its entirety by reference to the plan document itself.

Administration

The Directors' Plan will be administered by the Compensation/Option Committee of the Board of Directors. The Committee will have the responsibility for carrying out all terms of the Directors' Plan. However, the Committee will have no discretion either to determine which directors shall receive option awards or to set the number of shares subject to such option awards.

Aggregate Shares Subject to Option

The aggregate number of shares which may be issued under options exercised pursuant to the Directors' Plan may not exceed 250,000. All such shares will be authorized but unissued or reacquired shares of Common Stock of the Company. The number of shares available is subject to adjustment upon a recapitalization, stock split, or similar event. Shares for which options were granted but have since lapsed or otherwise terminated may again be subject to options under the Directors' Plan.

Eligibility

The Directors' Plan provides for automatic annual option grants to each director who is not also an employee of the Company or a subsidiary.

Option Grants

In February 1987, if the Directors' Plan is approved by the stockholders, each non-employee director automatically will receive an option grant of 5,000 shares. Thereafter, each non-employee director automatically will receive an option grant of 3,000 shares on the date of each annual meeting of stockholders.

Options will not be transferable, other than by will or the laws of descent and distribution, and will be exercisable during the lifetime of an optionee only by the optionee. The exercise price for shares subject to options granted under the Directors' Plan will be the fair market value of the shares at the date of the option grant. Payment of the exercise price must be made in cash or by the surrender of previously-held shares of Common Stock, which shares will be valued for this purpose at their fair market value on the date of exercise, or a combination thereof.

Except as provided below, options granted under the Directors' Plan will not be exercisable for a period of six months after grant. Thereafter, the option becomes exercisable as to an increasing amount on a daily basis, with the full amount exercisable 48 months after the date of grant. In the event that an optionee ceases to be a director within six months of the date on which the option was granted, the portion of the outstanding option which is not then exercisable will be forfeited. An optionee who ceases to be a director for any reason after six months from the grant date shall be entitled to exercise the portion of his or her option which is then exercisable within 12 months following such termination to the extent not previously exercised. All options granted under the Directors' Plan will lapse on the date ten years following the date of grant of the option.

If the Directors' Plan had been in effect in 1986, all non-employee directors as a group would have received options for an aggregate of 35,000 shares.

Amendment and Termination

The Directors' Plan may be amended or terminated by the Board, except that stockholder approval is required for any amendment which would increase the number of shares subject to option under the plan, change the number of shares subject to option that may be granted each year, or decrease the price at which options may be granted.

Federal Income Tax Information

The options granted under the Directors' Plan are nonstatutory options (i.e., they do not have any special status under the tax laws). See the discussion under "Approval of Amendments to the Tandem Computers Incorporated 1979 Stock Option Plan and 1981 Stock Option Plan—Federal Income Tax Information" for a summary of the federal tax law applicable to nonstatutory options.

Required Vote

Adoption of the Directors' Plan requires the affirmative vote of a majority of the outstanding shares of Common Stock present and voting at the meeting in person or by proxy.

The Board of Directors recommends a vote FOR the adoption of the Plan for Non-Employee Directors of Tandem Computers Incorporated.

APPROVAL OF AMENDMENTS TO THE TANDEM COMPUTERS INCORPORATED 1979 STOCK OPTION PLAN AND 1981 STOCK OPTION PLAN

The Board of Directors believes that stock options are an invaluable tool for the recruitment, retention, and motivation of qualified employees, including officers, who can materially contribute to the Company's success. The Board believes that the terms of the Company's stock option plans should be as flexible as possible in order to provide strong incentives to the Company's employees. The Board is therefore requesting stockholder approval to amend the Tandem Computers Incorporated 1979 Stock Option Plan (the "1979 Plan") and the Tandem Computers Incorporated 1981 Stock Option Plan (the "1981 Plan") (collectively, the "Option Plans") to (i) provide for the exercise of options upon the surrender of previously-held shares of the Company's Common Stock, and (ii) extend the maximum term of options to ten years. The Board has also authorized certain technical amendments to the Plans to conform to the new incentive stock option qualification rules contained in the Tax Reform Act of 1986. The Committee administering the Option Plans has authority to modify outstanding options to conform to the amendments to the Option Plans.

The 1981 Plan was approved by the stockholders at the Company's 1982 Annual Meeting of Stockholders and, as amended, at the 1985 Annual Meeting of Stockholders. The 1979 Plan was approved by the stockholders at the 1980 Annual Meeting of Stockholders.

An explanation of the Option Plans and a summary of their significant provisions is set forth below. Where the provisions of the 1979 Plan and the 1981 Plan are not the same, such differences are noted. Copies of the full plans may be reviewed by stockholders upon request to Patricia E. Garvey at the Company's address set forth above. The following summary is qualified in its entirety by reference to the plan documents themselves.

Administration

The Option Plans are administered by the Compensation/Option Committee of the Board of Directors. The Committee has the authority to select the employees to be granted options, determine the number of shares for each option, fix the terms and conditions of options, designate certain options as incentive stock options (ISOs) for the purpose of qualifying under Section 422A of the Internal Revenue Code, and interpret the Option Plans and any option granted under the Option Plans.

Aggregate Shares Subject to Option

The aggregate number of shares which may be issued under options exercised pursuant to the 1979 Plan may not exceed 6,000,000. As of November 28, 1986, options to purchase 5,666,022 shares had been granted under the 1979 Plan, of which options to purchase 3,814,297 shares had been exercised. The aggregate number of shares which may be issued under options exercised pursuant to the 1981 Plan may not exceed 9,000,000. As of November 28, 1986, options to purchase 4,809,235 shares had been granted under the 1981 Plan, of which options to purchase 757,428 shares had been exercised. All shares issued upon the exercise of options under the Option Plans are authorized but unissued or reacquired shares of Common Stock of the Company. The number of shares available, and the number of shares and per share exercise price of outstanding options, is subject to adjustment upon a recapitalization, stock split, or other event. Shares for which options were granted but have since lapsed or otherwise terminated may again be subject to options under the Option Plan pursuant to which they were granted.

Eligibility

All employees of the Company and employees and directors of its 80% or more owned subsidiaries are eligible to receive options under the 1979 Plan. All employees of the Company and its 50% or more owned subsidiaries, including officers and directors who are also employees, are eligible to receive options under the 1981 Plan.

Option Grants

Options granted under the Option Plans are required to have an option price of not less than 100% of the fair market value of the Company's Common Stock on the date of grant. Options may be made exercisable at such time or times as determined by the Compensation/Option Committee and provided in the option agreement entered into between the Company and the employee. However, except when the optionee's employment terminates because of death or permanent disability, an option may not be exercisable before six months following the date of grant.

ISOs granted before 1987 may not be exercised while there is outstanding any ISO previously granted to the same employee. ISOs granted after 1986 need not be exercised sequentially and may be exercised prior to the exercise of ISOs granted before 1987. The maximum value of ISOs granted before 1987 is limited to $100,000 per year for each employee, subject to carryover provisions. ISOs may be granted for any value after 1986, provided that the value of shares subject to one or more ISOs first exercisable in any calendar year does not exceed $100,000.

An employee may exercise an option only while employed by the Company or one of its subsidiaries or, subject to certain limitations, within 30 days following termination of such employment (three months if termination is due to permanent disability). If an optionee dies while in the employ of the Company or a subsidiary, subject to certain limitations, the optionee's legal representative may exercise the option within one year following the optionee's death. Options may not be transferred except by will or the laws of descent and distribution. In no event may an option be exercised more than ten years after the date of grant.

Shares purchased upon the exercise of an option must be paid for in full at the time of exercise in cash or, with the consent of the Company, by (i) the surrender of previously-held shares of the Company's Common Stock, which shares will be valued for such purpose at their fair market value on the date of exercise, (ii) the surrender of shares and cash, (iii) delivery of a full recourse, interest-bearing promissory note to the Company, calling for periodic repayments over a period not to exceed ten years from the date of exercise, or (iv) delivery of an irrevocable direction to a securities broker to sell shares and deliver all or a portion of the proceeds to the Company in payment for the stock.

The Compensation/Option Committee may determine that an option to be granted under the Option Plans will provide that the shares to be issued upon exercise of the option shall be subject to a right of repurchase by the Company at the option price. In such case, the option agreement will provide that if the optionee's employment terminates, the Company may repurchase a specified percentage of the shares.

Amendment and Termination

The Board of Directors may at any time amend, suspend, or discontinue the Option Plans, subject to the requirement that certain amendments be approved by the stockholders. If not terminated earlier by action of the Board of Directors, the 1979 Plan will terminate automatically on April 18, 1989, and the 1981 Plan will terminate automatically on October 29, 1991.

Federal Income Tax Information

The grant of a nonstatutory option is not taxable to the optionee and the Company cannot claim a deduction on account of the grant. When a nonstatutory option is exercised, the optionee is taxed at ordinary-income rates on the difference between (i) the exercise price and (ii) the fair market value of the shares on the date of exercise. In the case of an officer or director, the recognition of ordinary income is deferred until six months after the date of exercise and is calculated based on the fair market value of the shares on such date. However, an officer or director may file a Section 83(b) election within 30 days after exercise, in which case the amount of ordinary income to be recognized would be determined on the date of exercise. The Company will have a deduction equal to the amount of ordinary income that the optionee is required to recognize.

In general, an optionee's basis in shares acquired by exercising a nonstatutory stock option is equal to their fair market value on the date of exercise (or six months thereafter in the case of an officer or director if a Section 83(b) election is not made), and the holding period for long-term capital gain purposes begins on such date. Upon a subsequent disposition of the shares in a taxable transaction, the optionee will have a short-term or long-term capital gain (or loss), depending on the holding period, equal to the difference between his or her basis and the sale proceeds.

Special rules apply if the optionee surrenders previously-held shares of Common Stock to pay some or all of the exercise price. The exchange is tax-free with respect to the number of old shares equal to the number of new shares being acquired. The optionee's basis in the new shares is the same as that of the old shares and his holding period includes the time the old shares were held. The optionee must recognize ordinary income on any additional new shares acquired equal to the difference between (i) their fair market value on the date of exercise and (ii) any cash paid upon the exercise. The optionee's basis in such shares is their fair market value on the date they are transferred to him or her and the holding period commences on such date.

Neither an optionee nor the Company incurs any tax consequences as a result of the grant of an ISO. An optionee has no taxable income upon the exercise of an ISO, except that the difference between (i) the fair market value of the shares on the date of exercise and (ii) the exercise price is a tax preference item and is subject to the alternative minimum tax. The Company receives no deduction at the time of exercise.

If an optionee does not dispose of shares acquired upon exercise of an ISO for two years following the date of grant and one year following the date such shares were transferred to him or her upon exercise of the option, any gain (or loss) equal to the difference between (i) the exercise price and (ii) the sale proceeds will be long term. The Company is not entitled to a deduction under these circumstances. If the holding periods are not met prior to disposition (a "disqualifying disposition"), the optionee will recognize ordinary income equal to the difference between (i) the exercise price and (ii) the fair market value of the shares on the date of exercise (but in no event exceeding the gain realized on the sale). Any gain in excess of that taxed at ordinary-income rates will be long-term or short-term capital gain, depending on the length of time the shares were held. If no gain is realized, there generally will be no ordinary income and any loss will be a short-term or long-term capital loss. The special deferral and basis rules applicable to officers and directors pertain in these circumstances. The Company is entitled to a deduction equal to the amount of ordinary income recognized by the optionee.

If the optionee pays all or a portion of the exercise price of an ISO by surrendering shares previously acquired upon the exercise of an ISO and the requisite holding periods described above have not been met with respect to the old shares, such surrender will be deemed a "disqualifying disposition" and the ordinary-income tax consequences discussed above will apply. In other situations, complex rules exist with respect to the determination of the optionee's basis in the new shares.

1984 401(k) Investment Plan

All non-union employees of the Company who are on its United States payroll, including directors who are employees of the Company, and the employees of certain participating subsidiaries are eligible to participate in the Company's 1984 401(k) Investment Plan (the "Investment Plan"). The Investment Plan was amended and restated on November 7, 1985, to comply with the Tax Reform Act of 1984 and the Retirement Equity Act of 1984, and to make certain additional changes, including, but not limited to, an increase in participant contributions from 10% to 12% of compensation. The amended and restated Plan was amended in January and September of 1986 to add a fourth investment fund and to provide for the crediting of interest to amounts distributed to terminated participants. The Plan will also be amended, effective January 1, 1987, to comply with the Tax Reform Act of 1986.

Each participant may elect to contribute from 2% to 12% of his or her compensation. The Company matches 25% of the first 6% of the employee's compensation contributed to the Investment Plan, subject to a maximum Company matching contribution of $1,200 per employee per plan year ending September 30. An employee's contributions are made by deferring that portion of his or her compensation, thereby enabling such contributions to be made on a before-tax basis. Effective for taxable years beginning January 1, 1987, only $7,000 may be contributed by a participant during a calendar year on a before-tax basis. A participant is at all times fully vested in his or her contributions and becomes fully vested in Company contributions upon the last day of the fourth calendar quarter following the quarter for which such contributions were made. Contributions are held and invested by the Investment Plan trustee in four different funds. A participant may designate, within certain limitations, in which funds his or her accounts are to be invested. The Investment Plan permits participants to make withdrawals and to borrow from their accounts at market rates under certain conditions. In general, the vested portion of a participant's accounts is distributed in a single-sum cash payment upon his or her termination of employment.

Between July 1, 1984, (the inception of the Investment Plan) and November 28, 1986, the Company made matching contributions under the Investment Plan for the accounts of Messrs. Marshall, Rynne, McEvoy, and Peterson, all executive officers as a group, and all employees as a group in the amounts of $4,026, $3,622, $3,795, $3,567, $51,116, and $3,728,855, respectively.

Convertible Debenture Issuance

On September 26, 1985, the Company issued a 9.5% Convertible Subordinated Debenture Due September 26, 1989, (the "Debenture") in the principal amount of $1,667,500 to Mr. Treybig. The Company may redeem the Debenture in whole or in part beginning September 26, 1986. The Debenture is convertible into shares of the Company's Common Stock at $16.675 per share, which was 115% of the closing sale price of the Common Stock on the date of issuance of the Debenture. The principal amount which may be converted at any time is limited to the greater of (i) the amount which has been called for redemption but not yet redeemed or (ii) 25% of the aggregate principal amount commencing September 26, 1986, and an additional 25% each September 26 thereafter through 1989. If Mr. Treybig is disabled or dies or a "change in control," as defined, occurs, the entire amount then outstanding is convertible. The Debenture may not be transferred by Mr. Treybig except upon his death.

RATIFICATION OF INDEPENDENT AUDITORS

Upon the recommendation of the Audit Committee, the Board of Directors has reappointed the firm of Arthur Andersen & Co. as the Company's independent auditors for the 1987 fiscal year, subject to ratification by the stockholders. Representatives of Arthur Andersen & Co. are expected to be present at the Company's Annual Meeting. They will have an opportunity to make a statement, if they desire to do so, and will be available to respond to appropriate questions.

The Board of Directors recommends a vote FOR ratification of the appointment of Arthur Andersen & Co.

BOARD OF DIRECTORS MEETINGS AND COMMITTEES

The Company's Board Directors held four meetings during the 1986 fiscal year. All directors attended at least 75% of the aggregate number of meetings of the Board and of the committees on which such directors serve. Mr. Wriston became a director in July 1986 and was unable to attend the only meeting of the Board held after such time.

The Board of Directors of the Company has appointed an Audit Committee, Nominating Committee, and Compensation/Option Committee of the Board.

The current members of the Audit Committee are Messrs. Morton Collins, Franklin P. Johnson, Jr., and Thomas I. Unterberg. The Audit Committee held six meetings during the 1986 fiscal year. Its functions are to monitor the effectiveness of the audit effort, to supervise the Company's financial and accounting organization and financial reporting, and to select a firm of certified public accountants, whose duty it is to audit the books and accounts of the Company for the fiscal year for which they are appointed.

The current members of the Nominating Committee are Messrs. Franklin P. Johnson, Jr., Andrew Knight, Thomas J. Perkins, and Robert G. Stone, Jr. The Nominating Committee held two meetings during the 1986 fiscal year. The Nominating Committee's function is to select nominees for election as directors. The Nominating Committee will consider nominees recommended by stockholders. Such recommendations should be submitted in writing to the Nominating Committee in care of the Secretary of the Company at its address set forth on the front page of this Proxy Statement.

The current members of the Compensation/Option Committee are Messrs. Morton Collins, Thomas J. Perkins, and James G. Treybig. The Compensation/Option Committee held five meetings during the 1986 fiscal year. The Compensation/Option Committee's functions are to determine and supervise compensation to be paid to officers and directors of the Company and to supervise and manage the Company's Employee Stock Purchase Plan and stock option plans (except with respect to options granted to directors).

CERTAIN BENEFICIAL OWNERS

The following table sets forth information as of November 28, 1986, as to stockholders that have advised the Company that each is the beneficial owner of more than 5% of the Company's Common Stock.

	Beneficial Ownership of Common Stock	
	Number of Shares	Percent of Class
Sanford C. Bernstein & Co., Inc. 767 Fifth Avenue New York, NY 10153	3,465,577(1)	7.8
The Capital Group, Inc. 333 South Hope Street Los Angeles, CA 90071	3,407,000(2)	7.7
The Equitable Life Assurance Society of the United States 787—7th Avenue New York, NY 10019	2,575,850(3)	5.8

(1) Sanford C. Bernstein & Co., Inc. has advised the Company that as of September 30, 1986, it had sole voting power with regard to 1,250,650 shares and sole investment power with regard to 3,465,577 shares.

(2) The Capital Group, Inc., in its Schedule 13G dated February 12, 1986, advised the Company that the shares are held by three of its operating subsidiaries for various institutional investors. The subsidiaries have sole investment power with regard to 3,407,000 shares and one subsidiary has sole voting power with regard to 1,307,000 shares. The Capital Group, Inc. disclaims beneficial ownership of the shares.

(3) The Equitable Life Assurance Society of the United States, in its Schedule 13G dated February 14, 1986, advised the Company that the shares are held by it and two of its subsidiaries. These entities have sole investment power with regard to 2,575,850 shares and sole voting power with regard to 1,069,340 shares.

STOCKHOLDER PROPOSALS

To be considered for presentation at the Annual Meeting of Stockholders to be held in 1988, a stockholder proposal must be received at the offices of the Company, 19333 Vallco Parkway, Cupertino, California 95014, not later than September 10, 1987.

OTHER MATTERS

The Board of Directors knows of no other business which will be presented to the Annual Meeting. If any other business is properly brought before the Annual Meeting, it is intended that proxies in the enclosed form will be voted in accordance with the judgment of the persons voting the proxies.

Whether you intend to be present at the Annual Meeting or not, we urge you to return your signed proxy promptly.

By order of the Board of Directors,

THOMAS J. KLITGAARD
Secretary

EXHIBIT A

PROPOSED AMENDMENT TO TANDEM COMPUTERS INCORPORATED RESTATED CERTIFICATE OF INCORPORATION

ARTICLE XI*

A. A director of the corporation shall not be liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director except for liability which, by express provision of the General Corporation Law of Delaware as in effect from time to time (hereinafter "Delaware Law"), cannot be eliminated.

B. (i) The corporation shall, to the fullest extent permitted by Delaware Law, indemnify any person (the "Indemnitee") who is or was involved in any manner (including, without limitation, as a party or a witness) in any threatened, pending or completed investigation, claim, action, suit or proceeding, whether civil, criminal, administrative or investigative (including without limitation, any action, suit or proceeding brought by or in the right of the corporation to procure a judgment in its favor) (a "Proceeding"), by reason of the fact that Indemnitee is or was a director, officer, employee, agent, fiduciary or other official of the corporation, or is or was serving another entity or enterprise in such capacity at the request of the corporation, against all expenses and liabilities actually and reasonably incurred by Indemnitee in connection with such Proceeding.

(ii) The right to indemnification conferred by this Article XI shall be presumed to have been relied upon by Indemnitee and shall be enforceable as a contract right. The corporation may enter into contracts to provide individual Indemnitees with specific rights of indemnification to the fullest extent permitted by Delaware Law and may create trust funds, grant security interests, obtain letters of credit or use other means to ensure the payment of such amounts as may be necessary to effect the rights provided in this Article XI or in any such contract.

(iii) Upon making a request for indemnification, Indemnitee shall be presumed to be entitled to indemnification under this Article Seventh and the corporation shall have the burden of proof to overcome that presumption in reaching any contrary determination. Such indemnification shall include the right to receive payment in advance of any expenses incurred by Indemnitee in connection with any Proceeding, consistent with the provisions of Delaware Law.

C. Any repeal or modification of the foregoing provisions of this Article Seventh shall not adversely affect any right or protection of any director or any Indemnitee existing at the time of such repeal or modification.

ARTICLE VII**

This corporation reserves the right to amend, alter, change or repeal any provisions contained in this Certificate of Incorporation in any manner now or hereafter prescribed by law, and all rights herein conferred upon the stockholders are granted subject to this reservation; <u>provided, however, that the affirmative vote of the holders of at least 80% of the voting power of all of the then-outstanding shares of the capital stock of this corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required to amend or repeal this Article VII or Article XI hereof.</u>

* Article XI is new.

** New Portion of Article VII is underscored.

EXHIBIT A

PROPOSED AMENDMENT TO TANDEM COMPUTERS INCORPORATED RESTATED CERTIFICATE OF INCORPORATION

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A. A director of the corporation shall not be liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability which, by express provision of the General Corporation Law of Delaware as in effect from time to time (hereinafter "Delaware Law"), cannot be eliminated.

B. (i) The corporation shall, to the fullest extent permitted by Delaware Law, indemnify any person (the "Indemnitee") who is or was involved in any manner (including, without limitation, as a party or a witness) in any threatened, pending or completed investigation, claim, action, suit or proceeding, whether civil, criminal, administrative or investigative (including without limitation, any action, suit or proceeding brought by or in the right of the corporation to procure a judgment in its favor) (a "Proceeding"), by reason of the fact that Indemnitee is or was a director, officer, employee, agent, fiduciary or other official of the corporation, or is or was serving another entity or enterprise in such capacity at the request of the corporation, against all expenses and liabilities actually and reasonably incurred by Indemnitee in connection with such Proceeding.

(ii) The right to indemnification conferred by this Article XI shall be presumed to have been relied upon by Indemnitee and shall be enforceable as a contract right. The corporation may enter into contracts to provide individual Indemnitees with specific rights of indemnification to the fullest extent permitted by Delaware Law and may create trust funds, grant security interests, obtain letters of credit or use other means to ensure the payment of such amounts as may be necessary to effect the rights provided in this Article XI or in any such contract.

(iii) Upon making a request for indemnification, Indemnitee shall be presumed to be entitled to indemnification under this Article Seventh and the corporation shall have the burden of proof to overcome that presumption in reaching any contrary determination. Such indemnification shall include the right to receive payment in advance of any expenses incurred by Indemnitee in connection with any Proceeding, consistent with the provisions of Delaware Law.

C. Any repeal or modification of the foregoing provisions of this Article Seventh shall not adversely affect any right or protection of any director or any Indemnitee existing at the time of such modification.

ARTICLE VII**

This corporation reserves the right to amend, alter, change or repeal any provision contained in its Certificate of Incorporation in any manner now or hereafter prescribed by law, and all rights conferred upon the stockholders are granted subject to this reservation; provided, however, that the affirmative vote of the holders of at least 80% of the voting power of all of the then-outstanding shares of the capital stock of this corporation entitled to vote generally in the election of directors, voting together as a single class, shall be required to amend or repeal this Article VII or Article XI hereof.

* Article XI is new.

** New Portion of Article VII is underscored.

EXHIBIT B

DIRECTORS' FORM OF INDEMNIFICATION AGREEMENT

THIS INDEMNIFICATION AGREEMENT is entered into this day of , 19 ("Agreement"), by and between TANDEM COMPUTERS INCORPORATED, a Delaware corporation (the "Company"), and (the "Director").

In consideration of the mutual promises in this Agreement, and intending to be legally bound, the Company and Director hereby agree as follows:

SECTION 1. *Services by Director.* Director agrees to serve as a director of the Company or any of its subsidiaries for such period of time as he is duly appointed or elected and qualified, or until he resigns, is removed, or fails to stand for election.

SECTION 2. *Maintenance of Insurance.* As long as Director continues to serve as a director and thereafter as long as Director is subject to any possible proceeding because Director served in such capacity, the Company shall promptly purchase from reputable issuers and maintain in full force and effect one or more valid, binding, and enforceable Directors' and Officers' Liability Insurance Policies ("D&O Insurance") for the benefit of Director, which policies shall provide a reasonable amount of coverage for Expenses and Liabilities.

SECTION 3. *Indemnification.* (a) The Company shall indemnify Director against Expenses and Liabilities in connection with any Proceeding arising out of acts or omissions of Director occurring subsequent to the date hereof to the full extent permitted by applicable law or the Restated Certificate of Incorporation of the Company in effect on the date hereof or as such law or Restated Certificate of Incorporation may from time to time be amended (but, in the case of any such amendment, only to the extent such amendment permits the Company to provide broader indemnification rights than the law or Restated Certificate of Incorporation permitted the Company to provide before such amendment). The right to indemnification provided in the Restated Certificate of Incorporation shall be presumed to have been relied upon by Director in serving or continuing to serve the Company and shall be enforceable as a contract right. Without diminishing the scope of the indemnification provided by this Section 3, the Company shall indemnify Director (i) whenever he is or was a party or is threatened to be made a party to any Proceeding, other than a Proceeding brought by or in the right of the Company, because he is or was an Agent or because of anything done or not done by him in such capacity, against Expenses and Liabilities actually and reasonably incurred by Director or on his behalf in connection with such Proceeding, including the costs of any investigation, defense, settlement, or appeal and (ii) whenever he is or was a party or is threatened to be made a party to any Proceeding brought by or in the right of the Company because he is or was an Agent or because of anything done or not done by him in such capacity, against Expenses actually and reasonably incurred by Director or on his behalf in connection with such Proceeding, including the costs of any investigation, defense, settlement, or appeal, except that no indemnification shall be made with respect to any claim, issue, or matter if Director was finally adjudged to be liable to the Company by a court of competent jurisdiction due to his gross negligence unless and to the extent that a Delaware Court of Chancery or the court in which the action was heard determines that Director is entitled to indemnification for such amounts as the court deems proper.

(b) Director shall be paid promptly by the Company all amounts necessary to effectuate the foregoing indemnity.

SECTION 4. *Advancement of Expenses; Letter of Credit.*

(a) *Advances.* All reasonable Expenses incurred by or on behalf of Director shall be advanced to him from time to time by the Company within 20 days after the Company's receipt of a written request for an advance of Expenses, whether prior to or after final disposition of a Proceeding (unless there has been a final determination that Director is not entitled to be indemnified for such Expenses), including without limitation any Proceeding brought by or in the right of the Company. The request shall contain a description in reasonable detail of the Expenses incurred by Director. If required by law at the time of such advance, Director will agree to repay the amounts advanced if it is ultimately determined that he is not entitled to be indemnified pursuant to the terms of this Agreement.

(b) *Letter of Credit.* To secure the obligations of the Company to indemnify Director against Expenses and to advance Expenses to Director pursuant to this Agreement, at the time of any Triggering Event the Company shall obtain an irrevocable standby letter of credit naming Director as the sole beneficiary (the "Letter of Credit"). The Letter of Credit shall be in a reasonable amount, but in no event less than $1,000,000, issued by a financial institution having assets in excess of $100 million and containing terms and conditions reasonably acceptable to Director. The Letter of Credit shall provide that Director may from time to time draw amounts thereunder to pay Expenses, upon written certification by Director to the issuer of the Letter of Credit that (i) Director has made written request of the Company for an amount not less than the amount he is drawing under the Letter of Credit and that the Company has failed or refused to provide him such amount in full with 20 days after receipt of the request and (ii) Director believes that he is entitled under the terms of this Agreement to the amount that he is drawing under the Letter of Credit.

(c) *Term of Letter of Credit.* Once a Triggering Event occurs, the Company shall maintain and renew the Letter of Credit or a substitute letter of credit meeting the criteria of Section 5(b) during the term of this Agreement. The Letter of Credit shall have an initial term of five years, be renewed for successive five-year terms, and always have at least one year of its term remaining. The issuance of the Letter of Credit shall not, in any way, diminish the Company's obligation to indemnify Director against all Expenses to the full extent required by this Agreement.

SECTION 5. *Procedure for Determination of Entitlement to Indemnification.*

(a) Whenever Director believes that he is entitled to indemnification against Expenses or Liabilities pursuant to this Agreement, Director shall submit a written request for indemnification to the Company to the attention of the President or the Secretary. This request shall include such documentation or information as is then reasonably available to Director to support his claim for indemnification. A final determination of Director's entitlement to indemnification shall be made not later than 90 days after the Company's receipt of his written request for such indemnification. In any event, Director shall submit his claim for indemnification within a reasonable time, not to exceed five years, after any settlement, dismissal, conviction, acceptance of a plea of nolo contendere or its equivalent, or final termination of any Proceeding, whichever is the later date for which Director requests indemnification. The President or the Secretary shall, promptly upon receipt of Director's request for indemnification, advise the Board in writing of such request.

(b) Director's written request may designate the forum which shall determine his entitlement to indemnification. The forum shall be one of the following:

(i) A quorum of Disinterested Directors of the Board, provided that such quorum shall not be less than three persons;

(ii) Independent Counsel selected by Director, and reasonably approved by the Board, which counsel shall make the determination in a written opinion; or

(iii) A panel of three arbitrators, one selected by the Company, another by Director, and the third by the first two arbitrators selected. If for any reason three arbitrators are not selected within 30 days after the appointment of the first arbitrator, selection of the remaining arbitrator(s) shall be made by the American Arbitration Association. If any arbitrator resigns or is unable to serve in such capacity for any reason, the American Arbitration Association shall select his replacement. The arbitration shall be conducted pursuant to the commercial arbitration rules of the American Arbitration Association now in effect.

If Director fails to make such designation, his claim shall be determined by an appropriate court of the State of Delaware.

SECTION 6. *Presumptions and Effect of Certain Proceedings.* Upon making a request for indemnification, Director shall be presumed to be entitled to indemnification under this Agreement. The Company shall have the burden of proof to overcome that presumption in any action or proceeding under Section 5(b) to determine Director's right to indemnification. If the person or persons empowered in Section 5(b)(i) through (iii) fail to make a determination of whether Director is entitled to indemnification within 90 days after Director has submitted his request for such determination, the determination of such entitlement shall be deemed to have been made in favor of Director and Director shall be absolutely entitled to indemnification under this Agreement, absent (i) misrepresentation by Director of a material fact in the request for indemnification or (ii) a final judgment by a Delaware Court of Chancery that all or any part of such indemnification is expressly prohibited by law. The termination of any Proceeding by a judgment or order adverse to Director, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not of itself (a) adversely affect the rights of Director to indemnification except as may be provided herein, (b) create a presumption that Director did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Company, or (c) with respect to any criminal action or proceeding, create a presumption that Director had reasonable cause to believe that his conduct was unlawful.

SECTION 7. *Remedies of Director in Cases of Determination not to Indemnify or to Advance Expenses.*

(a) In the event that (i) an initial determination is made by a forum specified in Section 5(b)(i) through (iii) that Director is not entitled to indemnification, (ii) advances are not made pursuant to this Agreement, (iii) payment has not been timely made following a determination of entitlement to indemnification pursuant to this Agreement, or (iv) Director otherwise seeks enforcement of this Agreement, Director shall be entitled to a final adjudication of his rights in an appropriate court of the State of Delaware. The Company shall not oppose Director's right to seek any such adjudication. In any such proceeding, Director shall be presumed to be entitled to indemnification under this Agreement and the Company shall have the burden of proof to overcome that presumption.

(b) In the event a determination previously has been made, in whole or in part, that Director is not entitled to indemnification, the decision in the judicial proceeding provided in paragraph (a) of this Section 7 shall be made de novo.

(c) If a determination previously has been made or deemed to have been made pursuant to the terms of this Agreement that Director is entitled to indemnification, the Company shall be bound by such determination in the absence of (i) a misrepresentation of a material fact by Director or (ii) a specific finding (which has become final) by an appropriate court of the State of Delaware that all or any part of such indemnification is expressly prohibited by law.

(d) In any court proceeding pursuant to this Section 7, the Company shall be precluded from asserting that the procedures and presumptions of this Agreement are not valid, binding, and enforceable. The Company shall stipulate in any such proceeding that the Company is bound by all the provisions of this Agreement and is precluded from making any assertion to the contrary.

(e) Expenses incurred by Director in connection with his request for indemnification under, seeking enforcement of, or to recover damages for breach of this Agreement shall be borne by the Company.

SECTION 8. *Other Rights to Indemnification.* Director's rights of indemnification and advancement of Expenses provided by this Agreement shall not be deemed exclusive of any other rights to which Director may now or in the future be entitled under applicable law, the Restated Certificate of Incorporation, By-laws, agreement, vote of stockholders, resolution of the Board of Directors, or otherwise.

SECTION 9. *Limitations on Indemnity.* The Company shall not be liable under this Agreement to make any payment to Director to the extent that he has already been reimbursed therefor pursuant to such D&O Insurance as the Company may maintain for his benefit. However, Director may claim indemnification directly from the Company pursuant to this Agreement by assigning to the Company any claims under such insurance to the extent he is reimbursed by the Company.

SECTION 10. *Duration and Scope of Agreement.* This Agreement shall continue so long as Director may be subject to any possible Proceeding because he is or was an Agent and shall be applicable to Proceedings commenced after execution of this Agreement arising from acts or omissions occurring after such execution.

SECTION 11. *Binding Effect.* This Agreement shall be binding upon the Company and its successors and assigns and shall inure to the benefit of Director and his spouse, assigns, heirs, devisees, executors, administrators, and other legal representatives.

SECTION 12. *Severability.* If any provision or provisions of this Agreement (or any portion thereof) shall be held to be invalid, illegal, or unenforceable for any reason whatsoever, (a) the validity, legality, and enforceability of the remaining provisions of this Agreement shall not in any way be affected or impaired thereby, and (b) so far as legally permitted, the remaining provisions of this Agreement shall be construed so as to give effect to the intent manifested by the provision held invalid, illegal, or unenforceable.

SECTION 13. *Interpretation of Agreement.* This Agreement shall be interpreted so as to provide indemnification to Director to the fullest extent now or hereafter permitted by law.

SECTION 14. *Definitions.* For purposes of this Agreement:

(a) "Agent" shall mean any person who is or was a director, officer, employee, agent, fiduciary, or other official of (i) the Company (which term shall include any predecessor corporation) or a subsidiary of the Company or (ii) any domestic or foreign corporation, partnership, joint venture, trust, employee benefit plan (as such term is defined in section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA")), or other enterprise either at the request of, or to represent the interests of the Company or a subsidiary of the Company; or is determined or alleged to hold any such office or status.

(b) "Disinterested Director" shall mean a director of the Company who is not or was not a party to the Proceeding in respect of which indemnification is being sought by Director.

(c) "Expenses" shall include all direct and indirect costs (including, without limitation, attorneys' fees, retainers, court costs, transcripts, fees of experts, witness fees, travel expenses, duplicating costs, printing and binding costs, telephone charges, postage, delivery service fees, all other disbursements and out-of-pocket expenses, and lost wages and other lost compensation for time spent by Director for which he is not compensated by the Company) actually and reasonably incurred in connection with either the investigation, defense, settlement, or appeal of a Proceeding or establishing or enforcing a right to indemnification under this Agreement or applicable law; provided, however, that "Expenses" shall not include any judgments, fines, ERISA excise taxes or penalties, or amounts paid in settlement.

(d) "Independent Counsel" shall mean a law firm or a member of a law firm that neither is presently nor in the past five years has been retained to represent (i) the Company or Director in any matter material to either party or (ii) any other party to the Proceeding giving rise to a claim for indemnification hereunder. Further, the term "Independent Counsel" shall not include any person who, under the applicable standards of professional conduct then prevailing, would have a conflict of interest in representing either the Company or Director in an action to determine Director's right to indemnification under this Agreement.

(e) "Liabilities" shall mean all liabilities of any type whatsoever, including, but not limited to, judgments, fines, ERISA excise taxes or penalties, and amounts paid in settlement.

(f) "Proceeding" shall mean any action, suit, arbitration, alternate dispute resolution mechanism, investigation, administrative hearing, or any other proceeding whether civil, criminal, administrative, or investigative.

(g) "Triggering Event" shall mean the acquisition by any person (other than the Company) of 30% or more of the outstanding shares of common stock of the Company unless a majority of the entire Board, which shall include the affirmative vote of at least one director from each class of the Board, shall have earlier approved such acquisition.

SECTION 15. *Modification and Waiver.* No modification, amendment, or waiver of this Agreement or any term hereof shall be binding unless executed in writing by both of the parties to this Agreement. No waiver of any provision of this Agreement shall be deemed to constitute a waiver of any other provision hereof (whether or not similar) nor shall such waiver constitute a continuing waiver.

SECTION 16. *Notice by Director and Defense of Claims.* Director shall promptly notify the Company in writing upon being served with any summons, citation, subpoena, complaint, indictment, information, or other document relating to any matter which may be subject to indemnification hereunder, whether civil, criminal, administrative, or investigative; but the omission so to notify the Company shall not relieve the Company from any liability which it may have to Director if such omission does not prejudice the Company's rights. If such failure does prejudice the Company's rights, the Company shall be relieved from liability only to the extent of such prejudice. Such failure shall not relieve the Company from any liability which it may have to Director apart from this Agreement. With respect to any Proceeding as to which Director gives such notice to the Company:

(a) The Company shall be entitled to participate therein at its own expense.

(b) Except as otherwise provided below, the Company shall be entitled to assume the defense of Director therein, with counsel reasonably satisfactory to Director. After notice from the Company to Director of its election to assume the defense of Director, the Company shall not be liable to Director under this Agreement for any Expenses subsequently incurred by Director in connection with the defense thereof other than Director's reasonable costs of investigation or as otherwise provided below. Director shall have the right to employ his counsel in such Proceeding, but the fees and expenses of such counsel incurred after notice from the Company of its assumption of the Director's defense shall be at the expense of Director unless (i) the employment of counsel by Director has been authorized by the Company, (ii) Director shall have reasonably concluded that there may be a conflict of interest between the Company and Director in the conduct of the defense of such Proceeding or that counsel retained by the Company may not adequately represent Director's interests, (iii) a Triggering Event shall have occurred, or (iv) the Company shall not in fact have employed counsel to assume the defense of Director in such Proceeding, in each of which cases the fees and expenses of counsel shall be at the expense of the Company. The Company shall not be entitled to assume the defense of Director in any Proceeding as to which Director shall have reached the conclusion provided in (ii) above or if an event specified in (iii) above shall have occurred.

(c) The Company shall not be liable to indemnify Director under this Agreement for any amounts paid by Director in settlement of any Proceeding effected without the Company's written consent. The Company shall not settle any Proceeding in any manner which would impose any penalty or limitation on Director without Director's written consent. Neither the Company nor Director will unreasonably withhold their consent to any proposed settlement.

SECTION 17. *Notices.* All notices, requests, and demands hereunder shall be in writing and shall be deemed to have been duly given if (i) delivered by hand to the other party or (ii) mailed by certified or registered mail, with first class postage prepaid, addressed as follows:

(a) If to Director, to:

....

....

....

(b) If to the Company, to:

Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, CA 95014
Attn: Corporate Secretary

With a copy to:

President and Chief Executive Officer

or to such other address as previously may have been furnished in writing to the other party.

SECTION 18. *Governing Law.* This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Delaware, as applied to contracts between Delaware residents entered into and to be performed entirely within Delaware.

SECTION 19. *Consent to Jurisdiction.* The Company and Director each hereby irrevocably consent to the jurisdiction of the courts of the State of Delaware for all purposes in connection with any Proceeding which arises out of or relates to this Agreement and agree that any Proceeding instituted under this Agreement shall be brought only in the courts of the State of Delaware.

SECTION 20. *Pronouns.* Use of the masculine pronoun shall be deemed to include usage of the feminine pronoun where appropriate.

SECTION 21. *Headings.* The headings of the Sections and paragraphs of this Agreement are inserted for convenience only and shall not be deemed to constitute part of this Agreement or to affect its construction.

SECTION 22. *Identical Counterparts.* This Agreement may be executed in one or more counterparts, each of which shall for all purposes be deemed to be an original but all of which together shall constitute one and the same Agreement. Only one such counterpart signed by the party against whom enforceability is sought needs to be produced to evidence the existence of this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the day and year first above written.

ATTEST:	TANDEM COMPUTERS INCORPORATED
By	By ....
	Director
	....
	Address: ....

SECTION 18. *Governing Law.* This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware as applied to contracts entered into [illegible] and to be performed entirely within Delaware.

SECTION 19. *Consent to Jurisdiction.* The Company and each [illegible] irrevocably [illegible] jurisdiction of the courts of the State of Delaware [illegible] in connection with [illegible] this Agreement [illegible] that any Proceeding [illegible] shall be brought only in the courts of the State of Delaware.

SECTION 20. *Headings.* [illegible] used herein are for convenience of reference only [illegible].

SECTION 21. *Entire Agreement.* [illegible] constitute a part of this Agreement [illegible] consideration.

SECTION 22. *Counterparts.* This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, but all of which together [illegible] one and the same instrument. [illegible]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the day and year first above written.

[illegible] CORPORATION

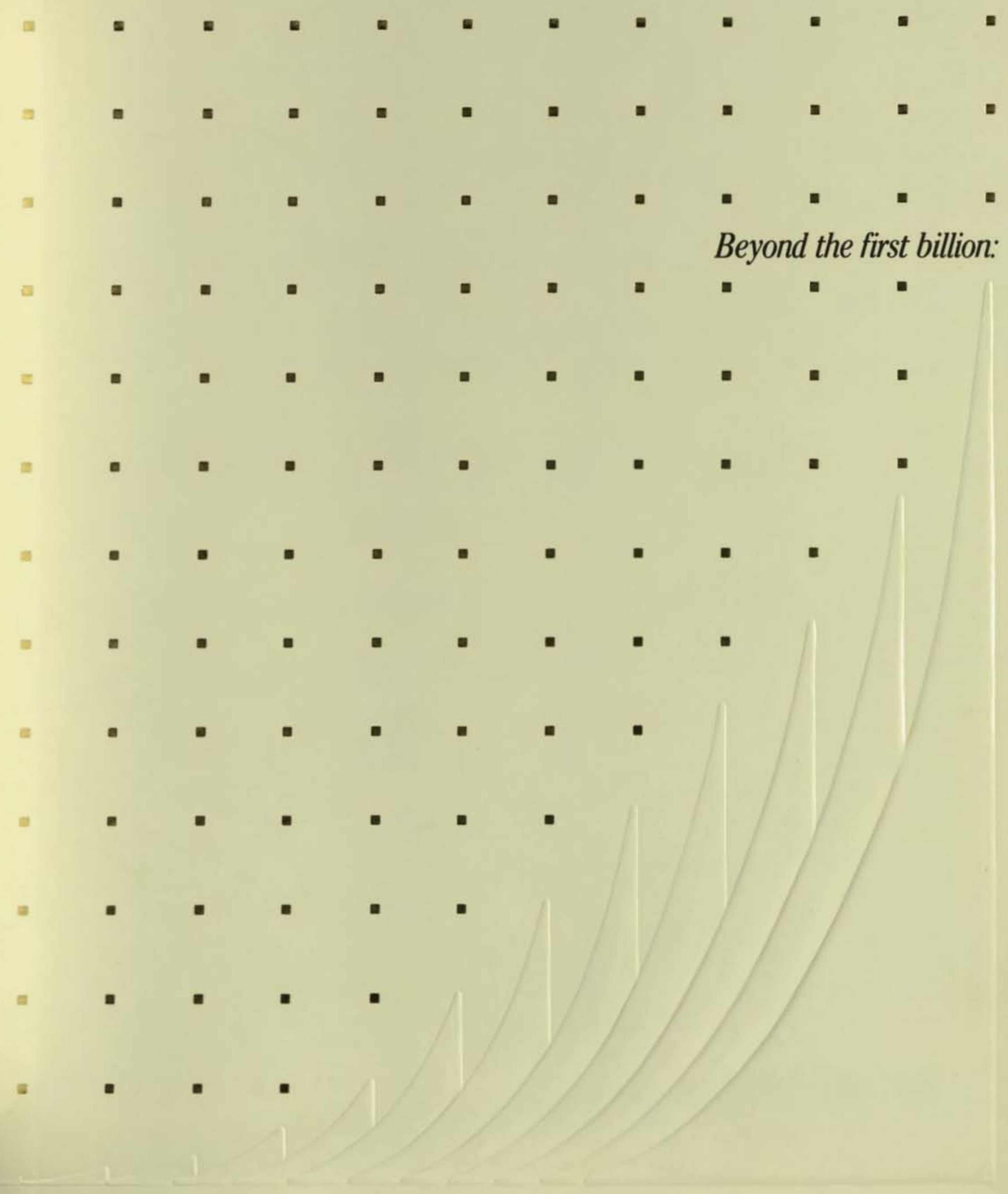
By [illegible]

Dated [illegible]

Address [illegible]

TANDEMCOMPUTERS ◆◆◆ 1987 ANNUAL REPORT

Beyond the first billion:



Highlights

Fiscal Year Ended September 30	1987	1986	1985
Revenue	$1,035,495,000	$767,793,000	$624,138,000
Operating income	$ 170,688,000	$105,978,000	$ 50,081,000
Operating margin	16.5%	13.8%	8.0%
Net income	$ 105,604,000	$ 63,766,000	$ 34,374,000
Earnings per share	$ 1.08	$ .72	$ .41
Working capital	$ 495,540,000	$384,419,000	$297,964,000
Total assets	$ 967,241,000	$705,025,000	$552,344,000
Stockholders' investment	$ 720,919,000	$534,680,000	$420,408,000
Number of employees	7,007	5,719	5,494

Tandem Computers Incorporated, founded 13 years ago, today ranks as a Fortune 500 company and employs over 7,000 people worldwide. It is a leading supplier of computer systems and networks for on-line transaction processing. Tandem systems are widely used to run ATM and point-of-sale networks, stock exchanges, factories, and other enterprises where hundreds of business transactions must be processed each second and recorded instantly.

Tandem provides the fully compatible family of NonStop systems that span the range of performance requirements for on-line transaction processing applications. NonStop systems can run the same applications and can be networked with each other and with equipment from other vendors to provide a single computing resource for an organization. The Company also offers a UNIX® based system, as well as two lines of workstations.

Tandem supports its customers from over 150 locations worldwide and manufactures its products in the United States, Mexico, and West Germany.

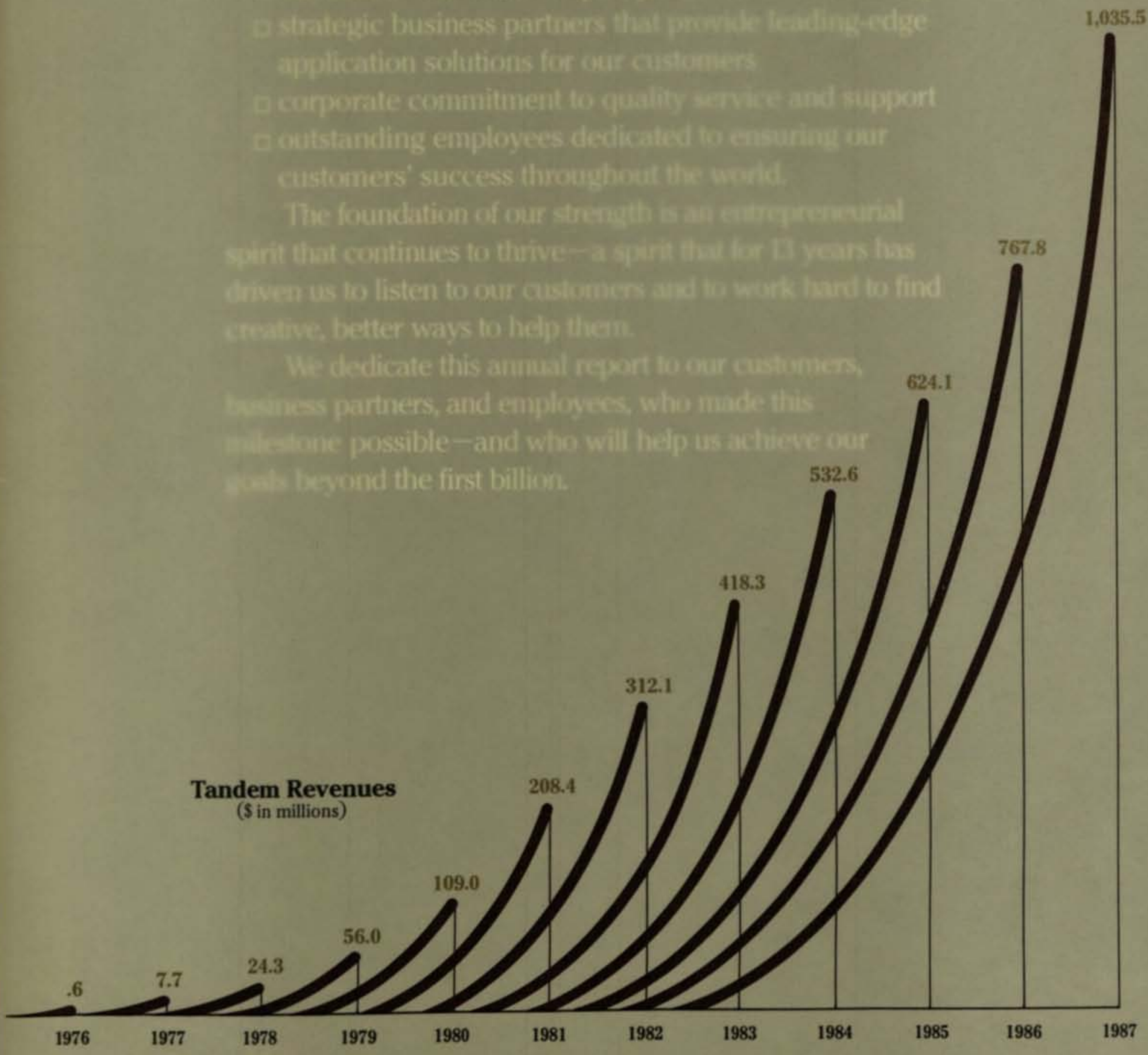
Tandem is moving beyond its first billion-dollar year with momentum and strength.

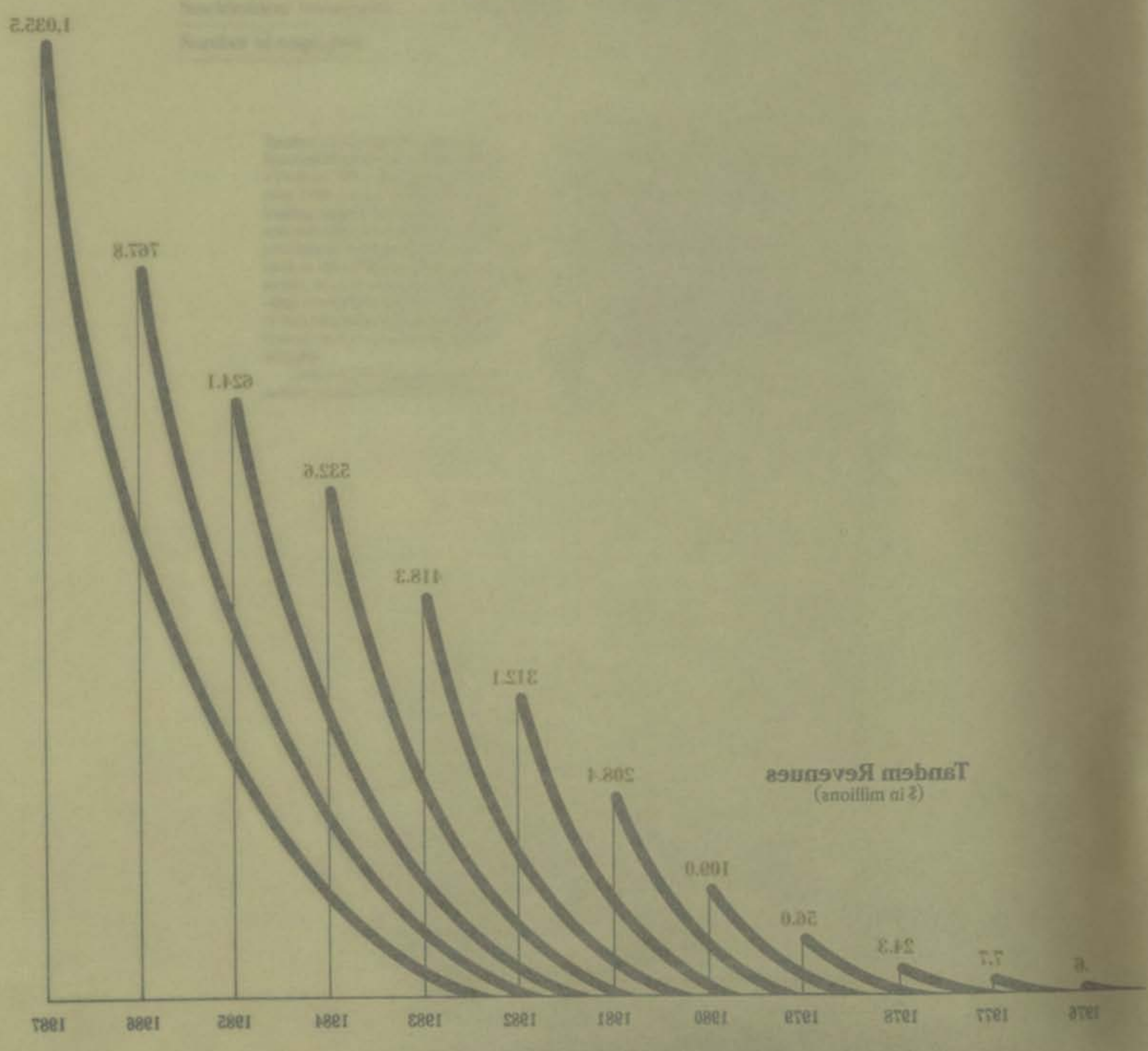
The winning strategies of Tandem customers worldwide drive that momentum—strategies significantly enhanced by Tandem's:

- □ excellence and leadership in products and technology
- □ strategic business partners that provide leading-edge application solutions for our customers
- □ corporate commitment to quality service and support
- □ outstanding employees dedicated to ensuring our customers' success throughout the world.

The foundation of our strength is an entrepreneurial spirit that continues to thrive—a spirit that for 13 years has driven us to listen to our customers and to work hard to find creative, better ways to help them.

We dedicate this annual report to our customers, business partners, and employees, who made this milestone possible—and who will help us achieve our goals beyond the first billion.




Tandem Revenues
($ in millions)
1,035.5
767.8
624.1
532.6
418.3
312.1
208.4
109.0
56.0
24.3
7.7
.6
1987
1986
1985
1984
1983
1982
1981
1980
1979
1978
1977
1976

Tandem is moving beyond its first billion-dollar year with momentum and strength.

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This has been a year of tremendous achievement for Tandem. We reached a major milestone by surpassing $1 billion in revenue for fiscal 1987, with strong earnings growth over last year.

Our fiscal 1987 results reached record levels in both revenue and earnings. Compared with fiscal 1986, revenue grew 35 percent to $1.035 billion, up from $768 million, and earnings per share grew 50 percent to $1.08, up from $.72.

Worldwide, our business showed significant strength. U.S. sales improved markedly, up 27 percent from fiscal 1986. International business grew 47 percent and now accounts for 43 percent of our revenue.

In April 1987, Tandem Common Stock was traded for the first time on the New York Stock Exchange. Listing on the Exchange increases our visibility in international markets and allows our stock to be traded more widely.

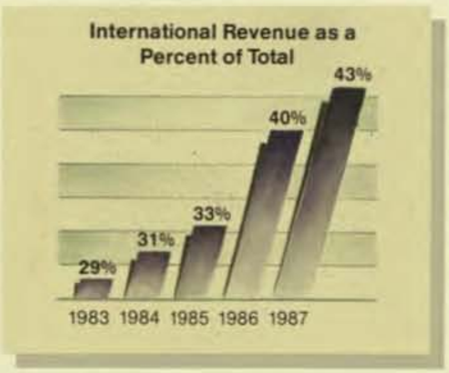
Strategic New Products

During the year, we announced a record number of hardware and software products.

The NonStop SQL distributed relational database management system, based on the industry-standard Structured Query Language (SQL) interface, provides the industry's first relational database software that combines high productivity with high performance. It significantly expands the markets for our products and gives us a competitive advantage.

At the high end of our product offerings, we added six models to the NonStop VLX mainframe line. At the low end, we significantly strengthened our position to meet the growing demand for distributed processing and networking by extending our GUARDIAN software-based product family with the introduction of the CMOS-based NonStop CLX system.

The LXN multiuser system, also introduced in 1987, is Tandem's first offering for users of UNIX software. It is an important product for us, one that will allow us to open new markets and develop additional distribution channels.



To capture transactions generated on the desktop, we added new models to our 6AX workstation family; and, late in the year, we announced the PSX workstations, a new line of MS-DOS- and OS/2-based workstations designed around Intel 80286 and 80386 microprocessors.

To address the important area of workstation integration, we began installing our MULTILAN local area network product at customer sites. MULTILAN allows customers to connect workstations to Tandem systems through nearly every type of local area network.

Recognizing the need to integrate and manage large networks of distributed systems and applications, we introduced the Distributed Systems Management software.

Developing New Markets

Tandem continued to focus on strategic relationships with other companies to develop opportunities in new industries and to expand current markets.

We worked to strengthen relationships with more than 280 software providers and value-added resellers (VARs) in Tandem's Alliance program and, through agreements with VARs, we opened new distribution channels.

Earnings Per Share
(amounts reflect a 2-for-1 stock split)

(*includes $.12 benefit from DISC tax reversal)

Responding to the market opportunity for automation and integration in manufacturing, we announced the Tandem Integrated Manufacturing Environment (T.I.M.E.) strategy. We joined with three industry leaders, Electronic Data Systems (EDS), Boeing Computer Services, and MSA Advanced Manufacturing Inc., to develop new software solutions for this market.

Also in 1987, we signed an agreement with a value-added reseller, Ultimate Corporation, which allows us to offer OLTP capabilities to the user base that has developed applications on the PICK operating system.

We made equity investments in companies whose strategies complement our own. Netlink, a leading-edge supplier of SNA interfaces, strengthens our ability to integrate Tandem systems into SNA networks. Automated Monitoring and Control International, Inc. (AMCI), a joint venture with Union Pacific and SEL Canada, will allow us to seek new opportunities in the transportation industry.

Shortly after the close of the fiscal year, we agreed to acquire Atalla Corporation, a leading supplier of secure transaction systems. Atalla's market presence and extensive experience in security systems complement our own position in financial and retail markets.

Excellence in Service and Support

During the year, we significantly strengthened our service and support organizations. Emphasizing our commitment to quality service for customers, we added a vice president of Customer Engineering to our executive staff and introduced a number of new service and support options.

To reduce service costs and enhance flexibility, we introduced our first user-serviceable systems, which diagnose faults and alert the computer operator. In the U.S., users will be able to order parts by phone and have them dispatched for overnight delivery.

Outstanding Employee Productivity

To ensure quality support for a growing customer base and to support our future growth, we made the first material increase in our employee population since 1984, adding employees in sales, support, field administration, and research and development. At the end of fiscal 1987, the number of employees worldwide reached 7,007, compared to 5,719 at the close of fiscal 1986.

Employee productivity is at an all-time high, with annual revenue per employee reaching a record $163,000. People remain our most important asset, and we are investing in them through innovative educational and management development programs.

We are proud of our results in fiscal 1987. This annual report provides a perspective of the past and the future of the Company. It includes statements from Tandem's original business plan. This plan is used at the Stanford Graduate School of Business as an example of a strategy successfully implemented.

Our original business strategy has been the foundation for our success. The ongoing evolution and implementation of our long-term market and product strategies provide momentum for our goal of continued growth.

The management and employees of Tandem have their sights set well beyond the first billion. We believe we have put the programs and products in place to help us achieve that goal.

James G. Treybig (left), President and Chief Executive Officer; Thomas J. Perkins, Chairman of the Board.

Sincerely,

James G. Treybig
President and Chief Executive Officer

Thomas J. Perkins
Chairman of the Board

November 13, 1987

Beyond the first billion:

Tandem's unique parallel architecture and leading-edge products designed for the on-line transaction processing market provide the Company and its customers with strategic competitive advantages.

"Multiprocessing is the next major direction in computing.... Computers, as conventionally designed, are not intended to work together, and these redundant systems are slow, difficult to program, excessively expensive, difficult or impossible to expand, and, sadly, not fail-safe."

–Tandem's original business plan, 1974

The New York Stock Exchange on one of the record-breaking volume days in October 1987.

1976

The Securities Industry Automation Corporation (SIAC) is charged with the monumental task of providing automation support to the New York and American stock exchanges.

SIAC uses Tandem systems to support almost every area of the securities industry, including order processing, trading, and market data reporting for the New York Stock Exchange.

In 1976, anticipating dramatic growth in stock trading volume and the need for a highly reliable computer system that could grow efficiently with it, SIAC looked to two-year-old Tandem Computers.

At the time, typical daily trading volume on the New York Stock Exchange was 20 to 30 million shares. As predicted by SIAC, this volume increased steadily over the next ten years. By the end of fiscal 1987, SIAC was using a network of 22 Tandem systems (more than 200 processors) to handle an average of 170 million shares daily.

A critical test for the Tandem systems came on October 19 and 20, 1987, when the 22 systems, intended to process up to 450 million shares daily, successfully handled over 600 million shares on successive days.

As it did ten years ago, SIAC today forecasts sweeping changes in trading floor support systems, and it plans to work with Tandem to meet these new opportunities.

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Around the world, 28 securities and commodities exchanges and over 40 brokerage firms use Tandem systems—positioning the Company to grow as deregulation and competition drive the industry toward greater efficiency, 24-hour trading, and greatly increased transaction rates.

In 1976, Tandem revolutionized the computer industry by introducing a totally new parallel computer architecture designed specifically for the on-line transaction processing (OLTP) marketplace.

OLTP is characterized by the continual need for instantaneous information to support vital aspects of business operations. OLTP is the industry's most demanding environment because system failures and loss of or damage to a user's databases can seriously disrupt business operations.

In stock exchanges, retail stores, factories, communications companies, airlines, and other organizations, the number of transactions that must be processed is burgeoning, creating an increasing demand for on-line transaction processing systems that market analysts forecast will exceed $49 billion within the next five years.

Customers have come to trust and depend on Tandem products to run mainstream applications for one simple reason: Tandem systems provide a competitive advantage.

Many industry experts consider the Company a technology leader in OLTP. At Tandem, technology leadership starts with a unique parallel computer architecture.

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Tandem Sets the OLTP Standard

We believe that Tandem sets the standard by which all other OLTP systems must be judged. Many users of on-line systems have found the fundamental elements of Tandem's architecture—linear expandability, data integrity, fault tolerance, inherent networking, and high performance—are requirements in the demanding OLTP environment.

Tandem's flexible, parallel architecture has become a strategic competitive advantage to many customers who have been first in their industries to deliver new revenue-generating services with OLTP systems.

Because of their network foundation, Tandem systems are well suited to meet the increasing demand for distributed computing and networking. There are Tandem systems for virtually any transaction processing need—from small, stand-alone systems to those handling hundreds of transactions per second in a single mainframe or across networks of branch office systems.

Over the years, Tandem has enriched its product offerings by using higher performance, state-of-the-art technologies, without sacrificing software compatibility. This allows customers to increase processing power while maintaining their investments in existing software applications.

Improving the ratio of price to performance is a key part of Tandem's strategy. In April, Tandem addressed the requirement for cost-effective, low-end systems with the introduction of the NonStop CLX and LXN systems for smaller network nodes or remote locations.

Equally important is the Company's emphasis on the development of software that makes distributed processing easier and more cost-effective.

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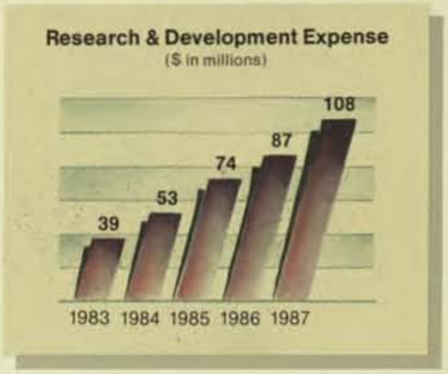
Distributed Database Management

The cornerstone of Tandem's distributed processing strategy is an important new product, the NonStop SQL relational database management system. We believe it provides a compelling reason for customers to develop new applications on Tandem systems.

NonStop SQL software conforms to an emerging industry standard for relational database management systems that provides significant productivity improvements for application developers.

Before the introduction of NonStop SQL software, the industry



lacked a relational database management system that could provide the high performance necessary for OLTP. NonStop SQL provides a ratio of price to performance that is *up to five times* better than other SQL products running on the industry's largest mainframes.

Tandem's NonStop SQL software is also the industry's first *fully distributed* relational database management system. A single transaction can transparently query or update information in multiple Tandem systems wherever they are located in the network.

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Networking and Distributed Systems

There is an emerging demand to link together workstations and dispersed systems to gain the numerous advantages of distributed computing.

For customers wanting to bring the benefits of OLTP to the desktop, Tandem offers the MULTILAN products. With these products, users have the flexibility to choose virtually any local area network that uses standard NETBIOS protocols—extending Tandem system capabilities, such as fault tolerance and data integrity, to personal computer applications.

In addition, users must have tools to *manage* systems and networks.

Tandem's Distributed Systems Management (DSM) products, announced in fiscal 1987, meet this requirement. This flexible software allows the management of systems, applications, and devices in a Tandem network to be centralized, distributed, or both, depending on the customer's needs. DSM software tools increase operator productivity by providing a single view of the network.

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Adding Value to Standards

Tandem is committed to adopting and making contributions to international and national standards such as SQL, SNA, the Ada® language, UNIX, OSI, and local area network standards.

For example, in 1987, we introduced NonStop SQL software, Tandem Ada, and MULTILAN products. We also began shipping our new LXN multiuser system that gives customers with standard UNIX applications access to Tandem OLTP networks, adding a high degree of data integrity and system reliability.

Standards are important to Tandem because they provide users with lower costs and better connectivity, and will help them leverage their investments in other computer systems.

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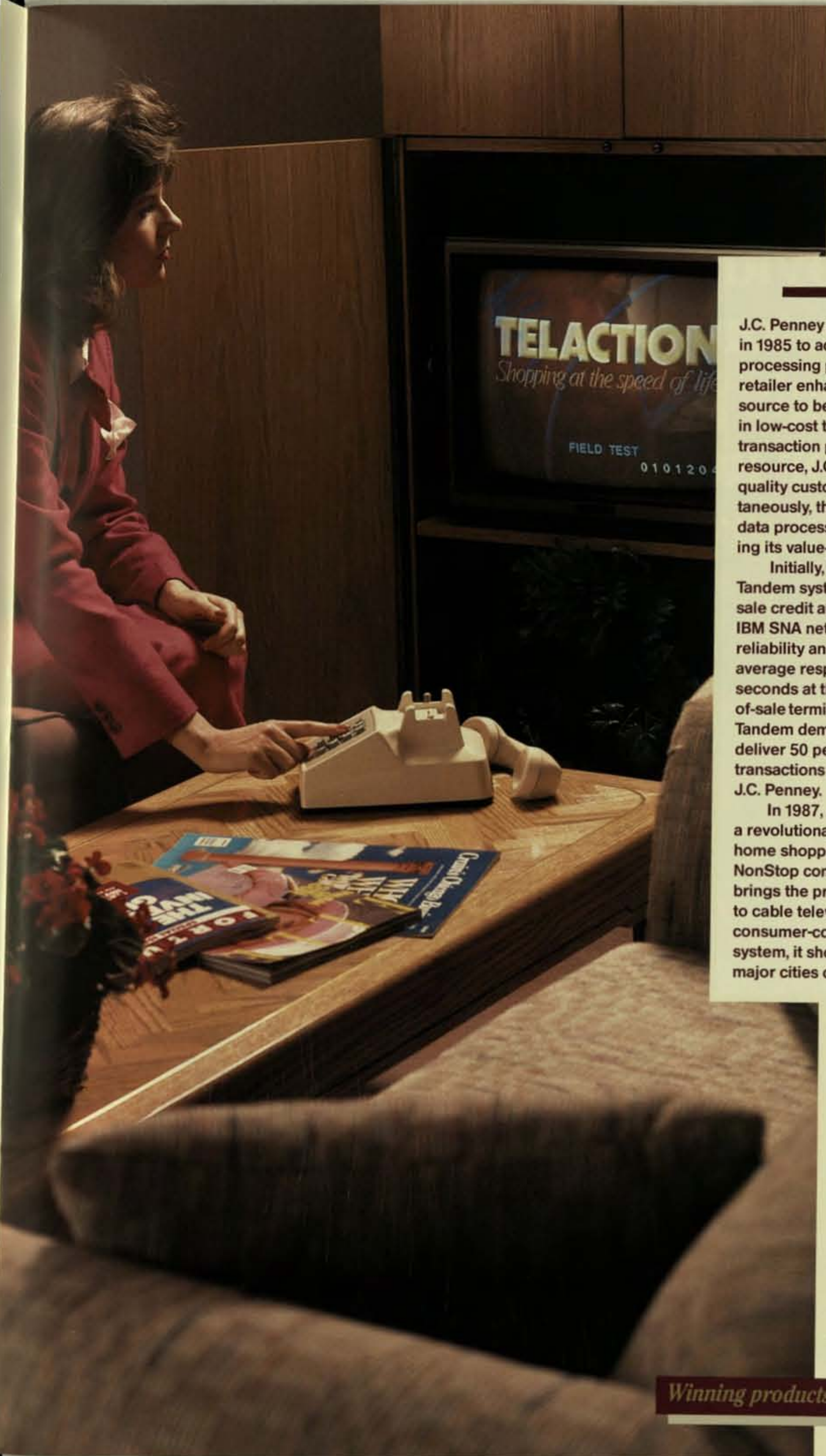
Defining the Future of OLTP

The future requires innovation in technology, and Tandem is committed to advancing the state of the art in its products. The Company's strategic investments in its own VLSI circuit prototype fabrication laboratory and computer-aided design systems have produced the circuit designs for the NonStop VLX systems and controllers.

Using silicon compilation techniques, we have been able to increase our circuit design productivity to develop products more rapidly. In 1987, we announced the first result of our efforts, the NonStop CLX system. This system will enable us to bring Tandem's unique architectural advantages to users at smaller locations.

Tandem's commitment to technological excellence in hardware and software, combined with future product plans and a strategy to add value to industry standards, provides the momentum to help us achieve our goal to grow beyond the first billion.



Testing in November 1987 in Chicago of J.C. Penney's new *Telaction* home shopping system.

1985

J.C. Penney selected Tandem systems in 1985 to accomplish a major data processing project. The $15 billion retailer enhanced its information resource to become its industry's leader in low-cost transactions. Using this transaction processing information resource, J.C. Penney provides high-quality customer service. And, simultaneously, the company leverages its data processing investment by marketing its value-added network services.

Initially, the company chose Tandem systems to integrate point-of-sale credit authorization into its existing IBM SNA network. This move improved reliability and dramatically decreased average response time to within three seconds at the company's 70,000 point-of-sale terminals. In winning the account, Tandem demonstrated a capability to deliver 50 percent more than the 100 transactions per second required by J.C. Penney.

In 1987, J.C. Penney announced a revolutionary interactive television home shopping service using Tandem NonStop computers. Called *Telaction*, it brings the products of many retailers to cable television viewers. The first consumer-controlled home shopping system, it should be available in 60 major cities over the next five years.

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Faced with increasing competition, major retailers look to Tandem systems to help them expand customer services, reduce costs, and more efficiently manage their multistore operations.

Beyond the first billion:

By providing superior solutions to customers, Tandem and its strategic partners are winning major new business in high-growth markets.

"Tandem believes that it is addressing a very large market with a new and extremely attractive solution. The potential opportunity and competitive advantage are larger than those enjoyed by any previous new computer company. The growth rates being projected are ambitious by many standards, but are achievable and extremely realistic based upon the market Tandem is pioneering."
–Tandem's original business plan, 1974

L eading businesses and government organizations are demanding comprehensive solutions—proven, cost-effective combinations of computer hardware and application software that complement their long-term strategies. Business solutions are critical to the success of Tandem as well as of its customers.

Tandem has aggressively established a broad range of strategic relationships to offer customers quality business solutions and to leverage our position in specific industries, geographic markets, and technologies.

Tandem's strategic partnerships take several forms: equity investments, joint ventures, acquisitions, and the highly successful Alliance program.

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Tandem Alliance Program

The Tandem Alliance program encourages the development of application software solutions and new distribution channels. It has established relationships with more than 280 software providers and value-added resellers.

The Tandem Alliance program provides sales, marketing, and technical support to help ensure the success of its partners.

The majority of Tandem Alliance members are independent application software houses that provide either off-the-shelf or custom programs that run on Tandem systems. They focus on industries identified by Tandem as high-growth OLTP markets.

Among Alliance members are some of the world's largest and most respected software houses. They commit development and marketing resources to Tandem systems because Tandem's architecture enhances their own products and competitiveness.

Some Alliance participants are Tandem customers who have developed sophisticated application software for their own use and then have joined with Tandem to license their solutions to others.

To increase the availability of Tandem systems and industry solutions for a wider spectrum of customers, the Alliance program has aggressively sought new channels of distribution through its value-added reseller program. During 1987, revenue generated by value-added resellers doubled.

In 1987, as part of Tandem's Alliance value-added reseller program, the Ultimate Corporation began marketing Tandem systems packaged with software enabling them to run applications based on the PICK operating system. Since PICK is an industry-standard operating system that runs an estimated 75,000 applications, this represents an important market opportunity for Tandem.

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Strategic New Ventures

With the increasing sophistication of customer organizations and their OLTP application plans, Tandem foresees a growing need by customers for solutions that are not currently available. Tandem is fulfilling that need with equity investments, joint ventures, and acquisitions to broaden its OLTP industry offerings.

During 1987, to bring the benefits of OLTP to the transportation industry, Tandem joined with SEL Canada and Union Pacific Railroad as stockholders in a new company, Automated Monitoring and Control International, Inc. (AMCI). AMCI will initially concentrate on developing an Advanced Train Control System (ATCS) to enhance safety and significantly improve operating efficiency.

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Leveraging Product Development

To complement its own development efforts, Tandem has made equity investments in companies whose technologies we believe can be leveraged for OLTP.

In 1987, Tandem invested in Netlink, Inc., to strengthen further Tandem's position in providing products for integration with IBM's Systems Network Architecture (SNA). Netlink's experience in providing solutions for the evolving SNA communications environment complements and extends our own technical capabilities in SNA. Netlink and Tandem will jointly develop and market products that enhance the SNA-connectivity of Tandem systems with IBM systems.

Shortly after the close of the fiscal year, Tandem agreed to acquire Atalla Corporation. Atalla provides secure system solutions in the areas of network interchange, electronic payment, and computer security. These products complement Tandem's own capabilities in OLTP and will provide new product offerings for the financial and retail point-of-sale markets.

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Meeting Worldwide Needs

Tandem invests in selected companies that offer software application design and support for key geographic markets.

In 1987, Tandem formed Twinac, a joint venture with the VOLMAC group, a leading Dutch software company with more than 2,000 employees.

Similar to Vartecs (Tandem's joint venture in Japan), Twinac will help meet the growing demand for OLTP systems in the Netherlands by providing project management and contract consulting services.

Tandem will continue to develop these relationships and seek others that benefit customers as we work to move beyond the first billion.

Girobank automated teller machines are located at post offices throughout England.

1975

In 1975, Applied Communications, Inc. (ACI), a start-up company with three employees, made a bold, strategic decision to entrust the future of its business to the entirely new computer architecture of another start-up company, called Tandem. ACI is now a leading provider of electronic delivery systems to the financial industry.

To gain the competitive edge, ACI developed its software for automated teller machines (ATM) on Tandem systems. Its customers could depend on the high availability of their systems and the integrity of the data. And as customers' businesses grew, computing capacity could be expanded cost-effectively to meet business needs.

The strategy worked. ACI has won the largest share of the world's ATM networks, with over 250 installations in 34 countries. In 1986, ACI was acquired by U S WEST, Inc., the $8 billion telecommunications company with nine million customers in the 14 western states.

Today, ACI, with 25 percent of its business in nonfinancial markets, is expanding its offerings in the retail, petroleum, and telecommunications markets—with a business strategy still based on Tandem systems. According to ACI, "It was the right strategy 12 years ago, and it's the right strategy for the future."

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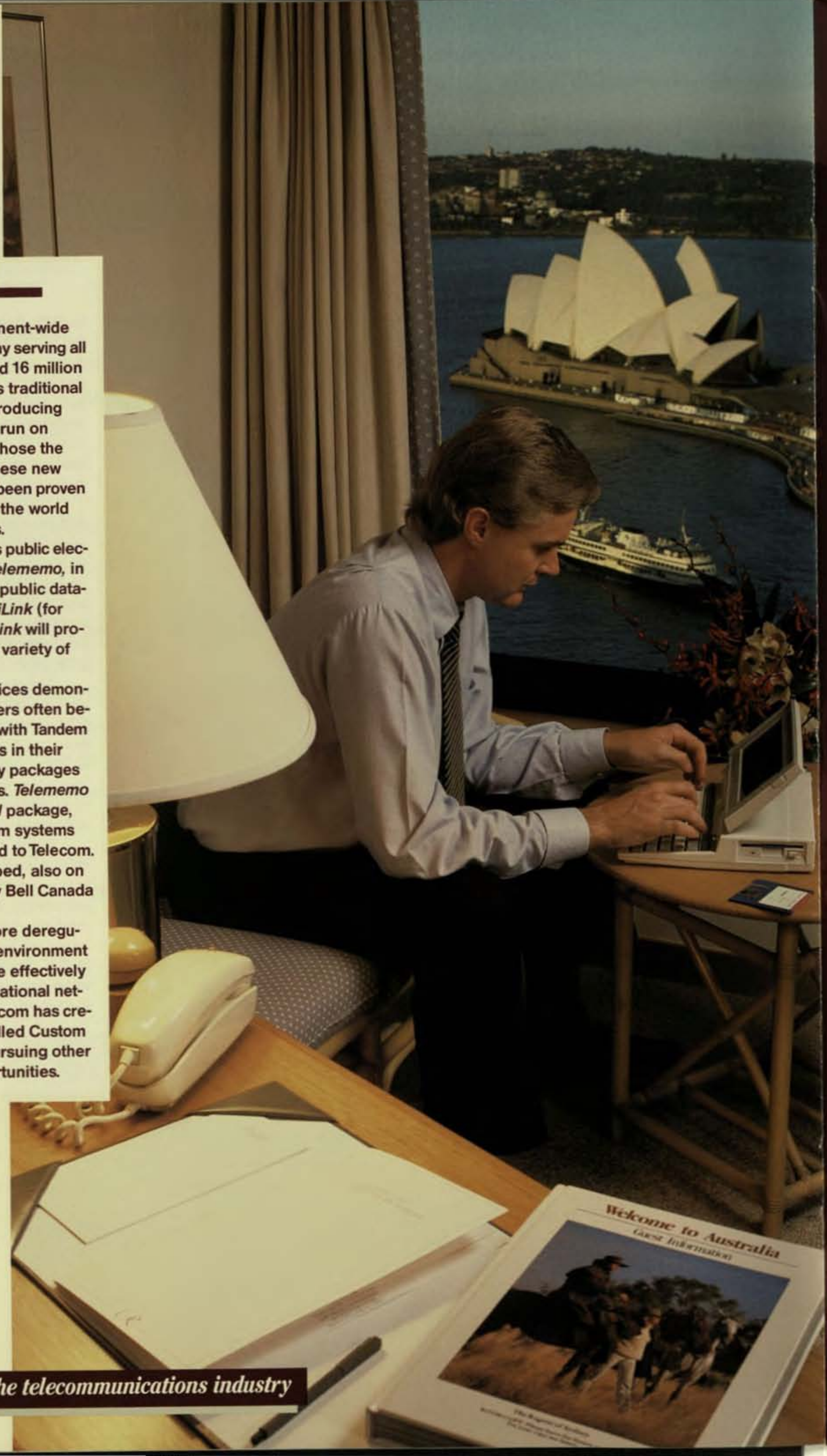
With installations at more than 300 banks worldwide, Tandem and its Alliance partners are poised to capitalize on the forces of deregulation and competition that are driving the expansion of OLTP into new areas of banking.



Businesspeople in Australia are using Telecom Australia's *Telememo*.

1986

Telecom Australia, the continent-wide telecommunications company serving all of Australia's businesses and 16 million people, began expanding its traditional revenue base in 1986 by introducing attractive new services that run on Tandem systems. Telecom chose the software and systems for these new services because they have been proven successful in other parts of the world by other Tandem customers.

Telecom inaugurated its public electronic mail service, called *Telememo*, in 1986, and plans to launch a public database access service called *iLink* (for "intelligent link") in 1988. *iLink* will provide users easy access to a variety of interactive databases.

Both of these new services demonstrate how Tandem customers often become marketing "partners" with Tandem by offering other companies in their industry proven, proprietary packages that run on Tandem systems. *Telememo* is derived from the *Telemail* package, developed to run on Tandem systems by GTE Telenet and licensed to Telecom. *iLink* was originally developed, also on Tandem systems, as *iNet* by Bell Canada and licensed to Telecom.

In preparation for a more deregulated telecommunications environment in Australia, and to compete effectively against other private international networking organizations, Telecom has created a separate division called Custom Link that is dedicated to pursuing other value-added-service opportunities.

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A significant player in the dynamic telecommunications industry, Tandem presently has more than 70 customers worldwide and is anticipating an even bigger role as part of this industry's exciting future.

Beyond the first billion:

Sustained growth can be attained only through satisfied, successful customers. Tandem is dedicated to helping ensure the continued success of our customers by striving to provide the highest quality, most comprehensive service and support available in the industry.

"The Tandem computer in a typical application has significantly higher throughput at a much lower cost compared to the competitive alternative. The customer will find these two characteristics of compelling interest."

–Tandem's original business plan, 1974

Customer satisfaction has played a major role in Tandem achieving its first billion-dollar year. A fundamental reason why Tandem continues to rank high in customer satisfaction surveys is the Company's emphasis on excellence in customer service and support.

Tandem systems are designed to meet the demanding requirements of on-line transaction processing. To many of our customers, this means that their systems must be running 24 hours a day. This high level of system availability not only requires computer systems designed to operate despite component failures, but also a service and support team that can maintain and repair the systems while business operations continue.

As Tandem installations grow in size and sophistication, so do the service requirements. Tandem, in turn, continues to expand its offerings to meet these needs. Just as Tandem's goal is to set the standard for OLTP, it also seeks to set the industry standard for quality service and support.

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Quality Service Today

Today, Tandem offers flexible service and support alternatives, from 24-hour on-site service to telephone consultation. In addition, the Company provides project and program management, network and application design and assistance, operations consulting, performance evaluation, and capacity planning.

Tandem also offers classroom training at education centers and customer sites around the world, and self-paced computer-aided instruction for selected products.

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Improved Serviceability by Design

Tandem is continuing to emphasize serviceability as a key engineering design goal for every new product. Technical innovation in product design supports Tandem's goal to offer a high level of service and reduced service costs. And, because equipment can be serviced more easily and quickly, the customer's decision to install an increased number of distributed Tandem systems is simplified.

Perhaps even more important to customers implementing large-scale projects is Tandem's commitment to joint strategic planning. This joint planning helps Tandem customers meet their business objectives and reflects the Company's dedication to providing the highest level of customer support in the industry.

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New Services in 1988

The environment for computer users is growing more exciting every day, as new technologies and capabilities emerge. This environment is also becoming more complex. Tandem's goal is to make computing easier for its customers.

For example, Tandem systems are typically connected to a wide variety of other vendors' devices. In 1988, the Company plans to broaden its service offerings to include support of some of

Robotic welding of Saab automobiles in Sweden.

1982

In 1982, Saab Scania AB decided to introduce just-in-time manufacturing techniques for the production of its increasingly popular automobiles. To control its already highly automated plants, Saab selected Tandem computer systems because of its requirements for an on-line information resource that could grow easily and inexpensively to meet the anticipated increase in demand for its cars. Since then, Saab has steadily increased both production and its computer capacity. By 1989, it expects to produce 50 percent more cars than it did in the early 1980s.

Saab's Tandem systems now control every phase of manufacturing at the company's two plants in Sweden. All cars are manufactured to advance customer orders on an assembly line that has been segmented into many small "minilines," each with 20 to 30 workers and its own quality control group. Part of the role of the Tandem systems is to direct parts assemblies from numerous off-site locations to each miniline just in time to build a specific car to the advance order.

Saab's future goals are ambitious. A third, state-of-the-art plant is planned. In addition, the company intends to integrate the production systems with its robotic control systems. For greater efficiency, productivity, and employee satisfaction, it expects to develop a Tandem EXPAND network to link all three plants.

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With more than 240 manufacturers worldwide using Tandem systems, the Company is well positioned to play a leading role in the challenging market for computer-integrated manufacturing.

The foreign exchange trading room at First Chicago's Tokyo office.

1978

At a pivotal point for its business in 1978, First National Bank of Chicago developed new long-range strategies to meet the growing national and international requirements of its customers. To help accomplish its goals, the bank chose Tandem, with its critical fault-tolerant technology, as a "strategic partner." In turn, Tandem opened new overseas offices to support First Chicago, as well as to develop other international business.

Today, First Chicago, with more than $44 billion in assets, is inaugurating new strategies to meet the sophisticated needs of its corporate, middle market, and consumer banking customers. And First Chicago still considers Tandem a strategic partner.

Extending its working relationship with Tandem, First Chicago is developing new applications and is upgrading its existing systems in global financial centers. In fiscal 1987, First Chicago awarded Tandem the largest computer order in First Chicago's history.

For the past two years, First Chicago has named Tandem as its outstanding data processing supplier, citing "distinguished service and support."

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Distributed relational databases, flexible networking, and gateways offer all industries more efficient ways to handle information. In this area of tremendous potential growth, the Tandem architecture has distinct advantages.

Winning support for networking

these key devices. Tandem also plans to expand its customized services for large users who want a single source of support.

Some Tandem customers are planning to implement large networks by purchasing quantities of Tandem's lower-cost CLX, EXT, and LXN systems and installing them in numerous geographically remote locations. To support these customers, Tandem plans to establish and staff additional service and support centers in locations throughout the world. These centers will become the first points of contact for customers, either by telephone or other electronic connections, providing prompt system diagnosis.

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Enhanced Support Programs

The Company is enhancing its on-line Customer Information Service, through which subscribing customers can keep abreast of a broad range of Tandem technical topics. Educational offerings also are being made available in more flexible formats and through new delivery systems, such as the Tandem Television Network.

Tandem plans to open an advanced customer support facility in Cupertino, California, to provide services to Tandem customers worldwide. The facility will house centers for expanded benchmark operations, application software conversion, design assistance, and network assurance to test large network configurations prior to installation.

Tandem's High-Performance Research Center in Frankfurt, West Germany, also has been expanded to provide additional consulting capabilities to Tandem's key customers and software houses around the world. As more customers move to distributed computing and networked environments, the high level of service and support Tandem provides will become even more important.

Customer satisfaction remains a cornerstone of our success. Tandem plans to continue investing in new service and support offerings to achieve its goals beyond the first billion.

Service and Support Personnel

Beyond the first billion:

In the end, customer satisfaction depends on the people who design and deliver quality products and services. Tandem will continue as a leader in developing people as well as computer systems.

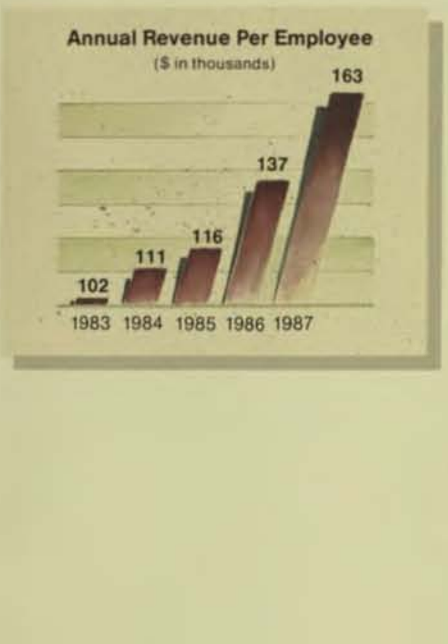
"Tandem will be a multi-million-dollar corporation with the dominant share of its sector. Its strategy will now be focused on keeping ahead."

–Tandem's original business plan, 1974

Tandem is a recognized leader and innovator in employee relations, making significant investments in its most important asset—Tandem employees.

"We develop people as well as systems" exemplifies Tandem's attitude toward and development of this strategic resource.

Over the years, Tandem has implemented numerous programs aimed at a single goal: attracting and retaining outstanding employees. The benefits of these programs extend beyond



the employees themselves to our customers, who are the beneficiaries of the experience and motivation of Tandem people.

The heart of Tandem's programs is communication. The Company believes that employees who are informed and encouraged to participate will be more productive and build a far stronger company. History has proven Tandem right.

The results of these programs are impressive: an employee turnover rate well below the industry average; one of the highest employee productivity levels in the nation; and a 1987 ranking of Tandem by *Business Week* magazine as one of the 50 most competitive U.S. corporations.

The Company invests in the latest communication technology. Tandem goes beyond the usual employee newsletter to electronic mail, teleconferencing, and incentive programs that facilitate communication across job functions and organizational and geographic boundaries.

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Electronic Open Door

Tandem has extended its traditional open door policy through the use of a private, worldwide electronic mail system.

PS MAIL software, a standard Tandem product, operates over the Company's worldwide network, instantly linking more than 7,000 employees in 19 countries.

In addition to communicating important business news, PS MAIL allows employees to have access to Tandem's technical specialists around the world, efficiently leveraging our resources to support customers.

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Tandem Television Network

The Company's use of television as an employee communication medium began in 1982 with monthly broadcasts. Originating from the Cupertino headquarters, the first teleconferences reached 15 sites in the United States.

Today, the Tandem Television Network (TTN) is an award-winning private broadcast network reaching 68 sites in North America. Several times each year, it broadcasts to European sites also.

Originally designed to improve internal communication, TTN has become a valuable corporate resource

Tandem's Harald Sammer, at left, with Dr. Andreas Reuter of the University of Stuttgart.

One of the world's foremost academic experts in the field of transaction processing is now pursuing practical, productive research into high-performance parallel processing, largely due to the initiative of a Tandem employee who secured a grant from Tandem.

Independent research under the direction of Dr. Andreas Reuter at the Department of Computer Science at the University of Stuttgart was hampered by the lack of the ideal computer.

In Frankfurt, Harald Sammer, director of Tandem's High-Performance Research Center, asked Tandem management to donate a system to the university. Working with the Corporate Contributions Committee, he won approval for the gift of a NonStop TXP system, valued at over $600,000.

"The best system for our PROSPECT research program—which stands for Processor Organization Supporting Parallel Execution of Complex Transactions—is the Tandem system with its inherent parallel processing capabilities and message-based operating system." The PROSPECT team's objective is to develop a programming interface for parallel processing that is as simple as classical, sequential programming and that executes automatically.

Tandem also provided training for a group of faculty members and graduate students, and maintained the system. The state government now provides funding for full-time researchers, and Sammer's staff supports them with consultation and exchange of ideas.

In addition to its use in advanced research, the Tandem system is used to teach undergraduate students the basics of database, transaction processing, and expert systems.

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Tandem remains an exciting company by attracting quality individuals who want demanding challenges in a creative, stimulating environment.

extended to our customers. During 1987, TTN broadcast several International Tandem Users' Group teleconferences and the Tandem VISIONS series, which features noted authorities discussing future business, economic, and social trends.

This year, Tandem began an exciting new venture, Educational Television (ETV). Designed to deliver technical information to employees, customers, and business partners, ETV provides cost-effective, comprehensive education to a wide audience.

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Rewarding Outstanding Performance

Tandem offers a wide variety of benefit programs, developed to reward excellence in performance.

Employee stock purchase and option programs, for instance, are designed to allow all employees to share financially in the success of the Company. Virtually all employees own or have options to purchase Tandem stock.

In addition, several times each year, selected individuals are recognized for exceptional achievement by nomination to Tandem Outstanding Performers (TOPS). TOPS winners come from all job functions, organizations, and locations. The winners are invited to attend an off-site meeting that provides an opportunity to exchange ideas and information with senior management.

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Sabbatical Programs

Another valued employee benefit is our sabbatical program. Tandem's program (available worldwide, except in countries where local customs allow extended annual vacations) grants an employee, on each fourth anniversary of employment, a six-week, fully paid leave—in addition to vacation time.

In 1987, the scope of that program was expanded to include the Public Service Sabbatical, which reflects the Company's commitment to return some of the rewards of success to the community.

Under the Public Service Sabbatical program, employees volunteer to work with a charitable organization. Tandem grants the volunteer additional leave-time, as well as monetary support for travel and living expenses for the employee and immediate family.

New benefit programs constantly are under development and introduction. Among those inaugurated during 1987 are childcare referral and dependent care assistance programs; a health and wellness program that provides on-site physical examinations as well as fitness and nutritional counseling; and financial planning seminars.

Tandem's focus on hiring, developing, and retaining outstanding people—along with continuing investments in programs to support those goals—will help the Company grow beyond the first billion.

Martha Jennings took her Tandem Public Service Sabbatical in rural Senegal.

Village women of Senegal were among the first beneficiaries of Tandem's newly inaugurated Public Service Sabbatical program, which supports employees' desires to perform volunteer work.

Martha Jennings, who joined Tandem in 1982 as a marketing support specialist, developed an interest in the role of women in Third World cultures during her years working at Tandem locations throughout Asia.

When the time came for her Tandem sabbatical, Martha became one of the first participants in Tandem's Public Service Sabbatical program. This program enables employees to combine public service with the regular six-week, fully paid leave that employees earn every four years. Tandem extends the sabbatical and helps pay expenses.

Martha chose to spend five weeks as a volunteer with the U.S. Agency for International Development, teaching rural Senegalese women in seven different villages how to make money from ongoing projects such as cattle raising. Her courses covered choosing a feasible project, marketing the product, and understanding credit systems. Drawings were used in the makeshift outdoor classrooms because the women were unable to read.

Martha is now a project leader in the Strategic Planning/New Ventures group at Tandem headquarters.

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Tandem is as innovative in designing programs that encourage employee loyalty as it is in designing systems.

Beyond the first billion:

The on-line transaction processing marketplace, pioneered by Tandem, is now a mainstream segment of data processing. Tandem believes it has the momentum to continue to lead the way.

"In summary, Tandem has identified a major market sector of high growth rate potential. By being first, and achieving an early dominant market share, Tandem can generate the profits required to finance continued growth at a rate faster than any single competitor, thereby assuring the retention of high share and the accruing high profit margins."

–Tandem's original business plan, 1974

Overview

Tandem Computers seeks to provide leadership in the expanding market for on-line transaction processing (OLTP) systems and networks. The Company believes that its computer architecture has major advantages in satisfying the fundamental requirements for such systems and networks. Achieving its goal of leadership involves many factors, including strategic market positioning, a commitment to product development, customer satisfaction, and an organizational structure and philosophy that foster employee productivity and creativity. Additionally, Tandem believes it is important to maintain a strong financial position to compete effectively in the rapidly growing OLTP marketplace.

Financial Condition

Throughout fiscal 1987, the Company strengthened its financial position. Cash and cash investments grew for the fifth consecutive year, from \$240 million at September 30, 1986, to \$317 million at September 30, 1987. Contributing to the growth of the cash balance were income from operations, employee stock purchases, and improvements in asset management. In fiscal 1987, net income increased 66 percent over the prior fiscal year, and cash flow from operations reached \$159 million, compared with \$138 million in fiscal 1986 and \$91 million in fiscal 1985.

The Company believes that attracting and retaining high-quality employees are key to success. Methods to achieve these objectives include employee stock option and stock purchase programs. These programs also serve as a source of funds for the Company. As a result of these programs, the Company received \$81 million in fiscal 1987, \$51 million in fiscal 1986, and \$11 million in fiscal 1985 in the form of employee stock purchases and related tax benefits.

The Company continues its emphasis on asset management. During fiscal 1987, accounts receivable grew at a rate lower than that of revenue. Accounts receivable days outstanding improved to 80 days at year-end, compared with 82 days at the end of fiscal 1986 and 86 days at the end of fiscal 1985. Inventories at fiscal year-end increased \$28 million over the fiscal 1986 year-end level. Although inventory days increased slightly to 80 days in fiscal 1987 from 78 days in fiscal 1986, current inventory management represents a substantial improvement over the 110 days recorded in fiscal 1985. The Company believes the current inventory level is appropriate.

During fiscal 1987, the Company invested \$161 million of cash in property, plant and equipment, and other assets, compared with \$71 million and \$67 million in each of the previous two fiscal years. The increased investment primarily supported the Company's rapid growth. For example, the Company installed its newest computer systems in field offices, expanded systems to accommodate personnel growth, and invested in field-replaceable parts to support an expanding customer base.

In addition, during the year, Tandem purchased two buildings in Cupertino, California. Previously, Tandem had not owned the buildings it occupied in its headquarters area. In fiscal 1987, the Company began implementing a program to create a permanent headquarters complex. This program includes projects to improve owned and leased buildings. In fiscal 1988, the Company plans to purchase at least five additional buildings in the community, including some that it currently leases. The additional space will allow for expansion and for relocation of employees housed in other Santa Clara County, California, locations.

Tandem believes that demonstrated financial strength is important in order to compete effectively in high technology markets. Consequently, the Company considers it strategically important to maintain a sound ratio of current assets to current liabilities and a conservative capital structure. The current ratio at fiscal year-end remained strong at 3.6:1, although it declined slightly from 3.9:1 at the end of the prior year. This was primarily the result of capital acquisitions programs that invested cash in long-term assets. At the end of fiscal 1987, the ratio of long-term debt and capital lease obligations remained at a very low 1.2 percent of total capital. Lines of credit totaled \$65 million, all of which were unused. The equity base grew to \$721 million in fiscal 1987, from \$535 million in fiscal 1986.

Results of Operations

The following table summarizes the changes in selected operating indicators. The percentages on the left show the relationships of various income and expense items to revenue. The percentages on the right measure the year-to-year increases or decreases.

Percent of Revenue				Percent Increase (Decrease)	
Fiscal Year					
1987	1986	1985		1987	1986
83	82	84	Product revenue	36	21
17	18	16	Service and other revenue	29	35
100	100	100	Total revenue	35	23
22	23	30	Cost of product	29	(6)
13	14	13	Cost of service and other	26	26
35	37	43	Total cost of revenue	28	4
10	11	12	Research and development	25	18
38	38	37	Marketing, general and administrative	35	27
16	14	8	Operating income	61	112
1	1	1	Interest income, net	67	36
18	15	9	Pretax income	62	103
8	7	4	Provision for income taxes	56	131
10	8	6	Net income	66	86
			Earnings per share	50	76

Amounts may not total due to rounding.

Revenue

Tandem's revenue growth rate again increased in fiscal 1987, as the Company expanded its position as a leading supplier of on-line transaction processing systems and networks. Revenue grew 35 percent to $1.035 billion in fiscal 1987 over the $768 million posted in fiscal 1986. The fiscal 1986 revenue growth rate was 23 percent. Tandem's revenue gains over the past two years resulted from increased shipments of hardware and software products to new and existing customers and from an increased number of customers using its support and training services.

Over the past two years, the Company introduced a number of new products, including systems, software, storage products, and peripherals, which contributed to revenue growth. In particular, the NonStop VLX computer system, introduced in fiscal 1986, and related products opened new high-end markets for the Company. Product revenue in fiscal 1987 grew 36 percent, partly due to continued customer acceptance of these products. Service and other revenue in fiscal 1987 grew 29 percent, somewhat slower than product revenue, in part because new technology lowered service costs to customers.

Domestic business strengthened throughout the year, growing at 27 percent in fiscal 1987, compared with 11 percent in fiscal 1986. As in the prior fiscal year, international revenue growth exceeded domestic growth. Revenue from Europe grew 46 percent in fiscal 1987, somewhat slower than the prior fiscal year's rate of 52 percent. International business accelerated in non-European countries by 50 percent in fiscal 1987, compared with 37 percent in fiscal 1986.

International business continued to grow as a percent of revenue. Europe contributed 29 percent of fiscal 1987 revenue, compared with 27 percent in fiscal 1986 and 22 percent in fiscal 1985. Other international business contributed 14 percent of revenue in fiscal 1987 versus 13 percent in fiscal 1986 and 11 percent in fiscal 1985. While the United States remained the largest contributor to revenue, with 57 percent of the Company's business coming from domestic customers, its share was 60 percent in fiscal 1986 and 67 percent in fiscal 1985.

Operating Income

Operating income increased sharply, reaching $171 million, or 16 percent of revenue, in fiscal 1987. This represents a significant improvement from the $106 million, or 14 percent of revenue, recorded in fiscal 1986 and the $50 million, or 8 percent of revenue, recorded in fiscal 1985. The improvement in operating margin is largely attributable to higher gross profit margins resulting from a favorable product mix and the Company's continued improvements in manufacturing and service operations.

Cost of Revenue

The improvement in cost of revenue as a percentage of revenue is due to several factors. Tandem successfully continued its programs to increase the efficiency of its manufacturing and service operations. In addition, cost of product as a percentage of revenue declined over the past three years. The percentage improved because the Company sold a favorable mix of products, many of which incorporate new technologies that provide greater performance at lower cost. The improvement in cost of service and other as a percentage of revenue was partially attributable to dramatic improvements in reliability of peripheral subsystems, such as the XL8 disk subsystem.

Cost of product increased 29 percent in fiscal 1987 over its fiscal 1986 level, primarily due to increases in volume. In fiscal 1986, cost of product declined 6 percent from the fiscal 1985 level, as manufacturing efficiencies offset volume-related cost increases. The 26 percent increases in cost of service and other recorded in both fiscal 1987 and 1986 were primarily attributable to growth in the installed base.

Research and Development

Research and development expenditures declined as a percentage of revenue over the past three years. This was partially attributable to higher than anticipated revenue, as well as capitalization of certain software expenditures. Although declining as a percentage of revenue, research and development expenditures increased over the past three years to support new product development efforts and programs to enhance existing products. Research and development activities focus on meeting the needs of customers who are implementing on-line systems at single sites and in geographically distributed information processing networks. Among the products announced in fiscal 1987 that resulted from prior years' research and development spending were NonStop SQL software, the NonStop CLX computer system, and the Distributed Systems Management software. The Company expects to increase expenditures on research and development in fiscal 1988.

Marketing, General and Administrative

The Company's marketing strategy emphasizes direct sales to organizations that are implementing on-line transaction processing applications critical to their businesses. The Company believes that offering solutions to customers' business problems and providing a high level of service and support are essential to meeting the needs of the customer base. To do this, Tandem has built a direct selling and support organization in the United States and in international industrial markets. Direct sales activities are complemented by relationships established with third-party application software developers, equipment remarketers, and distributors.

Over the past three years, the Company introduced products that required expenditures to bring those products to market. Despite this, in fiscal 1987, marketing, general and administrative expenditures as a percentage of revenue remained unchanged from the prior year, although they were slightly higher than in fiscal 1985.

The level of marketing, general and administrative expenditures has increased over the past three years as the Company continued to build its marketing organization, to train new and existing sales, service, and support personnel, and to develop marketing relationships with third parties in order to support the Company's growth. Tandem has also invested in joint ventures and taken equity positions in companies whose product, market, or geographic strengths support the Company's strategies.

Net Income and Earnings Per Share

The rate of change in net income has differed from that of operating income over the past three years because of the factors discussed above and because of changes in the Company's interest income and effective tax rate. In fiscal 1987, net interest income was almost $6 million higher than in fiscal 1986, and $8 million higher than in fiscal 1985. Net interest income increased primarily because of significantly higher balances of interest-earning investments.

The effective tax rate in fiscal 1987 was 43 percent, compared with rates of 44 percent in fiscal 1986 and 39 percent in fiscal 1985. The decline in the effective tax rate in fiscal 1987 versus 1986 was primarily the result of lower federal statutory tax rates brought about by the passage of the Tax Reform Act of 1986, offset by the repeal of the investment tax credit. The effective tax rate in fiscal 1986 was higher than in fiscal 1985 primarily because of higher levels of pretax income and a reduction of the research and development credit. Under the Tax Reform Act of 1986, the Company anticipates a lower tax rate in fiscal 1988 due to the lowering of statutory rates.

Earnings per share in fiscal 1987 were $1.08, compared with earnings per share in fiscal 1986 of $.72 and in fiscal 1985 of $.41. (Earnings per share reflect a two-for-one stock split effected in the form of a stock dividend in the 1987 fiscal year.) In each of the last three fiscal years, the growth in earnings per share differed from that of net income because of a higher number of weighted average shares outstanding. Under the treasury stock method of calculating weighted average shares outstanding, higher stock prices result in a greater dilutive effect from outstanding stock options. Sales of stock to employees under the stock purchase plan and grants under option plans, combined with higher stock prices, resulted in increases in weighted average shares outstanding of 11 percent in fiscal 1987, 6 percent in fiscal 1986, and 1 percent in fiscal 1985.

Personnel

In fiscal 1987, to support growth experienced over the past three fiscal years, Tandem increased personnel by 23 percent. This compares with a 4 percent personnel increase in fiscal 1986 and a 5 percent personnel increase in fiscal 1985. While hiring occurred in all functional areas, the greatest percentage increases were in research and development and marketing, reflecting investments in areas the Company believes are critical to its success.

Impact of Currency

In fiscal 1987, the weakness of the U.S. dollar against foreign currencies had a positive influence on revenue; however, the Company believes the impact was largely moderated by price reductions taken to maintain consistent pricing across international boundaries. This factor, combined with the negative effect of strengthening currencies on international expenditures, resulted in an overall impact that the Company believes was not significant to operating income.

Effect of Inflation

The effect of inflation on the Company's financial results has not been significant.

Certain prior period amounts have been reclassified to conform with the current period presentation. See footnote 2 to the financial statements.

For the Five Years Ended September 30, 1987

(In thousands except per share amounts)	1987	1986	1985	1984	1983
Revenue	$1,035,495	$767,793	$624,138	$532,620	$418,282
Cost of revenue	358,228	279,924	268,589	233,846	188,228
Research and development	108,474	87,024	73,832	52,982	39,489
Marketing, general and administrative	398,105	294,867	231,636	194,691	140,794
Operating Income	170,688	105,978	50,081	51,101	49,771
Interest income, net	14,223	8,504	6,269	5,183	730
Provision for income taxes					
Current period	79,307	50,716	21,976	23,076	19,696
Benefit of DISC tax reversal	—	—	—	(9,700)	—
Net Income	$ 105,604	$ 63,766	$ 34,374	$ 42,908	$ 30,805
Earnings Per Share	$ 1.08	$ .72	$ .41	$ .52	$ .38
Total assets	$ 967,241	$705,025	$552,344	$501,873	$415,525
Long term debt and capital lease obligations	$ 9,013	$ 5,725	$ 11,765	$ 16,871	$ 23,922
Stockholders' investment	$ 720,919	$534,680	$420,408	$375,122	$310,993

Certain prior period amounts have been reclassified to conform to the current period presentation. See footnote 2 to the financial statements.

Shown above are some of the newer members of the Tandem product line. Clockwise, from left, are the NonStop CLX, NonStop VLX, and NonStop EXT25 systems, the PSX workstation, and the LXN system.

For the Three Years Ended September 30, 1987

(In thousands except per share amounts)	1987	1986	1985
Revenue			
Product revenue	$ 861,042	$632,277	$523,413
Service and other revenue	174,453	135,516	100,725
Total revenue	1,035,495	767,793	624,138
Costs and Expenses			
Cost of product revenue	226,804	175,239	185,565
Cost of service and other revenue	131,424	104,685	83,024
Research and development	108,474	87,024	73,832
Marketing, general and administrative	398,105	294,867	231,636
Total costs and expenses	864,807	661,815	574,057
Operating Income	170,688	105,978	50,081
Interest expense	(1,588)	(1,979)	(2,407)
Interest income	15,811	10,483	8,676
Income Before Income Taxes	184,911	114,482	56,350
Provision For Income Taxes	79,307	50,716	21,976
Net Income	$ 105,604	$ 63,766	$ 34,374
Earnings Per Share	$ 1.08	$ .72	$ .41
Weighted average shares outstanding	97,711	88,402	83,530

The accompanying notes are an integral part of these statements.

As of September 30, 1987 and 1986

(In thousands except share amounts)	1987	1986
Assets		
Current Assets		
Cash and cash investments	$317,461	$239,819
Accounts receivable, net of allowances of $8,378 in 1987 and $7,292 in 1986	254,758	197,658
Inventories	92,315	64,229
Prepaid expenses and other	22,776	17,505
Total current assets	687,310	519,211
Property, Plant and Equipment, at cost		
Land and buildings	54,336	38,652
Machinery and equipment	80,395	62,302
Computer equipment and spares	199,901	137,388
Leasehold improvements	41,348	34,270
Construction in process	21,821	9,513
	397,801	282,125
Accumulated depreciation and amortization	(145,000)	(107,103)
Net property, plant and equipment	252,801	175,022
Other Assets	27,130	10,792
Total Assets	$967,241	$705,025
Liabilities and Stockholders' Investment		
Current Liabilities		
Accounts payable	$ 78,714	$ 50,768
Accrued liabilities		
Accrued payroll and payroll related	27,925	21,290
Accrued vacation	15,789	10,795
Accrued commissions to third parties	13,008	4,996
Deferred income	13,521	2,719
Income taxes	10,989	21,670
Other	30,324	16,585
Current portion of long term debt and capital lease obligations	1,500	5,969
Total current liabilities	191,770	134,792
Long Term Debt and Capital Lease Obligations	9,013	5,725
Deferred Income Taxes	45,539	29,828
Stockholders' Investment		
Common stock $.025 par value, authorized 200,000,000 shares, outstanding 93,160,054 in 1987 and 87,837,512 in 1986	2,329	2,196
Additional paid-in capital	368,845	288,343
Retained earnings	349,745	244,141
Total stockholders' investment	720,919	534,680
Total Liabilities and Stockholders' Investment	$967,241	$705,025

The accompanying notes are an integral part of these balance sheets.

For the Three Years Ended September 30, 1987

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance September 30, 1984	81,234	$2,031	$227,090	$146,001	$375,122
Sale of common stock under stock option plans	704	17	3,866	–	3,883
Sale of common stock under stock purchase plan	836	21	6,173	–	6,194
Tax benefit from employee transactions in common stock	–	–	835	–	835
Net income	–	–	–	34,374	34,374
Balance September 30, 1985	82,774	2,069	237,964	180,375	420,408
Sale of common stock under stock option plans	4,286	107	39,199	–	39,306
Sale of common stock under stock purchase plan	778	20	5,916	–	5,936
Tax benefit from employee transactions in common stock	–	–	5,264	–	5,264
Net income	–	–	–	63,766	63,766
Balance September 30, 1986	87,838	2,196	288,343	244,141	534,680
Sale of common stock under stock option plans	4,859	121	51,839	–	51,960
Sale of common stock under stock purchase plan	463	12	7,613	–	7,625
Tax benefit from employee transactions in common stock	–	–	21,050	–	21,050
Net income	–	–	–	105,604	105,604
Balance September 30, 1987	93,160	$ 2,329	$368,845	$349,745	$720,919

The accompanying notes are an integral part of these statements.

For the Three Years Ended September 30, 1987

(In thousands)	1987	1986	1985
Funds (Cash and cash investments) at beginning of period	$239,819	$128,676	$106,862
Funds Provided by Operations			
Net income	105,604	63,766	34,374
Items not requiring current outlay of funds			
Depreciation and amortization	52,025	43,242	35,616
Deferred income taxes	15,711	(2,890)	12,296
Net book value of property, plant and equipment sold or retired	14,868	8,742	13,810
Funds provided by (used for) working capital items			
Increase in accounts receivable	(57,100)	(34,280)	(17,036)
Decrease (increase) in inventories	(28,086)	14,733	13,413
Net change in prepaid expenses and non-debt current liabilities	56,176	45,161	(1,795)
Total provided by operations	159,198	138,474	90,678
Funds Invested to Support Operations			
Investment in property, plant and equipment	142,364	65,011	67,568
Increase (decrease) in other assets, net	18,646	5,860	(511)
Total invested to support operations	161,010	70,871	67,057
Funds Provided by (Used for) Financing Activities			
Decrease in long term debt and capital lease obligations, net	(1,181)	(6,966)	(12,719)
Sale of common stock under employee stock option and stock purchase plans	59,585	45,242	10,077
Tax benefit from employee transactions in common stock	21,050	5,264	835
Total provided by (used for) external financing activities	79,454	43,540	(1,807)
Net increase in cash and cash equivalents	77,642	111,143	21,814
Funds (Cash and cash investments) at end of period	$317,461	$239,819	$128,676

The accompanying notes are an integral part of these statements.

1. *Summary of Significant Accounting Policies*

Consolidation

The consolidated financial statements include the accounts of Tandem Computers Incorporated and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

Revenue Recognition

The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Translation of Non-U.S. Currency Amounts

Assets and liabilities of the Company's subsidiaries which are denominated in the local currency of the subsidiary are translated into U.S. dollars (the functional currency) at year-end exchange rates, except for inventories and property, plant and equipment, which are translated at approximate rates prevailing when the assets were acquired. Income and expense items are translated at average rates of exchange prevailing during the year, except that cost of revenue and depreciation are translated at historical rates. The Company enters into forward exchange contracts to reduce the impact of foreign currency fluctuations on asset and liability positions of foreign subsidiaries. The net gains and losses arising from foreign currency transactions are generally not significant and are included in income as incurred.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include materials, labor, and manufacturing overhead. The components of inventories as of September 30 were:

(In thousands)	1987	1986
Purchased parts and subassemblies	$53,166	$31,191
Work-in-process	16,567	12,138
Finished goods	22,582	20,900
Total	$92,315	$64,229

Income Taxes

The Company accounts for investment and research and development tax credits as a reduction of the provision for income taxes in the year in which the related credits are generated. In general, the Company's practice is to provide U.S. federal taxes on all undistributed international earnings.

Cash and Cash Investments

Short-term cash investments are valued at cost, which approximates market, and principally include certificates of deposit, time deposits, treasury notes, preferred stocks, municipal notes, and commercial paper.

Property, Plant and Equipment

Systems spares (original cost of $54,963,000 and $34,785,000 at September 30, 1987 and 1986, respectively) are depreciated over a five-year period using an accelerated depreciation method. All other property, plant and equipment are depreciated using the straight-line method. The estimated useful lives are:

Buildings	30 years
Machinery and equipment	5–10 years
Computer equipment	3–7 years
Leasehold improvements	Lease term

Included in the land and buildings and the construction in process balances at September 30, 1987 and 1986 were approximately $26,743,000 and $26,575,000, respectively, of costs relating to land and land improvements on a parcel held for future development.

Software Development Costs

During fiscal 1986, the Company adopted the Financial Accounting Standards Board Statement No. 86, which requires the capitalization of certain software development costs. The Company capitalizes costs as the development of products becomes "technologically feasible" and amortizes those costs as a charge to the income statement when, and as, the particular products are shipped. However, in no event will the amortization be less than that which would be achieved by amortizing such costs on a three-year straight-line basis from the date of product release. The amounts of unamortized software development cost included in other assets at September 30, 1987 and 1986 were $8,419,000 and $2,982,000, respectively. The amounts amortized and charged to expense for 1987 and 1986 were $1,090,000 and $190,000, respectively.

Earnings Per Share

Earnings per share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of outstanding stock options and a convertible debenture that have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

2. *Reclassifications*

The current period income statement has been reformatted to distinguish "Cost of product revenue" from "Cost of service and other revenue." In addition, to conform to industry trends in financial reporting, certain items previously classified as marketing, general and administrative expenses have been reclassified to cost of product revenue and research and development expense. Similar amounts for 1986 and 1985 associated with revenue and costs and expenses have also been reclassified in order to conform to the current period presentation. Certain other prior period amounts have also been reclassified to conform to the current period presentation.

3. *Leasing Program*

In fiscal 1986, the Company entered into a vendor leasing program and associated remarketing arrangement with a bank, whereby up to $15,000,000 of trade lease receivables may be financed either through limited recourse sales of the receivables or borrowings. In the event of a default by a lessee, recourse by the bank is limited to the collateralized computer equipment and the amount available, if any, in a limited recourse pool established as a percentage of each associated group of financed lease transactions. In addition, upon repossession, the Company may, at its option, repurchase the equipment from the bank at the greater of the bank's book or fair market value. Under the agreement, the Company may also be required to remarket the computer equipment on a "best efforts" basis on the bank's behalf. All administration and collection of lease receivables are carried out by the bank. In fiscal 1987, $7,462,000 was received as financing for lease receivables, of which $2,550,000 (see note 5) was received in the form of borrowings and $4,912,000 was received as a result of sales of such receivables. At September 30, 1987, approximately $433,000 was accrued as a reserve for recourse liabilities on the sales of lease receivables.

4. *Income Taxes*

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1987	1986	1985
Federal:			
Current	$40,235	$26,037	$ 2,950
Deferred (Prepaid)	4,750	(3,923)	4,610
	44,985	22,114	7,560
State:			
Current	9,261	6,880	3,522
Deferred	3,171	89	423
	12,432	6,969	3,945
Foreign:			
Current	20,804	21,686	12,005
Deferred (Prepaid)	1,086	(53)	(1,534)
	21,890	21,633	10,471
Total Provision	$79,307	$50,716	$21,976

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1987	1986	1985
Installment sale method for income tax reporting	$10,300	$(8,043)	$ 9,752
DISC income	–	–	(6,117)
Accelerated depreciation	1,606	447	2,586
Effect of intercompany profit eliminations	(10,227)	2,048	(90)
Other (including expenses recognized for financial statements, but not for income tax reporting)	7,328	1,661	(2,632)
Total Deferred (Prepaid)	$9,007	$(3,887)	$ 3,499

The provision for income taxes differs from the amount obtained by applying the federal statutory income tax rate to income before taxes as follows:

	1987	1986	1985
Federal statutory tax rate	43.0%	46.0%	46.0%
State taxes, net of federal income tax benefit	3.8	3.2	3.8
Investment tax credits	–	(2.1)	(2.6)
Research and development tax credits	(2.1)	(0.8)	(7.6)
Tax exempt DISC and FSC income	(2.5)	(2.0)	(4.3)
Other	0.7	–	3.7
Effective Tax Rate	42.9%	44.3%	39.0%

In fiscal 1986, the Company provided taxes pursuant to tax laws in effect on September 30, 1986. On October 22, 1986, the Tax Reform Act of 1986 was passed into law and, as expected, had an immaterial impact on the fiscal 1986 tax provision. The negative effects of the Tax Reform Act (repeal of investment tax credit, reduction of research and development tax credit, and certain changes in international provisions) were largely offset by the reduction in the federal statutory tax rate from 46% to 43% in fiscal 1987. A scheduled reduction of the federal statutory tax rate to 34% in fiscal 1988, currently provided in the legislation, is expected to further reduce the Company's effective tax rate in the future.

In September 1986, the Financial Accounting Standards Board issued an Exposure Draft, entitled "Accounting for Income Taxes." The currently proposed changes, if adopted, are not expected to have a material impact on the Company's results of operations.

5. Long Term Debt, Capital Lease Obligations, and Other Commitments

Long term debt and capital lease obligations as of September 30 consist of the following:

(In thousands)	1987	1986
5.7% and 5.6% promissory notes payable to a bank in Japanese yen, due November 1989 and December 1989, respectively	$ 3,552	$ 3,292
Installment notes payable to a bank through 1990, at a weighted average interest rate of 8.75%, collateralized by lease receivables	2,441	–
Convertible subordinated debenture payable to an officer of the Company, bearing interest at 9.5% and due September 1989	1,667	1,667
Industrial revenue bond, bearing interest at 12%, due July 1992	1,000	1,000
Industrial revenue bond, bearing interest at 12.4%, due July 1992 and collateralized by certain equipment	1,000	1,000
Obligations under capital leases, interest ranging from 6% to 19%, net of imputed interest totaling $99 and $749, in 1987 and 1986, respectively	853	4,735
	10,513	11,694
Less current portion	1,500	5,969
Long Term Debt and Capital Leases	$ 9,013	$ 5,725

The $1,667,500 convertible subordinated debenture is convertible into 200,000 shares of Common Stock at a price of $8.3375. The debenture becomes convertible as to 50,000 shares each year beginning in September 1986 and is subject to conversion acceleration in the event of certain occurrences.

Interest costs of $213,000, none, and $594,000 were capitalized during fiscal 1987, 1986, and 1985, respectively, relating to construction projects in process during those fiscal years.

The Company has entered into unsecured credit agreements totaling $65,000,000 with several banks for working-capital purposes. The agreements provide for revolving borrowings through March 1988, at which time outstanding amounts may be converted to term loans to be amortized through 1991. Domestic borrowings bear interest at or below the banks' prime rates through March 1988 and approximately 1/4% above these rates through 1991. The Company is required to pay a commitment fee of 1/4% per annum. There were no compensating balances required, and there were no borrowings outstanding at September 30, 1987, under any of these arrangements.

Certain financial covenants and restrictions are included in the loan agreements. The Company was in compliance with all such covenants and restrictions at September 30, 1987.

The Company has guaranteed payment of loans made to officers and other key employees totaling $913,000 at September 30, 1987, under a $2,000,000 bank line of credit. In addition, the Company has a $1,667,500 note receivable from an officer, included in other assets, which matures in September 1989 and bears interest at an annual rate of 10%.

The Company leases its headquarters, field offices, certain equipment, automobiles, and most of its operating facilities under operating lease agreements. The Company also has capital leases for certain equipment. Future minimum lease payments as of September 30, 1987, are as follows:

(In thousands)	Lease Obligations	
Fiscal Year	Capital	Operating
1988	$ 757	$ 47,720
1989	64	42,015
1990	64	34,189
1991	35	30,649
1992	32	25,432
Thereafter	–	76,713
Total minimum lease payments	$ 952	$256,718

The cost of assets held under capitalized leases totaled $3,547,000 and $11,981,000 at September 30, 1987 and 1986, respectively, and are included in the machinery and equipment and computer equipment and spares classifications in the financial statements. The accumulated depreciation associated with these assets totaled $3,254,000 and $8,894,000 at September 30, 1987 and 1986, respectively.

Rent expenses were $50,767,000 in 1987, $43,092,000 in 1986, and $38,213,000 in 1985.

6. *Capital Stock*

The Company's authorized capital stock consists of 2,400,000 shares of preferred stock (of which 800,000 have been designated Series A Participating Preferred), 4,000,000 shares of Junior Common Stock, and 196,000,000 shares of Common Stock. At September 30, 1987, 21,095,790 shares of Common Stock were reserved for future issuance under stock option plans, the employee stock purchase plan and a convertible subordinated debenture. There were no shares of preferred stock or Junior Common Stock outstanding at September 30, 1987.

Stock Split

On April 27, 1987, the Board of Directors declared a two-for-one stock split of the Company's Common Stock, effected in the form of a stock dividend. The additional shares were issued on June 12, 1987, to stockholders of record on May 22, 1987. Accordingly, the Common Stock, additional paid in capital, and all common share and per share data in the financial statements have been retroactively adjusted to reflect the split.

Preferred Stock Rights

During 1985, the Company declared a dividend of one preferred share purchase right for each then outstanding share of Common Stock. In addition, one right will be issued with each share of Common Stock issued by the Company before the date the rights become exercisable, are redeemed by the Company, or expire on May 17, 1990. The rights will not be exercisable, or transferable apart from the Common Stock, until 10 days after another person or group of persons acquires 20% of the Common Stock or commences, or announces its intention to commence, a tender or exchange offer for at least 30% of the Common Stock. Each right entitles the holder to buy one one-hundredth of a share of a series of preferred stock of the Company, par value $.10 per share, designated as Series A Participating Preferred Stock, at an exercise price of $80.00. In certain circumstances, the right will entitle its holder to purchase a larger amount of preferred stock or stock in an acquiring company.

Stock Option Plans

The Company has employee stock option plans under which permanent employees may be granted options to purchase shares of Common Stock generally at 100% of fair market value at the time of the grant. Options generally vest over a four-year period, become exercisable six months after the effective date, and expire no later than ten years after the effective date. At the discretion of the Board of Directors, options granted under the stock option plans may qualify for Incentive Stock Option treatment under the Economic Recovery Tax Act of 1981. At September 30, 1987, options for 5,015,355 shares were available for future grant.

Employee Stock Purchase Plan

Under the plan, the Company may offer shares to employees by two methods. Under one method, eligible employees may elect to purchase shares of Common Stock at 85% of fair market value as of the last trading day before, or the last trading day of, the participation period. Under this method, in fiscal years ended September 30, 1987, 1986, and 1985, employees purchased 463,000 shares for aggregate proceeds of $7,625,000; 778,000 shares for aggregate proceeds of $5,936,000; and 836,000 shares for aggregate proceeds of $6,194,000, respectively. Under a second method, the Company may grant to all employees the option to purchase the same number of shares of Common Stock at not less than 85% of fair market value at the grant date. As of September 30, 1987, the Company has reserved 3,981,448 shares of Common Stock for future issuance under its employee stock purchase plan.

Information concerning the combined option activity during the three fiscal years ended September 30, 1987, under the stock option and employee stock purchase plans is summarized as follows:

	1987		1986		1985	
	Shares	Aggregate Price	Shares	Aggregate Price	Shares	Aggregate Price
(In thousands except per share amounts)						
Beginning of year	13,799	$154,521	13,867	$146,900	12,485	$137,071
Options granted	4,516	110,103	5,384	59,968	3,225	26,581
Options exercised ($2.62 to $37.00 per share)	(4,859)	(51,960)	(4,286)	(39,306)	(704)	(3,883)
Options cancelled	(324)	(4,240)	(1,166)	(13,041)	(1,139)	(12,869)
End of year	13,132	$208,424	13,799	$154,521	13,867	$146,900
Options at year end						
Exercisable	11,503		11,360		12,611	
Vested	7,062		7,536		8,195	

Although all outstanding dilutive stock options and a convertible debenture are considered common stock equivalents in presenting earnings per share under the treasury stock method, the following table shows the maximum share dilution that would occur from assumed option exercises under existing options based upon vesting in future years within specified price ranges. The Company has had a long-standing policy of encouraging all levels of employees to become stockholders through various stock option and purchase programs. This policy is based upon a belief that all stockholders will benefit from the higher productivity, lower turnover, and improved customer satisfaction realized by providing employees with a personal stake in the Company's future success.

			Maximum number of existing options vested each fiscal year				
Exercise Price Range	Aggregate Price	Shares	1987 and Prior	1988	1989	1990	1991
(In thousands except price ranges)							
$ 0-$10	$ 36,865	4,211	2,771	893	510	37	–
$10-$20	97,126	6,523	4,110	844	793	677	99
$20-$30	31,536	1,079	81	278	270	270	180
$30-$40	42,897	1,319	100	408	310	310	191
	$208,424	13,132	7,062	2,423	1,883	1,294	470

Common and Common Equivalent Shares	Outstanding Shares	Outstanding Equivalents	Total
Fiscal 1987 weighted average	90,927	6,784	97,711
At September 30, 1987	93,160	6,119	99,279

7. Contingencies

The Company, along with one former and two present principal officers, was named as a defendant in a class action complaint filed in the United States District Court for the Northern District of California on October 23, 1984, purporting to state claims for alleged violations of federal securities laws and pendent state claims arising out of the Company's December 1982 restatement of revenue and earnings for fiscal 1982. The court dismissed the complaint as to the individual defendants in March 1985 with leave to amend. In September 1985, the court granted the defendant's motion for summary judgment and dismissed the suit. The plaintiff filed a notice of appeal in October 1985. On June 3, 1987, the Federal Court of Appeals for the Ninth Circuit reversed the lower court's dismissal of the suit, reinstated claims against the individual defendants, and remanded the case for further proceedings. No provision has been made in the financial statements concerning possible liability because, in the opinion of management, it is unlikely that the ultimate disposition of the suit would have a material effect on the Company's financial position.

In addition, there are various actions or claims which have been brought or asserted against the Company. Management does not consider them to be material to the Company's financial position.

8. Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the three fiscal years ended September 30, 1987.

(In thousands)	1987	1986	1985
Revenues			
United States-customers	$ 587,634	$ 463,705	$ 417,460
United States-interarea	249,034	118,989	111,742
Europe-customers	302,966	207,670	136,307
Europe-interarea	22,383	57,032	75,583
Americas/Pacific-customers	144,895	96,418	70,371
Americas/Pacific-interarea	10,813	–	–
	1,317,725	943,814	811,463
Eliminations	(282,230)	(176,021)	(187,325)
Total revenue	$1,035,495	$ 767,793	$ 624,138
Pretax Income			
United States	$ 146,503	$ 73,716	$ 34,586
Europe	37,229	39,821	15,496
Americas/Pacific	7,726	1,007	6,555
	191,458	114,544	56,637
Eliminations	(6,547)	(62)	(287)
Total pretax income	$ 184,911	$ 114,482	$ 56,350
Identifiable Assets			
United States	$ 707,454	$ 541,381	$ 436,835
Europe	213,688	131,853	101,836
Americas/Pacific	105,791	63,701	47,386
	1,026,933	736,935	586,057
Eliminations	(59,692)	(31,910)	(33,713)
Total identifiable assets	$ 967,241	$ 705,025	$ 552,344

Interarea transfers are made at arm's-length prices, which include manufacturing profits attributable to each respective area's operations. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $12,390,000 in 1987, $10,048,000 in 1986, and $7,053,000 in 1985. The Company operates primarily in one industry segment which includes the manufacture, servicing, and marketing of computer systems.

9. *Unaudited Quarterly Financial Data*

(In thousands except per share amounts)

Quarters Ended	Dec. 31	March 31	June 30	Sept. 30
Year ended September 30, 1987				
Revenue				
Product revenue	$198,725	$202,010	$218,838	$241,469
Service and other revenue	39,310	40,358	45,140	49,645
Total revenue	238,035	242,368	263,978	291,114
Costs and Expenses				
Cost of product revenue	53,581	54,912	57,028	61,283
Cost of service and other revenue	27,837	30,061	36,164	37,362
Research and development	24,315	25,867	27,416	30,876
Marketing, general and administrative	86,761	96,235	102,346	112,763
Total costs and expenses	192,494	207,075	222,954	242,284
Operating Income	45,541	35,293	41,024	48,830
Interest income, net	2,847	3,233	3,934	4,209
Income Before Income Taxes	48,388	38,526	44,958	53,039
Provision For Income Taxes	21,291	16,082	19,341	22,593
Net Income	$ 27,097	$ 22,444	$ 25,617	$ 30,446
Earnings Per Share	$ .29	$ .23	$ .26	$ .31
Year ended September 30, 1986				
Revenue				
Product revenue	$140,293	$146,109	$163,361	$182,514
Service and other revenue	29,768	30,218	37,492	38,038
Total revenue	170,061	176,327	200,853	220,552
Costs and Expenses				
Cost of product revenue	43,310	41,500	43,431	46,998
Cost of service and other revenue	22,821	24,754	26,924	30,186
Research and development	19,847	21,287	22,337	23,553
Marketing, general and administrative	64,768	68,788	77,560	83,751
Total costs and expenses	150,746	156,329	170,252	184,488
Operating Income	19,315	19,998	30,601	36,064
Interest income, net	1,673	2,362	2,054	2,415
Income Before Income Taxes	20,988	22,360	32,655	38,479
Provision For Income Taxes	9,340	9,950	14,531	16,895
Net Income	$ 11,648	$ 12,410	$ 18,124	$ 21,584
Earnings Per Share	$ .14	$ .14	$ .20	$ .23

10. *Merger of Subsidiary Subsequent to Year End (unaudited)*

On November 12, 1987, the Company and one of its wholly owned subsidiaries entered into an agreement with Atalla Corporation (Atalla) which will result, subject to approval by Atalla's shareholders, in Atalla becoming a wholly owned subsidiary of the Company. The agreement provides for the exchange of Atalla common stock into Tandem Common Stock. Atalla provides secure system solutions in the areas of network interchange, electronic payment, and computer security. The merger transaction will be accounted for as a pooling of interests.

Auditors' Report

To Tandem Computers Incorporated:

We have examined the consolidated balance sheets of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1987 and 1986, and the related consolidated statements of income, stockholders' investment, and changes in financial position for each of the three years in the period ended September 30, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1987 and 1986, and the results of their operations and the changes in their financial position for each of the three years in the period ended September 30, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

San Jose, California
October 20, 1987

Arthur Andersen & Co.

Tandem Stock Price

Fiscal Quarter		High	Low
1987	4th Quarter	33 1/4	26 1/2
	3rd Quarter	36 7/8	30 7/8
	2nd Quarter	37 1/4	17 1/2
	1st Quarter	19 3/8	16 3/4
1986	4th Quarter	19 5/8	14
	3rd Quarter	16 3/4	11 3/8
	2nd Quarter	13 1/8	10
	1st Quarter	11 7/8	6 5/8
1985	4th Quarter	9 1/8	7
	3rd Quarter	11 7/8	7 5/8
	2nd Quarter	14 1/4	9 1/4
	1st Quarter	9 7/8	7 1/2

Through April 6, 1987, Tandem Computers Incorporated was traded via the NASDAQ National Market System under the trading symbol TNDM. On April 7, 1987, the Company's Common Stock began trading via the New York Stock Exchange under the trading symbol TDM. All quotations shown represent the high and low closing sale prices as reported in the *Wall Street Journal*. The Company has not declared or paid any cash dividends on its Common Stock and has no plans to do so in the foreseeable future.

Board of Directors

Thomas J. Perkins,
Chairman of the Board;
General Partner,
Kleiner, Perkins, Caufield & Byers

Morton Collins,
General Partner, DSV Partners

Thomas J. Davis, Jr.,
General Partner, Mayfield Fund

Franklin P. Johnson, Jr.,
General Partner,
Asset Management Partners

Andrew Knight,
Chief Executive,
The Daily Telegraph

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer,
Tandem Computers Incorporated

Robert G. Stone, Jr.,
Chairman of the Board,
Kirby Exploration Company, Inc.

James G. Treybig,
President and
Chief Executive Officer,
Tandem Computers Incorporated

Thomas I. Unterberg,
Managing Director,
Shearson Lehman Brothers Inc.

Walter B. Wriston,
Chairman, President's Economic
Policy Advisory Board

Advisor to the Board of Directors

Washington SyCip
Chairman, The SGV Group

Auditors

Arthur Andersen & Co.
San Jose, California

Registrar and Transfer Agent

Bank of America N.T.&S.A.
San Francisco, California

Form 10-K

A copy of the Company's Report on Form 10-K for the 1987 fiscal year, as filed with the Securities and Exchange Commission, is available on written request. Please direct your request to:

Manager of Investor Relations
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Wednesday, January 27, 1988, at the Company's headquarters.

Corporate Headquarters

19333 Vallco Parkway
Cupertino, California 95014-2599
(408) 725-6000

Officers

James G. Treybig,
President and
Chief Executive Officer

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer

Michael K. Bateman,
Vice President—
Third-Party Marketing

Jack W. Chapman,
Vice President—
International Sales Operations

Thomas Lyman Chun,
Vice President—
Corporate Projects

George M. Eckert,
Vice President—
Major Projects Management

John M. Elkins,
Vice President—
Customer Engineering

Donald E. Fowler,
Vice President—Strategy and
Corporate Development

Robert G. Gargus,
Corporate Controller

Gerald D. Held,
Vice President—New Ventures

Robert F. Hoogstraten,
Vice President and Managing
Director—European Division

Jan E. Jensen,
Vice President—Human Resources

Thomas J. Klitgaard,
Vice President, General Counsel
and Secretary

Lawrence A. Laurich,
Vice President—Transaction
Systems Division

Dennis L. McEvoy,
Vice President—Transaction
Networks Division

Lawrence W. McGraw,
Vice President—
U.S. Sales Operations

Michael C. Moore,
Vice President and Intercontinental Division Manager

Gerald L. Peterson,
Vice President—Marketing

David J. Rynne,
Vice President and
Chief Financial Officer

Stephen C. Schmidt,
Vice President—Operations

Gerd Stoecker,
Treasurer

Alois J. Strnad,
Vice President—
Management Information Systems

Barry E. Young,
Vice President—Micro Products
Division

[illegible] SUBSIDIARIES

[illegible]

INTERNATIONAL SUBSIDIARIES

AUSTRALIA

Tandem NonStop Pty. Ltd.

Adelaide
Canberra
Melbourne
Perth
Queensland (Brisbane)
Sydney
Tasmania

AUSTRIA

Tandem Computers Ges.m.b.H.

Vienna

BELGIUM

Tandem Computers S.A./N.V.

Zaventem (Brussels)

CANADA

Tandem Computers Canada Limited

Edmonton
Markham
Milton
Montreal
Ottawa
Scarborough
Toronto
Vancouver

DENMARK

Tandem Computers A/S

Glostrup (Copenhagen)

FRANCE

Tandem Computers S.A.

Paris
Strasbourg

HONG KONG

Tandem Computers (Hong Kong) Limited

Hong Kong

ITALY

Tandem Computers Italia, S.p.A.

Milan
Rome

JAPAN

Tandem Computers Japan, Limited

Nagoya
Osaka
Tokyo

THE NETHERLANDS

Tandem Computers B.V.

Hoofddorp (Amsterdam)

NEW ZEALAND

Tandem NonStop Pty. Ltd.

Auckland
Wellington

NORWAY

Tandem Computers (Norway) A/S

Hovik (Oslo)

SINGAPORE

Tandem Computers (Singapore) Pte. Limited

Singapore

SPAIN

Tandem Computers Ibérica, S.A.

Madrid

SWEDEN

Tandem Computers AB

Sundbyberg (Stockholm)

SWITZERLAND

Tandem Computers AG

Zurich

UNITED KINGDOM

Tandem Computers Limited

Birmingham
Glasgow
High Wycombe
London
Stafford
Reading

WEST GERMANY

Tandem Computers GmbH

Berlin
Düsseldorf
Frankfurt
Hamburg
Hilden
Nürnberg
Munich
Stuttgart

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Corporate Headquarters

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Cupertino, California [illegible]
(408) 725-6000

DOMESTIC SALES OFFICES

ARIZONA
Phoenix
Tucson

ARKANSAS
Little Rock

CALIFORNIA
Culver City
Los Angeles
Oakland
Sacramento
San Diego
San Francisco
Santa Ana
Santa Clara

COLORADO
Englewood (Denver)

CONNECTICUT
Hartford
Norwalk

FLORIDA
Jacksonville
Miami
Orlando
Tampa

GEORGIA
Atlanta

HAWAII
Honolulu

ILLINOIS
Chicago
Itasca
Palatine

INDIANA
Ft. Wayne
Indianapolis

IOWA
Bettendorf
Cedar Rapids
Des Moines

KANSAS
Overland Park (Kansas City)

KENTUCKY
Louisville

LOUISIANA
Metairie (New Orleans)

MARYLAND
Linthicum (Baltimore)

MASSACHUSETTS
Newton (Boston)

MICHIGAN
Detroit
Flint
Lansing

MINNESOTA
Minneapolis

MISSOURI
Creve Coeur (St. Louis)

NEBRASKA
Omaha

NEVADA
Las Vegas

NEW JERSEY
Cherry Hill
Hasbrouck Heights

NEW MEXICO
Albuquerque

NEW YORK
Jericho
New York City
Amherst (Rochester)

NORTH CAROLINA
Charlotte

OHIO
Cincinnati
Cleveland
Columbus
Dayton

OKLAHOMA
Oklahoma City
Tulsa

OREGON
Portland

PENNSYLVANIA
Allentown
Horsham
Philadelphia
Pittsburgh

TENNESSEE
Memphis

TEXAS
Austin
Dallas
Fort Worth
Houston

UTAH
Salt Lake City

VIRGINIA
Reston
Richmond

WASHINGTON
Olympia
Seattle
Salem

WISCONSIN
Milwaukee

INTERNATIONAL DISTRIBUTORS

Argentina
Chile
Colombia
Finland
Israel
Middle East
Malaysia
Mexico
Peru
Philippines
South Korea
Taiwan
Thailand
Venezuela

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Perth
Queensland (Brisbane)
Sydney
Tasmania

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Vienna

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Ottawa
Scarborough
Toronto
Vancouver

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Tandem Computers A/S

Glostrup (Copenhagen)

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Tandem Computers S.A.

Paris
Strasbourg

HONG KONG

Tandem Computers (Hong Kong) Limited

Kowloon

ITALY

Tandem Computers Italia S.p.A.

Milan
Rome

JAPAN

Tandem Computers Japan, Limited

Nagoya
Osaka
Tokyo

THE NETHERLANDS

Tandem Computers B.V.

Hoofddorp (Amsterdam)

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Tandem NonStop Pty. Ltd.

Auckland
Wellington

NORWAY

Tandem Computers (Norway) A/S

Hovik (Oslo)

SINGAPORE

Tandem Computers International Incorporated

Singapore

SPAIN

Tandem Computers Iberica, S.A.

Madrid

SWEDEN

Tandem Computers AB

Spanga (Stockholm)

SWITZERLAND

Tandem Computers AG

Zurich

UNITED KINGDOM

Tandem Computers Limited

Birmingham
Glasgow
High Wycombe
London
Northolt
Rochdale

WEST GERMANY

Tandem Computers GmbH

Bonn
Dortmund
Frankfurt
Hamburg
Hilden (Duesseldorf)
Mannheim
Neufahrn (Munich)
Stuttgart

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200132

TANDEM COMPUTERS

December 18, 1987

Dear Stockholder:

You are cordially invited to attend the Annual Meeting of Stockholders which will be held on Wednesday, January 27, 1988, at 10:00 A.M. at the offices of the Company at 19333 Vallco Parkway, Cupertino, California.

The formal notice of the Annual Meeting and the Proxy Statement have been made a part of this invitation.

After reading the Proxy Statement, please mark, sign, and return, at an early date, the enclosed proxy in the prepaid envelope addressed to the Bank of America, our agent, to assure that your shares will be represented. YOUR SHARES CANNOT BE VOTED UNLESS YOU SIGN AND RETURN THE ENCLOSED PROXY OR ATTEND THE ANNUAL MEETING IN PERSON.

A copy of the Company's Annual Report to Stockholders is also enclosed.

The Board of Directors and Management look forward to seeing you at the meeting.

Sincerely yours,

Thomas J. Perkins	James G. Treybig
Chairman of the Board	*President and Chief Executive Officer*

TANDEM COMPUTERS INCORPORATED

19333 Vallco Parkway • Cupertino, CA 95014 • (408) 725-6000

TANDEM COMPUTERS INCORPORATED

Notice of Annual Meeting of Stockholders
to be held January 27, 1988

The Annual Meeting of Stockholders of Tandem Computers Incorporated (the "Company") will be held at the offices of the Company at 19333 Vallco Parkway, Cupertino, California, on January 27, 1988, at 10:00 A.M. for the following purposes:

1. To elect three Class II Directors to hold office until 1991.

2. To consider and vote upon a proposal to amend the Tandem Computers Incorporated Employee Stock Purchase Plan to increase the number of shares of common stock available for issuance under the Plan.

3. To consider and vote upon a proposal to amend the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated to decrease, and to eliminate automatic adjustment of, the number of shares of Common Stock subject to annual option grants under the Plan.

4. To ratify the selection of Arthur Andersen & Co. as the Company's independent auditors.

5. To transact such other business as may properly come before the Meeting and any adjournment of the Meeting.

The Board of Directors has fixed the close of business on November 30, 1987, as the record date for determining the stockholders entitled to notice of and to vote at the Meeting and any adjournment of the Meeting. A complete list of stockholders entitled to vote will be available at the Company's headquarters, 19333 Vallco Parkway, Cupertino, California, for ten days before the meeting.

IF YOU DO NOT EXPECT TO ATTEND IN PERSON, PLEASE PROMPTLY MARK, SIGN, AND RETURN THE ENCLOSED PROXY.

THOMAS J. KLITGAARD
Secretary

December 18, 1987

TANDEM COMPUTERS INCORPORATED

PROXY STATEMENT

This Proxy Statement is furnished in connection with the solicitation by the Board of Directors of Tandem Computers Incorporated, a Delaware corporation (the "Company"), with principal executive offices at 19333 Vallco Parkway, Cupertino, California 95014, of proxies in the accompanying form to be used at the Annual Meeting of Stockholders to be held on January 27, 1988, and any adjournment of the Annual Meeting. The shares represented by the proxies received in response to this solicitation and not revoked will be voted at the Annual Meeting. A proxy may be revoked at any time before it is exercised by submitting a later-dated proxy or by voting in person at the Annual Meeting. On the matters coming before the Meeting for which a choice has been specified by a stockholder by means of the ballot on the proxy, the shares will be voted accordingly. If no choice is specified, the shares will be voted FOR the election of the three nominees for director listed in this Proxy Statement and FOR approval of proposals 2, 3, and 4 described in the Notice of Annual Meeting and in this Proxy Statement.

Stockholders of record at the close of business on November 30, 1987, are entitled to notice of and to vote at the Annual Meeting. On November 30, 1987, the Company had 93,473,912 shares of Common Stock outstanding. Each holder of Common Stock is entitled to one vote for each share held as of the record date, except that in voting for directors each stockholder is entitled to cumulate votes for the election of directors whose names have been placed in nomination; that is, a stockholder may cast as many votes as there are directors to be elected multiplied by the number of shares which the stockholder holds. All such votes may be cast for one candidate or distributed among the nominees for director as the stockholder sees fit. The persons authorized to vote shares represented by executed proxies in the enclosed form (if authority to vote for the election of directors is not withheld) will have full discretion and authority to vote cumulatively and to allocate votes among any or all of the nominees for election to the Board of Directors as they may determine or, if authority to vote for a specified candidate or candidates has been withheld, among those nominees for whom authority to vote has not been withheld.

The expense of printing and mailing proxy materials will be borne by the Company. In addition to the solicitation of proxies by mail, solicitation may be made by certain directors, officers, and other employees of the Company by personal interview, telephone, or telegraph. No additional compensation will be paid to such persons for such solicitation. The Company has also engaged Corporate Investor Communications, Inc. to assist in the solicitation of proxies and will pay this firm a fee of approximately $5,500 plus expenses. The Company will reimburse brokerage firms and others for their reasonable expenses in forwarding solicitation materials to beneficial owners of the Company's Common Stock.

This Proxy Statement and the accompanying form of proxy are being mailed to stockholders on or about December 18, 1987.

IMPORTANT

Please mark, date, and sign the enclosed proxy and return it at your earliest convenience in the enclosed postage-prepaid return envelope so that, if you are unable to attend the Annual Meeting, your shares may be voted.

ELECTION OF DIRECTORS

The Company has three classes of directors serving staggered three-year terms. Classes I and II consist of three directors and Class III consists of four directors. Three Class II directors are to be elected at the Annual Meeting for three-year terms expiring on the date of the Annual Meeting in 1991 or until each such director's successor shall have been duly elected or appointed.

Unless authority to vote for directors is withheld, it is intended that the shares represented by the enclosed proxy will be voted for the election of Messrs. Franklin P. Johnson, Jr., Thomas J. Perkins, and Thomas I. Unterberg as Class II directors, each of whom is currently a member of the Board of Directors of the Company. In the event any of such nominees becomes unable or unwilling to serve, the shares represented by the enclosed proxy will be voted for the election of the balance of those named and such other person as the Board of Directors may select. The Board of Directors has no reason to believe that any such nominee will be unable or unwilling to serve.

Set forth below are the names and ages of the nominees and directors, the class to which each has been elected or nominated for election, their principal occupations at present and for the past five years, certain directorships held by each, and the year in which each became a director of the Company. Information with respect to the Company includes the Company's predecessor California corporation.

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Class I		
Morton Collins (1)(2)	1975	51
General Partner of DSV Partners, DSV Partners III, and DSV Partners IV, Princeton, New Jersey, private investment partnerships, since 1974, 1981, and 1985, respectively; Director of The Liposome Company.		
Andrew Knight (3)	1984	47
Chief Executive, The Daily Telegraph plc, since February 1986; Editor, *The Economist*, Economist Newspaper Ltd., from 1974 to 1986; Chairman, Ballet Rambert; Governor of Imperial College of Science and Technology, University of London; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University.		
Robert C. Marshall (4)	1980	56
Senior Vice President and Chief Operating Officer of the Company since July 1980.		
Class II		
Franklin P. Johnson, Jr. (1)(3)	1975	59
General Partner since 1982 of Asset Management Partners, a Palo Alto, California, private investment partnership; Owner since 1967 of Asset Management Company, a Palo Alto, California, investment management proprietorship; Director of Amgen, Boole & Babbage, Coherent, Inc., Ross Stores, Inc., SBE, Inc., and Teradyne, Inc.; Member of the Advisory Board of the Center for Economic Policy Research, Stanford University.		

(See footnotes on page 4)

Name and Principal Occupation at Present and for the Past Five Years; Directorships	Director Since	Age
Thomas J. Perkins (2)(3)	1974	55
Chairman of the Board of the Company since 1974; General Partner since 1972, 1978, 1980, 1982, and 1986 of Kleiner & Perkins, Kleiner, Perkins, Caufield & Byers, Kleiner, Perkins, Caufield & Byers II, Kleiner, Perkins, Caufield & Byers III, and Kleiner, Perkins, Caufield & Byers IV, respectively, San Francisco, California, private investment partnerships; Chairman of the Board of Acuson Corporation and Genentech, Inc.; Director of Alliant Computer Systems Corporation and LSI Logic Corporation.		
Thomas I. Unterberg (1)(5)	1985	56
Managing Director since January 1987 of Shearson Lehman Brothers Inc., an investment banking and securities brokerage firm; Chairman from January 1986 to December 1986 and Chief Executive Officer from March 1986 to December 1986 of L.F. Rothschild, Unterberg, Towbin Holdings, Inc., and Chairman and Senior Managing Director of its predecessor partnership, an investment banking and securities brokerage firm, from 1983 to 1985; Managing Partner of such firm from 1981 to 1982; General Partner of such firm from 1977 to 1980; Director of Applied Energy Services, Inc., ASK Computer Systems, Inc., LIN Broadcasting Corporation, and Systems & Computer Technology Corporation.		
Class III		
Thomas J. Davis, Jr.	1976	75
General Partner since 1973, 1979, 1981, and 1983 of Mayfield II, Mayfield III, Mayfield IV, and Mayfield V, respectively, Menlo Park, California, private investment partnerships; Director of Equatorial Communications Co.		
Robert G. Stone, Jr. (3)	1978	64
Chairman of the Board of Kirby Exploration Company, Inc., an oil and gas exploration company, and its predecessor, General Energy Corporation, since 1971; Chairman of the Board of West India Shipping Company, Inc. from 1974 to 1983; Director of The Chubb Corporation, Combustion Engineering, Inc., Core Industries, Inc., Corning Glass Works, Great Northern Nekoosa Corporation, Hamilton Oil Corporation, The Japan Fund, Inc., The Pittston Company, Scudder International Fund, Inc., and Scudder New Asia Fund, Inc.		
James G. Treybig (2)(4)	1974	47
President and Chief Executive Officer of the Company since 1974.		
Walter B. Wriston(3)	1986	68
Chairman and Member, President's Economic Policy Advisory Board since 1982 and 1981, respectively; Chairman and Chief Executive Officer of Citicorp and Citibank, N.A., from 1970 to 1984; President and Chief Executive Officer of Citicorp from 1968 to 1970; President and Chief Executive Officer of Citibank, N.A., from 1967 to 1970; Director of Bechtel Investments, Inc., BRIntec Corporation, The Chubb Corporation, General Electric Company, J. C. Penney Company, Inc., Pan Am Corporation, Pfizer Inc., Reuters Holdings PLC, Sequoia Ventures, Inc., and United Meridian Corporation.		

(See footnotes on following page)

(1) Member of Audit Committee.

(2) Member of Compensation/Option Committee.

(3) Member of Nominating Committee.

(4) On October 2, 1984, the Securities and Exchange Commission (the "Commission") filed a civil action for injunctive and other equitable relief in the United States District Court for the Northern District of California against the Company, Messrs. Treybig and Marshall and a former officer of the Company. The Commission's complaint alleged that during fiscal 1982, the Company, aided and abetted by the named persons, engaged in certain conduct which resulted in improper recognition of revenue. This conduct was alleged to have resulted in the violation by the Company of certain provisions of the Securities Exchange Act of 1934 (the "Exchange Act") through the filing with the Commission of reports which overstated the Company's revenue and net income for the second and third fiscal quarters of 1982 and the issuance of a press release which overstated the Company's revenue and net income for the fourth fiscal quarter of 1982 and fiscal 1982 as a whole. The complaint further alleged that during fiscal 1982, the Company, aided and abetted by the named persons, violated certain accounting provisions of the Exchange Act relating to record keeping and internal accounting controls. The Company had restated its fiscal 1982 financial statements in December 1982 and the Commission did not seek a further restatement.

    In order to avoid the time and expense of protracted litigation, without admitting or denying the allegations in the complaint, on October 2, 1984, the Company and the named persons consented to the entry of a final judgment permanently enjoining them from violating various provisions of the Exchange Act and requiring certain ancillary relief, including an annual review and report for three years by the Company's independent accountants of the Company's system of accounting and internal controls in specified areas, including revenue recognition.

(5) From time to time, Shearson Lehman Brothers Inc. advises the Company with respect to investment banking matters.

STOCK OWNERSHIP OF DIRECTORS AND OFFICERS

The following table sets forth information as of October 30, 1987, as to shares of Common Stock beneficially owned by the directors and nominees named under "Election of Directors" and the directors and officers of the Company as a group. Except as otherwise indicated, each person has sole investment and voting power with respect to the shares shown. Ownership information is based upon information furnished by the respective individuals.

	Beneficial Ownership of Common Stock	
	Number of Shares(1)	Percent of Class
Thomas J. Perkins	1,010,936	1.1
James G. Treybig (2)	774,266	0.9
Franklin P. Johnson, Jr. (3)	410,000	0.5
Robert C. Marshall	380,490	0.4
Robert G. Stone, Jr. (4)	157,200	0.2
Thomas I. Unterberg	54,000	(5)
Thomas J. Davis, Jr.	37,144	(5)
Andrew Knight	34,000	(5)
Morton Collins (6)	30,608	(5)
Walter B. Wriston	30,000	(5)
All officers and directors as a group (31 persons including the ten directors named above)	4,410,005	4.7

(1) Includes shares which may be acquired within 60 days pursuant to the exercise of options or convertible securities as follows: Mr. Perkins, 10,000 shares; Mr. Treybig, 296,000 shares; Mr. Johnson, 10,000 shares; Mr. Marshall, 151,000 shares; Mr. Stone, 10,000 shares; Mr. Unterberg, 34,000 shares; Mr. Davis, 10,000 shares; Mr. Knight, 34,000 shares; Mr. Collins, 10,000 shares; Mr. Wriston, 28,000 shares; and all officers and directors as a group, 1,538,265 shares.

(2) Includes 3,600 shares held by trusts, of which Mr. Treybig is the trustee.

(3) Includes 400,000 shares held by Asset Management Partners, a partnership of which Mr. Johnson is general partner.

(4) Includes 14,400 shares held by trusts, of which Mr. Stone is a trustee, and 69,200 shares beneficially owned by Mr. Stone's wife and children, as to all but 1,200 of which shares Mr. Stone disclaims any beneficial interest.

(5) Less than one-tenth of one percent.

(6) Includes 2,800 shares held in a trust for the benefit of Mr. Collins' children, and as to which Mr. Collins disclaims any beneficial interest.

COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

Information is set forth below as to the cash compensation paid or accrued during the 1987 fiscal year by the Company and its subsidiaries to each of the five most highly compensated executive officers of the Company individually, to all executive officers as a group, and to directors. Information is given only for the period each served as an executive officer or director of the Company. Information for the past three fiscal years as to stock options granted and amounts allocated to such persons, to all current executive officers as a group, to all directors as a group, and to all employees under the Company's employee benefit plans is set forth under "Stock Options" on page 7, "Approval of Amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan" on page 8, "Approval of Amendment to the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated" on page 12, and the description of each other plan under "Description of Other Plans" which commences on page 15 of this Proxy Statement.

Cash Compensation of Executive Officers for Fiscal 1987

Name of Individual or Number in Group and Capacities in Which Served	Amount
James G. Treybig — President, Chief Executive Officer, and Director	$ 513,405
Robert C. Marshall — Senior Vice President, Chief Operating Officer, and Director	$ 385,743
David J. Rynne — Vice President and Chief Financial Officer	$ 356,630
Gerald L. Peterson — Vice President—Marketing	$ 314,908
Lawrence A. Laurich — Vice President—Transaction Systems Division	$ 313,502
All executive officers as a group (24 persons including the five named above)	$5,867,644

For the 1987 fiscal year, directors who were not officers of the Company were paid an annual retainer of $20,000, plus expenses, payable quarterly. For the same period, the Chairman of the Board was paid an additional annual retainer of $5,000. For the 1988 fiscal year, directors who are not officers of the Company will be paid an annual retainer of $25,000, plus expenses, payable quarterly, and the Chairman of the Board will be paid an additional retainer of $2,500.

During the 1985 fiscal year, the Company guaranteed a bank loan under a $2,000,000 bank line of credit to Lawrence A. Laurich in the principal amount of $430,000, plus interest. The largest aggregate principal amount outstanding in fiscal 1987 was $150,000, plus interest. Mr. Laurich paid his loan in full during the 1987 fiscal year. During the 1987 fiscal year, the Company guaranteed bank loans under the line of credit to Jan E. Jensen (Vice President—Human Resources), Thomas J. Klitgaard (Vice President, General Counsel and Secretary), and Gerald L. Peterson in the principal amounts of $747,000, $75,256, and $100,000, respectively, plus interest, which were the largest aggregate amounts outstanding under such guarantees in fiscal 1987. At September 30, 1987, the outstanding balances of the loans of Messrs. Jensen and Klitgaard were $747,000 and $75,256, respectively. Mr. Peterson paid his loan in full in fiscal 1987. The Company has not had to perform under the guarantees.

In addition to the guarantee discussed above, since May 9, 1983, the Company has made loans to Jan E. Jensen. These loans have been consolidated into a single loan bearing interest at the fixed rate of 9.5% accrued monthly. The principal of and interest on the loan are due in full on June 30, 1988. The largest aggregate principal amount outstanding under the loan during fiscal 1987 was $205,406, all of which is currently outstanding.

On September 26, 1985, the Company loaned Mr. Treybig $1,667,500 in consideration of his promissory note in that amount. The principal amount of the note is due September 26, 1989, and bears interest at 10% per annum payable quarterly. The note is fully secured. See "Description of Other Plans—Convertible Debenture Issuance" on page 18 of this Proxy Statement.

STOCK OPTIONS

With respect to options to purchase shares of the Company's Common Stock granted to certain executive officers, all current executive officers as a group, and all directors as a group during the period October 1, 1984, to September 30, 1987, the following table sets forth (i) the aggregate amount of Common Stock subject to options granted (net of cancellations) during the specified period, (ii) the weighted average per share option exercise price of such options, and (iii) the net value of shares (market value less any exercise price) realized during the specified period upon the exercise of such options during the period. The information set forth below includes the options granted to current executive officers and directors, as the case may be, discussed under "Approval of Amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan," "Approval of Amendment to the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated," and "Other Plans," as well as options granted under the Company's 1981 and 1979 Stock Option Plans. Information is given only for the period each served as an executive officer or director of the Company.

Common Stock(1)	James G. Treybig	Robert C. Marshall	David J. Rynne(2)	Gerald L. Peterson (2)	Lawrence A. Laurich(2)	All Current Executive Officers as a Group(2)	All Directors as a Group(3)
Granted—October 1, 1984, to September 30, 1987:							
Number of shares	224,000	85,000	56,600	59,600	56,600	975,950	148,000
Weighted average per share exercise price	$8.348	$15.137	$16.63	$17.29	$16.631	$15.34	$21.12
Exercised—October 1, 1984, to September 30, 1987:							
Net value realized in shares (market value less exercise price)(4)	$1,180,642	$888,850	$5,627	$1,170,551	$318,333	$9,649,651	$26,120

(1) Adjusted for stock splits.

(2) Includes options granted under the Stock Option Grant Program of the Company's Employee Stock Purchase Plan, all of which have an exercise price of 85% of the market value of the shares on the date of grant. The numbers of options granted under such Plan to Messrs. Rynne, Peterson, and Laurich, and all current executive officers as a group during the period October 1, 1984, to September 30, 1987, are 600, 600, 600, and 7,800, respectively, and the weighted average per share exercise price of such options and the per share market price of the Common Stock on the date of grant are $9.403 and $11.063, respectively.

(3) Excludes directors who are also executive officers.

(4) Represents the difference between the exercise price and the fair market value of the Company's Common Stock on the date or dates of exercise of stock options for the specified individual or group. These amounts do not reflect, and may or may not bear any relationship to, the net realized value when or if the shares are sold. Pursuant to rules of the Securities and Exchange Commission, no executive officer or director of the Company may sell shares of the Company's Common Stock within six months prior to or after exercising an option without the possible imposition of a severe penalty.

During the period October 1, 1984 to September 30, 1987, employees other than the current executive officers and directors included in the above table were granted (net of cancellations) options to purchase 9,372,050 shares of Common Stock at an average per share option price of $15.83. As of September 30, 1987, there were outstanding options under the Company's stock option plans to purchase 13,132,064 shares held by approximately 5,886 participants, and there were approximately 7,143 employees eligible to participate in such plans. The expiration dates of all such options range from November 30, 1987, to December 25, 1997, and the weighted average exercise price per share is $15.10. Of such options, options to purchase 21,800 shares were granted to employees of a foreign subsidiary of the Company pursuant to the Tandem Computers Incorporated Stock Option Plan for Employees of Affiliated Companies at an exercise price of 70% of the market value of the shares on the date of grant. The average per share exercise price of such options and the per share market price of the Common Stock on the date of grant are $11.955 and $17.00, respectively. As of September 30, 1987, approximately 16,436,520 shares had been issued upon the exercise of options under the Company's stock option plans.

APPROVAL OF AMENDMENT TO THE TANDEM COMPUTERS INCORPORATED EMPLOYEE STOCK PURCHASE PLAN

On November 10, 1987, the Board of Directors adopted an amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan (the "Purchase Plan") to increase the number of shares of Common Stock available for purchase under the Purchase Plan from 12,200,000 to 22,200,000 shares, subject to approval of the Company's stockholders. As of September 30, 1987, 3,981,448 shares remained available for purchase under the Purchase Plan, before giving effect to the amendment, and a total of 8,218,552 shares had been purchased under the Purchase Plan. Of the shares remaining available for purchase, 997,000 have been reserved for issuance upon the future exercise of options granted under the Stock Option Grant Program of the Purchase Plan described below.

The purpose of the Purchase Plan is to attract, retain, and motivate qualified employees by providing them with the opportunity to subscribe for and purchase Common Stock from the Company at a price lower than its market value at the time of purchase and to pay for such stock through payroll deductions. The Board of Directors believes that employee stock ownership is an effective means of securing to the

Company and its stockholders the advantages of the incentive inherent in stock ownership by participating employees, upon whose judgment, initiative, and efforts the Company is largely dependent for the successful conduct of its business. Consequently, the Board of Directors believes that the use of the Purchase Plan as a supplement to other forms of compensation paid by the Company is desirable.

An explanation of the Purchase Plan and a summary of its significant provisions is set forth below. A copy of the full plan may be reviewed by stockholders upon request to Patricia E. Hart at the offices of the Company at 19333 Vallco Parkway, Cupertino, California 95014, during normal business hours. The following summary is qualified in its entirety by reference to the plan document itself.

Administration

The Purchase Plan is administered by the Board of Directors. The Board of Directors may interpret the Purchase Plan, adopt rules and regulations for its administration, prescribe additional terms and limitations on the options, and delegate administration of the Purchase Plan to a committee consisting of not less than three members of the Board of Directors. The Board of Directors has delegated administration of the Purchase Plan to the Compensation/Option Committee (the "Committee").

Eligibility

All employees of the Company and its 50% or more owned subsidiaries, including officers, who customarily work more than five months in a calendar year are eligible to purchase shares under the Purchase Plan. Directors of the Company are not eligible to participate in the Purchase Plan. As of September 30, 1987, approximately 7,143 employees were eligible to participate in the Purchase Plan. No employee may be granted a right or an option to purchase Common Stock under the Purchase Plan which if exercised would result in (i) his or her owning stock possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or any subsidiary or (ii) his or her ability to purchase stock under the Purchase Plan or similar plans of the Company in any one calendar year with a fair market value in excess of $25,000 (determined as of the time such right or option is granted).

Purchase Price and Terms

The Purchase Plan has two segments, a Payroll Withholding Accumulation Program and a Stock Option Grant Program.

Under the Payroll Withholding Accumulation Program, an eligible employee may authorize the Company to withhold any whole percentage from 1% to 10% of his or her compensation. "Compensation" means, for this purpose, a participant's total quarterly compensation including bonuses and commissions but excluding special payments (such as moving expenses) and income with respect to stock options or other stock purchases. A participant is deemed to have elected to purchase the maximum number of whole shares of the Company's Common Stock which can be purchased with the amount withheld during a participation period (calendar quarters commencing on each July 1, October 1, January 1, and April 1 while the Purchase Plan is in effect). A participant may not purchase more than 1,500 shares in any one participation period. At the end of each participation period the participant's accumulated period payroll withholdings are divided by the purchase price for that period, which is the lesser of (i) 85% of the fair market value of a share of Common Stock on the last trading day before the participation period commences or (ii) 85% of the fair market value of a share of Common Stock on the last trading day during the participation period.

If a participant's employment terminates for any reason (including death), his or her participation in the Payroll Withholding Accumulation Program will terminate immediately and the entire amount credited to his or her Purchase Plan account will be refunded to the participant in cash, without interest.

During the period from October 1, 1984 to September 30, 1987, the aggregate difference between the purchase price and the fair market value on the dates of purchase of shares acquired pursuant to the Payroll Withholding Accumulation Program by all current executive officers as a group and by all employees (excluding current executive officers) was $118,350 and $8,518,409, respectively.

Under the Stock Option Grant Program, options for an identical number of shares of Common Stock are granted periodically at the discretion of the Committee to every participant who is eligible on the date of grant. The exercise price must not be less than 85% of the fair market value of a share of Common Stock on the date of grant. Options expire no later than 27 months after the date of grant. Shares purchased upon the exercise of an option must be paid for in full at the time of exercise. Payment may be by personal check or by delivery of an irrevocable direction to a securities broker, approved by the Company, to sell shares and deliver all or a portion of the proceeds to the Company in payment for the shares. In addition, with the Committee's approval given at the time the option is granted, payment may be by delivery of a full recourse, interest-bearing promissory note.

Upon termination of employment, an optionee may exercise an outstanding option granted under the Stock Option Grant Program (to the extent it was exercisable on the date of termination) within 30 days following the date of termination (but in no event later than the expiration date of such option), unless termination of employment is because of permanent disability, in which case the option may be exercised within three months following the date of termination. In the case of the death of an optionee while an eligible employee, the optionee's heirs or legal representative may exercise the option within one year after the date of death.

As of September 30, 1987, there were outstanding stock options under the Stock Option Grant Program to purchase 400, 2,800, and 994,200 shares held by Mr. Rynne, by all current executive officers as a group, and by all employees (excluding current executive officers), respectively. These options have a weighted average exercise price of $22.50 and have expiration dates which range from February 10, 1988 to October 18, 1988. As of September 30, 1987, the aggregate market value of the shares subject to such options was $33,150,250, based upon a closing price of $33.25 per share for the Company's Common Stock on the New York Stock Exchange on that date.

Adjustment Upon Recapitalization

The Purchase Plan provides for appropriate adjustment by the Board of Directors of the number and price of shares and option price of any outstanding options and of the aggregate number of shares available for issuance under the Purchase Plan in the event of a reorganization, stock split, combination of shares, stock dividend, or other recapitalization of the Company.

Term of the Plan, Amendment, and Termination

The Board of Directors may at any time amend, modify, or terminate the Purchase Plan. Any increase in the aggregate number of shares to be issued under the Purchase Plan will not be effective until approved by the stockholders of the Company. Unless earlier terminated by the Board of Directors, the Purchase Plan will be in effect until June 30, 1998, pursuant to an amendment to the Purchase Plan adopted by the Board of Directors on November 10, 1987, extending the term of the Purchase Plan for 10 years.

Transferability

A participant may not assign his or her rights or interest in the Purchase Plan, in any option granted under the Purchase Plan, or in any Common Stock or moneys to which he or she may become entitled under the Purchase Plan during a present or future participation period to any other person. Any such attempted assignment other than by will shall be treated as an election by the participant to withdraw from the Purchase Plan.

Federal Income Tax Information

The following tax discussion is only a brief summary of current United States federal income tax consequences of participation in the Purchase Plan. The federal income tax laws have frequently been revised and may be changed again any time in the future. Beginning in 1988, net capital gain is taxed at the same rate as ordinary income. In addition, capital gain ceases to be an item of tax preference. Capital losses continue to be allowed up to $3,000 of ordinary income, but now on a favorable one-for-one basis.

The Purchase Plan is intended to qualify as an "employee stock purchase plan" under the provisions of Section 423 of the Internal Revenue Code of 1954, as amended. No taxable income is recognized by a participant either at the time a right or an option is granted to purchase Common Stock under the Purchase Plan or at the time the shares are purchased thereunder.

If a participant does not dispose of shares acquired under the Purchase Plan before two years after the date of grant (which under the Payroll Withholding Accumulation Program is the first day of each participation period and under the Stock Option Grant Program is the date an option is granted) or, in the case of shares acquired under the Stock Option Grant Program, before six months after the date the shares are transferred to him or her, then upon such disposition the United States federal income tax consequences will be as follows: (1) the lesser of (a) the excess of the fair market value of the Common Stock on the date of disposition over the purchase price or (b) 15% of the fair market value of the shares on the date of grant will be taxed to the participant as ordinary income, but the Company will not be entitled to any deduction with respect thereto, and (2) the excess, if any, of the fair market value of the shares on the date of disposition over the sum of the purchase price and the amount of ordinary income recognized upon disposition will be taxed as capital gain. If such taxable disposition produces a loss (i.e., the value of the shares on the date of disposition is less than the purchase price) and the disposition involves certain unrelated parties, the loss will be a capital loss.

If a participant disposes of the shares earlier than two years after the date of grant, or in the case of shares acquired under the Stock Option Grant Program, earlier than six months after the date the shares are transferred to him or her, then upon such disposition the United States federal income tax consequences will be as follows: (1) the difference between the purchase price and the fair market value of the Common Stock on the date of purchase will be taxed to the participant as ordinary income in the year of disposition and will be deductible by the Company, and (2) the excess, if any, of the fair market value of the shares on the date of disposition over their fair market value on the date of purchase will be taxed as capital gain. If the value of the shares on the date of disposition is less than the sum of the purchase price and the amount of ordinary income recognized upon disposition, then such difference will result in a capital loss, provided the disposition is between certain unrelated parties. Any such loss will not affect the ordinary income realized upon the disposition.

Generally, a transfer of shares to a decedent's estate or to an heir by bequest or inheritance or to any transferee pursuant to certain tax-free exchanges is not considered a disposition by the participant for purposes of the foregoing rules. Also, a pledge of the shares is not considered a disposition unless the shares are actually disposed of pursuant to the pledge.

If a participant dies after purchasing shares under the Purchase Plan, then upon the participant's death he or she will realize ordinary income equal to the amount he or she would have recognized as ordinary income if he or she had made a qualifying disposition of the shares on the date of his or her death. The basis of the shares in the hands of the estate or legatee will be determined without regard to the realization of such ordinary income, and the Company will receive no deduction with respect thereto.

Because the capital gain deduction was repealed by the Tax Reform Act of 1986, it is no longer classified as an item of tax preference, and the entire capital gain upon the disposition of stock is included in "alternative minimum taxable income." Alternative minimum taxable income is defined as regular taxable income plus items of tax preference plus an add-back of certain itemized deductions which are not allowable for minimum-tax purposes.

If a taxpayer's alternative minimum taxable income exceeds $40,000 in the case of a married individual filing a joint return ($30,000 in the case of a single taxpayer), then the minimum tax equals 21% of the excess. The exemption amounts, e.g., $40,000 and $30,000, are reduced $.25 for each dollar by which alternative minimum taxable income exceeds $150,000 for joint returns ($112,500 for single taxpayers and $75,000 for married taxpayers filing separately). The minimum tax is payable if it exceeds the amount of the taxpayer's regular federal income tax for the same taxable year. The portion of a taxpayer's minimum tax attributable to certain items of tax preference (including the spread upon the exercise of an incentive stock option) can be credited against the taxpayer's regular tax liability in later years to the extent that liability exceeds the alternative minimum tax.

Required Vote

Adoption of the amendment to increase the number of shares of Common Stock available under the Purchase Plan requires the affirmative vote of a majority of the outstanding shares of Common Stock.

The Board of Directors recommends a vote For the amendment to the Tandem Computers Incorporated Employee Stock Purchase Plan.

APPROVAL OF AMENDMENT TO THE STOCK OPTION PLAN FOR NON-EMPLOYEE DIRECTORS OF TANDEM COMPUTERS INCORPORATED

The Company believes it is important to encourage the Company's non-employee directors to acquire a proprietary interest in the Company and to continue their association with the Company or its subsidiaries. The Board of Directors therefore adopted the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated (the "Directors' Plan") on November 3, 1986, which was effective February 20, 1987, upon being approved by the Company's stockholders. As of September 30, 1987, options to purchase 80,000 shares had been granted under the Directors' Plan pursuant to its terms which provided for an initial grant on February 20, 1987, to each of the eight non-employee directors of an option to purchase 10,000 shares (as adjusted for the two-for-one stock split effected in the form of a stock dividend on May 22, 1987). As of September 30, 1987, 420,000 shares remained available for option grants.

Under the terms of the Directors' Plan as approved by the stockholders at the 1987 Annual Meeting, each non-employee director would automatically receive on the date of each subsequent annual meeting of stockholders an option grant for 3,000 shares, subject to adjustment for a stock split, combination of shares, stock dividend, or similar event. Accordingly, to reflect the two-for-one stock split effected in the form of a stock dividend on May 22, 1987, annual grants to each non-employee director would be increased to 6,000 shares and would be subject to future adjustments. The Board of Directors has determined that, in order to be consistent with the procedures followed for option grants to new employees, the number of shares to be subject to the annual grants should remain at 3,000 shares. Therefore, on November 10, 1987, the Board amended the Directors' Plan, subject to approval of the stockholders at the Meeting, to provide that no adjustment in the number of shares subject to the annual option grants would be made for a stock split, combination of shares, stock dividend, or similar event. The number of shares and option price of shares subject to outstanding options and the aggregate number of shares to be issued under the Directors' Plan will remain subject to such adjustment.

An explanation of the Directors' Plan and a summary of its significant provisions is set forth below. A copy of the full plan may be reviewed by stockholders upon request to Patricia E. Hart at the offices of the Company at 19333 Vallco Parkway, Cupertino, California 95014, during normal business hours. The following summary is qualified in its entirety by reference to the plan document itself.

Administration

The Directors' Plan is administered by the Compensation/Option Committee of the Board of Directors. The Committee has the responsibility for carrying out all terms of the Directors' Plan. However, it has no discretion either to determine which directors shall receive option awards or to set the number of shares subject to such option awards.

Eligibility

The Directors' Plan provides for automatic annual option grants to each director who is not also an employee of the Company or a subsidiary.

Exercise Price and Terms

The exercise price for shares subject to options granted under the Directors' Plan is the fair market value of the shares at the date of the option grant. Payment of the exercise price must be made in cash or by the surrender of previously held shares of Common Stock, which shares will be valued for this purpose at their fair market value on the date of exercise, or a combination thereof.

Except as provided below, options granted under the Directors' Plan are not exercisable for a period of six months after grant. Thereafter, the option becomes exercisable as to an increasing amount on a daily basis, with the full amount exercisable 48 months after the date of grant. In the event that an optionee ceases to be a director within six months of the date on which the option was granted, the portion of the outstanding option which is not then exercisable will be forfeited. An optionee who ceases to be a director for any reason after six months from the grant date is entitled to exercise the portion of his or her option which is then exercisable within 12 months following such termination to the extent not previously exercised. All options granted under the Directors' Plan will lapse on the date 10 years following the date of grant of the option.

Following the Annual Meeting held on February 20, 1987, pursuant to the terms of the Directors' Plan each of the Company's eight non-employee directors received an option to purchase 10,000 shares at an exercise price of $29.00 per share, the fair market value of the shares on such date (adjusted to reflect the two-for-one stock split effected in the form of a stock dividend on May 22, 1987), all of which are currently outstanding. These options expire on February 20, 1997. As of September 30, 1987, the aggregate market value of the shares subject to such options was $2,660,000, based upon a closing price of $33.25 per share for the Company's Common Stock on the New York Stock Exchange on that date.

Amendment and Termination

The Directors' Plan may be amended or terminated by the Board, except that stockholder approval is required for any amendment which would increase the number of shares subject to option under the plan, change the number of shares subject to option that may be granted each year, or decrease the price at which options may be granted.

Transferability

Options are not transferable, other than by will or the laws of descent and distribution, and are exercisable during the lifetime of an optionee only by the optionee.

Federal Income Tax Information

The options granted under the Directors' Plan are nonstatutory options (i.e., they do not have any special status under the tax laws).

The grant of a nonstatutory option is not taxable to the Director and the Company cannot claim a deduction on account of the grant. When a nonstatutory option is exercised, the Director is taxable at ordinary-income rates on the difference between (a) the exercise price and (b) the fair market value of the shares on the date six months after the date of exercise. However, the Director may file a section 83(b) election within 30 days after the date of exercise, in which case the amount of ordinary income to be recognized with respect to the exercise would be determined on the date of exercise. The Director's basis in shares acquired by exercising a nonstatutory option is equal to their fair market value on the date six months after the exercise date (or on the date of exercise, if a section 83(b) election is made). In the year in which the Director recognizes income, the Company is entitled to a deduction equal to the amount of ordinary income so recognized. Special tax rules apply to the exercise of an option upon the surrender of previously held shares of Common Stock.

Required Vote

Adoption of the amendment to decrease, and to eliminate automatic adjustment of, the number of shares of Common Stock to be subject to annual option grants under the Directors' Plan requires the affirmative vote of a majority of the outstanding shares of Common Stock.

The Board of Directors recommends a vote For the amendment to the Stock Option Plan for Non-Employee Directors of Tandem Computers Incorporated.

DESCRIPTION OF OTHER PLANS

Other Stock Option Plans

Tandem Computers Incorporated 1981 Stock Option Plan. The Tandem Computers Incorporated 1981 Stock Option Plan (the "1981 Plan") was approved by the stockholders at the Company's 1982 Annual Meetings of Stockholders and, as amended, at the 1985 and 1987 Annual Meetings of Stockholders. The 1981 Plan was subsequently amended by the Board of Directors on (i) February 20, 1987, to delegate administration on certain routine matters to the Non-Insider Option Committee (consisting of a person designated by the Board of Directors) and (ii) September 22, 1987, to provide for administration as to officers and directors by a committee of three disinterested members of the Board of Directors or the Board of Directors and to provide that an optionee may satisfy all withholding tax requirements incident to the exercise of a nonstatutory stock option with shares of the Company's Common Stock. Except as indicated above, the 1981 Plan is administered by the Compensation/Option Committee. All employees of the Company and its 50% or more owned subsidiaries, including officers and directors who are also employees, are eligible to receive options. Options may be either nonstatutory stock options or incentive stock options ("ISOs"). The maximum value of ISOs granted before 1987 is limited to $100,000 per year for each employee, subject to certain carryover provisions. ISOs may be granted for any value after 1986; however, options first exercisable in a calendar year that exceed $100,000 will be nonstatutory options. Options granted must have an option price of not less than 100% of the fair market value of the Company's Common Stock on the date of grant. Options may be made exercisable at such times as determined by the administering committee, provided that an ISO granted before 1987 may not be exercised while there is outstanding any ISO previously granted to the same employee. ISOs granted after 1986 need not be exercised sequentially and may be exercised prior to the exercise of ISOs granted before 1987. Except when an optionee's employment terminates because of death or permanent disability, an option may not be exercised for six months following the date of grant. Shares purchased upon the exercise of an option must be paid for in full at the time of exercise in cash or, with the consent of the Company, by (i) the surrender of previously-held shares of the Company's Common Stock, which shares will be valued for such purpose at their fair market value on the date of exercise, (ii) the surrender of shares and cash, (iii) delivery of a full recourse, interest-bearing promissory note to the Company, calling for periodic repayments over a period not to exceed 10 years from the date of exercise, or (iv) delivery of an irrevocable direction to a securities broker to sell shares and deliver all or a portion of the proceeds to the Company in payment for the stock. An optionee may satisfy all withholding tax requirements incident to the exercise of a nonstatutory stock option with shares of the Company's Common Stock. An option may not be exercised after 10 years from its effective date and is not transferable except by will or the laws of descent and distribution. In the event of a reorganization, stock split, combination of shares, stock dividend, or other recapitalization, the Compensation/Option Committee may make appropriate adjustments in the number and kind of shares available for issuance under the 1981 Plan, in the number and kind of shares as to which outstanding options will be exercisable, and in the exercise price specified in any agreement with respect to any unpurchased shares. The Compensation/Option Committee may determine that an option will provide that the shares to be issued upon exercise of the option shall be subject to certain rights of repurchase by the Company at the option price. In such case, the option agreement will provide that if the optionee's employment terminates, the Company may repurchase a specified percentage of the shares.

Tandem Computers Incorporated 1979 Stock Option Plan. The Tandem Computers Incorporated 1979 Stock Option Plan (the "1979 Plan") was approved by the stockholders at the Company's 1980 Annual Meeting of Stockholders and, as amended, at the 1987 Annual Meeting of Stockholders. The 1979 Plan has been subsequently amended in the same manner as the 1981 Plan. The 1979 Plan is administered in the same manner as the 1981 Plan. The provisions of the 1979 Plan and the terms of the options granted under the 1979 Plan are substantially similar to those of the 1981 Plan, except as follows. Only employees of the Company, including officers and directors who are also employees, and employees and directors of its 80% or more owned subsidiaries, are eligible to receive options. Certain options outstanding on January 1, 1981, could not be designated as incentive stock options.

Tandem Computers Incorporated Stock Option Plan for Employees of Affiliated Companies. The Tandem Computers Incorporated Stock Option Plan for Employees of Affiliated Companies (the "Affiliated Companies Plan") was adopted by the Board of Directors on August 1, 1986. The Affiliated Companies Plan is administered by the Compensation/Option Committee. Employees, including officers and directors, of certain designated subsidiaries of the Company are eligible to receive options. As of September 30, 1987, the only such designated subsidiary was Tandem Computers de Mexico, S.A. de C.V. In addition, options may be granted to employees of companies in which the Company owns voting securities but which are not deemed to be subsidiaries and to employees of companies with which the Company has established a business or commercial relationship. Only nonstatutory options may be granted under the Affiliated Companies Plan. Options granted may have an option price of 100%, or any percentage thereof as determined by the Compensation/Option Committee, of the fair market value of the Company's Common Stock on the date of grant. Options may be made exercisable at such times as determined by the Compensation/Option Committee, provided that an option may not be exercised after seven years from its date of grant. Payment may be made in cash or, with the consent of the Company, delivery of a promissory note or irrevocable sell direction to a securities broker as described above. The remaining provisions of the Affiliated Companies Plan are substantially similar to those of the 1981 Plan.

Tandem Computers Incorporated Non-Qualified Stock Option Plan. The Tandem Computers Incorporated Non-Qualified Stock Option Plan was approved by the stockholders at the Company's 1978 Annual Meeting of Stockholders and, as amended, at the 1979 Annual Meeting of Stockholders and was administered in the same manner as the 1981 Plan. The Non-Qualified Stock Option Plan expired on November 12, 1985, and no options granted under this plan are outstanding. The terms of the options granted under this plan were substantially similar to those of the 1981 Plan, except as follows. Only employees of the Company, including officers and directors, and employees and directors of its wholly-owned subsidiaries, were eligible to receive options. Payment for shares purchased upon the exercise of an option could be by personal check or, with the consent of the Company, by delivery of a full recourse, interest-bearing promissory note.

Tandem Computers Incorporated Qualified Stock Option Plan. The Tandem Computers Incorporated Qualified Stock Option Plan was approved by the stockholders in 1976 and was administered in the same manner as the 1981 Plan. The Qualified Stock Option Plan expired on November 12, 1985, and no options granted under this plan are outstanding. The terms of the options granted under this plan were substantially similar to those of the 1981 Plan, except as follows. Only key employees of the Company, including officers and directors, and its subsidiaries could be granted options. Options could not be exercised after five years from the date of grant. Under certain circumstances, options could not be exercised while the optionee held another option previously granted at a higher option price. Payment for shares purchased upon the exercise of an option was by personal check.

Individual Stock Option Agreements. The Company has entered into Non-Qualified Stock Option Plans and Agreements with Messrs. Andrew Knight, Thomas I. Unterberg, and Walter B. Wriston, directors of the Company. Under the Plans, Messrs. Knight and Unterberg were each granted a five-year option to purchase 24,000 shares of the Company's Common Stock, and Mr. Wriston was granted a five-year option to purchase 20,000 shares of the Company's Common Stock. The per share exercise price of the options for Messrs. Knight, Unterberg, and Wriston are \$9.50, \$12.375, and \$14.063, respectively, which equal 100% of the market value of the Company's Common Stock on the dates of grant (as adjusted for the two-for-one stock split effected in the form of a stock dividend on May 22, 1987). The provisions of these Plans are substantially similar to those of the Non-Qualified Stock Option Plan except that no further grants are permitted under these Plans. Mr. John B.M. Place, a former director of the Company, was similarly granted, during his term as director, two options to purchase 4,000 (of which 2,006 have lapsed) and 20,000 (of which 12,108 have lapsed) shares of the Company's Common Stock at \$13.375 and \$14.563, respectively, per share.

Incentive Cash Bonus Plan

The Company has an incentive cash bonus plan (the "Bonus Plan") in which selected individuals who have material roles in achieving certain corporate goals are eligible to participate. Awards under the Bonus Plan are made if certain goals are met with respect to revenue and pretax profit, or in cases of special individual contribution. Prior to fiscal 1986, only executive officers of the corporation were eligible to participate. No awards were made for fiscal years 1982 through 1985. For fiscal years 1986 and 1987, Messrs. Treybig, Marshall, Rynne, Peterson, and Laurich, all current executive officers as a group, and all employees (excluding current executive officers) were awarded an aggregate of \$123,604, \$92,478, \$83,159, \$77,131, \$74,356, \$1,264,653, and \$4,827,874, respectively. Amounts awarded to current executive officers for fiscal 1987 are also included in the disclosure of management remuneration.

1984 401(k) Investment Plan

All non-union employees of the Company who are on its United States payroll, including directors who are employees of the Company, and the employees of certain participating subsidiaries, are eligible to participate in the Company's 1984 401(k) Investment Plan (the "Investment Plan"). The Investment Plan was amended and restated on November 7, 1985, to comply with the Tax Reform Act of 1984 and the Retirement Equity Act of 1984, and to make certain additional changes, including, but not limited to, an increase in maximum participant contributions from 10% to 12% of compensation. The amended and restated Plan was amended in January and September of 1986 to add a fourth investment fund and to provide for the crediting of interest to amounts distributed to terminated participants. The Plan was also amended, effective January 1, 1987, to comply with the Tax Reform Act of 1986 and, effective October 1, 1987, to permit maximum participant contributions of 18% of compensation.

Each participant may elect to contribute from 2% to 18% of his or her compensation, and the Company matches 25% of the first 6% of the employee's quarterly compensation contributed to the Investment Plan, subject to a maximum Company matching contribution of \$1,200 per employee per plan year ending September 30. An employee's contributions are made by deferring that portion of his or her compensation, thereby enabling such contributions to be made on a pretax basis. Effective for taxable years beginning January 1, 1987, only $7,000 may be contributed by a participant during a calendar year on a pretax basis. A participant is at all times fully vested in his or her contributions and becomes fully vested in Company contributions upon the last day of the fourth calendar quarter following the quarter for which such contributions were made. Contributions are held and invested by the Investment Plan trustee in four different funds. A participant may designate, within certain limitations, in which funds his or her accounts are to be invested. The Investment Plan permits participants to make hardship withdrawals and to borrow from their accounts at market rates under certain conditions. In general, the vested portion of a participant's accounts is distributed in a single-sum cash payment upon his or her termination of employment.

Between October 1, 1984 and September 30, 1987, the Company made matching contributions under the Investment Plan for the accounts of Messrs. Marshall, Rynne, Peterson, and Laurich, all current executive officers as a group, and all employees (excluding current executive officers) in the aggregate amounts of $3,600, $3,600, $3,335, $3,600, $50,488, and $5,129,294, respectively. Amounts of Company contributions for current executive officers for fiscal 1987 are also included in the disclosure of management remuneration.

Convertible Debenture Issuance

On September 26, 1985, the Company issued a 9.5% Convertible Subordinated Debenture Due September 26, 1989, (the "Debenture") in the principal amount of $1,667,500 to Mr. Treybig. The Company may redeem the Debenture in whole or in part. The Debenture is convertible into shares of the Company's Common Stock at $8.338 per share, which was 115% of the closing sale price of the Common Stock on the date of issuance of the Debenture (as adjusted for the two-for-one stock split effected in the form of a stock dividend on May 22, 1987). The principal amount which may be converted at any time is limited to the greater of (i) the amount which has been called for redemption but not yet redeemed or (ii) 25% of the aggregate principal amount commencing September 26, 1986, and an additional 25% each September 26 thereafter through 1989, unless Mr. Treybig is disabled or dies or a "change in control," as defined, occurs in which case the entire amount then outstanding is convertible. The Debenture may not be transferred by Mr. Treybig except upon his death.

RATIFICATION OF INDEPENDENT AUDITORS

Upon the recommendation of the Audit Committee, the Board of Directors has reappointed the firm of Arthur Andersen & Co. as the Company's independent auditors for the 1988 fiscal year, subject to ratification by the stockholders. Representatives of Arthur Andersen & Co. are expected to be present at the Company's Annual Meeting. They will have an opportunity to make a statement, if they desire to do so, and will be available to respond to appropriate questions.

The Board of Directors recommends a vote For ratification of the appointment of Arthur Andersen & Co.

BOARD OF DIRECTORS MEETINGS AND COMMITTEES

The Company's Board of Directors held six meetings during the 1987 fiscal year. All directors attended at least 75% of the aggregate number of meetings of the Board and of the committees on which such directors serve.

The Board of Directors of the Company has appointed an Audit Committee, Nominating Committee, and Compensation/Option Committee of the Board.

The current members of the Audit Committee are Messrs. Morton Collins, Franklin P. Johnson, Jr., and Thomas I. Unterberg. The Audit Committee held eight meetings during the 1987 fiscal year. Its functions are to monitor the effectiveness of the audit effort, to supervise the Company's financial and accounting organization and financial reporting, and to select a firm of certified public accountants, whose duty it is to audit the books and accounts of the Company for the fiscal year for which they are appointed.

The current members of the Nominating Committee are Messrs. Franklin P. Johnson, Jr., Andrew Knight, Thomas J. Perkins, Robert G. Stone, Jr., and Walter B. Wriston. The Nominating Committee held one meeting during the 1987 fiscal year. The Nominating Committee's function is to select nominees for election as directors. The Nominating Committee will consider nominees recommended by stockholders. Such recommendations should be submitted in writing to the Nominating Committee in care of the Secretary of the Company at its address set forth on the front page of this Proxy Statement.

The current members of the Compensation/Option Committee are Messrs. Morton Collins, Thomas J. Perkins, and James G. Treybig. The Compensation/Option Committee held nine meetings during the 1987 fiscal year. The Compensation/Option Committee's functions are to determine and supervise compensation to be paid to officers and directors of the Company and to supervise and manage the Company's Employee Stock Purchase Plan and stock option plans (except with respect to options granted to directors).

BENEFICIAL OWNER

As of November 13, 1987, The Equitable Life Assurance Society of the United States, 787-7th Avenue, New York, New York 10019, owned 5,577,613 shares (or 5.97%) of the Company's outstanding Common Stock. The Equitable Life Assurance Society of the United States has advised the Company that the shares are held by it and four of its subsidiaries. These entities have sole investment power with regard to 5,577,513 shares, shared investment power with regard to 100 shares, sole voting power with regard to 3,174,013 shares, shared voting power with regard to 454,800 shares, and no voting power with regard to 1,948,800 shares (as to which shares, the entities' clients have retained voting power).

STOCKHOLDER PROPOSALS

To be considered for presentation at the Annual Meeting of Stockholders to be held in 1989, a stockholder proposal must be received at the offices of the Company, 19333 Vallco Parkway, Cupertino, California 95014, not later than August 21, 1988.

OTHER MATTERS

The Board of Directors knows of no other business which will be presented at the Annual Meeting. If any other business is properly brought before the Annual Meeting, it is intended that proxies in the enclosed form will be voted in accordance with the judgment of the persons voting the proxies.

Whether you intend to be present at the Annual Meeting or not, we urge you to return your signed proxy promptly.

By order of the Board of Directors,

THOMAS J. KLITGAARD
Secretary

OTHER MATTERS

The Board of Directors knows of no other business which will be presented at the Annual Meeting. If any other business is properly brought before the Annual Meeting, it is intended that proxies in the enclosed form will be voted in accordance with the judgment of the persons voting the proxies.

Whether or not you intend to be present at the Annual Meeting in person, we urge you to return your signed proxy card promptly.

By order of the Board of Directors,

Thomas F. [illegible]
Secretary

TANDEM

1988 **ANNUAL** REPORT ◆ ◆ ◆ THE **ON-LINE** ENTERPRISE

Highlights

For the years ended September 30

(Dollars in thousands except per share amounts)	1988	1987	1986
Revenue	$1,314,721	$1,047,532	$778,014
Operating income	$ 147,261	$ 170,439	$107,013
Operating margin	11.2%	16.3%	13.8%
Net income	$ 94,485	$ 105,229	$ 64,258
Earnings per share	$ .96	$ 1.07	$ .72
Working capital	$ 278,465	$ 497,713	$387,042
Total assets	$1,318,377	$ 973,040	$710,024
Stockholders' investment	$ 856,861	$ 723,855	$537,978
Number of employees	8,624	7,077	5,784

Tandem Computers Incorporated, a FORTUNE 500 company, is a leading supplier of on-line transaction processing computer systems and enterprise-wide networks.

Founded in 1974, Tandem employs more than 8,600 people worldwide. Tandem systems around the world run ATM and point-of-sale networks, stock exchanges, factories, and other enterprises where hundreds of business transactions must be processed each second and recorded instantly.

The Tandem NonStop system family spans the range of performance requirements for on-line transaction processing applications. NonStop systems are software compatible and can run the same application programs. They can be connected in networks with each other and with equipment from other vendors to provide a single computing resource for an organization.

Through its wholly owned subsidiaries Ungermann-Bass, Inc., and Atalla Corporation, Tandem provides additional products for enterprise-wide networks and security applications, respectively. Tandem's wholly owned subsidiary, Tandem Telecommunications Systems, Inc., is developing network services software for the telecommunications industry.

Tandem and its wholly owned subsidiaries manufacture products in the United States, Mexico, West Germany, and Japan, and support customers from more than 150 locations worldwide.

ON THE COVER:
Tandem fundamentals for on-line transaction processing form the foundation for the on-line enterprise. These fundamentals, illustrated on the bottom row from left to right, are price/performance, networking, distributed data, linear expandability, data integrity, security, and fault tolerance.

THE ON-LINE ENTERPRISE

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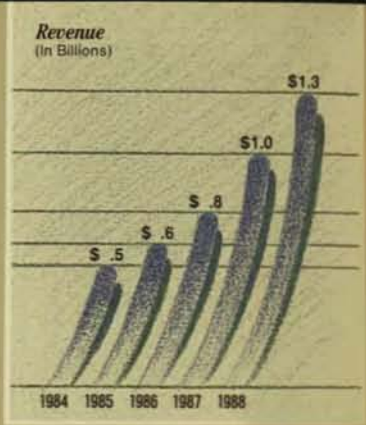
Today, more than ever before, organizations need a competitive edge. Whether managing people, inventory, or the bottom line, improving productivity and meeting customer needs are no longer merely sound business practices—they are necessary for survival.

Nowhere are the requirements more demanding, the pace of change faster, or the competitive advantages greater than in the area of on-line computer systems.

The market Tandem helped pioneer, on-line transaction processing, has been both a force for change and a tool with which to manage it.

The environment of the 1990s will demand a dramatic shift in thinking. Business must be more global. Decisions must be made faster. Entire organizations must be brought on-line to weld together the power of enterprise-wide resources.

We believe that no company is better prepared or more dedicated than Tandem to bringing to reality the emerging phenomenon we call the on-line enterprise.



To Our Stockholders:

1988 was an important, strategic year for Tandem – a year in which we continued to strengthen our foundation for the future. Among our accomplishments were several mergers that will enable us to serve our customers better and to maintain our leadership position as we meet the needs of the developing on-line enterprise.

Revenue growth of 26 percent in fiscal 1988 over the prior year was good, considering the weak market for large systems in the United States. Revenue reached $1.3 billion in fiscal 1988, up from $1.0 billion a year earlier.

Although we achieved record revenue in fiscal 1988, earnings were affected by our investments in mergers, the resolution of a class-action lawsuit, revenue below our plan due to softness in the U.S. market for computers, and some product delays which were resolved during the year. Earnings per share were $.96, compared with $1.07 in fiscal 1987.

International operations performed especially well during fiscal 1988, accounting for 50 percent of our annual revenue. In the fourth quarter, our U.S. business became more robust as well.

THE NEW TANDEM

Today Tandem is more than just one company dedicated to on-line transaction processing (OLTP). Although OLTP remains at the heart of Tandem, we are now a family of companies focused on the evolution of OLTP to the on-line enterprise.

Most significant to this change was our merger with Ungermann-Bass, Inc., a leader in open, enterprise-wide networks.

Tandem and Ungermann-Bass merged not only because our product lines are complementary, but also because our strategies match very well. We are both committed to standards in networking. We both sell primarily to the largest corporations, and we focus on similar industries. We are both entrepreneurial Silicon Valley companies that believe in the importance of high growth.

Since the completion of the merger in June, each company has opened the door to new opportunities for the other.

Two other mergers were completed in fiscal 1988 that sharpen our focus on serving the enterprise.

As OLTP networks increase in size and scope, data security becomes more complex and critical. To strengthen Tandem's leadership in this area, we merged with a leader in secure transaction systems, Atalla Corporation. Atalla currently focuses on the finance and retail industries, but its expertise will help enhance security offerings for Tandem's entire product line.

We also merged with Integrated Technology, Inc., renamed Tandem Telecommunications Systems, Inc. (TTSI). TTSI is developing advanced products for the telecommunications industry, where new services and applications are being sought aggressively.

Tandem supports the enrichment of life in many communities where it operates. In fiscal 1988, the Company sponsored the first Far East tour in 30 years by San Francisco Ballet, America's oldest professional ballet company.

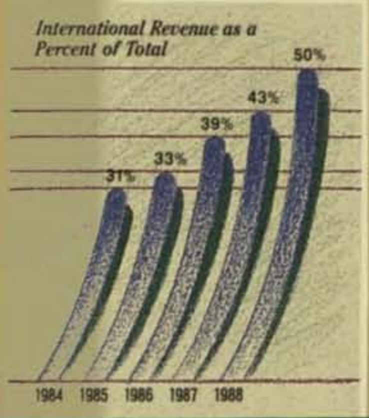
We are excited to welcome the people of Ungermann-Bass, Atalla, and TTSI to Tandem. They have dynamic, positive cultures of their own. We look forward to working together to create an even more successful Tandem.

Open communication has been instrumental to the success of integrating our new companies. Tandem television programs help create understanding among our groups. Electronic mail is used to communicate joint sales opportunities. And people from all of our new groups have the opportunity to meet other Tandem employees at our symposiums for outstanding performers and at our educational seminars.

STRENGTH FROM PEOPLE

The mergers and our shift to a broader market view led Tandem to reorganize into five operating groups. Our goal is to maintain the entrepreneurial spirit of the merged companies and our operating groups, while incorporating the processes and procedures that underlie the strength of a large company.

One operating group develops and manufactures our OLTP systems and networks. Another markets these products. Ungermann-Bass remains an independent group, pursuing its complementary activities. The Tandem Companies Group manages Atalla and TTSI, our equity investments, and our Micro Products Division.



The fifth group provides Tandem's highly regarded worldwide customer service and support.

We strongly believe that Tandem's outstanding employee programs bond this organization together. In fact, our employee turnover rate in 1988 was just above eight percent—far superior to the industry average. Tandem has been very successful in attracting and retaining top-flight people.

While adding more than 1,500 outstanding people through our mergers and select hiring in 1988, we also expanded our Board of Directors and initiated an International Advisory Board.

The new members of our Board of Directors are Jack F. Bennett, a senior vice president and director of Exxon Corporation, and Ralph K. Ungermann, president and chief executive officer of Ungermann-Bass. Dr. Martin M. (John) Atalla, founder of Atalla Corporation, is a new advisor to the Board of Directors. These members provide insight in the strategic areas of international and economic issues, enterprise networking, and security, respectively.

The International Advisory Board will further our international success by giving us a greater understanding of the special needs of markets worldwide.

MOVING THE ENTERPRISE ON-LINE

More and more computing functions of major enterprises are moving on-line. Tandem is a leader in meeting the requirements of this emerging environment. The products we delivered in 1988 will help customers make this transition.

The record number of new customers who turned to Tandem for solutions in the last two

TANDEM'S PUBLIC SERVICE SABBATICAL PROGRAM SUPPORTS VOLUNTEER WORK BY EMPLOYEES. PARTICIPANT ROSEMARIE HALL WORKED FOR SIX WEEKS IN FISCAL 1988 FOR THE CALIFORNIA MARINE MAMMAL CENTER, A PRIVATE, NON-PROFIT GROUP THAT RESCUES, REHABILITATES, AND RELEASES DISTRESSED MARINE MAMMALS.

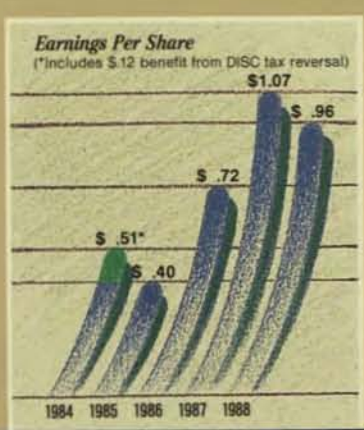
quarters of 1988 is indicative of the increasing strength of our product line.

Customers are looking for a wide range of capabilities. They want the flexibility to put their computing power where it is needed—whether in a large central site, at multiple remote locations, or on desktops. And they want the ability to tie all their data together with a fully distributed database.

The NonStop CLX system, which became fully available in the fourth quarter, showed its potential. More than half of our new customers in the last quarter purchased CLX systems.

The CLX system is designed for remote sites and for distributed applications, where price/performance, ease of use, and ease of maintenance are particularly critical. When it is coupled with NonStop SQL software, our relational database management system, customers have a powerful solution for their distributed applications.

Our computer-room system, the NonStop VLX, continued to be well-received in fiscal 1988. Enhancements are making this flagship product even more powerful. Expanded memory modules and ultra high-capacity disk storage facilities target the demand for cost-effective processing of large numbers of transactions.



The proliferation of workstations and personal computers is a phenomenon that we saw accelerate in 1988. We believe in future years this trend will enhance Tandem's growth. Tandem systems can be the critical connection to bring this desktop power into the on-line enterprise. As database servers, our systems can capture and process the millions of transactions created on the desktops of large organizations.

To help make this possible, we are working with the leaders of emerging standards in personal computers—Apple Computer, Inc., and Microsoft Corporation—as well as with providers of leading personal computer database tools and application-generation tools.

Reduced instruction set computing (RISC) is now recognized as an important technology for advanced system architectures. Tandem is working closely with MIPS Computer Systems, Inc., a leader in this technology, to apply RISC to future UNIX® systems from Tandem. This relationship was further strengthened when Jim Treybig was elected to the MIPS board of directors.

ENTERPRISE-WIDE NETWORKS

To integrate the many elements of the on-line enterprise, customers need the ability to connect to a variety of standard networks.

Tandem has strong offerings for SNA connectivity. Along with our own development projects in SNA, our investment in Netlink, Inc., is helping us maintain this leadership position. This partnership already has led to new SNA product offerings and joint sales.

Ungermann-Bass's leadership in open, enterprise-wide networking, combined with Tandem's leadership in providing the fundamentals of OLTP, will be key to taking entire enterprises on-line.

During 1988, Ungermann-Bass introduced its Access/One network delivery system, which exceeded sales projections in its first two quarters of general availability. The Access/One product sets new standards with the most advanced combination of networking and wiring capabilities in the industry.

We also have made important investments to address products for public networks. We believe that TTSI and a new partnership with AT&T will help put Tandem at the forefront of Integrated Services Digital Network (ISDN) technology, which combines voice, data, and other information on a single telephone line. This emerging technology is expected to have a major impact on the telecommunications industry worldwide well into the next century.

LEADERSHIP IN SOLUTIONS

We are also excited about the directions of our markets. New OLTP applications are constantly being created that make our customers more productive and more competitive.

Major software houses and system integrators are joining us in providing solutions. For example, this year we welcomed NYNEX Information Solutions Group, Inc., into our Alliance program.

We are pleased to be working with firms such as Electronic Data Systems, Boeing Computer Services, and MSA Advanced Manufacturing, Inc., in connection with OLTP systems for manufacturing. These three are codevelopers of T.I.M.E., the Tandem Integrated Manufacturing Environment, which provides an architecture to integrate various manufacturing applications. We plan to apply this concept to other Tandem markets moving toward the on-line enterprise.

LOOKING FORWARD

We are excited about our future. The challenge going forward is to reach our potential. We must remain cautious about the U.S. marketplace and currency movement and the impact they can have. But, as this report will show, we believe that strategic actions taken in 1988 make Tandem better equipped than ever to compete and grow.

Sincerely,

James G. Treybig
President and Chief Executive Officer

Thomas J. Perkins
Chairman of the Board

December 1, 1988

James G. Treybig (right), President and Chief Executive Officer; Thomas J. Perkins, Chairman of the Board

POWERFUL SYSTEMS AND DATABASE PRODUCTS

Quality is important in every aspect of Tandem products—from the OLTP advantages they offer on-line enterprises to their reliability, serviceability, and overall design.

Because of this attention to design, several Tandem products received prestigious awards in fiscal 1988. West Germany's Hannover Faire presented its Good Industrial Design award to the NonStop CLX system, V80 disk storage facility, and PSX workstation—all three of which were first delivered to Tandem customers in fiscal 1988. Japan's Ministry of International Trade and Industry (MITI) gave its Good Design Prize for Foreign Products to the high-performance NonStop VLX system.

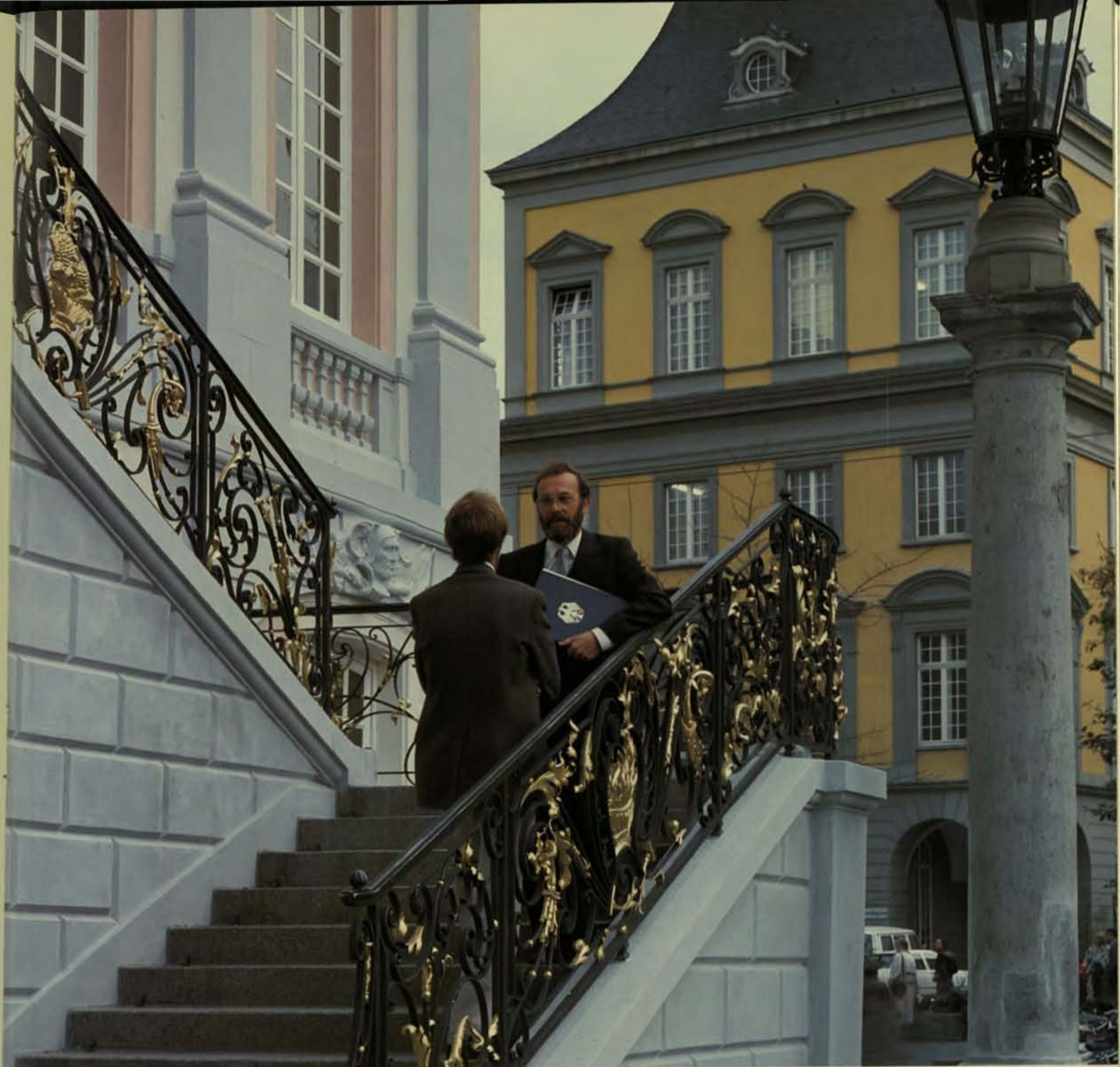
Pictured, from left to right, are the V80 disk storage facility, NonStop VLX and NonStop CLX systems, and PSX workstation.

TANDEM OLTP SYSTEMS AND DATABASES OFFER FUNDAMENTAL ADVANTAGES FOR THE ON-LINE ENTERPRISE.

Organizations are recognizing the advantages of instant access to accurate, up-to-date information. Entire businesses and government groups are moving to on-line transaction processing (OLTP) systems to ensure their competitiveness in a changing world.

Meanwhile, computing environments are changing dramatically. Gone are the days when a massive central computer could answer the varying needs of a growing organization. Companies today need to harness the power of many different systems, from large to small, including numerous personal computers valued for their inexpensive power and ease of use.

The proliferation of different systems and resulting isolation of information present a new challenge to computer vendors. How can systems and data be united to extend the advantages of on-line systems throughout organizations without creating data processing chaos? And, how can the productivity bonuses of resources such



THE FOREIGN OFFICE OF THE GERMAN FEDERAL REPUBLIC IS INSTALLING TANDEM NONSTOP CLX SYSTEMS AT WORLDWIDE LOCATIONS.

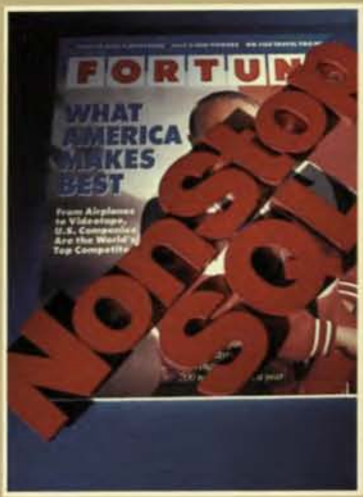
Volume shipments of Tandem's well-received, entry-level NonStop CLX systems began during fiscal 1988.

A large order came from The Foreign Office of the German Federal Republic, which began to implement a far-reaching program to streamline communications between Bonn and its embassies and consulates worldwide.

As many as 80 Siemens desktop computers at each facility will be linked via a local area network and Tandem's MULTILAN product to each of the distributed-processing CLX systems, replacing typewriters and integrating isolated word processors.

Three CLX systems were installed at Bonn during the year, including one in the foreign minister's private office. Three more systems were installed in New York, including one at the German representation to the United Nations. And shipments began to other locations worldwide, a process that will continue at an accelerated rate during 1989 and beyond.

Key considerations of The Foreign Office in selecting CLX systems included the ease of use, self-maintainability, and tolerance of power fluctuations and failures.



In 1988, FORTUNE magazine named Tandem's distributed database management technology among the "100 Products That America Makes Best."

Tandem's NonStop SQL distributed relational database management system combines the productivity of the SQL standard with high performance for OLTP. At the same time, NonStop SQL software incorporates Tandem OLTP fundamentals.

as personal computers and local area networks (LANs) be added to OLTP systems?

The answers lie in an emerging kind of computing environment Tandem calls the on-line enterprise. Here, the potential synergy between on-line systems and other powerful computing resources throughout the enterprise becomes reality.

We believe the product strengths and market experience of an OLTP pioneer such as Tandem are required to lead the way to the on-line enterprise. In fiscal 1988, Tandem took strategic actions to position itself better to address these emerging needs.

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OLTP LEADERSHIP

For over a decade, Tandem has provided OLTP solutions to customers. In OLTP applications, transactions must be handled and data updated instantly—so that the most current state of the business is always accurately reflected.

OLTP systems are central to the minute-by-minute operations of businesses. Understanding this, Tandem offers a rich combination of fundamental system advantages that protects applications, data, and customers' competitive positions. These fundamentals include fault tolerance, data integrity, linear expandability, superior price/performance, distributed data, networking, and security.

These combined strengths become even more valuable in the on-line enterprise because so many systems and applications depend on each other.

From the high-end NonStop VLX system to the mid-range NonStop CLX system to NonStop SQL relational database software, Tandem products address the requirements of the on-line enterprise.

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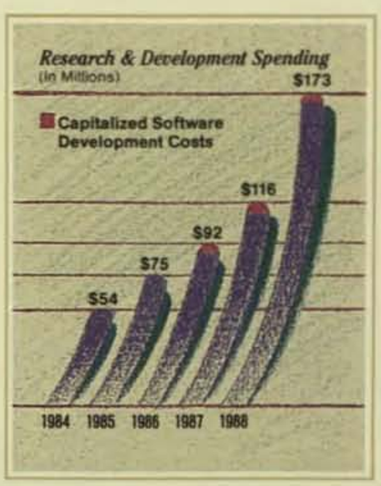
DISTRIBUTED POWER THROUGHOUT THE ENTERPRISE

For locations far from headquarters resources, users need systems that are cost-effective and easy to install and maintain, yet ensure availability and protect the integrity of data.

The NonStop CLX system, first delivered in fiscal 1988, fills this vital role in the on-line enterprise. Designed to work in the office environment, this system is ideal for regional centers or branch offices.

The CLX system combines superior price/performance with all of the other OLTP fundamentals of NonStop systems. It offers fault tolerance and expandability, and is



ENHANCED CUSTOMER SERVICE IS THE PRIMARY OBJECTIVE OF AN IMPORTANT NEW APPLICATION AT PACIFIC BELL IN CALIFORNIA.

Since becoming a Tandem customer in 1981, Pacific Bell has used Tandem systems in a number of projects.

In 1987, Pacific Bell began developing a major project intended to assist its 5,000 customer service representatives, who handle some 80,000 requests daily at the company's 48 California business offices.

The project is based on a network of Tandem NonStop VLX and CLX systems and PSX workstations, as well as local area networks (LANs) from Tandem subsidiary Ungermann-Bass, Inc. (Ungermann-Bass also provides Pacific Bell with LAN products for many other applications throughout the company.)

Scheduled to begin implementation in late 1988, the project will allow customer service representatives to use the advanced presentation capabilities of desktop workstations to access and display data simultaneously from several different customer service programs.

Later phases of the project are planned to refine and enhance the presentation further. And, elsewhere within Pacific Bell, other applications are under development on Tandem systems.

Pacific Bell is a subsidiary of Pacific Telesis Group, one of the seven U.S. Regional Bell Holding Companies. Pacific Telesis has more than 70,000 employees and annual revenue of more than $9 billion.

BANK OF TOKYO HEADQUARTERS IN JAPAN IS CONNECTED TO MORE THAN 250 LOCATIONS WORLDWIDE BY A NETWORK OF TANDEM VLX SYSTEMS.

Bank of Tokyo, Ltd. (BOT), Japan's foremost international financial institution, began in 1986 to build what is today, according to BOT, the world's largest international banking network.

Over 250 BOT and subsidiary locations worldwide are tied together through four nodes of Tandem VLX systems in Tokyo, New York, London, and Hong Kong—the latter coming on-line during 1988. Operating around the clock, the network handles an average of 40,000 foreign exchange transactions daily, in addition to administrative communications.

Through its foreign exchange, capital market, and international corporate finance activities, BOT plays an important role in the international development of the Japanese economy. In the coming year and beyond, BOT plans to expand its Tandem network in Europe and the United States to keep pace with the global expansion of Japanese businesses.

Anticipated business growth and the ability of Tandem systems to expand in small increments were key considerations in the bank's selection of a Tandem network.

BOT has assets of more than $160 billion.

easily added to a network of other NonStop systems.

The CLX system is designed for ease of service. Nearly all component failures are user-serviceable. Should a component fail, the computer itself can automatically report the failure to a Tandem support center.

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HIGH-PERFORMANCE COMPUTER-ROOM SYSTEMS

Headquarters sites in the on-line enterprise require powerful systems that can handle very high transaction volumes with excellent response times and can store vast amounts of data cost-effectively.

Designed for the computer-room, the high-performance NonStop VLX system is capable of handling many hundreds of transactions per second.

With its new VLX Large Memory modules, introduced shortly after the fiscal year ended, the VLX system can store large amounts of information in main memory, where data can be directly accessed by application programs to speed processing further.

The new XL80 disk storage facility, first delivered to customers in fiscal 1988, increases the VLX system's already powerful ability to handle the growing databases of on-line enterprises. This product stores large amounts of data in a small floor area—preserving costly computer-room space—and offers low-cost-per-megabyte storage.

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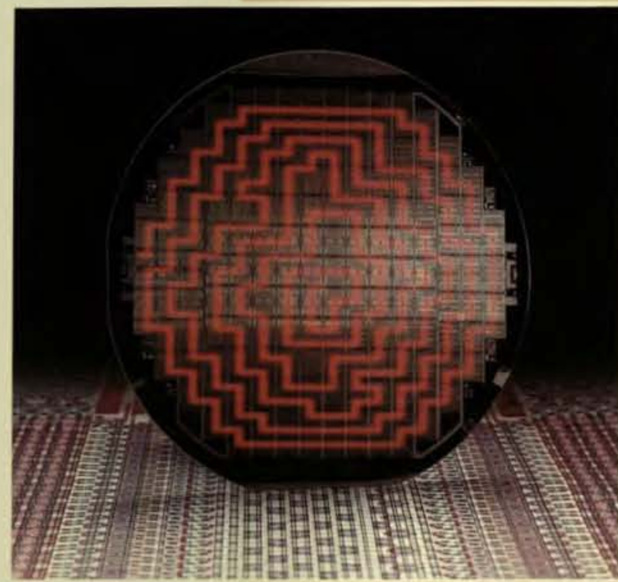
ENTERPRISE DATABASE ARCHITECTURE

Information is the lifeblood of a successful enterprise. As organizations move on-line, OLTP databases are increasingly becoming the main repositories of information: the corporate databases of record.

In the on-line enterprise, databases must satisfy a wide range of demands. High performance is essential to keep pace with ever-increasing transaction volumes. Databases must be distributed throughout a network so that information is stored close to where it is used most often, yet must be available to the entire network. And to make programmers more productive, databases need the emerging industry standard Structured Query Language (SQL).

Tandem's commitment to implementing standards—while adding value to them—is reflected



In the on-line enterprise, performance is more essential than ever. Advanced memory and storage products are key contributors to transaction-processing performance.

In 1988, Tandem invested in Anamartic Limited of Cambridge, England. Anamartic is developing a new class of high-performance storage subsystems that combines Anamartic's own proprietary whole-wafer integration architecture with state-of-the-art semiconductor technology.

COURTESY APPLE COMPUTER, INC.

Building on a strategy of integrating powerful desktop devices with on-line transaction processing networks, Tandem entered into an agreement in fiscal 1988 with Apple Computer, Inc., under which Tandem will sell, support, and service Apple Macintosh computers for its OLTP customers. Tandem will also develop products to link the Macintosh computer with Tandem systems.

Pictured are James G. Treybig, Tandem President and CEO (on left), and John Sculley, Apple Chairman and CEO, with a Tandem NonStop CLX system; and (bottom photograph) an Apple Macintosh IIx computer.

in the Company's NonStop SQL software, the industry's first fully distributed relational database management system.

Generally available to customers in fiscal 1988, NonStop SQL software combines the productivity of SQL with high OLTP performance. At the same time, because NonStop SQL software runs on Tandem NonStop systems, it benefits from fundamental OLTP strengths.

We believe Tandem database technology offers customers an important strategic advantage in the new environment of the on-line enterprise.

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PRODUCTIVE APPLICATION ENVIRONMENTS

The on-line enterprise will require a single, open computing environment for a variety of application types. Some OLTP applications will continue to use terminals to capture transactions. Others will provide database services to connected personal computers. In other applications, personal computers and host systems will share processing tasks. Tandem is leveraging its decade of experience with OLTP database technology and its NonStop SQL software to meet these needs.

To make application programming more productive, Tandem plans to market application-development and decision-support tools from well-known third-party vendors. Because these tools are common throughout the industry, they will allow programmers to create Tandem applications faster and more easily.

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MANAGING COMPLEX RESOURCES

The trend toward increasingly distributed networks of systems, data, and applications means users must be equipped to manage these complex resources efficiently.

Tandem's Distributed Systems Management (DSM) software, first delivered to customers in fiscal 1988, manages resources throughout a network of Tandem systems, including remote systems, applications, and communications facilities.

DSM software gives users the freedom to consolidate or decentralize the management and control of systems, applications, and networks according to business needs. Its architecture will support future capabilities to automate critical applications such as problem management and tracking.

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POWERFUL ANSWERS FOR THE ON-LINE ENTERPRISE

Systems and databases that meet the diverse needs of organizations are all-important to today's—and tomorrow's—computing environments. Tandem strives to add value to these core elements to give our customers solutions that provide a competitive edge.

When connected through enterprise networks, these systems, databases, and management tools become the foundation for serving the on-line enterprise.

FOR GREATER PRODUCTIVITY, PROGRAMMERS AT MICROSOFT'S CAMPUS-LIKE HEADQUARTERS NEAR SEATTLE SHARE RESOURCES OVER AN UNGERMANN-BASS, INC., NETWORK.

Microsoft Corporation, the world's largest producer of microcomputer software, has used Net/One products from Ungermann-Bass, Inc., since 1985. The firm's growing corporate network includes one of the largest local area networks (LANs) in the United States.

Microsoft's network is crucial to the productivity of hundreds of programmers at the firm's sprawling facilities in the Seattle area. Using the network to share critical source code and other resources, Microsoft is consistently able to meet release dates of new products.

The network also handles some one million electronic mail messages each month.

With a total of 4,200 nodes, the network links domestic sales offices and international subsidiaries. By the end of 1988, over 1,000 of these nodes were connected to the network by Access/One systems. The Access/One system is Ungermann-Bass's new offering that allows the use of conventional twisted-pair telephone wiring for network connections, providing superior flexibility and broad connectivity to a wide variety of devices.

Microsoft, which is expanding its marketing activities worldwide, had Ungermann-Bass networks at 16 locations at the end of 1988. Net/One products are slated for installation at 11 new locations during 1989.

In a major move to position itself for the future, US Sprint, the Kansas City based provider of state-of-the-art telecommunications services, has installed the first nationwide all-digital fiber-optic network.

As a second important step, US Sprint has deployed Signalling System 7, the system that supports inter-LATA intelligent network features and services. These services include enhanced 800-number translation, calling-card validation, and virtual private networks.

High-transaction-rate Data Control Points for the network are provided by Tandem Telecommunications Systems, Inc. (TTSI), and run on Tandem NonStop VLX systems.

CONNECTING THE ENTERPRISE

STRATEGIC MOVES IN 1988 BUILD A FOUNDATION FOR LEADERSHIP IN ENTERPRISE NETWORKING.

In the on-line enterprise, computing is strategically tied to networking. As more databases move on-line, more users demand immediate access to this always-current information. To provide this access, on-line systems must allow different systems to connect to on-line resources through LANs and through the support of major networking standards.

Because the success of an organization can depend on the success of its on-line applications, enterprise networks also require fast response time, availability, data integrity, and security.

Tandem has long been a leader in providing networks with fundamental OLTP advantages. In fiscal 1988, strategic mergers, new relationships, and new products further strengthened the Company's capabilities in enterprise networks, workstation integration, support of standards, and security. We believe these moves position Tandem to serve the networking needs of the on-line enterprise.

UNGERMANN-BASS, INC.– A LEADER IN ENTERPRISE NETWORKING

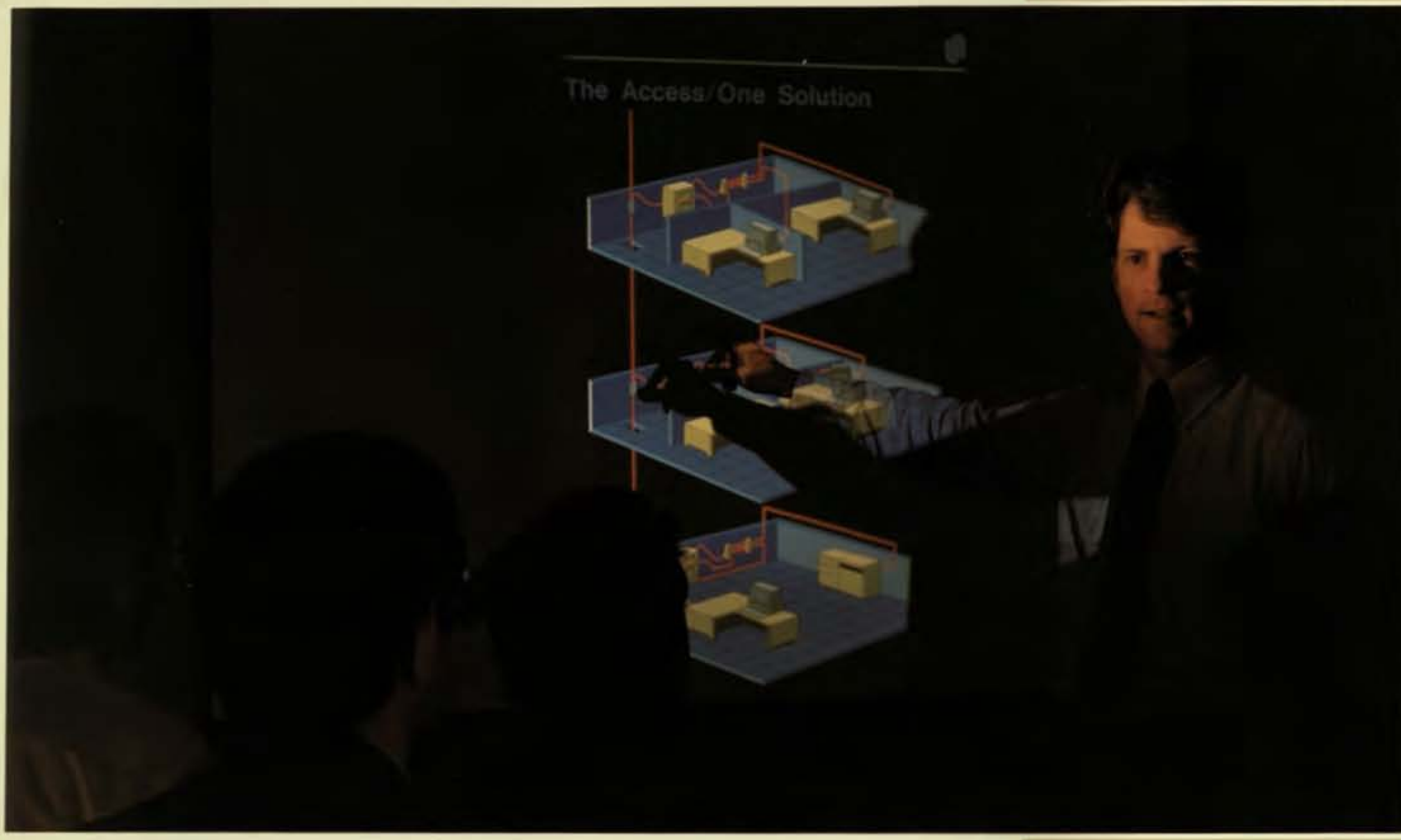
Today, processing power is moving to computers on users' desktops. These systems need to access and share data with others and with corporate resources.

Such developments mean that vendors who want to meet the requirements of customers in the 1990s need to offer complete networking capabilities that link LAN-based systems with other organizational resources.

To address this key market need, Tandem joined with an industry leader: Ungermann-Bass, Inc.

Through enterprise networks, Ungermann-Bass products connect workstations and other intelligent devices to each other and to a variety of resources, including file servers and host systems from different vendors.

Ungermann-Bass is committed to supporting open networking standards. An example of Ungermann-Bass's approach to standards is the Access/One network delivery system, introduced in fiscal 1988.



The Access/One system gives network planners and end users a common architectural platform for distributing network services to personal computers and workstations over ordinary telephone wiring.

This system integrates personal-computer LANs into enterprise networks. It works in environments of mixed systems from a variety of vendors and supports both industry networking standards and international standards. The Access/One system also includes features for high network availability and modular growth, and powerful tools for network management and control.

Tandem and Ungermann-Bass are cooperating in product development and jointly calling on major customers—and generating significant opportunities for both companies. We believe that Tandem and Ungermann-Bass can grow together by meeting market needs for OLTP systems and enterprise networks.

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LINKING WORKSTATIONS AND TANDEM SYSTEMS

Since before its merger with Ungermann-Bass, the Company's strategy has been to allow workstations to access the OLTP benefits of Tandem systems. Customers can then use personal computers for what they do best—provide sophisticated, user-friendly interfaces—while Tandem OLTP systems

Tandem and Ungermann-Bass merged not only because our product lines are complementary, but also because our strategies match well. We are committed to standards in networking, sell primarily to the largest corporations, and focus on similar industries.

Security products from Atalla Corporation, a wholly owned Tandem subsidiary, have helped reduce operating expenses and increase customer satisfaction at San Francisco based Wells Fargo Bank since 1983.

The bank uses the Atalla Card Activation and PIN Selection System (CAPS), in conjunction with a Tandem NonStop VLX system. The CAPS product allows the bank's customers to choose their own debit and credit card personal identification numbers (PINs) with security and ease.

Wells Fargo has an active card base well beyond the banking industry average. The use of customer-selected PINs has contributed to this success because customers can remember them more easily than bank-generated PINs.

As part of its fraud prevention program, Wells Fargo also uses Atalla Security Modules attached to Tandem VLX systems to verify encrypted PINs from the bank's 1,200 ATMs.

process transactions and manage on-line data.

Tandem's MULTILAN products are examples of this strategy. They allow a wide variety of standard LANs to connect to Tandem systems. This capability lets customers implement cooperative processing, whereby personal computers and Tandem systems share application tasks.

In fiscal 1988, we began working with Microsoft Corporation to extend similar support to OS/2 based personal computers.

Tandem is committed to supporting a wide variety of personal computers and workstations, including workstations running the UNIX® operating system and Apple Macintosh computers.

Reflecting this commitment, in 1988 we entered into a value-added reseller agreement with Apple Computer, Inc., under which Tandem will sell, support, and service Macintosh computers as part of Tandem OLTP systems. Tandem, Ungermann-Bass, and Apple are developing new products to connect Macintosh computers and Tandem systems.

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STANDARDS FOR WIDE-AREA NETWORKS

Networking standards are increasingly important to our customers. Not just LAN and workstation standards, but also other networking standards are key.

An international networking standard independent of any single vendor, Open Systems Interconnection (OSI) is important to Tandem's future. Customers can today implement OSI applications using capabilities Tandem provides, and work is underway to strengthen our offerings for this standard.

Another important standard is IBM's Systems Network Architecture (SNA). Tandem already provides a wide range of SNA connectivity solutions.

Tandem strengthened its SNA offerings in fiscal 1988. The Company delivered software that supports LU6.2, a strategic SNA protocol. In addition, Tandem became a reseller of the SNA_Hub product from Netlink, Inc., in which Tandem has an equity investment. This product lets devices in an SNA network access the benefits of OLTP applications running on Tandem systems.

The Company is working to provide more ways for users to add Tandem systems to SNA networks. Our goal is to add the value of Tandem OLTP fundamentals while protecting customers' existing network investments.

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OLTP BENEFITS FOR TELECOMMUNICATIONS NETWORKS

Around the world, telecommunications networks are being upgraded to enable telephone companies to provide new services, improve service quality, and lower operating costs. Key to these changes are international networking standards that will allow computers to connect to telecommunications networks to provide services, including ones based on on-line applications.

Two important actions in fiscal 1988 reflect Tandem's commitment to becoming a leader in this exciting new arena.

Tandem merged with Integrated Technology, Inc. Renamed Tandem Telecommunications Systems, Inc. (TTSI), this wholly owned subsidiary is developing products that we believe will allow Tandem systems to provide a variety of services and applications within telecommunications networks.

We also signed a cooperative agreement with AT&T to develop Integrated Services Digital Network (ISDN) applications for OLTP. ISDN is an international standard for combining transmission of voice, data, and other information over a single phone line.

Making Tandem equipment compatible with specific AT&T equipment will enable telephone companies and many Tandem system users to offer new OLTP-based services.

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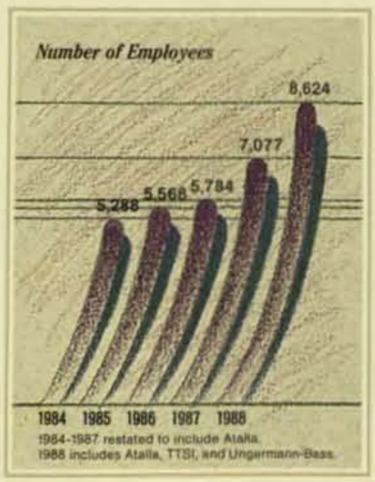

SECURITY: THE NEW IMPERATIVE

As networks grow, more users require access. Inevitably, data security becomes increasingly crucial.

In fiscal 1988, Tandem merged with Atalla Corporation, a supplier of secure transaction systems to financial and retail industries worldwide.

Tandem and Atalla are jointly marketing secure financial and retail payment systems. Shortly after the end of the fiscal year, Atalla announced that its Card Activation and PIN Selection System (CAPS) will now run on Tandem NonStop systems.

Atalla plans to continue to develop its expertise in security and to apply its knowledge to OLTP networks.

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PREPARING FOR THE FUTURE OF OLTP

Strategic moves in fiscal 1988 expanded Tandem's capabilities in enterprise networking, workstation integration, support of networking standards, telecommunications, and security.

Combined with Tandem's OLTP product strengths in systems and database, we believe the past year's achievements enhance our ability to serve the needs of the on-line enterprise.

LEADERSHIP IN SOLUTIONS

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T.I.M.E.—the Tandem Integrated Manufacturing Environment—is designed to enhance productivity and quality by linking islands of automation in engineering, planning, and production.

Maybelline Cosmetics will implement T.I.M.E. factory control systems with software from MSA Advanced Manufacturing, Inc., at its 800,000-square-foot plant in North Little Rock, Arkansas. This massive plant produces and distributes all Maybelline cosmetics sold in the United States.

Maybelline is part of the Consumer Operations Division of Schering-Plough Corp., with headquarters in Memphis, Tennessee.

MARKET UNDERSTANDING AND INNOVATIVE SOLUTIONS MAKE TANDEM A LEADER IN OLTP.

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On-line transaction processing is a dynamic marketplace—one of the fastest growing in commercial data processing. InfoCorp, a leading market research firm, estimates worldwide OLTP revenue will nearly double by 1993.

Businesses faced with increased competition, government regulation, and changing economic conditions look to on-line systems for solutions that enhance service, quality, profitability, and accountability.

OLTP systems have transformed the way many organizations conduct business. Users have strengthened competitiveness through increased efficiency and through completely new services—automated teller machines, automated gasoline pumps, and computerized home shopping.

We believe Tandem's understanding of this complex market and our advanced approach to

A BARCLAYCARD HOLDER MAKES A PURCHASE AT LONDON'S FAMED FORTNUM & MASON DEPARTMENT STORE.

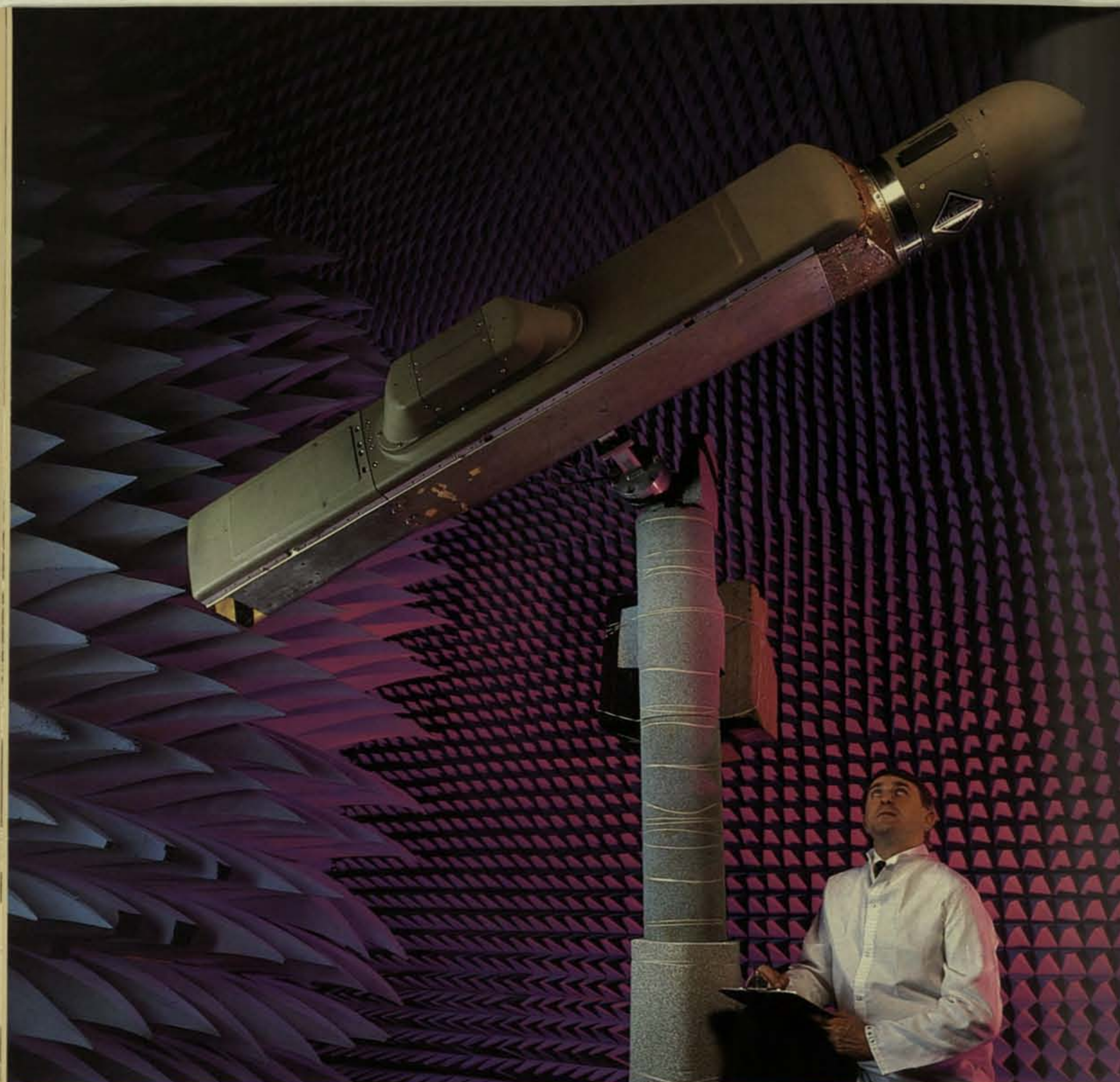
An ambitious program will make electronic funds transfer (EFT) available at retail points of sale (POS) throughout the United Kingdom during 1989.

Of the 14 participants of EftPos U.K. Ltd—which include the U.K.'s largest banks and building societies, and the major bank credit card consortium—12 have installed or ordered Tandem systems in

preparation for the program's inauguration. The inaugural service will act as a proving ground in advance of roll-out of the full national service. Many of the banks have begun independent EFT/POS services, which will later link to the national service. These independent services are already supporting approximately 15,000 EFT/POS terminals.

Some of these institutions are converting their automated teller machines to run on Tandem systems as well.

In the U.K., most retail purchases are made by cash or check. Major financial institutions have joined EftPos U.K. Ltd, whose board includes a representative of The Bank of England, in a concerted effort to reduce check-clearing paperwork by creating paperless customer transactions.



WESTINGHOUSE ELECTRONIC SYSTEMS GROUP IS EXPANDING ITS NETWORK OF TANDEM SYSTEMS.

Westinghouse Electronic Systems Group (ESG), which produces commercial and military radar systems, uses a network of Tandem systems for shop-floor control, factory data collection, and quality assurance. The network provides access to distributed applications and data for more than 4,000 users at ESG's 1.6-million-square-foot facility near Baltimore, Maryland.

ESG plans to expand the network of NonStop VLX and TXP systems in 1989 to link others of its 26 locations worldwide and to implement an application under development called Westinghouse Integrated Systems for Engineering (WISE).

Using the Tandem NonStop SQL relational database management system, WISE will enhance productivity by linking engineering and shop-floor data and automating engineering functions for the complete life cycles of products.

application solutions are key reasons for continued leadership as the Company grows to support the on-line enterprise.

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SERVING LEADING ORGANIZATIONS WITH OLTP SYSTEMS

Today, Tandem systems are helping customers maintain leadership in their respective markets.

Tandem systems enable corporations, consumers, and financial institutions to transfer vast amounts of money electronically—and safely. Many banks connect ATMs and point-of-sale terminals to Tandem systems, providing customer services 24 hours each day, every day.

Tandem systems help run 33 stock exchanges around the world and prepare trade orders in 70 brokerage firms. Large retailers use Tandem systems to approve credit requests, ensure adequate merchandise distribution, and retrieve store sales data electronically.

More than 300 manufacturers in the automotive, aerospace, electronics, pharmaceutical, and chemical industries, for example, use Tandem systems for applications that include shop-floor control, work-in-process tracking, collection and analysis of quality-control data, and inventory management.

Telecommunications providers worldwide use Tandem systems for applications such as service order entry and customer billing, and for value-added services such as electronic mail, information gateways, and videotex.

As more organizations realize the competitive advantages OLTP systems offer, opportunities to apply this technology multiply. Customers find new applications, new services, and new ways to streamline the computer-based functions that support the enterprise.

To maintain a market leadership position, Tandem strives to anticipate such changes in the market and to lead the way with solutions.

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NEW ON-LINE SERVICES

Important changes in the telecommunications industry make it an exciting market for OLTP systems. Regulatory changes around the world are providing telecommunications companies with opportunities to offer new, revenue-generating services.

Many emerging telecommunications services are transaction-oriented. These services require continuous system availability and high performance—strong features of Tandem NonStop systems. Another Tandem system advantage is the ability to start an on-line system small, then expand it in steps as the service grows.

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ELECTRONIC DELIVERY SYSTEMS

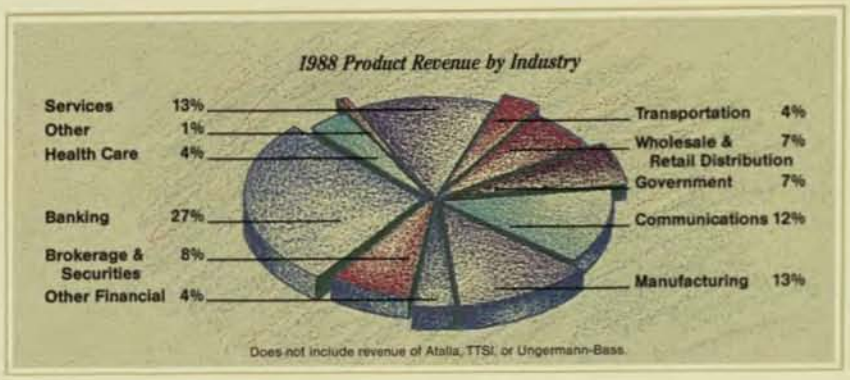
OLTP users are discovering that there are many significant advantages to the electronic delivery of consumer services.

Retailers, for example, can implement electronic systems for debit cards, check authorization, and check clearing. The tedious job of sorting paper credit-card slips

Under a strategy of joining with partners to address emerging market needs, Tandem agreed with AT&T in 1988 to develop interfaces between Tandem systems and AT&T's 5ESS® central office switch for Integrated Services Digital Network (ISDN) applications.

ISDN, an international networking standard for combining transmission of voice, data, and other information over a single phone line, is key to providing many new services.

Making Tandem equipment compatible with AT&T equipment through the use of ISDN will help telephone companies and others offer new OLTP services to the marketplace.



can be eliminated, and the entire process handled electronically. These applications improve checkout service and save labor, while providing immediate on-line access to current sales and inventory data.

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INTEGRATING APPLICATIONS

A variety of organizations want to link existing automated functions into enterprise-wide, on-line networks. The goal is to create a single, cohesive application environment for greater efficiency, improved decision making, and better customer service.

An example is found in the manufacturing industry, where users want to integrate islands of automation in engineering, business management, and factory-floor operation.

To address these needs, Tandem developed T.I.M.E., the Tandem Integrated Manufacturing Environment, in cooperation with major development partners Electronic Data Systems Corporation, MSA Advanced Manufacturing, Inc., and Boeing Computer Services.

T.I.M.E. helps protect customers' investments in systems by providing open specifications that allow software developers to create compatible products and to incorporate future applications as they are developed.

Tandem is working to develop application architectures similar to T.I.M.E. for other industries.

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THE TANDEM ALLIANCE PROGRAM

As business and government organizations seek to implement new services and streamline operations, they require comprehensive solutions involving computer hardware and application software.

Tandem has addressed this need with the Tandem Alliance, a program that encourages the development of application software for Tandem systems. The program includes more than 260 software providers, value-added resellers, and other third parties.

Most Tandem Alliance members are independent software houses providing off-the-shelf or custom software programs. Among the Alliance members are some of the world's largest and most respected software houses.

Tandem customers who have developed application software for their own use may also join the Alliance program to license their solutions to others.

In addition, this program supports system integrators who provide numerous essential services—from initial planning to final installation—including integrating Tandem systems with custom software and hardware from other vendors.

In fiscal 1988, NYNEX Information Solutions Group, Inc., a subsidiary of NYNEX Corporation, joined the Tandem Alliance. NYNEX Information Solutions Group will assist Tandem users with large-scale integration projects in the telecommunications and financial services industries.

The Tandem Alliance program contributes to Tandem's market leadership by providing key business solutions in a wide range of major industries.

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Tandem's market understanding and innovative solutions have helped make the Company a leader in OLTP. We believe that these strengths, plus Tandem's powerful systems, database products, and networks to connect the enterprise, will help the Company maintain a leadership position as it serves the evolving on-line enterprise.

ONE OF DAIEI GROUP'S 3,000 CONVENIENCE STORES IN JAPAN.

Daiei Group, Japan's largest retailer, is undertaking a massive program to replace existing computer systems with an on-line, distributed data network that the firm believes will be the biggest in Japan's dynamic and competitive retail industry.

The network began operations during 1988 with two NonStop VLX systems, with a total of 24 processors divided between Tokyo and Osaka. Today, it links 3,000 Daiei-affiliated convenience stores for processing orders and collecting point-of-sale (POS) data.

In addition, the Tandem network connects more than 10,000 POS terminals at several hundred general merchandise stores, discount and department stores, offices, and distribution centers. More than 3,500 vendors are tied into the network.

Daiei chose Tandem systems because the firm needed

the flexibility to grow its network and distribute data as its business needs require. The rapidly growing company expects to have 7,000 outlets within five years. To support this expansion, NonStop VLX nodes are planned for five other major cities over the next few years.

The company also wanted an integrated networking capability that could reduce its dependence on centralized host computers while protecting its investment in current systems.

Daiei had sales in its most recent year of over $11 billion.

DEDICATED TO CUSTOMER SATISFACTION

Tandem offers systems with an impressive combination of proven OLTP fundamentals: fault tolerance, data integrity, linear expandability, distributed data, networking, superior price/performance, and security.

The Company is building on these fundamentals—plus its 12 years of experience serving OLTP customers—to meet the developing needs of the on-line enterprise.

CUSTOMER SATISFACTION IS OUR ULTIMATE GOAL.

Systems and databases, enterprise networks, and application solutions are essential to the on-line enterprise. We believe that Tandem is meeting these requirements through superior products and strategic relationships that complement our strengths.

Our ultimate goal is customer satisfaction. Tandem customers must know that our products will meet expectations from the time they are installed. Two ways in which we ensure customer satisfaction are through performance measurement and through customer support and service.

ENSURING SUPERIOR PERFORMANCE

Critical on-line applications demand superior system performance to keep customers ahead of their competition. That performance must also increase as the business grows.

We believe that Tandem systems offer the best combination of performance and OLTP functionality in the industry. Our development efforts and strategic partnerships are aimed at maintaining this competitive advantage.

To maximize their investments in OLTP systems, customers need effective tools for comparing the performance of different vendors' systems. As a result, Tandem supports efforts to develop useful performance benchmarks.

An example is the so-called DebitCredit benchmark. This benchmark is embraced by many consulting, research, and auditing firms as a measure of transaction-processing performance.

Key to the value of the DebitCredit benchmark is that it not only measures performance, but also specifies that vendors incorporate many functions critical to on-line transaction-processing applications.

The DebitCredit benchmark is useful, but, like most benchmark specifications, it leaves many implementation details up to the vendor, which can greatly influence the outcome of testing.

Tandem is looking at ways in which the value of benchmarks as measures of transaction-processing performance may be enhanced for the benefit of customers.

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CUSTOMER BENCHMARKS

A tool such as the DebitCredit benchmark provides one measure of transaction-processing performance. Tandem customers also want to know what kind of performance they will achieve running their own applications.

So that customers can test actual applications on Tandem systems, the Company maintains state-of-the-art benchmark centers in

The most reliable benchmarks are those performed for specific customer applications. In Cupertino, California, Tandem's Benchmark Center (pictured above) gives customers and Tandem Alliance partners a state-of-the-art environment for testing software applications.

The center uses Tandem systems with a total of 64 processors, ranging from the powerful NonStop VLX system to the NonStop CLX system.

Cupertino, California, and Frankfurt, West Germany. Here, customer applications can be run on large Tandem systems updating massive on-line databases.

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EXPERIENCED SERVICE AND SUPPORT TEAMS

The most important key to customer satisfaction is high-quality service and support. Tandem is dedicated to excellence in comprehensive, state-of-the-art service and support.

Tandem's large internal computer network, in addition to helping run the Company's business, links thousands of experienced Tandem support specialists all over the world—ready to help customers with installation, hardware maintenance, and software support.

In this on-line environment, Tandem customer engineers and systems analysts exchange ideas on how best to serve customers. They maintain a knowledge base on the network of service-related problems and solutions from around the world.

Flexible support plans give Tandem customers a range of options. Customers can select that all services be delivered by Tandem or can choose to assume responsibility for part of the maintenance themselves.

When a customer has a support problem, a call may be placed to the local or regional Tandem office or directly to one of the Tandem National Support Centers in Canada, Denmark, France, Japan, Sweden, the United Kingdom, the United States, and West Germany.

We continue to search for new ways to enhance communication between Tandem and our customers. For example, shortly after the close of fiscal 1988, Tandem and the International Tandem Users' Group jointly announced the creation of a worldwide information network for sharing technical information among the Company and its customers.

Through these support offerings and others, Tandem customers receive reliable service for all the components of their Tandem systems—whether mainframes, distributed systems, database software, workstations, or entire enterprise networks.

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POISED TO WIN

Tandem is moving forward to serve the evolving needs of the OLTP market. We believe the strong foundation built while successfully serving OLTP customers since 1976 strengthens our position and provides momentum.

Tandem products offer fundamental advantages that many other vendors are just beginning to address. In fiscal 1988, the delivery of important new products, the establishment of strategic relationships, and the addition of a record number of new customers served to maintain Tandem's leadership.

We believe these advances mean that Tandem is now—more than ever—poised to win and grow by meeting the needs of the on-line enterprise.

TELEKURS AG IN ZURICH IS A UNIQUE FINANCIAL SERVICES ORGANIZATION THAT SELLS ITS PRODUCTS INTERNATIONALLY USING A LARGE TANDEM NETWORK.

Telekurs AG, jointly owned by Switzerland's 350 banks, is a unique and rapidly growing financial services organization with worldwide activities. A Tandem customer since 1983, Telekurs operates a distributed data network of 24 NonStop systems (at the close of 1988) with over 130 processors.

Telekurs' Tandem network gathers, processes, and distributes information on international securities, commodities, and foreign exchange for the Swiss banks and other financial organizations globally. Its on-line database, with details on more than 230,000 securities from some 100 exchanges, is claimed to be the most comprehensive of its kind in the world.

In addition, the high-volume network processes and updates all transactions on the five Swiss stock exchanges. Furthermore, it handles all funds transfers for the Swiss banks, including those related to check clearing, the nationwide ATM network, EFT/POS system (electronic funds transfer at point of sale), and EUROCARD/MasterCard.

During 1988, Telekurs began expanding its domestic four-node Tandem network internationally with new locations in London, Frankfurt, and the New York area. The company, which is growing 30 percent annually, intends to extend the network to additional locations in Europe, Asia, and the United States.

Management's Discussion and Analysis of Financial Condition and Results of Operations

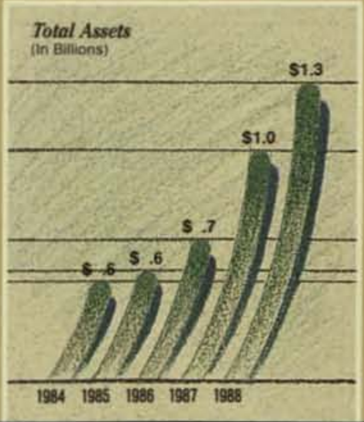
Overview

In fiscal 1988, Tandem Computers Incorporated took major steps to enhance its leadership position in providing systems and networks for on-line transaction processing (OLTP) and to meet the needs of the developing on-line enterprise. During the year, Tandem merged with Atalla Corporation, a leading vendor of secure transaction systems; acquired Ungermann-Bass, Inc. (Ungermann-Bass), a leader in open enterprise networks for multivendor environments; and acquired Tandem Telecommunications Systems, Inc. (TTSI), formerly Integrated Technology, Inc., a developer of computer products and services for the telecommunications industry. The Company believes the new business combination will lead to increased market opportunities and enable it to bring important competitive products to market in a shorter time than previously possible.

During the year, Tandem experienced some of the benefits of those increased opportunities as Ungermann-Bass contributed to the Company's revenue growth. However, despite tight operating management practices, operating income declined because of a product mix shift, increased research and development spending partially as a result of the acquisitions, and the amortization of cost in excess of net assets acquired. The acquired companies (Ungermann-Bass and TTSI) are not included in results of operations from prior years, so these and other growth rates and ratios are affected as discussed below.

The Company believes achieving its goal of market leadership involves many factors, including strategic positioning, a commitment to product development, partnerships with companies that have complementary strengths, customer satisfaction, and an organizational structure and philosophy that foster employee productivity and creativity. Additionally, Tandem believes it is important to maintain a strong financial position to compete effectively in the rapidly growing OLTP marketplace. The bold moves and financial choices the Company made throughout the year reflect these priorities.

All references to the years 1988, 1987, and 1986 throughout this section represent the Company's fiscal year ended September 30.



Results of Operations

The following table summarizes the changes in selected operating indicators. The percentages on the left show the relationships of income and expense items to total revenue. The percentages on the right measure the year-to-year changes.

Percent of Revenue				Percent Increase (Decrease)	
1988	1987	1986		1988	1987
82.1	83.2	82.4	Product revenue	24	36
17.9	16.8	17.6	Service and other revenue	34	28
100.0	100.0	100.0	Total revenue	26	35
23.6	22.1	22.9	Cost of product revenue	34	30
13.5	12.6	13.5	Cost of service and other revenue	35	26
37.1	34.7	36.4	Total cost of revenue	34	28
12.9	10.4	11.3	Research and development	55	24
38.8	38.6	38.5	Marketing, general, and administrative	26	35
11.2	16.3	13.8	Operating income	(14)	59
(.1)	1.3	1.1	Net other income (expense)	NM	69
11.1	17.6	14.9	Income before income taxes	(21)	60
3.9	7.6	6.6	Provision for income taxes	(36)	55
7.2	10.0	8.3	Net income	(10)	64
			Earnings per share	(10)	49

Prior period amounts have been restated to reflect the merger with Atalla Corporation, which occurred during 1988, and was accounted for as a pooling of interests.

Current period amounts include the consolidation of results of TTSI from January 8, 1988, and of Ungermann-Bass from March 18, 1988, the dates Tandem assumed effective control of each company.

Revenue

Revenue in 1988 was 26 percent higher than in the previous year. Revenue reached $1.3 billion in 1988, compared with $1.0 billion posted in 1987 and $778 million recorded in 1986. Tandem's revenue gains over the past two years resulted from increased shipments of hardware and software products to new and existing customers and from an increased number of customers using its support and training services. Revenue from Ungermann-Bass is included in the consolidated results since March 18, 1988, the date when Tandem assumed effective control of the company. Its revenue contributed to revenue growth in 1988.

The revenue growth rate was lower in 1988 than in the prior year, primarily because of reduced domestic demand experienced by the Company and in the computer industry as a whole. Domestic revenue growth for 1988, including the contribution made by Ungermann-Bass, was 11 percent, compared with the strong domestic performance of 27 percent growth a year earlier.

As in the prior year, international revenue grew faster than domestic revenue in 1988. European operations maintained the 46 percent growth rate achieved in the prior year. Revenue growth in non-European countries remained high at 43 percent, although less than the very strong 50 percent growth posted in 1987. Ungermann-Bass contributed to the growth in international revenue, though less significantly than to domestic revenue.

Strong international performance, coupled with the less robust domestic environment, brought the contribution from international business to 50 percent of the Company's 1988 revenue, compared with 43 percent in 1987 and 39 percent in 1986. Europe contributed 34 percent of 1988 revenue, compared with 29 percent in 1987 and 27 percent in 1986. Other international business grew to 16 percent of 1988 revenue, compared with 14 percent in 1987 and 12 percent in 1986.

Over the past three years, the Company has introduced a number of systems, software, storage products, and peripheral products that have contributed to revenue growth. These products include the NonStop VLX computer system, introduced in 1986; NonStop SQL software, introduced in 1987; the NonStop CLX computer system, first sold in 1988; and related products. These products opened new markets for the Company. The addition of Ungermann-Bass's open, enterprise-wide networking products to the Company's product line also contributed to revenue growth in 1988.

Despite continued customer acceptance of the Company's products, product revenue growth slowed to 24 percent in 1988 from the 36 percent recorded in the prior year. This was primarily the result of lower domestic demand.

The growth rate of service and other revenue increased to 34 percent, compared with the 28 percent achieved a year earlier. The Company believes the growth in service and other revenue in 1988 reflects the increase in the size of its customer base resulting from the strong product growth achieved in the prior year.

Operating Income

Operating income in 1988 was $147 million, or 11 percent of revenue; compared with $170 million, or 16 percent of revenue, reached in 1987; and $107 million, or 14 percent of revenue, recorded in 1986. Operating margin decreased as a percentage of revenue in 1988, compared with the prior two years, primarily as the result of higher cost of revenue, additional research and development spending, and the amortization of cost in excess of net assets acquired related to the acquisitions of Ungermann-Bass and TTSI. The improvement in operating income from 1986 to 1987 was largely attributable to higher gross profit margins resulting from a favorable product mix and the Company's improvements in manufacturing and service operations.

Cost of revenue as a percentage of revenue increased in 1988, compared with a decrease recorded in 1987. The improvement in 1987 was primarily the result of ongoing programs to increase the efficiency of manufacturing and service operations. Cost of product revenue as a percentage of revenue also improved in 1987, in part because the Company sold a favorable mix of products, many of which incorporated new technologies that provided greater performance at lower cost. In 1988, however, the costs of product revenue and service and other revenue each increased as a percentage of revenue, leading to an increase in total cost of revenue as a percentage of revenue. This was primarily the result of the acquisition of Ungermann-Bass, which has lower product and service margins than Tandem's historic business. In addition, product upgrade programs, a product-mix shift toward the Company's PSX workstations and NonStop CLX computer systems, and an increase in discounts granted to customers contributed to the increase in the Company's product costs as a percentage of revenue.

Cost of product revenue grew 34 percent in 1988 over its 1987 level, compared with a 30 percent increase recorded in the prior year. In both cases, this was due primarily to increases in volume; however, in 1988, product cost grew faster than product revenue for the reasons stated above. The growth in the cost of service and other revenue in 1988 and 1987 was attributable primarily to growth in the installed base. The acquired companies contributed to increases in costs of both product and service revenue in 1988.

Research and development expenses increased as a percentage of revenue in 1988 from the prior year level. This compares with the decrease recorded in 1987, which was partially attributable to higher-than-anticipated revenue, as well as capitalization of certain software development costs. In 1988, the increase in research and development expenses as a percentage of revenue was attributable primarily to lower-than-anticipated revenue growth and the acquisition of TTSI. In addition, the Company capitalized less software development cost in 1988 than in the prior year.

Research and development activities focus on meeting the needs of customers who are implementing on-line systems for single sites or for geographically distributed information processing networks. The level of research and development expenses increased over the past three years to support new product development efforts and programs to enhance existing products. Among the products that resulted from prior years' research and development spending were the XL80 disk subsystem, which began shipping in 1988, and NonStop SQL software, the NonStop CLX computer system, and the V80 disk subsystem, which became generally available during the year.

The acquisitions of Ungermann-Bass and TTSI, a development organization, also contributed to the growth in research and development expenses. The Company expects to support new product development with increased research and development spending, although the Company expects the expenses as a percentage of revenue to decline.

The Company's marketing strategy emphasizes direct sales to organizations that are implementing OLTP applications critical to their businesses. The Company believes that providing a high level of service and support and offering solutions to customers' business problems are essential to meeting the needs of the customer base. Consequently, Tandem has built a direct sales and support organization in the United States and international industrial markets. Relationships established with third-party application software developers, equipment remarketers, and distributors complement direct sales activities.

Although marketing, general, and administrative expenses as a percentage of revenue have remained stable over the past three years, the level of spending has increased as the Company has continued to build its marketing organization, to train new and existing sales, service, and support personnel, and to develop marketing relationships with third parties to support the Company's growth. In addition to the acquisitions of Ungermann-Bass and TTSI, Tandem has invested in joint ventures and taken equity positions in companies whose product, market, or geographic strengths support its strategies. These factors have all contributed to the growth in marketing, general, and administrative expenses. Although the 1988 marketing, general, and administrative expenses include the amortization of cost in excess of net assets acquired from the acquisitions, the Company's continued tight management of spending levels has enabled it to match the growth in marketing, general, and administrative expenses with revenue growth in both 1987 and 1988.

Net Income and Earnings Per Share

Net income in 1988 was $94.5 million, compared with $105.2 million in 1987 and $64.3 million in 1986. In addition to factors discussed above, changes in net income over the past three years were the result of changes in the Company's net other income or expense and its effective tax rate.

In 1987, net interest income was approximately $6 million higher than in 1986. Interest income in 1987 increased primarily because of significantly higher balances of interest-earning investments. However, in 1988, the Company expended a large portion of its cash balance to purchase tendered shares and the outstanding debt of Ungermann-Bass; the Company also incurred interest expense in connection with borrowings related to the Ungermann-Bass acquisition and the assumption of mortgages on real estate purchased during the year. As a result, net interest income during 1988 was approximately $7 million lower than in the prior year. In addition, in 1988, the Company settled a class action lawsuit that resulted in a pretax charge of $9.4 million.

The effective tax rate in 1988 was 35 percent, compared with rates of 43 percent in 1987 and 44 percent in 1986. The effective tax rate in 1988 would have been lower except for the amortization of cost in excess of net assets acquired resulting from the Ungermann-Bass acquisition, which is not tax-deductible. The decline in the effective tax rate was primarily the result of lower federal statutory tax rates brought about by the passage of the Tax Reform Act of 1986. The Company elected not to implement Financial Accounting Standards Board Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes," in 1988 and believes adoption will not have a material effect on the Company's financial statements.

Earnings per share in 1988 were $.96 per share, compared with $1.07 per share earned in 1987 and $.72 per share in 1986. In 1988, the decline in earnings per share matched the decline in net income. However, in 1987, the growth in earnings per share, compared with the prior year, differed from that of net income because of a higher number of weighted average shares outstanding. Sales of stock to employees under the stock purchase plan, grants under option plans, and changes in stock prices resulted in increases in weighted average shares outstanding of less than one percent in 1988, and of 10 percent in 1987.

Personnel

During the year, the number of employees increased by 1,547, bringing the total number of employees at year-end to 8,624. More than two-thirds of the increase was the result of the acquisitions of Ungermann-Bass and TTSI. Other hiring occurred in areas the Company believes are critical to its success, with the greatest percentage increases in research and development, marketing, and service.

Impact of Currency and Inflation

In 1988, the weakness of the U.S. dollar against foreign currencies had a positive influence on revenue; however, the impact on operating income was largely moderated by price reductions taken to maintain consistent pricing across international boundaries, combined with the negative effect of strengthening currencies on international expenses.

The effect of inflation on the Company's financial results has not been significant.

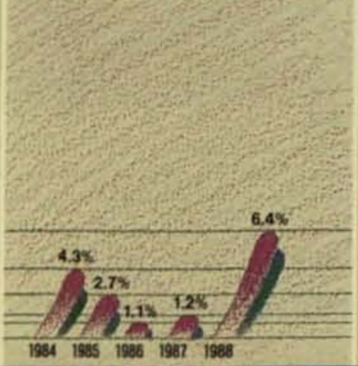
Financial Condition

The Company's financial position remains strong. Total assets at year-end increased to $1.3 billion, compared with $973 million in 1987 and $710 million in 1986. The 1988 increase was due to the Ungermann-Bass acquisition and favorable operating results during the year. The equity base grew to $857 million from $724 million and $538 million in 1987 and 1986, respectively. Cash and equivalents declined during the year, and the Company's debt and short-term borrowing increased as the Company invested in the acquisitions of Ungermann-Bass and TTSI and acquired more property, plant, and equipment. The balance of cash and equivalents stood at $125 million at September 30, 1988, compared with $318 million at September 30, 1987, and $240 million at September 30, 1986.

Funds to support the Company's operations have historically been generated internally from operations and improvements in asset management. These sources of funds have traditionally been supplemented by employee stock purchases. In 1988, cash flow from operations was $123 million, compared with $153 million in 1987 and $134 million in 1986.

During 1988, Tandem invested $270 million in cash, net of cash acquired, in the acquisitions of Ungermann-Bass and TTSI, and $216 million in additional property, plant, and equipment. The cost of these investments includes the acquired debt. There were no significant business acquisitions prior to 1988. Property, plant, and equipment investments were $143 million in 1987 and $65 million in 1986. The increased investment primarily supported the Company's growth. Property, plant, and equipment investments in 1988 included the purchase of six buildings in the Company's headquarters area in Cupertino, California, and a building near London for the Company's headquarters in the United Kingdom. Tandem purchased two buildings in 1987 in Cupertino. Prior to 1987, Tandem did not own the buildings it occupied in its headquarters area. The Company previously leased most of the buildings it has purchased. The additional space will allow for expansion and for relocation of employees housed in other Santa Clara County, California, locations.

Long-Term Obligations to Capital



In 1988, the Company borrowed to support its investment activity. In connection with acquisitions and real estate purchases, Tandem's borrowings at year-end were $148 million, compared with $11 million at the end of 1987.

Tandem believes it is strategically important to maintain a conservative capital structure and a sound ratio of current assets to current liabilities in order to demonstrate its financial strength and to compete effectively in high-technology markets. As a result of the level of investment activity in 1988, the Company's current ratio decreased and its long-term obligations to capital ratio increased. The current ratio at year-end 1988 was 1.8:1, compared with 3.6:1 and 3.8:1 at the end of 1987 and 1986, respectively. Nineteen percent of the Company's current assets are cash and equivalents; the Company believes the current ratio is sound. The Company plans to repay a portion of the short-term borrowings during fiscal 1989, which would improve the current ratio. Long-term obligations as a percent of capital at the end of 1988 were 6.4 percent, compared with 1.2 percent at the end of 1987 and 1.1 percent at the end of 1986.

The Company has various alternatives to meet future capital needs, including funds generated from future operations, continued stock issuances under employee stock purchase and option plans, and a new $200 million multiple-option financing facility. The new facility replaces a former $65 million credit line and was unused at year-end.

Inventory management improved over the prior year, as inventory days declined to 78 days at the end of fiscal 1988, compared with 87 days recorded in 1987 and 76 days in 1986. Accounts receivable days at year-end were 85, compared with 80 and 82 at the end of 1987 and 1986, respectively. The increase in receivable days was partially attributable to the acquisition of Ungermann-Bass. Ungermann-Bass has historically had higher average receivable days than Tandem.

The Company believes that attracting and retaining high-quality employees are keys to success. Methods to achieve these objectives include employee stock option and stock purchase programs, which also provide funds for the Company. As a result of these programs, the Company received $33 million in 1988, $81 million in 1987, and $51 million in 1986 from employee stock purchases and related tax benefits.

Selected Financial Data

For the years ended September 30

(In thousands except per share amounts)	1988	1987	1986	1985	1984
Revenue	$1,314,721	$1,047,532	$778,014	$635,983	$540,514
Cost of revenue	487,791	363,730	283,227	273,516	236,416
Research and development	169,356	109,504	88,202	75,357	54,144
Marketing, general, and administrative	510,313	403,859	299,572	238,152	199,709
Operating income	147,261	170,439	107,013	48,958	50,245
Net interest income	7,477	14,207	8,399	6,178	5,289
Settlement of litigation	(9,375)	—	—	—	—
Provision for income taxes					
Current year	(50,878)	(79,417)	(51,154)	(21,554)	(22,876)
DISC tax reversal	—	—	—	—	9,700
Net income	$ 94,485	$ 105,229	$ 64,258	$ 33,582	$ 42,358
Earnings per share	$ .96	$ 1.07	$ .72	$ .40	$ .51
Total assets	$1,318,377	$ 973,040	$710,024	$559,244	$507,935
Long-term obligations	$ 58,197	$ 9,055	$ 5,795	$ 11,884	$ 17,072
Stockholders' investment	$ 856,861	$ 723,855	$537,978	$423,214	$378,715

See the Business Combinations note to the consolidated financial statements for a description of significant transactions affecting the 1988 data.

Members of Tandem's Executive Committee, reporting to James G. Treybig, president and chief executive officer, are, from left to right: Ralph K. Ungermann, senior vice president, Ungermann-Bass Group; Donald E. Fowler, senior vice president, Tandem Companies Group; Gerald L. Peterson, senior vice president, Tandem Sales and Marketing Group; Robert C. Marshall, senior vice president and chief operating officer; Stephen C. Schmidt, senior vice president, Tandem Systems Group; and Thomas J. Klitgaard, senior vice president, general counsel and secretary. Not pictured: Gerald D. Held, vice president, strategy and corporate development; and David J. Rynne, senior vice president and chief financial officer.

Consolidated Statements of Income

For the years ended September 30

(In thousands except per share amounts)	1988	1987	1986
Revenue			
Product revenue	$1,079,563	$ 872,003	$640,993
Service and other revenue	235,158	175,529	137,021
Total revenue	1,314,721	1,047,532	778,014
Costs and expenses			
Cost of product revenue	309,896	231,659	178,300
Cost of service and other revenue	177,895	132,071	104,927
Research and development	169,356	109,504	88,202
Marketing, general, and administrative	510,313	403,859	299,572
Total costs and expenses	1,167,460	877,093	671,001
Operating income	147,261	170,439	107,013
Interest income	15,560	15,811	10,483
Interest expense	(8,083)	(1,604)	(2,084)
Settlement of litigation	(9,375)	–	–
Income before income taxes	145,363	184,646	115,412
Provision for income taxes	50,878	79,417	51,154
Net income	$ 94,485	$ 105,229	$ 64,258
Earnings per share	$ .96	$ 1.07	$ .72
Weighted average shares outstanding	98,683	98,424	89,096

The accompanying notes are an integral part of these statements.

Consolidated Balance Sheets

September 30, 1988 and 1987

(In thousands except share amounts)	1988	1987
Assets		
Current assets		
Cash and equivalents	$ 124,599	$318,271
Accounts receivable, net of allowances of $9,491 in 1988 and $8,394 in 1987	355,635	256,296
Inventories	129,426	94,846
Prepaid expenses and other	34,103	22,891
Total current assets	643,763	692,304
Property, plant, and equipment, at cost	633,159	399,350
Accumulated depreciation and amortization	(214,638)	(146,118)
Net property, plant, and equipment	418,521	253,232
Cost in excess of net assets acquired, net of amortization of $6,248	205,128	—
Other assets	50,965	27,504
Total assets	$1,318,377	$973,040
Liabilities and stockholders' investment		
Current liabilities		
Notes payable	$ 80,971	$ —
Accounts payable	91,935	79,489
Accrued liabilities		
Accrued payroll	35,136	28,140
Accrued vacation	17,450	15,847
Accrued commissions	14,757	13,793
Deferred income	29,479	13,928
Income taxes	25,412	10,728
Other	60,836	31,129
Current maturities of long-term obligations	9,322	1,537
Total current liabilities	365,298	194,591
Long-term obligations	58,197	9,055
Deferred income taxes	38,021	45,539
Stockholders' investment		
Common stock $.025 par value, authorized 200,000,000 shares, outstanding 96,108,000 in 1988 and 93,849,000 in 1987	2,403	2,346
Additional paid-in capital	403,241	370,142
Retained earnings	445,852	351,367
Accumulated translation adjustments	5,365	—
Total stockholders' investment	856,861	723,855
Total liabilities and stockholders' investment	$1,318,377	$973,040

The accompanying notes are an integral part of these statements.

Consolidated Statements of Stockholders' Investment

For the years ended September 30

(In thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Translation Adjustments	Total Stockholders' Investment
Balances, September 30, 1985	83,451	$2,086	$239,248	$181,880	$ —	$423,214
Sale of Common Stock under stock plans, including tax benefits	5,064	127	50,379	—	—	50,506
Net income	—	—	—	64,258	—	64,258
Balances, September 30, 1986	88,515	2,213	289,627	246,138	—	537,978
Sale of Common Stock under stock plans, including tax benefits	5,334	133	80,515	—	—	80,648
Net income	—	—	—	105,229	—	105,229
Balances, September 30, 1987	93,849	2,346	370,142	351,367	—	723,855
Effect of redesignating functional currency	—	—	—	—	10,191	10,191
Balances, October 1, 1987	93,849	2,346	370,142	351,367	10,191	734,046
Sale of Common Stock under stock plans, including tax benefits	2,259	57	33,099	—	—	33,156
Translation adjustments	—	—	—	—	(4,826)	(4,826)
Net income	—	—	—	94,485	—	94,485
Balances, September 30, 1988	96,108	$2,403	$403,241	$445,852	$ 5,365	$856,861

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

For the years ended September 30

(In thousands)	1988	1987	1986
Cash flows from operating activities			
Net income	$ 94,485	$105,229	$ 64,258
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	85,971	52,501	43,366
Deferred income taxes	(11,831)	8,582	(4,003)
Loss on property, plant, and equipment sales	1,820	1,068	246
Foreign currency hedging losses	3,172	11,064	4,108
Translation adjustments	—	3,775	2,767
Changes in:			
Accounts receivable	(60,993)	(48,591)	(26,966)
Inventories	(12,728)	(29,084)	15,296
Lease receivables	(13,337)	(2,252)	—
Prepaid expenses and non-debt current liabilities	36,292	50,435	34,814
Net cash from operating activities	122,851	152,727	133,886
Cash flows used in investing activities			
Payments for UB and ITI, net of cash acquired	(240,503)	—	—
Investment in property, plant, and equipment	(185,108)	(142,552)	(65,169)
Proceeds from property, plant, and equipment sales	12,046	13,800	7,144
Increase in other assets	(6,093)	(16,550)	(4,681)
Foreign currency hedging activity	(6,447)	(13,227)	(4,085)
Net cash used in investing activities	(426,105)	(158,529)	(66,791)
Cash flows from financing activities			
Borrowings	88,518	2,701	3,420
Repayments	(11,061)	(4,147)	(13,094)
Issuance of Common Stock under stock plans, including tax benefits	33,156	80,648	50,506
Net cash provided by financing activities	110,613	79,202	40,832
Effect of exchange rate fluctuations on cash and equivalents	(1,031)	4,562	3,343
Net increase (decrease) in cash and equivalents	$(193,672)	$ 77,962	$111,270
Supplementary cash flow information–cash paid during the year for:			
Income taxes	$ 39,077	$ 54,291	$ 23,017
Interest	$ 7,328	$ 2,746	$ 2,561

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

Summary of Significant Accounting Policies

Consolidation
The consolidated financial statements include the accounts of Tandem Computers Incorporated and its subsidiaries after the elimination of intercompany accounts and transactions.

Revenue recognition
The Company generally recognizes revenue from equipment sales at the time of shipment. Service and other revenue are recognized ratably over the contractual period or as the services are provided.

Translation of non-U.S. currency amounts
As a result of growth and other changes relating to business conducted internationally, on October 1, 1987, the Company redesignated the functional currency of its foreign subsidiaries to the local currencies of the countries in which they operate. The most significant impact is that inventory and long-term assets, for periods after October 1, 1987, have been translated at year-end rather than historical exchange rates. Using the prior method, cost of revenue and depreciation expense were translated using historical rates in effect when the related assets were acquired. All revenues and expenses are now translated at average rates of exchange during the year. The effect of this change on 1988 income was insignificant. In addition, all ongoing adjustments resulting from the process of translating each subsidiary's financial statements into U.S. dollars have been accumulated and recorded within a separate component of stockholders' investment. For years prior to 1988, such adjustments were included in net income.

The Company enters into forward exchange and option contracts to reduce the impact of foreign currency fluctuations on monetary asset and liability positions of foreign subsidiaries.

Inventories
Inventories are stated at the lower of cost (first-in, first-out) or market. The components of inventories at September 30 were:

(In thousands)	1988	1987
Purchased parts and subassemblies	$ 68,718	$54,521
Work-in-process	25,894	16,567
Finished goods	34,814	23,758
Total	$129,426	$94,846

Income taxes
The Company accounts for research and development and investment tax credits as a reduction of the provision for income taxes in the year in which the credits are generated. In general, the Company's practice is to provide U.S. federal taxes on undistributed international earnings.

Cash and equivalents
In November 1987, the Financial Accounting Standards Board issued Statement No. 95, "Statement of Cash Flows." The Company adopted the provisions of the Statement in its fiscal 1988 financial statements and restated previously reported statements of changes in financial position for fiscal 1987 and 1986. Short-term cash investments are valued at cost, which approximates market; have maturity dates not exceeding ninety days; and generally consist of certificates of deposit, time deposits, treasury notes, money market preferred stocks, municipal notes, and commercial paper.

Property, plant, and equipment
Property, plant, and equipment is stated at cost. Depreciation and amortization are computed using the straight-line method over estimated useful lives, as follows: buildings, 30 years; computer equipment, 3–7 years; leasehold improvements, 1–7 years (the lease term). System spares are depreciated using the double-declining balance method over five years. Property, plant, and equipment balances at September 30 were as follows:

(In thousands)	1988	1987
Land and buildings	$193,940	$ 54,336
Machinery and equipment	113,133	81,866
Computer equipment	206,076	144,938
System spares	65,022	54,963
Leasehold improvements	39,939	41,426
Construction in progress	15,049	21,821
Total	$633,159	$399,350

Included in the land and buildings and the construction in progress balances at September 30, 1988 and 1987, were approximately $27 million of costs relating to land and land improvements on a parcel located in San Jose, California, held for future development.

During fiscal 1988, the Company purchased land and six buildings for its headquarters in Cupertino, California, for $85.5 million. The purchases were financed using $54.8 million in cash and the assumption of mortgages totaling $30.7 million. The Company also purchased land and a building for $16.7 million near London for its U.K. headquarters.

Cost in excess of net assets acquired
The excess acquisition cost over the fair value of net assets of businesses acquired is being amortized using the straight-line method over estimated lives ranging from 10 to 20 years.

Software development costs
The Company capitalizes software development costs as the resulting products become "technologically feasible" and amortizes those costs when, and as, the products are shipped. At a minimum, the amortization must be that which would result using a three-year straight-line method from the date of product release. The amounts of unamortized software development costs included in other assets at September 30, 1988 and 1987, were $12.2 million and $8.7 million, respectively. The amortization expense for 1988 and 1987 was $5.2 million and $1.3 million, respectively.

Earnings per share
Earnings per share have been computed based upon the weighted average number of common and common equivalent shares outstanding. Common equivalent shares result from the assumed exercise of outstanding stock options and a convertible debenture, which have a dilutive effect when applying the treasury stock method. Fully diluted earnings per share are substantially the same as reported earnings per share.

Leasing Program

The Company has a vendor leasing program whereby trade lease receivables may be financed by a financial institution either through limited recourse sales of the receivables or through direct borrowings. In the event of a default by a lessee, recourse by the financial institution is limited to the collateralized computer equipment and a recourse amount, if any, from either a limited recourse pool established as a percentage of each associated group of financed lease transactions or limited recourse specified in the individual transaction agreement. The Company may also be required to remarket the computer equipment on a "best efforts" basis on behalf of the financial institution. Collection of the lease receivables is performed by the financial institution. In fiscal 1988 and 1987, the following amounts were received under the leasing program:

(In thousands)	1988	1987
Sales of lease receivables	$25,915	$4,912
Borrowings	14,147	2,550
Total financing	$40,062	$7,462

At September 30, 1988 and 1987, reserves for recourse liabilities on sales of lease receivables were approximately $1.7 million and $.4 million, respectively.

Business Combinations

Atalla Corporation (Atalla) merger
Atalla provides secure system solutions in the areas of network interchange, electronic payment, and computer security. On November 24, 1987, Atalla became a wholly owned subsidiary of the Company. The merger involved the exchange of 689,363 of the Company's shares for all of the outstanding shares of Atalla. The transaction has been accounted for as a pooling of interests and the consolidated financial statements have been restated for periods prior to the combination. The effects of the restatement were insignificant.

Integrated Technology, Inc. (ITI) acquisition
ITI is a telecommunications company that specializes in software development for intelligent telephone networks. In a series of transactions during the year, the Company acquired ITI. In May 1988, ITI became Tandem Telecommunications Systems, Inc. (TTSI).

The Company has paid approximately $5.9 million in cash, issued a five-year note for $6.1 million, and assumed ITI's obligations, resulting in cost in excess of net assets acquired of $16.2 million, which is being amortized on a straight-line basis over ten years.

Ungermann-Bass, Inc. (UB) acquisition
UB designs, manufactures, markets, and services open enterprise-wide data communications systems for large organizations worldwide. The Company acquired UB for an estimated $271.4 million, which includes $21 million of UB debentures. Subsequent to the acquisition, an additional $6.2 million of debentures were acquired. For accounting purposes, March 18, 1988, was established as the effective date of the acquisition. Accordingly, the Company's consolidated financial statements include the results of UB's operations from that date forward.

The acquisition was accounted for as a purchase and, accordingly, the net assets acquired have been recorded at their estimated fair values at the date of acquisition. A summary of what was acquired, including the excess of the purchase price over the fair value of net assets acquired, follows:

(In thousands)	
Current assets	$103,432
Cost in excess of net assets acquired	194,722
Other assets	35,190
Total assets	333,344
Current liabilities	44,500
Other liabilities	17,451
Total liabilities	61,951
Total acquisition cost	$271,393

The cost in excess of net assets acquired is being amortized on a straight-line basis over 20 years.

The following unaudited pro forma financial information shows the results of operations as if the UB acquisition had occurred at the beginning of fiscal 1987 at the purchase price established in March 1988. The information does not include the effects of TTSI because its impact on the pro forma results is immaterial.

The results are not necessarily indicative of what would have occurred during the periods presented had the acquisition actually been made on October 1, 1986, or of future operations of the combined companies. The pro forma results include a reduction of interest income, and where necessary, an increase in interest expense for the cost of funds that would have been used in the assumed purchase at the beginning of each respective period. The pro forma information includes the straight-line amortization of the cost in excess of net assets acquired. Net income and earnings in fiscal 1988 include an after-tax charge of $6.1 million, or approximately $.06 per share related to the settlement of litigation.

(In thousands except per share amounts)	Pro Forma (Unaudited) For the year ended September 30	
	1988	1987
Revenues	$1,372,000	$1,185,000
Net income	$ 94,900	$ 90,100
Earnings per share	$ .96	$ .92

Settlement of Litigation

On May 12, 1988, the U.S. District Court for the Northern District of California entered the final order of judgment providing for the settlement of a 1984 securities class action lawsuit arising from the Company's December 1982 restatement of revenue and earnings for fiscal 1982. In light of the ongoing costs of providing the Company's defense, and without any admission or presumption of liability, the Company elected to contribute $9.4 million to a settlement fund of $16.5 million. The Company's insurance carrier contributed $7.1 million.

Income Taxes

The provision for income taxes included the following deferred (prepaid) items:

(In thousands)	1988	1987	1986
Federal:			
Current	$ 21,220	$40,669	$26,492
Deferred (prepaid)	(8,253)	4,402	(4,039)
	12,967	45,071	22,453
State:			
Current	10,195	9,362	6,979
Deferred (prepaid)	(917)	3,094	89
	9,278	12,456	7,068
Foreign:			
Current	31,294	20,804	21,686
Deferred (prepaid)	(2,661)	1,086	(53)
	28,633	21,890	21,633
Total provision	$ 50,878	$79,417	$51,154

Sources of deferred (prepaid) taxes were as follows:

(In thousands)	1988	1987	1986
Inventory reserves	$(3,668)	$(2,574)	$ (205)
Installment sale method for income tax reporting	(1,700)	10,300	(8,043)
Accelerated depreciation	440	1,606	447
Effect of intercompany profit eliminations	(2,681)	(10,227)	2,048
Other (including expenses recognized for financial statements, but not for income tax reporting)	(4,222)	9,477	1,750
Total deferred (prepaid)	$(11,831)	$ 8,582	$(4,003)

The provision for income taxes differs from the amount obtained by applying the federal statutory income tax rate to income before income taxes, as follows:

	1988	1987	1986
Federal statutory tax rate	34.0%	43.0%	46.0%
State taxes, net of federal income tax benefit	4.2	3.8	3.2
Investment tax credits	–	–	(2.1)
Research and development tax credits	(3.8)	(2.1)	(.8)
Tax exempt DISC and FSC income	(2.9)	(2.5)	(2.0)
Amortization of cost in excess of net assets acquired	1.5	–	–
Other	2.0	.8	–
Effective tax rate	35.0%	43.0%	44.3%

Largely as a result of the reduction in the federal tax rate by the Tax Reform Act of 1986, the effective tax rate decreased from 44.3 percent in 1986 to 43 percent in 1987, and to 35 percent in 1988. The 3 percent reduction in the federal rate between 1986 and 1987 was partially offset by the elimination of the investment tax credit.

In December 1987, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 96, "Accounting for Income Taxes," which, under a current proposal, the Company would not be required to adopt until fiscal 1991. Earlier adoption has not been elected by Management, pending resolution of certain implementation issues. However, the adoption of SFAS No. 96 is not expected to have a material impact on the Company's financial statements.

Notes Payable

Short-term notes payable at September 30, 1988, consist of notes and bankers' acceptances of approximately $74.5 million at a weighted average interest rate of 8.5 percent, and borrowings under uncommitted foreign credit lines of approximately $6.5 million at a weighted average rate of 8.2 percent.

Long-term Obligations

Long-term obligations at September 30 consist of the following:

(In thousands)	1988	1987
Mortgages (9.3–14.5%)[1]	$29,998	$ –
Installment notes due through 1993, collateralized by lease receivables (10.6%)[2]	14,524	2,441
Industrial revenue and development bonds due 1991 to 1996 (7.5–12.4%)[3]	7,863	2,000
Term note, variable interest, due May 1993[4]	6,085	–
Notes payable in Japanese yen, payable 1989 through 1993 (5.7%)[2]	4,606	3,552
Convertible subordinated debenture, payable to an officer in September 1989 (9.5%)[5]	1,667	1,667
6.875% convertible subordinated debentures, due March 2011[6]	1,564	–
Capital lease obligations due 1989-1992 (5–15%)	1,212	932
Total obligations	67,519	10,592
Less current portion	(9,322)	(1,537)
Long-term obligations	$58,197	$ 9,055

(1) Payable monthly; maturing 1990 to 2001; weighted average interest rate at September 30, 1988, was 11.9%. The mortgages are secured by certain land and buildings with a cost of $68.3 million.

(2) Weighted average interest rate at September 30, 1988.

(3) Weighted average interest rate at September 30, 1988, was 8.7%.

(4) Interest rate at September 30, 1988, was 6.3%.

(5) The debenture may be converted into a total of 200,000 shares of Common Stock (50,000 shares per year, beginning September 30, 1986) at a price of $8.3375, subject to acceleration in certain events.

(6) Convertible into $833.34 per $1,000 of principal amount.

Principal repayments required in the next five fiscal years are as follows (in millions): $9.3 (1989), $23.2 (1990), $5.2 (1991), $6.0 (1992) and $9.2 (1993).

Interest costs related to construction in progress of $1.6 million and $.2 million were capitalized in 1988 and 1987. No interest was capitalized in 1986.

In September, 1988, the Company entered into a five-year multiple-option financing facility with 12 banks. The facility agreement provides for U.S. dollar and multicurrency advances. Borrowings under the agreement carry interest based on one of the following: the agent bank's prime rate, an average of the banks' certificate of deposit rates, or the London Interbank Offered Rate (LIBOR). The facility agreement also provides for the establishment of an uncommitted note placement facility, whereby the Company may request the banks to bid for the subscription of notes. Borrowings under the various options are allowed up to an aggregate amount of $200 million.

The Company pays an annual facility fee of $.4 million for the commitment, and there are no compensating balance requirements. The agreement also contains certain financial covenants and restrictions with which the Company was in compliance at September 30, 1988.

The Company has guaranteed payment of loans made to officers totaling $1.9 million at September 30, 1988, under a $5 million bank line of credit. In addition, the Company has a $1.7 million note receivable from an officer, bearing interest at 10 percent, and maturing in September 1989 included in other assets.

The Company leases its field offices, certain equipment, automobiles, and some of its operating facilities under operating lease agreements. The Company also has capital leases for certain equipment. Future minimum lease payments, as of September 30, 1988, are as follows:

(In thousands) Fiscal Year	Lease Obligations Capital	Operating
1989	$ 659	$ 52,518
1990	475	45,048
1991	66	36,401
1992	28	28,746
1993	2	15,863
Thereafter	–	71,741
Total minimum lease payments	$1,230	$250,317

The cost of assets held under capitalized leases totaled $6.5 million and $3.7 million at September 30, 1988 and 1987, respectively. The accumulated depreciation associated with these assets totaled $5.4 million and $3.3 million at September 30, 1988 and 1987, respectively.

Rent expenses were $53.4 million in 1988, $51.1 million in 1987, and $43.2 million in 1986.

Capital Stock

The Company's authorized capital stock consists of 2.4 million shares of preferred stock, of which 800,000 shares are designated as Series A Participating Preferred Stock; 4 million shares of Junior Common Stock; and 196 million shares of Common Stock. At September 30, 1988, 29.1 million shares of Common Stock were reserved for future issuance under stock option plans, the employee stock purchase plan, and a convertible subordinated debenture. There were no shares of preferred stock or Junior Common Stock outstanding at September 30, 1988.

Stock rights

On June 17, 1988, the Company amended and restated its rights plan (Plan), originally adopted in 1985. The Plan is intended to protect stockholders from unfair takeover practices. Under the Plan, each share of Common Stock carries one right to obtain additional stock or other property with equivalent value on terms provided in the Plan. The rights will not be exercisable, or transferable apart from the Common Stock, until another person or group of persons (subject to certain exceptions) acquires at least 20 percent of the Common Stock or commences, or announces its intention to commence, a tender offer for at least 30 percent of the Common Stock.

The rights are redeemable by the Board of Directors or upon vote of the stockholders for $.05, or property with an equivalent value, per right and expire on June 17, 1998.

Employee Benefits

Stock option plans

The Company has employee stock option plans under which employees and nonemployee directors may be granted options to purchase shares of Common Stock generally at fair market value at the time of the grant. In general, options become exercisable six months after the effective date, vest over four years, and expire no more than ten years after the effective date. At the discretion of the Board of Directors, options granted under the stock option plans may qualify for incentive stock option treatment under the Economic Recovery Tax Act of 1981. At September 30, 1988, options for 1.2 million shares were available for future grant.

Employee stock purchase plan

Under the plan, the Company may offer shares to employees in two ways. Under one method, eligible employees may elect to purchase shares of Common Stock at 85 percent of fair market value as of the last trading day before, or the last trading day of the quarter. Under this method, in 1988, 1987, and 1986, employees purchased 610,000 shares for aggregate proceeds of $11.2 million, 463,000 shares for aggregate proceeds of $7.6 million, and 778,000 shares for aggregate proceeds of $5.9 million, respectively. Under a second method, the Company may grant to all employees the option to purchase the same number of shares of Common Stock at not less than 85 percent of fair market value at the grant date. As of September 30, 1988, the Company has reserved 10.7 million shares of Common Stock for future issuance under its employee stock purchase plan.

Information concerning the combined option activity during the fiscal years ended September 30, under the stock option and the option portion of the employee stock purchase plan, follows:

	1988		1987		1986	
	Shares	Aggregate Price	Shares	Aggregate Price	Shares	Aggregate Price
(In millions except per share amounts)						
Beginning of year	13.2	$208.9	13.8	$154.8	13.9	$147.2
Options granted	6.1	100.4	4.6	110.3	5.4	60.0
Options exercised ($2.62 to $37.00 per share)	(1.6)	(18.5)	(4.9)	(52.0)	(4.3)	(39.3)
Options cancelled	(.7)	(12.9)	(.3)	(4.2)	(1.2)	(13.1)
End of year	17.0	$277.9	13.2	$208.9	13.8	$154.8
Options vested at year-end	7.3		7.1		7.6	

Although all outstanding dilutive stock options and a convertible debenture are considered common stock equivalents in presenting earnings per share under the treasury stock method, the following table shows the maximum share dilution that would occur from assumed option exercises under existing options, based upon vesting in future years within specified price ranges. The Company has a long-standing policy of encouraging all levels of employees to become stockholders through various stock option and purchase programs. This policy is based on a belief that all stockholders benefit from higher productivity, lower turnover, and improved customer satisfaction realized by providing employees with a personal stake in the Company's success.

Maximum number of existing options vested each fiscal year

Exercise Price Range	1988 and prior	1989	1990	1991	1992	Total Shares	Aggregate Price
(In thousands except price range amounts)							
$0-$10	2,844	688	47	–	–	3,579	$ 31,486
$10-$20	3,702	3,501	1,734	1,115	683	10,735	166,890
$20-$30	325	351	350	259	27	1,312	36,161
$30-$40	384	371	363	234	–	1,352	43,398
	7,255	4,911	2,494	1,608	710	16,978	$277,935

Common and common equivalent shares

	Outstanding Shares	Outstanding Equivalents	Total
Fiscal 1988 weighted average	94,976	3,707	98,683
At September 30, 1988	96,108	2,070	98,178

Commitments and Contingencies

In fiscal 1988, the Company entered into a partnership for the development of an office building in Cupertino, California, and is committed to fund 50 percent of the project's estimated cost of approximately $14 million over the next two years.

Various actions and claims have been brought or asserted against the Company. Management does not consider them to be material to the Company's financial position.

Geographic Segment Information

The following table sets forth information about the Company's operations in different geographic regions for the fiscal years ended September 30.

(In thousands)	1988	1987	1986
Revenues			
United States—customers	$ 664,458	$ 599,671	$473,926
United States—interarea	302,601	249,034	118,989
Europe—customers	442,735	302,966	207,670
Europe—interarea	16,823	22,383	57,032
Americas/Pacific—customers	207,528	144,895	96,418
Americas/Pacific—interarea	7,308	10,813	–
	1,641,453	1,329,762	954,035
Eliminations	(326,732)	(282,230)	(176,021)
Total revenue	$1,314,721	$1,047,532	$778,014
Pretax income			
United States	$ 79,521	$ 146,238	$ 74,646
Europe	64,310	37,229	39,821
Americas/Pacific	10,575	7,726	1,007
	154,406	191,193	115,474
Eliminations	(9,043)	(6,547)	(62)
Total pretax income	$ 145,363	$ 184,646	$115,412
Identifiable assets			
United States	$ 895,062	$ 713,253	$546,380
Europe	319,413	213,688	131,853
Americas/Pacific	164,782	105,791	63,701
	1,379,257	1,032,732	741,934
Eliminations	(60,880)	(59,692)	(31,910)
Total identifiable assets	$1,318,377	$ 973,040	$710,024

Intercompany transfers are made at arm's-length prices. Identifiable assets are those assets of the Company that are identified with the operations of the corresponding geographic area. United States customer revenue includes export sales of $20.3 million in 1988, $12.4 million in 1987, and $10 million in 1986. The Company operates primarily in one industry segment, which includes the manufacturing, servicing, and marketing of computer systems and networks.

Quarterly Financial Data (Unaudited)

(In thousands except per share amounts)

Fiscal 1988 Quarters Ended	Dec. 31	March 31	June 30	Sept. 30
Total revenue	$282,282	$309,449	$338,993	$383,997
Gross margin	$180,026	$199,547	$214,248	$233,109
Income before income taxes	$ 37,019	$ 36,452	$ 26,232	$ 45,660
Net income	$ 23,693	$ 23,330	$ 17,286	$ 30,176
Earnings per share	$ .24	$ .24	$ .18	$ .31

Fiscal 1987 Quarters Ended	Dec. 31	March 31	June 30	Sept. 30
Total revenue	$240,240	$245,695	$267,824	$293,773
Gross margin	$157,868	$159,134	$172,885	$193,915
Income before income taxes	$ 48,343	$ 38,649	$ 45,490	$ 52,164
Net income	$ 27,074	$ 22,465	$ 25,884	$ 29,806
Earnings per share	$ .29	$ .23	$ .26	$ .30

Tandem Stock Price

Fiscal Quarter		High	Low
1988	4th Quarter	20 7/8	12 1/2
	3rd Quarter	20 5/8	16 1/2
	2nd Quarter	28 1/4	17 1/2
	1st Quarter	36 3/8	19 7/8
1987	4th Quarter	33 1/4	26 1/2
	3rd Quarter	36 7/8	30 7/8
	2nd Quarter	37 1/4	17 1/2
	1st Quarter	19 3/8	16 3/4

Tandem Computers Incorporated is traded on the New York, Midwest, and Pacific Stock Exchanges under the trading symbol TDM. All quotations shown represent the high and low closing sale prices. The Company has not declared or paid any cash dividends on its Common Stock and has no plans to do so in the foreseeable future.

Auditors' Report

To Tandem Computers Incorporated:

We have audited the consolidated balance sheets of Tandem Computers Incorporated (a Delaware corporation) and subsidiaries as of September 30, 1988 and 1987, and the related consolidated statements of income, stockholders' investment, and cash flows for each of the three years in the period ended September 30, 1988. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tandem Computers Incorporated and subsidiaries as of September 30, 1988 and 1987, and the results of their operations and their cash flows for each of the three years in the period ended September 30, 1988, in conformity with generally accepted accounting principles.

San Jose, California
October 24, 1988

Arthur Andersen & Co.

Board of Directors

Thomas J. Perkins,
Chairman of the Board;
General Partner,
Kleiner, Perkins, Caufield & Byers

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Senior Vice President & Director,
Exxon Corporation

Morton Collins,
General Partner, DSV Partners

Thomas J. Davis, Jr.,
General Partner, Mayfield Fund

Franklin P. Johnson, Jr.,
General Partner,
Asset Management Partners

Andrew Knight,
Chief Executive,
The Daily Telegraph

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer,
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Robert G. Stone, Jr.,
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President and
Chief Executive Officer,
Tandem Computers Incorporated

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Tandem Computers Incorporated

Washington SyCip,
Chairman, The SGV Group

International Advisory Board

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Spain

Dr. Yaichi Ayukawa,
Japan

Sir Campbell Fraser,
United Kingdom

Sir Leslie Froggatt,
Australia

Auditors

Arthur Andersen & Co.
San Jose, California

Registrar and Transfer Agent

Bank of America N.T.&S.A.
San Francisco, California

Form 10-K

A copy of the Company's Report on Form 10-K for the 1988 fiscal year, as filed with the Securities and Exchange Commission, is available on written request. Please direct your request to:

Manager of Investor Relations
Tandem Computers Incorporated
19333 Vallco Parkway
Cupertino, California 95014-2599

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. on Monday, February 13, 1989, at 10435 North Tantau Avenue, Cupertino, California.

Corporate Headquarters

19333 Vallco Parkway
Cupertino, California 95014-2599
(408) 725-6000

Corporate Officers

James G. Treybig,
President and
Chief Executive Officer

Robert C. Marshall,
Senior Vice President and
Chief Operating Officer

Martin M. Atalla,
Vice President

Jack W. Chapman,
Vice President—Sales

Donald E. Fowler,
Senior Vice President and
General Manager—
Tandem Companies Group

Robert G. Gargus,
Corporate Controller

Gerald D. Held,
Vice President—Strategy and
Corporate Development

Thomas J. Klitgaard,
Senior Vice President, General
Counsel and Secretary

Lawrence A. Laurich,
Vice President—Systems
Development and Manufacturing

Gerald L. Peterson,
Senior Vice President and General
Manager—Tandem Sales and
Marketing Group

David J. Rynne,
Senior Vice President and
Chief Financial Officer

Stephen C. Schmidt,
Senior Vice President and General
Manager—Tandem Systems
Group

Gerd Stoecker,
Treasurer

Ralph K. Ungermann,
Senior Vice President—
Ungermann-Bass Group

TANDEM COMPUTERS INCORPORATED

Domestic Sales Offices

ARIZONA
Phoenix
Tucson

CALIFORNIA
Culver City
Los Angeles
Oakland
Sacramento
San Diego
San Francisco
Santa Ana
Santa Clara

COLORADO
Englewood (Denver)

CONNECTICUT
Farmington (Hartford)
Norwalk

FLORIDA
Jacksonville
Miami
Tampa

GEORGIA
Atlanta

HAWAII
Honolulu

ILLINOIS
Chicago
Itasca

INDIANA
Indianapolis

IOWA
Cedar Rapids
Des Moines

KANSAS
Overland Park
(Kansas City)

KENTUCKY
Louisville

MARYLAND
Linthicum (Baltimore)

MASSACHUSETTS
Newton (Boston)

MICHIGAN
Flint
Northville (Detroit)

MINNESOTA
Minneapolis

MISSOURI
Creve Coeur (St. Louis)

NEBRASKA
Omaha

NEVADA
Las Vegas

NEW JERSEY
Cherry Hill
Hasbrouck Heights

NEW MEXICO
Albuquerque

NEW YORK
Albany
Fairport (Rochester)
Jericho
New York City

NORTH CAROLINA
Charlotte
Raleigh

OHIO
Cincinnati
Cleveland
Columbus
Miamisburg (Dayton)

OKLAHOMA
Oklahoma City
Tulsa

OREGON
Lake Oswego (Portland)
Salem

PENNSYLVANIA
Allentown
Cherry Hill
(Philadelphia)
King of Prussia
Pittsburgh

TENNESSEE
Memphis

TEXAS
Austin
Dallas/Fort Worth
Houston

UTAH
Salt Lake City

VIRGINIA
Reston
Richmond

WASHINGTON
Kirkland (Seattle)
Olympia

WISCONSIN
Brookfield (Milwaukee)

International Distributors

Argentina
Chile
Colombia
Finland
Greece
Israel
Middle East
Malaysia
Mexico
Peru
Philippines
South Korea
Taiwan
Thailand
Venezuela

International Subsidiaries

AUSTRALIA

Tandem NonStop Pty. Ltd.

Adelaide
Canberra
Melbourne
Perth
Queensland (Brisbane)
Sydney
Tasmania

AUSTRIA

Tandem Computers
Ges.m.b.H.

Vienna

BELGIUM

Tandem Computers
S.A./N.V.

Zaventem (Brussels)

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Tandem Computers
Canada Limited

Edmonton
Markham
Milton
Montreal
Ottawa
Scarborough
Toronto
Vancouver

DENMARK

Tandem Computers A/S

Glostrup (Copenhagen)

FRANCE

Tandem Computers S.A.

Paris
Strasbourg

HONG KONG

Tandem Computers
(Hong Kong) Limited

Hong Kong

ITALY

Tandem Computers
Italia S.p.A.

Milan
Rome

JAPAN

Tandem Computers
Japan, Limited

Nagoya
Osaka
Tokyo

THE NETHERLANDS

Tandem Computers
Europe, Inc.

Amstelveen
(European Headquarters)

Tandem Computers B.V.

Hoofddorp (Amsterdam)

NEW ZEALAND

Tandem NonStop Pty. Ltd.

Auckland
Wellington

NORWAY

Tandem Computers
(Norway) A/S

Hovik (Oslo)

SINGAPORE

Tandem Computers
International Incorporated

Singapore

SPAIN

Tandem Computers
Iberica, S.A.

Madrid

SWEDEN

Tandem Computers AB

Kista (Stockholm)

SWITZERLAND

Tandem Computers AG

Schlieren (Zurich)

UNITED KINGDOM

Tandem Computers
Limited

Birmingham
Glasgow
High Wycombe
Leeds
London
Rochdale
Uxbridge
(U.K. Headquarters)

WEST GERMANY

Tandem Computers GmbH

Bonn
Dortmund
Frankfurt
Hamburg
Hilden (Duesseldorf)
Mannheim
Neufahrn (Munich)
Stuttgart

UNGERMANN-BASS, INC.

Domestic Sales Offices

Atlanta, Georgia
Boston, Massachusetts
Chicago, Illinois
Dallas, Texas
Denver, Colorado
Detroit, Michigan
Hartford, Connecticut
Houston, Texas
Los Angeles, California
Madison, Connecticut
New York, New York
Newport Beach, California
Orlando, Florida
Philadelphia, Pennsylvania
San Diego, California
San Jose, California
Seattle, Washington
St. Louis, Missouri
Washington, D.C.

International Subsidiaries

Ungermann-Bass (Europe) S.A.

Brussels, Belgium

Ungermann-Bass Deutschland GmbH

Frankfurt, West Germany

Ungermann-Bass (France) S.A.

Paris, France

Ungermann-Bass K.K.

Tokyo, Japan
Osaka, Japan

Ungermann-Bass Limited

Altrincham, England
Maidenhead, England

LANTEC/Ungermann-Bass A.S.

Kongsberg, Norway

Ungermann-Bass A.B.

Solna, Sweden

Ungermann-Bass, Ltd.

Montreal, Canada
Toronto, Canada

International Distributors

Australia
Belgium
Denmark
Finland
Italy
Israel
The Netherlands
Spain
Switzerland

ATALLA CORPORATION

San Jose, California

TANDEM TELECOMMUNICATIONS SYSTEMS, INC.

Plano, Texas