

A Letter from the President and CEO

I am pleased to report that IBM had another strong year in 2011. Your company continued to outperform our industry and the market at large. We capped IBM's first century by achieving record revenue, profit, free cash flow and earnings per share. At the same time, we continued to deliver superior returns to you, and we are well positioned for future growth in a globally integrating economy.

Revenue and income: Our revenue in 2011 was \$107 billion, up 7 percent. We grew operating pre-tax income by 9 percent, to \$21.6 billion, our highest ever.

Margins: IBM's operating pre-tax income margin rose for the ninth consecutive year—to 20.2 percent, up 10 points since 2000. We achieved this by continuing to shift our business mix to more profitable segments and by driving productivity. More than 90 percent of our segment profit in 2011 was from software, services and financing.

Earnings per share: We have continued to achieve strong EPS growth. Last year was another record, with diluted operating earnings per share of \$13.44, up 15 percent. This marked nine straight years of double-digit EPS growth.

Cash flow: IBM has consistently generated strong cash flow, a key indicator of real business performance. In 2011 our free cash flow was \$16.6 billion. We have improved our free cash flow by nearly \$10 billion over the past decade. We ended 2011 with \$11.9 billion of cash and marketable securities.

Investment and return to shareholders: Our cash flow has enabled us to invest in the business and to generate substantial returns to investors, while spending \$6.3 billion on R&D. In 2011 we invested \$1.8 billion for five acquisitions in key areas of software and \$4.1 billion in net capital expenditures. We were able to return \$18.5 billion to you—\$15 billion through share repurchases and \$3.5 billion through dividends. Last year's dividend increase was 15 percent, marking the 16th year in a row in which we have raised our dividend, and the 96th consecutive year in which we have paid one.

A road map to the future

This performance was the result of disciplined execution by more than 400,000 IBMers and the strategic repositioning of the company over the past decade. We have steadily realigned our business to lead in a new era of computing and to enable our clients to benefit from the new capabilities that era is creating. As a consequence, our investors benefit from a business model that is both sustainable over the long term and fueled by some of the world's most attractive high-growth markets and technologies.



Virginia M. Rometty, President and CEO
Samuel J. Palmisano, Chairman of the Board

You see this expressed in financial terms in our EPS road maps. We introduced our first in 2007, and surpassed our 2010 objectives. Now, we are well on track toward our 2015 Road Map goal of at least \$20 in operating earnings per share.

As before, the road map is not simply a list of targets, but a management model built on exploiting multiple ways to create value. Operating leverage will come from our continuing shift to higher-margin businesses and improving enterprise productivity—expected to be \$8 billion over this five-year period. We will create value for shareholders through an anticipated \$50 billion in share repurchases and \$20 billion in dividends.

When it comes to growth strategies, we are focused on four high-growth spaces that should drive approximately \$20 billion in revenue growth by 2015:

1. Growth Markets. Revenue for our Growth Markets Unit was up 11 percent at constant currency for the second year in a row. Growth markets contributed 22 percent of IBM's geographic revenue in 2011, up from 11 percent in 2000, and we expect them to approach 30 percent by 2015.

2. Business Analytics. Our analytics business grew 16 percent for the year. Having spotted early the emergence of “big data,” IBM built the world's leading analytics software and consulting practice, and we are translating it into powerful new capabilities, which enable our clients to identify, manage and even predict outcomes that matter to their success.

3. Cloud. IBM has helped thousands of clients adopt aspects of cloud computing, where IT resources are virtualized, highly automated and accessed by self-service. Our cloud revenue in 2011 was more than three times the prior year.

Our strong strategic positioning, solid balance sheet, recurring revenue, robust profit streams and unmatched global reach give us confidence that we will achieve success in the next five years, as we have during the past decade.

4. Smarter Planet. All of this comes together in our solutions to build Smarter Planet systems, transforming systems such as supply chains, retail, energy, transportation, telecommunications, food and water. It includes the successful establishment of large new market categories, such as Smarter Cities and Smarter Commerce. Smarter Planet revenue grew by almost 50 percent in 2011.

In sum, our strong strategic positioning, solid balance sheet, recurring revenue, robust profit streams and unmatched global reach give us confidence that we will achieve success in the next five years, as we have during the past decade. The information on pages 9 to 15 — “Generating Higher Value at IBM” — explains how.

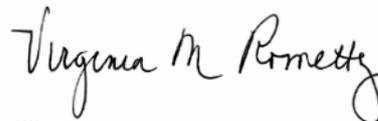
The decade ahead

The next decade holds enormous promise for IBM, most importantly because of what it holds for business and society at large. We are uniquely positioned to deliver the benefits of a vast new natural resource — a gusher of data from both man-made and natural systems that can now be tapped to help businesses and institutions succeed in an increasingly complex and dynamic global economy. Together, we can create economic and societal value of incalculable potential, across the developed and developing worlds, as well as in new global markets such as those in Africa.

Without question, the world is undergoing disruption. But IBM now stands out among our industry peers and in business at large as distinctively able to keep moving to the future, and to keep generating differentiating value for our clients, our employees and the citizens of the world. And that, in turn, promises to continue generating high value for our owners.

The fact that we enter IBM’s second century with such strength and confidence is a testament to the extraordinary leadership of Sam Palmisano as IBM’s CEO. I will leave to Sam the description of our historic transformation. But there is no doubt that IBM today is far stronger than it was a decade ago, in both its performance and its impact on the world.

Let me close by expressing my pride in the worldwide IBM team for bringing us to this point, and my gratitude to you, our shareholders, for your unwavering support. I trust you share our excitement about your company’s performance and the way in which IBMers are building on our storied past to build an even brighter future.



Virginia M. Rometty
President and Chief Executive Officer