



# 3Q 2014 Earnings Presentation

*October 20, 2014*

[www.ibm.com/investor](http://www.ibm.com/investor)



## Forward Looking Statements and Non-GAAP Information

Certain comments made in this presentation may be characterized as forward looking under the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on the company's current assumptions regarding future business and financial performance. Those statements by their nature address matters that are uncertain to different degrees. Those statements involve a number of factors that could cause actual results to differ materially. Additional information concerning these factors is contained in the Company's filings with the SEC. Copies are available from the SEC, from the IBM web site, or from IBM Investor Relations. Any forward-looking statement made during this presentation speaks only as of the date on which it is made. The company assumes no obligation to update or revise any forward-looking statements. These charts and the associated remarks and comments are integrally related, and are intended to be presented and understood together.

In an effort to provide additional and useful information regarding the company's financial results and other financial information as determined by generally accepted accounting principles (GAAP), the company also discusses, in its earnings press release and earnings presentation materials, certain non-GAAP information including "operating earnings" and other "operating" financial measures. The rationale for management's use of this non-GAAP information, the reconciliation of that information to GAAP, and other related information are included in supplemental materials entitled "Non-GAAP Supplemental Materials" that are posted on the Company's investor relations web site at

<http://www.ibm.com/investor/events/earnings/3q14.html> The Non-GAAP Supplemental Materials are also included as Attachment II to the Company's Form 8-K dated October 20, 2014.



## 3Q 2014 Overview

\$ in Billions, except EPS	<u>Operating</u>		<u>Discontinued Ops.</u>
	<u>3Q14</u>		<u>3Q14</u>
	<u>\$</u>	<u>Yr/Yr</u>	<u>\$</u>
Revenue	\$22.4	(4%)	\$0.4
@CC excl. Customer Care		(2%)	
Net Income	\$3.7	(18%)	(\$3.4)
EPS*	\$3.68	(10%)	(\$3.44)**

\* See EPS reconciliation on slide 19

\*\* Includes one-time transaction-related charges (\$3.35) and ongoing operational impacts (\$0.09)

- New operating results presentation format reflects microelectronics business as a discontinued operation
- 3Q performance impacted by:
  - Software revenue below expectations
  - Insufficient productivity in Services
  - Environment, including currency
- Continued strong results in strategic imperatives
- Aggressive actions to accelerate transformation



# Key Transactions

## x86 Business

- Divested x86 business to Lenovo
- Strategic reseller relationship
- \$4B+ revenue in 2013
- Effective October 1, 2014, 4<sup>th</sup> quarter will reflect gain on sale (net of related costs) and loss of x86 business

## Microelectronics Manufacturing

- Divesting semiconductor technology manufacturing to GLOBALFOUNDRIES
- IBM continues to lead semiconductor R&D and systems innovation; GLOBALFOUNDRIES to supply semiconductors for future IBM systems
- \$1.4B revenue in 2013
- Ongoing operations & transaction charges reported as discontinued operations effective 3<sup>rd</sup> quarter 2014

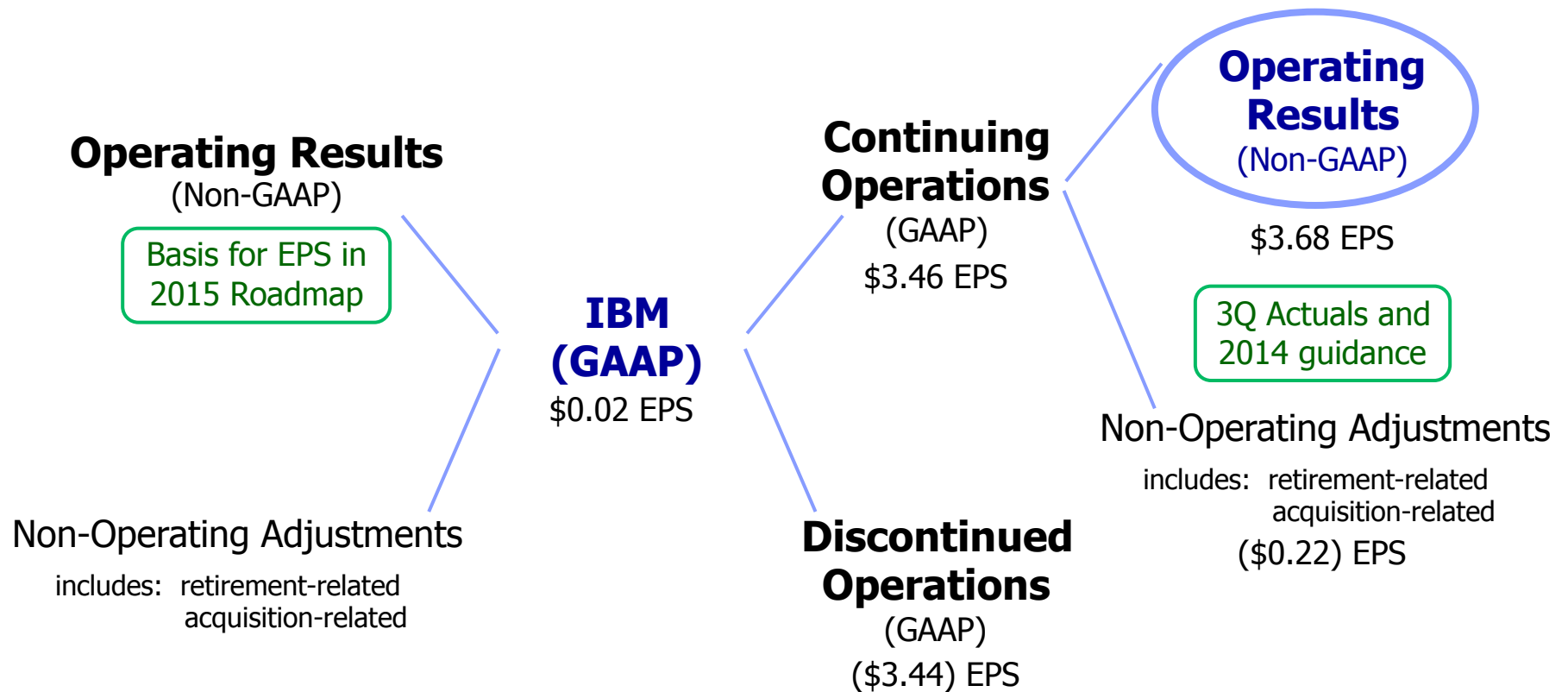
*IBM remains committed to leadership in high-end systems*



# Reporting Format

Basis for Prior Presentation

Current Presentation  
reflecting Discontinued Operations



*Operating (Non-GAAP) results based on Continuing Operations*



## Key Financial Metrics – 3Q 2014

\$ in Billions, except EPS

### P&L Highlights

	<u>3Q14</u>	<u>B/(W) Yr/Yr</u>
Revenue	\$22.4	(4%)
<i>@CC excl. Cust. Care</i>		(2%)
PTI – Operating	\$4.6	(15%)
NI – Operating	\$3.7	(18%)
EPS – Operating	\$3.68	(10%)

### P&L Ratios (Operating)

	<u>3Q14</u>	<u>B/(W) Yr/Yr</u>
GP Margin	49.2%	(0.9 pts)
PTI Margin	20.7%	(2.6 pts)
Tax Rate	20.8%	(3.2 pts)
NI Margin	16.4%	(2.8 pts)

### Cash Highlights

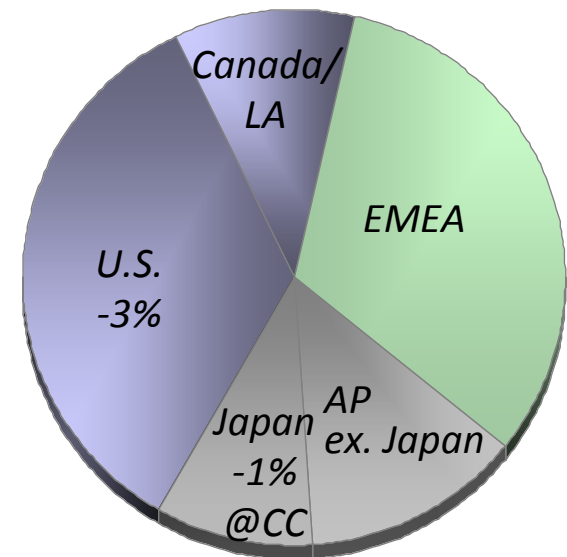
	<u>3Q14</u>	<u>Last 12 Mos.</u>
Free Cash Flow (excl GF Receivables)	\$2.2	\$14.2
Share Repurchase (Gross)	1.7	19.3
Dividends	1.1	4.2
Cash Balance @ Sept. 30	9.6	



## Revenue by Geography

\$ in Billions

		<u>B/(W) Yr/Yr</u>	
	<u>3Q14</u>	<u>Rptd</u>	<u>@CC</u>
Americas	\$10.1	(2%)	(1%)
Europe/ME/A	7.2	(2%)	(3%)
Asia Pacific	5.0	(9%)	(8%)
IBM	\$22.4	(4%)	(4%)
<i>excl. Cust. Care BPO</i>		(3%)	(2%)
<i>Major Markets</i>		(3%)	(3%)
<i>Growth Markets</i>		(6%)	(5%)
<i>BRIC Countries</i>		(7%)	(7%)







# Revenue and Gross Profit Margin by Segment

\$ in Billions	Revenue			Operating Gross Profit Margin	
	<u>3Q14</u>	<u>B/(W) Yr/Yr</u> <u>Rptd</u>	<u>@CC</u>	<u>3Q14</u>	<u>B/(W) Yr/Yr Pts</u>
Global Technology Services <i>excl. Cust. Care BPO</i>	\$9.2	(3%) <i>Flat</i>	(2%) <i>1%</i>	38.5%	(0.5 pts)
Global Business Services	4.5	(2%)	(1%)	31.3%	(1.6 pts)
Software	5.7	(2%)	(2%)	87.6%	(0.4 pts)
Systems & Technology	2.4	(15%)	(15%)	33.9%	(5.9 pts)
Global Financing	0.5	(3%)	(3%)	47.8%	0.7 pts
Total Revenue & Op. GP Margin <i>excl. Cust. Care BPO</i>	\$22.4	(4%) <i>(3%)</i>	(4%) <i>(2%)</i>	49.2%	(0.9 pts)





## Expense Summary

\$ in Billions	<u>3Q14</u>	<u>B/(W)</u> <u>Yr/Yr</u>	<u>B/(W) Yr/Yr Drivers</u>		
			<u>Currency</u>	<u>Acq.*</u>	<u>Base</u>
SG&A – Operating	\$5.1	(2%)	0 pts	(1 pts)	(1 pts)
RD&E – Operating	1.4	(2%)	0 pts	(2 pts)	0 pts
IP and Development Income	(0.1)	(24%)			
Other (Income)/Expense	(0.1)	60%			
Interest Expense	0.1	(30%)			
<b>Operating Expense &amp; Other Income</b>	<b>\$6.4</b>	<b>(2%)</b>	<b>(1 pts)</b>	<b>(2 pts)</b>	<b>0 pts</b>

\* Includes acquisitions made in the last twelve months, net of non-operating acquisition-related charges



# Services Segments

## Global Technology Services (GTS)

		<u>B/(W) Yr/Yr</u>	
\$ in Billions	<u>3Q14</u>	<u>Rptd</u>	<u>@CC</u>
Revenue (External) <i>excl. Cust. Care BPO</i>	\$9.2	(3%) <i>Flat</i>	(2%) <i>1%</i>
Gross Margin (External)	38.5%	(0.5 pts)	
PTI Margin	17.7%	(1.7 pts)	

	<u>Yr/Yr</u>	
<u>GTS 3Q14 Revenue</u>	<u>Rptd</u>	<u>@CC</u>
GTS Outsourcing <i>excl. Cust. Care BPO</i>	(5%) <i>1%</i>	(4%) <i>2%</i>
Integrated Technology Services	Flat	1%
Maintenance	(1%)	(1%)

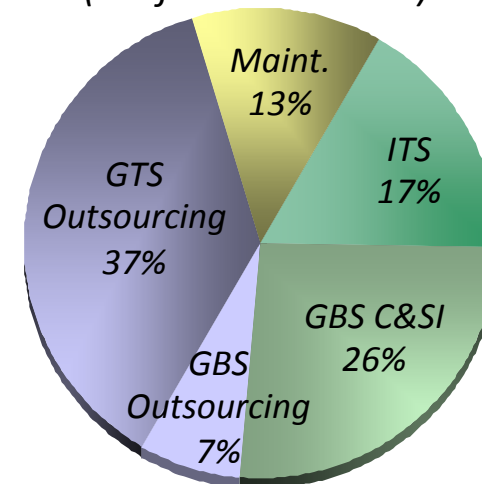
<u>GBS 3Q14 Revenue</u>		
GBS Outsourcing	(7%)	(6%)
Consulting & Systems Integration	(1%)	Flat

	<u>3Q14</u>		
Backlog <i>adj. for Cust. Care BPO</i>	\$128B	(7%)	(2%)

## Global Business Services (GBS)

		<u>B/(W) Yr/Yr</u>	
\$ in Billions	<u>3Q14</u>	<u>Rptd</u>	<u>@CC</u>
Revenue (External)	\$4.5	(2%)	(1%)
Gross Margin (External)	31.3%	(1.6 pts)	
PTI Margin	17.5%	(2.5 pts)	

3Q14 Revenue  
(% of Total Services)





# Software Segment

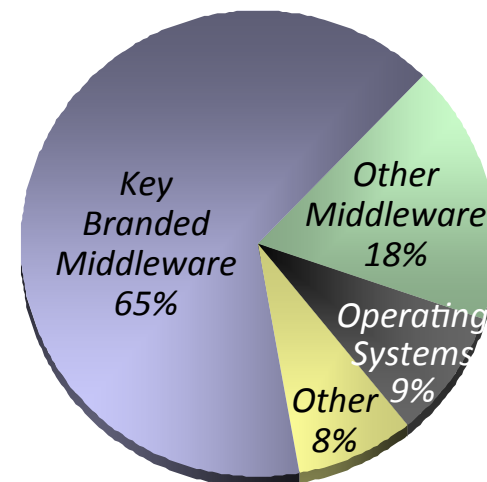
\$ in Billions

	<u>B/(W) Yr/Yr</u>		
	<u>3Q14</u>	<u>Rptd</u>	<u>@CC</u>
Revenue (External)	\$5.7	(2%)	(2%)
Gross Margin (External)	87.6%	(0.4 pts)	
PTI Margin	35.5%	(1.3 pts)	

## 3Q14 Revenue

	<u>Yr/Yr</u>	
	<u>Rptd</u>	<u>@CC</u>
WebSphere	7%	6%
Information Management	(5%)	(5%)
Tivoli	3%	3%
Workforce Solutions	1%	1%
Rational	(12%)	(12%)
Key Branded Middleware	(1%)	(1%)
Total Middleware	Flat	(1%)
Total Software	(2%)	(2%)

3Q14 Revenue  
(% of Total Software)





# Systems & Technology Segment

\$ in Billions

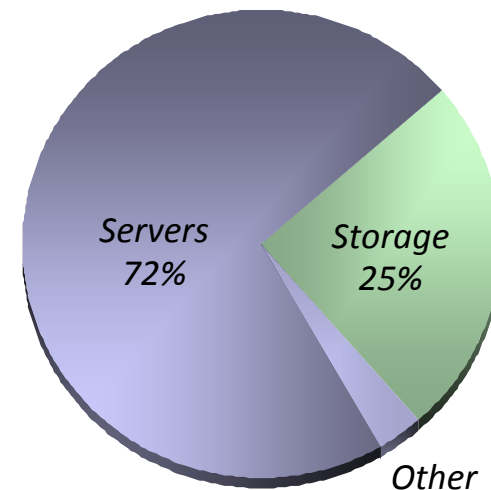
	<u>B/(W) Yr/Yr</u>		
	<u>3Q14</u>	<u>Rptd</u>	<u>@CC</u>
Revenue (External)	\$2.4	(15%)	(15%)
Gross Margin (External)	33.9%	(5.9 pts)	
PTI Margin	(3.8%)	(3.5 pts)	

## 3Q14 Revenue

## Yr/Yr

	<u>Rptd</u>	<u>@CC</u>
System z	(35%)	(35%)
Power Systems	(12%)	(12%)
System x	(10%)	(9%)
Storage	(6%)	(6%)
Other	(29%)	(29%)
<b>Total Systems &amp; Technology</b>	<b>(15%)</b>	<b>(15%)</b>

3Q14 Revenue  
(% of Total Sys & Tech)



# Cash Flow Analysis

\$ in Billions	<u>3Q14</u>	<u>Yr/Yr</u>	<u>YTD</u> <u>3Q14</u>	<u>Yr/Yr</u>
Net Cash from Operations	\$3.9	\$0.1	\$10.8	(\$0.1)
Less: Global Financing Receivables	<u>0.7</u>	<u>0.2</u>	<u>2.2</u>	<u>0.6</u>
Net Cash from Operations (excluding GF Receivables)	3.2	(0.1)	8.6	(0.7)
Net Capital Expenditures	<u>(1.0)</u>	<u>0.0</u>	<u>(2.8)</u>	<u>(0.1)</u>
Free Cash Flow (excluding GF Receivables)	2.2	(0.1)	5.8	(0.8)
Acquisitions	0.0	2.3	(0.6)	1.9
Divestitures	0.1	(0.2)	0.5	0.2
Dividends	(1.1)	(0.1)	(3.2)	(0.1)
Share Repurchases (Gross)	(1.7)	0.2	(13.5)	(5.5)
Non-GF Debt	(0.5)	(1.8)	4.5	3.0
Other (includes GF A/R & GF Debt)	<u>0.9</u>	<u>(0.5)</u>	<u>5.1</u>	<u>0.7</u>
Change in Cash & Marketable Securities	(\$0.2)	\$0.0	(\$1.5)	(\$0.6)

## Balance Sheet Summary

\$ in Billions	<u>Sept. '13</u>	<u>Dec. '13</u>	<u>Sept. '14**</u>
Cash & Marketable Securities	\$10.2	\$11.1	\$9.6
Non-GF Assets*	73.0	76.5	74.5
Global Financing Assets	34.7	38.7	34.8
<b>Total Assets</b>	<b>117.8</b>	<b>126.2</b>	<b>118.9</b>
Other Liabilities	61.7	63.6	58.8
Non-GF Debt*	10.4	12.2	17.1
Global Financing Debt	25.8	27.5	28.6
<b>Total Debt</b>	<b>36.2</b>	<b>39.7</b>	<b>45.7</b>
<b>Total Liabilities</b>	<b>97.8</b>	<b>103.3</b>	<b>104.5</b>
<b>Equity</b>	<b>20.0</b>	<b>22.9</b>	<b>14.4</b>
<b>Non-GF Debt / Capital</b>	<b>39%</b>	<b>39%</b>	<b>62%</b>
<b>Global Financing Leverage</b>	<b>7.1</b>	<b>7.2</b>	<b>7.4</b>

\* Includes eliminations of inter-company activity

\*\* Includes \$3.3B impact to Equity from divestiture of Microelectronics business

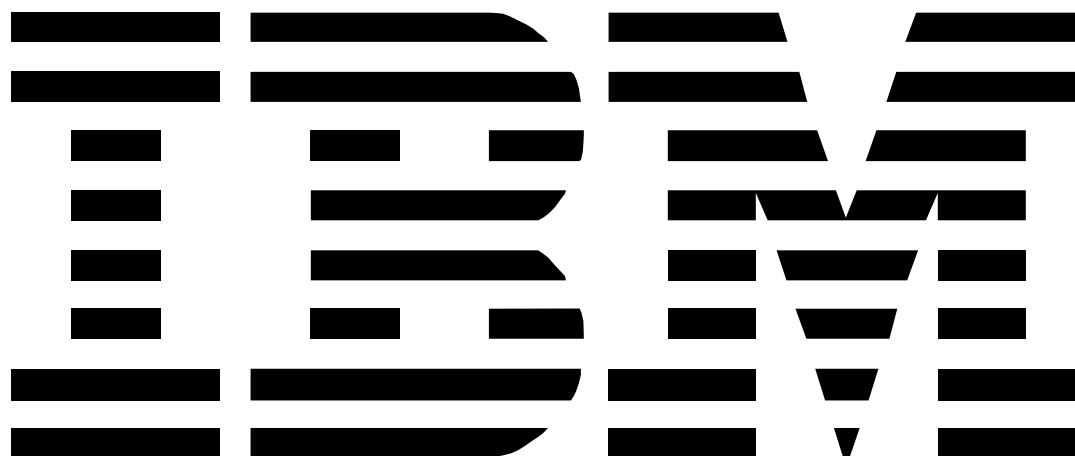
# Strategic Imperatives

- Strategic imperatives address market shifts in data, cloud, engagement
  - Business Analytics      +8% yr/yr YTD
  - Cloud                      >50% yr/yr YTD
    - Cloud-as-a-Service   \$3.1B annual run rate, exiting 3Q14
  - Engagement
    - Mobile                >100% yr/yr YTD
    - Social                +1% yr/yr YTD
    - Security              >20% yr/yr YTD
- Double-digit revenue growth in strategic imperatives, with about half of the content in Software



## Summary

- Strategy addresses shift to new areas of IT
  - Strong performance in strategic imperatives
  - Actions and investments to accelerate shift
- Updating expectations
  - Expect 2014 Operating EPS -4% to -2% as compared to \$16.64 in 2013
    - Reflects new definition based on Continuing Operations
  - No longer expect to deliver “at least \$20 Operating EPS” in 2015
    - Will provide view of 2015 in January
- Accelerating implementation of strategy, while we continue to:
  - Remix to higher value
  - Manage for the long-term
  - Return significant value to shareholders



# Supplemental Materials

Some columns and rows in these materials, including the supplemental exhibits, may not add due to rounding.  
2013 reclassified to reflect discontinued operations presentation.

- Earnings Per Share Reconciliation
- Currency – Year/Year Comparison
- Supplemental Segment Information – Global Services
- Supplemental Segment Information – Systems & Technology, Software
- Global Financing Portfolio
- Cash Flow (FAS 95)
- Non-GAAP Supplemental Materials
  - Operating (Non-GAAP) Earnings Per Share and Related Income Statement Items, Constant Currency
  - Cash Flow, Debt-to-Capital Ratio, Customer Care Outsourcing Business Divestiture,
  - Reconciliation of Operating Earnings Per Share
  - GAAP to Operating (Non-GAAP) Bridge – 3Q 2014
  - GAAP to Operating (Non-GAAP) Bridge – 3Q 2013
  - GAAP to Operating (Non-GAAP) Bridge – 3Q YTD 2014
  - GAAP to Operating (Non-GAAP) Bridge – 3Q YTD 2013
  - GAAP to Operating (Non-GAAP) Bridge – 3Q 2014 and 3Q 2013
  - Reconciliation of B/(W) Yr/Yr Expense Drivers – 3Q14
  - Reconciliation of Debt-to-Capital Ratio
  - Reconciliation of Free Cash Flow (excluding GF Receivables) – 12 months ended 9/30/14
  - Reconciliation of Revenue Growth

## Earnings Per Share Reconciliation

	<u>3Q14</u>	<u>3Q13</u>
<b>GAAP EPS</b>	<b>\$0.02</b>	<b>\$3.68</b>
<b>Discontinued Operations EPS (GAAP)</b>	<b>(3.44)</b>	<b>(0.09)</b>
<b>Continuing Operations EPS (GAAP)</b>	<b>3.46</b>	<b>3.77</b>
<b>Adjustments</b>		
Acquisition-Related Charges	0.16	0.15
Non-Operating Retirement-Related Items	0.06	0.16
<b>Operating EPS (Non-GAAP)</b>	<b>\$3.68</b>	<b>\$4.08</b>

# Currency – Year/Year Comparison

Quarterly Averages per US \$

	<u>1Q14</u>	<u>Yr/Yr</u>	<u>2Q14</u>	<u>Yr/Yr</u>	<u>3Q14</u>	<u>Yr/Yr</u>	<u>10/17 Spot</u>	<u>4Q14</u>	<u>10/17 Spot</u> <u>FY14</u>	<u>1Q15</u>	<u>2Q15</u>
Euro	0.73	4%	0.73	5%	0.76	0%	0.78	(7%)	1%	(7%)	(7%)
Pound	0.60	6%	0.59	9%	0.60	7%	0.62	(1%)	5%	(3%)	(5%)
Yen	103	(11%)	102	(3%)	104	(5%)	107	(6%)	(6%)	(4%)	(4%)

Revenue Impact	(2 pts)	0 pts	(0.4 pts)	(3 pts)	(1 pts)	(2-3 pts)	(3 pts)
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July 17 View

0-1 pts

0 pts

0 pts

<u>3Q14</u>	<u>(US\$B)</u>	<u>Yr/Yr</u>
Revenue As Reported	\$22.4	(4%)
Currency Impact	(0.1)	(0.4 pts)
Revenue @CC		(4%)

# Supplemental Segment Information – 3Q 2014

## Global Services Revenue

	<u>Revenue Growth</u>	
	<u>Yr/Yr</u>	<u>@CC</u>
GTS Outsourcing	(5%)	(4%)
<i>excl. Cust. Care BPO</i>	1%	2%
Integrated Tech Services	Flat	1%
Maintenance	(1%)	(1%)
Total GTS	(3%)	(2%)
<i>excl. Cust. Care BPO</i>	Flat	1%
GBS Outsourcing	(7%)	(6%)
GBS C&SI	(1%)	Flat
Total GBS	(2%)	(1%)
Total Outsourcing	(5%)	(4%)
Total Transactional	Flat	Flat
Maintenance	(1%)	(1%)

## Global Services Backlog / Signings

	<u>\$ in Billions</u>		<u>Backlog</u>	
	<u>3Q14</u>		<u>Yr/Yr</u>	<u>@CC</u>
Total Backlog	\$128		(9%)	(5%)
<i>excl. Cust. Care BPO</i>			(7%)	(2%)
<u>Change in Backlog due to Currency</u>				
Quarter-to-Quarter	(\$6)			
Year-to-Year	(\$6)			
Outsourcing Backlog	\$79		(12%)	(8%)
<u>Signings</u>				
	<u>3Q14</u>		<u>Yr/Yr</u>	<u>@CC</u>
Outsourcing	\$5.0		(17%)	(17%)
- GTS O/S, GBS O/S (AMS)				
Transactional	6.0		(4%)	(2%)
- ITS, Consulting & AMS SI (incl. US Federal)				
Total Signings	\$11.0		(10%)	(10%)

Note: Actual backlog calculated using September 30 currency spot rates

# Supplemental Segment Information – 3Q 2014

## Systems & Technology

	<u>Revenue Growth</u>		
	<u>Yr/Yr</u>	<u>@CC</u>	<u>GP%</u>
System z	(35%)	(35%)	↓
Power Systems	(12%)	(12%)	↓
System x	(10%)	(9%)	↓
Storage	(6%)	(6%)	↓
Other	(29%)	(29%)	
Total Sys & Tech	(15%)	(15%)	

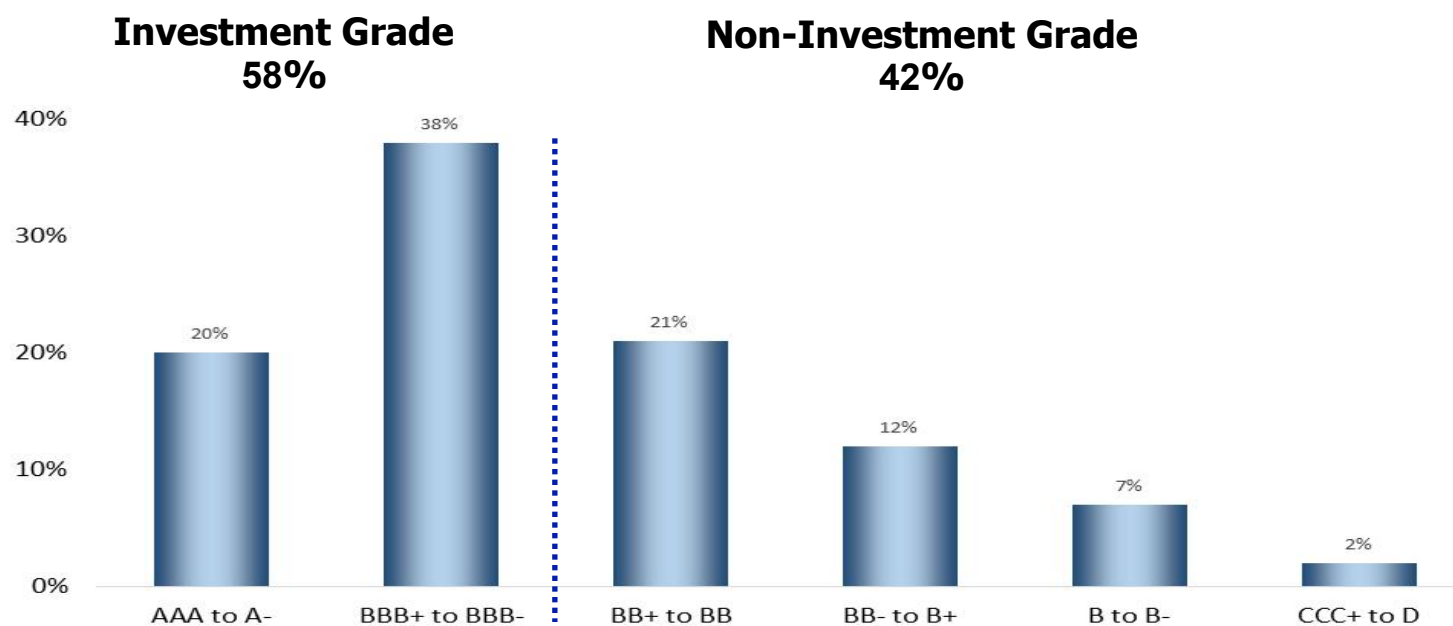
## Software

	<u>Revenue Growth</u>	
	<u>Yr/Yr</u>	<u>@CC</u>
WebSphere	7%	6%
Information Management	(5%)	(5%)
Tivoli	3%	3%
Workforce Solutions	1%	1%
Rational	(12%)	(12%)
Key Branded Middleware	(1%)	(1%)
Other Middleware	1%	1%
Total Middleware	Flat	(1%)
Operating Systems	(11%)	(11%)
Other Software/Services	(1%)	(1%)
Total Software	(2%)	(2%)



# Global Financing Portfolio

3Q14 – \$27.8B Net External Receivables



	<u>3Q14</u>	<u>2Q14</u>	<u>3Q13</u>
Identified Loss Rate	1.5%	1.1%	1.0%
Anticipated Loss Rate	0.3%	0.4%	0.3%
<b>Reserve Coverage</b>	<b>1.8%</b>	<b>1.5%</b>	<b>1.3%</b>
Client Days Delinquent Outstanding	4.0	3.8	3.0
Commercial A/R > 30 Days	\$ 28 M	\$ 30 M	\$ 44 M

# Cash Flow (FAS 95)

\$ in Billions

	<u>QTD</u> <u>3Q14</u>	<u>QTD</u> <u>3Q13</u>	<u>YTD</u> <u>3Q14</u>	<u>YTD</u> <u>3Q13</u>
Net Income from Operations	\$0.0	\$4.0	\$6.5	\$10.3
Depreciation / Amortization of Intangibles	1.1	1.2	3.4	3.5
Stock-based Compensation	0.2	0.1	0.4	0.5
Working Capital / Other	(1.5)	(2.1)	(5.2)	(4.9)
Global Financing A/R	0.7	0.5	2.2	1.6
Net loss on divestiture of Microelectronics	3.3	0.0	3.3	0.0
<b>Net Cash provided by Operating Activities</b>	<b>3.9</b>	<b>3.8</b>	<b>10.8</b>	<b>11.0</b>
Capital Expenditures, net of payments & proceeds	(1.0)	(1.0)	(2.8)	(2.7)
Divestitures, net of cash transferred	0.1	0.2	0.5	0.2
Acquisitions, net of cash acquired	0.0	(2.4)	(0.6)	(2.6)
Marketable Securities / Other Investments, net	0.2	0.6	1.2	0.6
<b>Net Cash used in Investing Activities</b>	<b>(0.8)</b>	<b>(2.5)</b>	<b>(1.8)</b>	<b>(4.4)</b>
Debt, net of payments & proceeds	(0.2)	2.0	6.4	3.4
Dividends	(1.1)	(1.0)	(3.2)	(3.0)
Common Stock Repurchases	(1.7)	(1.9)	(13.5)	(8.1)
Common Stock Transactions - Other	0.1	0.2	0.5	0.8
<b>Net Cash used in Financing Activities</b>	<b>(2.8)</b>	<b>(0.8)</b>	<b>(9.8)</b>	<b>(6.9)</b>
Effect of Exchange Rate changes on Cash	(0.4)	0.1	(0.4)	0.0
<b>Net Change in Cash &amp; Cash Equivalents</b>	<b>(\$0.2)</b>	<b>\$0.5</b>	<b>(\$1.2)</b>	<b>(\$0.3)</b>

# Non-GAAP Supplemental Materials

In an effort to provide investors with additional information regarding the company's results as determined by generally accepted accounting principles (GAAP), the company also discusses, in its earnings press release and earnings presentation materials, the following Non-GAAP information which management believes provides useful information to investors.

## Operating (Non-GAAP) Earnings Per Share and Related Income Statement Items

Management presents certain financial measures from continuing operations excluding the effects of certain acquisition-related charges, non-operating retirement-related costs and any related tax impacts. Management uses the term "operating" to describe this view of the company's financial results and other financial information. For acquisitions, these measures exclude the amortization of purchased intangible assets and acquisition-related charges such as in-process research and development, transaction costs, applicable restructuring and related expenses, and tax charges related to acquisition integration. For retirement-related costs, the company has characterized certain items as operating and others as non-operating. The company includes service cost, amortization of prior service cost and the cost of defined contribution plans in its operating results. Non-operating retirement-related costs include interest cost, expected return on plan assets, amortized actuarial gains/losses, the impacts of any plan curtailments/settlements, multi-employer plan costs, pension insolvency costs, and other costs. Non-operating costs primarily relate to changes in pension plan assets and liabilities which are tied to market performance, and management considers these costs to be outside the operational performance of the business. Management's calculation of these operating measures, as presented, may differ from similarly titled measures reported by other companies.

Overall, management believes that providing investors with an operating view as described above provides increased transparency and clarity into both the operational results of the business and the performance of the company's pension plans, improves visibility to management decisions and their impacts on operational performance, enables better comparison to peer companies, and allows the company to provide a long term strategic view of the business going forward. For its earnings per share guidance, the company is utilizing an operating view to establish its objectives and track its progress. The company's segment financial results and performance reflect operating earnings, consistent with the company's management and measurement system.

## Constant Currency

Management refers to growth rates at constant currency or adjusting for currency so that certain financial results can be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons of the company's business performance. Financial results adjusted for currency are calculated by translating current period activity in local currency using the comparable prior year period's currency conversion rate. This approach is used for countries where the functional currency is the local currency. Generally, when the dollar either strengthens or weakens against other currencies, the growth at constant currency rates or adjusting for currency will be higher or lower than growth reported at actual exchange rates.

# Non-GAAP Supplemental Materials

## Cash Flow

Management uses a free cash flow measure to evaluate the company's operating results, plan share repurchase levels, evaluate strategic investments and assess the company's ability and need to incur and service debt. The entire free cash flow amount is not necessarily available for discretionary expenditures. The company defines free cash flow as net cash from operating activities less the change in Global Financing receivables and net capital expenditures, including the investment in software. A key objective of the Global Financing business is to generate strong returns on equity, and increasing receivables is the basis for growth. Accordingly, management considers Global Financing receivables as a profit-generating investment, not as working capital that should be minimized for efficiency. Therefore, management includes presentations of both free cash flow and cash flow from operations that exclude the effect of Global Financing receivables.

## Debt-to-Capital Ratio

Management presents its debt-to-capital ratio excluding the Global Financing business. A financing business is managed on a leveraged basis. The company funds its Global Financing segment using a debt-to-equity ratio target of approximately 7 to 1. Given this significant leverage, the company presents a debt-to-capital ratio which excludes the Global Financing segment debt and equity because the company believes this is more representative of the company's core business operations.

## Customer Care Outsourcing Business Divestiture

On September 10, 2013, the company announced that it had signed a definitive agreement with SYNnex for the sale of its worldwide customer care process outsourcing services business. Management presents certain financial results excluding the effects of the customer care outsourcing business divestiture. Management believes that presenting financial information without this item is more representative of operational performance and provides additional insight into, and clarifies the basis for, historical and/or future performance, which may be more useful to investors.

# Non-GAAP Supplemental Materials

## *Reconciliation of Operating Earnings Per Share*

	<b>Full Year <u>2013</u></b>	<b>2014 Expectations <u>vs. 2013</u></b>
<b>IBM Continuing Operations EPS (GAAP)</b>	<b>\$15.30</b>	<b>0% to -2%</b>
<b>IBM Operating EPS (Non-GAAP)</b>	<b>\$16.64</b>	<b>-2% to -4%</b>

<b>Adjustments</b>	<b><u>2014 Expectations</u></b>
<b>Acquisition-Related Charges *</b>	<b>\$0.73</b>
Amortization of Purchased Intangibles	\$0.70
Other Acquisition-Related Charges	\$0.03
<b>Non-Operating Retirement-Related Items</b>	<b>\$0.27</b>

\* Includes acquisitions through September 30, 2014

The above serves to reconcile the Non-GAAP financial information contained in "Summary" discussion in the company's earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## GAAP to Operating (Non-GAAP) Bridge – 3Q 2014

\$ in Millions, except EPS

	<u>GAAP</u>	<u>Acquisition-related Adjustments*</u>	<u>Retirement-related Adjustments**</u>	<u>Operating (Non-GAAP)</u>
Gross Profit	\$10,874	\$106	\$43	\$11,023
SG&A	5,281	(96)	(48)	5,137
RD&E	1,354	0	19	1,373
Other Income & Expense	(103)	0	0	(103)
Total Operating Expense & Other Income	6,513	(96)	(29)	6,389
Pre-Tax Income from Continuing Operations	4,361	202	71	4,634
Tax ***	906	42	14	963
Net Income from Continuing Operations	3,455	159	57	3,671
Diluted Earnings Per Share from Continuing Operations	\$3.46	\$0.16	\$0.06	\$3.68

\* Includes amortization of purchased Intangibles, in process R&D, severance cost for acquired employees, vacant space for acquired companies, deal costs and acquisition integration tax charges

\*\* Includes retirement related interest cost, expected return on plan assets, recognized actuarial losses or gains, amortization of transition assets, other settlements, curtailments, multi-employer plans and insolvency insurance

\*\*\*The tax impact on the Operating (Non-GAAP) Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

The above serves to reconcile the Non-GAAP financial information contained in the "3Q 2014 Overview", "Key Financial Metrics - 3Q 2014" and "Expense Summary" discussions in the company's earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## GAAP to Operating (Non-GAAP) Bridge – 3Q 2013

\$ in Millions, except EPS

	<u>GAAP</u>	<u>Acquisition-related Adjustments*</u>	<u>Retirement-related Adjustments**</u>	<u>Operating (Non-GAAP)</u>
Gross Profit	\$11,429	\$102	\$154	\$11,686
SG&A	5,260	(111)	(89)	5,060
RD&E	1,356	0	(14)	1,342
Other Income & Expense	(63)	(1)	0	(64)
Total Operating Expense & Other Income	6,458	(112)	(103)	6,243
Pre-Tax Income from Continuing Operations	4,972	214	257	5,443
Tax ***	832	48	77	958
Net Income from Continuing Operations	4,139	166	181	4,485
Diluted Earnings Per Share from Continuing Operations	\$3.77	\$0.15	\$0.16	\$4.08

\* Includes amortization of purchased Intangibles, in process R&D, severance cost for acquired employees, vacant space for acquired companies, deal costs and acquisition integration tax charges.

\*\* Includes retirement related interest cost, expected return on plan assets, recognized actuarial losses or gains, amortization of transition assets, other settlements, curtailments, multi-employer plans and insolvency insurance.

\*\*\*The tax impact on the Operating (Non-GAAP) Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

The above serves to reconcile the Non-GAAP financial information contained in the "3Q 2014 Overview", "Key Financial Metrics – 3Q 2014" and "Expense Summary" discussions in the company's earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.



# Non-GAAP Supplemental Materials

## GAAP to Operating (Non-GAAP) Bridge – 3Q YTD 2014

\$ in Millions, except EPS

	<u>GAAP</u>	<u>Acquisition-related Adjustments*</u>	<u>Retirement-related Adjustments**</u>	<u>Operating (Non-GAAP)</u>
Gross Profit	\$33,545	\$315	\$141	\$34,001
SG&A	17,146	(291)	(162)	16,693
RD&E	4,117	0	56	4,173
Other Income & Expense	(433)	0	0	(433)
Total Operating Expense & Other Income	20,654	(292)	(106)	20,257
Pre-Tax Income from Continuing Operations	12,891	607	246	13,744
Tax ***	2,655	123	49	2,827
Net Income from Continuing Operations	10,237	483	197	10,917
Diluted Earnings Per Share from Continuing Operations	\$10.09	\$0.48	\$0.19	\$10.76

\* Includes amortization of purchased Intangibles, in process R&D, severance cost for acquired employees, vacant space for acquired companies, deal costs and acquisition integration tax charges

\*\* Includes retirement related interest cost, expected return on plan assets, recognized actuarial losses or gains, amortization of transition assets, other settlements, curtailments, multi-employer plans and insolvency insurance

\*\*\*The tax impact on the Operating (Non-GAAP) Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

The above serves to reconcile the Non-GAAP financial information contained in the Year-To-Date 2014 Results discussions in the company's earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## GAAP to Operating (Non-GAAP) Bridge – 3Q YTD 2013

\$ in Millions, except EPS

	<u>GAAP</u>	<u>Acquisition-related Adjustments*</u>	<u>Retirement-related Adjustments**</u>	<u>Operating (Non-GAAP)</u>
Gross Profit	\$34,347	\$289	\$474	\$35,110
SG&A	17,463	(294)	(286)	16,884
RD&E	4,291	0	(43)	4,248
Other Income & Expense	(217)	(8)	0	(225)
Total Operating Expense & Other Income	21,205	(302)	(329)	20,574
Pre-Tax Income from Continuing Operations	13,142	590	803	14,536
Tax ***	2,478	112	239	2,828
Net Income from Continuing Operations	10,665	479	564	11,708
Diluted Earnings Per Share from Continuing Operations	\$9.60	\$0.43	\$0.51	\$10.54

\* Includes amortization of purchased Intangibles, in process R&D, severance cost for acquired employees, vacant space for acquired companies, deal costs and acquisition integration tax charges.

\*\* Includes retirement related interest cost, expected return on plan assets, recognized actuarial losses or gains, amortization of transition assets, other settlements, curtailments, multi-employer plans and insolvency insurance.

\*\*\*The tax impact on the Operating (Non-GAAP) Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

The above serves to reconcile the Non-GAAP financial information contained in the Year-To-Date 2014 Results discussions in the company's earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## GAAP to Operating (Non-GAAP) Bridge – 3Q 2014 and 3Q 2013

<u>3Q 2014</u>	<u>GAAP</u>	<u>Acquisition- related Adjustments*</u>	<u>Retirement-related Adjustments **</u>	<u>Operating (Non-GAAP)</u>
Gross Profit Margin from Continuing Operations	48.6%	0.5 pts	0.2 pts	49.2%
PTI Margin from Continuing Operations	19.5%	0.9 pts	0.3 pts	20.7%
Tax Rate ***	20.8%	0.0 pts	0.0 pts	20.8%
Net Income Margin from Continuing Operations	15.4%	0.7 pts	0.3 pts	16.4%

### 3Q 2013

Gross Profit Margin from Continuing Operations	49.0%	0.4 pts	0.7 pts	50.1%
PTI Margin from Continuing Operations	21.3%	0.9 pts	1.1 pts	23.3%
Tax Rate ***	16.7%	0.2 pts	0.6 pts	17.6%
Net Income Margin from Continuing Operations	17.7%	0.7 pts	0.8 pts	19.2%

\* Includes amortization of purchased Intangibles, in process R&D, severance cost for acquired employees, vacant space for acquired companies, deal costs and acquisition integration tax charges

\*\* Includes retirement related interest cost, expected return on plan assets, recognized actuarial losses or gains, amortization of transition assets, other settlements, curtailments, multi-employer plans and insolvency insurance

\*\*\*The tax impact on the Operating (Non-GAAP) Pre-Tax Income from continuing operations is calculated under the same accounting principles applied to the As Reported Pre-Tax Income under ASC 740, which employs an annual effective tax rate method to the results.

The above serves to reconcile the Non-GAAP financial information contained in the "Key Financial Metrics - 3Q 2014" and "Revenue and Gross Profit Margin by Segment" discussion in the company's earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## *Reconciliation of B/(W) Yr/Yr Expense Drivers – 3Q14*

	<u>GAAP</u>	<u>Non-GAAP Adjustments</u>	<u>Operating (Non-GAAP)</u>
SG&A			
Currency	0 pts	0 pts	0 pts
Acquisitions	(1 pts)	0 pts	(1 pts)
Base	1 pts	(1 pts)	(1 pts)
RD&E			
Currency	0 pts	0 pts	0 pts
Acquisitions	(2 pts)	0 pts	(2 pts)
Base	2 pts	(2 pts)	0 pts
Operating Expense & Other Income			
Currency	(1 pts)	0 pts	(1 pts)
Acquisitions	(2 pts)	0 pts	(2 pts)
Base	1 pts	(2 pts)	0 pts

The above serves to reconcile the Non-GAAP financial information contained in the “Expense Summary” discussion in the company’s earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## *Reconciliation of Debt-to-Capital Ratio*

	<u>Sept. 2014*</u>	<u>Dec. 2013</u>	<u>Sept. 2013</u>
Non-Global Financing Debt / Capital	62%	39%	39%
IBM Consolidated Debt / Capital	76%	63%	64%

\*September 2014 reflects \$3.3 billion net loss on divestiture of Microelectronics.

The above serves to reconcile the Non-GAAP financial information contained in the “Balance Sheet Summary” discussion in the company’s earnings presentation. See Slide 26 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## *Reconciliation of Free Cash Flow (excluding GF Receivables)*

\$ in Billions	12 months ended <u>9/30/14</u>
Net Cash from Operations	\$17.3
Less: Global Financing Receivables	<u>(0.7)</u>
Net Cash from Operations (excluding GF Receivables)	18.0
Net Capital Expenditures	<u>(3.9)</u>
Free Cash Flow (excluding GF Receivables)	\$14.2

The above serves to reconcile the Non-GAAP financial information contained in the “Key Financial Metrics – 3Q 2014” discussion in the company’s earnings presentation. See Slide 26 of this presentation for additional information on the use of these Non-GAAP financial measures.

# Non-GAAP Supplemental Materials

## *Reconciliation of Revenue Growth*

	<u>3Q14 Yr/Yr</u>		<u>2Q14 Yr/Yr</u>	
	<u>As Reported</u>	<u>At Constant Currency</u>	<u>As Reported</u>	<u>At Constant Currency</u>
Major Markets			Flat	(1%)
Growth Markets			(7%)	(4%)
Japan	(6%)	(1%)		
Global Services	(3%)	(2%)		

The above serves to reconcile the Non-GAAP financial information contained in the “Revenue by Geography” and “Services” discussions in the company’s earnings presentation. See Slide 25 of this presentation for additional information on the use of these Non-GAAP financial measures.



