Dear IBM Investor:

The businesses of the world are changing the way they work. We have prepared your company for this moment.

During the past five years, propelled by our belief that the phenomenon of data would reorder technology and business, we have undertaken one of the most ambitious reinventions in IBM’s modern history. This phase is largely complete. IBM is now a cognitive solutions and cloud platform company. IBM now possesses capabilities that are unmatched in our industry to address our clients’ most pressing needs.

In my letter to you this year, I will describe our performance in 2017, which reflects the progress we have made in building these capabilities. And I will explain why we believe this moment marks an inflection point, not just for our company, but for business and society at large.
The substantial progress we made last year

We achieved operating earnings per share of $13.80, up 2 percent. Our revenue for the year was $79.1 billion, with operating pre-tax income of $13.9 billion. In the fourth quarter, we grew revenue 4 percent, 1 percent adjusted for the effects of currency (as are all other revenue numbers in this letter).

We did so in significant part because our strategic imperatives reached critical mass. With revenue of $36.5 billion and growing 11 percent, these products and services now contribute 46 percent of IBM’s revenue. And we expect to achieve our goal of growing these new products and services to $40 billion in 2018.

Watson strengthened its position as the AI platform for business. We are embedding AI into more of what we offer—including security, the Internet of Things, commerce and verticals, such as Watson Health. Together, these helped IBM’s Cognitive Solutions business generate more than $18 billion in revenue in 2017.

We also remained the global leader in cloud for the enterprise. In 2017, our cloud revenue grew 24 percent, to $17 billion. Cloud by itself is now more than 21 percent of our total revenue.

Our reinvented systems franchises generated strong growth. Mainframes enjoyed a very strong fourth quarter, thanks to the launch of the new z14, the world’s first system that can encrypt data pervasively without requiring changes to applications and with no downtime. We expect this breakthrough will drive significant expansion of the mainframe’s already broad market.

Similarly, we are reinventing our services business. Global Business Services saw signings growth throughout the year, as clients engaged with our high-value consulting practices in areas such as AI, blockchain, and digital strategy and design.

In addition, our Technology Services and Cloud Platform team is working with clients worldwide to integrate public, private and managed cloud environments through a single architecture.

IBM is the clear leader in quantum computing. The world’s first (and only) prototype 50-qubit system, announced in 2017, was a major step toward systems that can tackle problems beyond the scope of classical computation. Through IBM Q Experience, the world’s first publicly available quantum computers, more than 75,000 users have run more than 2.5 million quantum experiments. A dozen clients, including partners JPMorgan Chase, Daimler AG, Samsung and JSR, are now exploring practical applications on our latest commercial systems.

We have also achieved global leadership in blockchain. By providing a permissioned and immutable shared ledger, blockchain is doing for trusted transactions what the Internet did for information. Hundreds of leading organizations already have embraced IBM’s blockchain platform. Walmart, Nestlé, Dole, Kroger and others are applying blockchain to improve food safety. Early in 2018, we announced a joint venture with Maersk to apply blockchain to the complex world of international shipping. We also are working with The Depository Trust & Clearing Corporation (DTCC) on new blockchain approaches for complex derivatives, such as credit default swaps.

Finally, 2017 saw a milestone in innovation as IBM, for the 25th year in a row, led the world in U.S. patents earned, setting a new record of 9,043. Importantly, nearly half of those patents were in AI, cloud, blockchain, quantum, security and other technologies that will power our portfolio for years to come.

We did all this while continuing to invest heavily for long-term competitiveness—$5.6 billion in research and development and $3.3 billion in net capital expenditures, adding to the capabilities of our high-growth strategic businesses.

We also returned $9.8 billion to you, our owners, including dividends of $5.5 billion and $4.3 billion in gross share repurchases. We raised our dividend for the 22nd consecutive year—it was IBM’s 102nd straight year of providing one. All of this is due to the creativity and passion of IBMers. They are the reason we have reached an inflection point, and they are our greatest competitive advantage.


**Today’s IBM: Built for smarter businesses**

For over a century, IBM has reinvented itself again and again to help its clients move from one era to the next. Today, we are witnessing another such transition, at the dawn of smarter business. All companies need an enterprise-strength cloud platform. They need AI capable of understanding all their data. They need services grounded in their professions and industries. And they need a technology infrastructure infused with intelligence, protected with advanced security and future-proofed against the flow of new breakthroughs and risks.

That is, they need today’s IBM.

<table>
<thead>
<tr>
<th>IBM Cloud: The platform for smarter businesses</th>
<th>IBM Watson: AI for the enterprise</th>
<th>IBM Systems: The industry’s most powerful infrastructure</th>
<th>IBM Security: The gold standard for cyber protection</th>
<th>IBM Research: The world’s premier private research organization</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBM Cloud uniquely provides a single architecture that unifies infrastructure and higher-value services, including AI, IoT, quantum computing and blockchain.</td>
<td>IBM Watson offers the fullest spectrum of cognitive technologies to professionals who are transforming work and decision-making in healthcare, transportation, retail, insurance, education and more.</td>
<td>IBM’s mainframe, cognitive systems and storage offerings provide the world’s most powerful, secure and flexible foundation for AI and data-intensive applications and workloads.</td>
<td>IBM’s industry-leading enterprise security offerings have been taken to the next level through AI and advanced analytics.</td>
<td>Twelve global research labs bring an unmatched range of scientific expertise—from AI, to blockchain, to quantum computing and more—to bear on the needs of clients and their industries.</td>
</tr>
<tr>
<td>58 cloud data centers across 19 countries</td>
<td>100,000+ patients and consumers touched by Watson Health</td>
<td>87 percent of all credit card transactions and nearly $8 trillion in payments are supported by IBM Z systems</td>
<td>60 billion security events monitored each day</td>
<td>50-qubit prototype quantum system debuted</td>
</tr>
<tr>
<td>1,900+ cloud-technology patents awarded in 2017</td>
<td>70+ percent growth in organizations using Watson</td>
<td>POWER9 introduced as the most advanced servers for enterprise AI and data-intensive workloads</td>
<td>22 of 25 of the world’s largest banks protected</td>
<td>5 nanometer transistors developed, which will lead to high-performance, low-power chips</td>
</tr>
<tr>
<td></td>
<td></td>
<td>X-Force Command opened as the industry’s first commercial cyber range, allowing clients to experience simulated cyberattacks</td>
<td></td>
<td>MIT-IBM Watson AI Lab launched as a large, long-term collaboration with MIT for joint research in AI science and technology</td>
</tr>
</tbody>
</table>
Inflection points

This is not just an inflection point for IBM. It is also an inflection point for our clients—the enterprises and institutions of the world.

Until a year or so ago, you would find many who believed that “digital disruption” was here to stay. They believed that the world’s incumbent businesses were at risk of being marginalized.

We had a different point of view. We did not believe the platform giants alone would dominate a data-centric economy—in large measure because they lack access to the most valuable sources of the world’s data: the 80 percent that is not searchable on the Web. The world’s incumbent businesses and institutions own and generate this data, coming from their professional expertise, their industry’s practices and market dynamics, their processes and operations, their people and cultures. Therefore, we believe they are positioned to lead.

In this letter and throughout this report, you will find the names of many of the world’s great enterprises and institutions. This is not a coincidence. It is a reflection of an important new reality: The incumbents of the world understand that they can be the new disruptors, and they are going on offense to seize this opportunity and to capture this moment.

They are doing so by becoming smarter businesses.

• Businesses are becoming smarter by leveraging intelligent digital platforms. The IBM Cloud has emerged as the platform of choice for business—built for all applications, ready for AI and secure to the core. It is the unifying platform for IBM’s capabilities, integrated into a single architecture that spans public and private clouds. Through this powerful platform, we are delivering to the world’s businesses a continuous stream of innovative capabilities: computation and storage, data and Watson services, IoT and blockchain services, and IBM Q.

• Businesses are becoming smarter by making their systems and processes intelligent—which is why IBM’s services and solutions are grounded in deep knowledge of our clients’ industries. This has made IBM the partner of choice for smarter businesses’ digital and cognitive transformation and IT services. Clients include RBS, Autodesk and Hyundai Card, as well as the large client bases of our strategic partners, such as Salesforce, Workday, Apple, SAP and VMware. This deep industry dimension is also what has allowed us to establish successful new solutions businesses, such as Watson Health, Watson IoT and Watson Financial Services.

• Businesses are becoming smarter by embedding AI and data to change how work is done, equipping themselves for an era of man + machine. Watson for Oncology is helping doctors identify treatment options for their patients at more than 150 hospitals around the world, including Gachon University Gil Medical Center in South Korea, Svet Zdravia in Slovakia and Taipei Medical University in Taiwan. A year ago, Watson for Oncology was trained in four types of cancer. Today, it is trained in multidisciplinary support for 13 cancer types. Watson is helping tax preparers at H&R Block provide the best advice to millions of clients. Bankers and customer service representatives at Crédit Mutuel, Banco Bradesco, Orange Bank and other financial institutions are reinventing banking. Woodside Energy chose Watson to help it preserve the institutional knowledge—and reinvent the work—of petroleum engineers.

You can read in this report how these and other leaders are making their companies smarter, in all dimensions. They are placing big bets on the future to increase their competitiveness and to reconnect with their company’s true reason for being.
We also stand at an inflection point for society, everywhere in the world.

IBM does not believe that the future belongs to the few. We believe it belongs to all of us—and we translate that belief into practice and policy.

*On data and AI responsibility:* As the world’s new natural resource, unleashed by the maturation of AI, data holds the potential to generate growth, prosperity and societal progress. But it will only do so if the world can trust that data is being collected, managed and analyzed responsibly.

At a time when many are questioning the power and behavior of some companies, IBM is stepping forward as a responsible steward of data and AI. We believe that AI’s purpose is to augment, not replace, human intelligence. We are clear on the need for transparency—on where AI is used, who trained it and what data sets were ingested. We also believe that data and the insights it generates belong to their creators. No one should have to give up ownership or control of their data to benefit from AI and cloud computing. We have built and are deploying Watson accordingly.

Trust also requires the protection of data through strong encryption and security systems that are constantly tested and strengthened. The privacy of data must be respected. Those, too, are core dimensions of the IBM Cloud with Watson.

*On jobs:* Without question, new technology will eliminate work; it always has. At the same time, new job categories will emerge. The challenge, however, is that AI will transform the skills required for all jobs. There still will be doctors, lawyers, salespeople, teachers and engineers. But the tasks and tools they need to perform their work will be different.

---

**IBM patent leadership is building the future for smarter businesses**

IBMers received a record-breaking 9,043 U.S. patents during 2017—the 25th consecutive year that the company has led the world.

Even more important, nearly half of IBM’s new patents are advancing AI, cloud computing, blockchain, quantum computing, cybersecurity and other technologies that will change the way the world works—again.

**Five 2017 patents that are shaping the future:**

- **Luring Hackers**
  U.S. Patent 9,560,075: Cybersecurity technology that enables AI systems to lure malicious hackers with email exchanges and websites that divert their attacks.

- **Personalizing AI Communication**
  U.S. Patent 9,601,104: A system that analyzes, interprets and mirrors a user’s unique speech and linguistic traits.

- **Forecasting Cloud Resources**
  U.S. Patent 9,755,923: A system to predict cloud computing needs, based on human behaviors and current events.

- **Improving Quantum Signal Fidelity**
  U.S. Patent 9,818,064: A method for improving a quantum computer’s ability to read signals, which can lead to efficiency in the system’s components.

- **Speeding Trust on Blockchain**
  U.S. Patent 9,824,031: A method to remove steps for settling transactions among multiple parties, even untrusted ones, without involving a third party.
We also are clear on the markets we serve. IBM is global in presence and mind-set.

We earn trust. We take positions—and act—on issues that matter for our time. Today, that begins with data, AI and security, and extends to inclusion and trust.

Put it all together, and you have a company that always has been unique in combining innovative technology with deep industry expertise, underpinned by security, trust and responsible stewardship. In helping businesses move from era to era, we seek to be essential—to our clients and to the world.

Let me close by expressing my gratitude to the treasured clients we serve, and to the hundreds of thousands of IBMers whose brilliance and resilience make it possible for us all to achieve our life’s work at the world’s most essential enterprise.

I never have been more optimistic in my IBM career—optimistic about our technology, about our clients, about IBM and about the world we are building together.

Virginia M. Rometty
Chairman, President and Chief Executive Officer

Rediscovering IBM

At the deepest level, the most important fact about IBM’s 2017 was not our return to revenue growth in the fourth quarter or the continued scaling of our new products and services or our patent achievement. It is our reaffirmation of IBM’s essential identity.

IBM is an enterprise technology company. We deliver services with the simplicity, speed and delight of the best consumer products and services, but we are very clear on whom we serve. We are dedicated to our clients’ success, and our reinvention during the past five years has been driven by helping our clients serve their customers. This unrelenting focus on the client is a particular source of pride.

For more than a century, IBMers have earned the world’s trust. We continue that legacy.

This is why building skills for the jobs of the future—not blue collar or white collar, but “new collar” jobs—will require a major reinvention of education. We at IBM are leading that transformation, in the U.S. and worldwide, through public-private partnerships to create the revolutionary Pathways in Technology Early College High Schools (P-TECH) education model, 21st century apprenticeships and retraining programs. This includes investing $5 billion over 10 years in the continuous renewal of IBMers and the re-skilling of mid-career professionals looking to get back into the tech workforce.

On inclusion: Today, we proudly carry forward a global commitment to inclusion that has defined IBM for more than a century. We are stepping forward to support the open exchange of people, information and ideas, as well as to protect cross-border data flows for international privacy and security agreements.

IBM is the recognized gold standard for inclusion, reflected in winning the 2018 Catalyst Award for advancing women in business. IBM is the first company to win this award four times. We advocate for fairness and equality—as everyone is, and always has been, welcome at IBM.

For more than a century, IBMers have earned the world’s trust by building progress with responsibility. We continue this legacy today.

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), these materials contain certain non-GAAP financial measures on a continuing operations basis, including revenue at constant currency, strategic imperatives revenue at constant currency, cloud revenue at constant currency, operating pre-tax income, operating (non-GAAP) research, development and engineering and operating earnings per share. The rationale for management’s use of this non-GAAP information is included on pages 26, 27 and 68 of the company’s 2017 Annual Report, which is Exhibit 13 to the Form 10-K submitted with the SEC on February 27, 2018. For reconciliation of these non-GAAP financial measures to GAAP and other information, please refer to pages 28, 43, 49 and 50 of the company’s 2017 Annual Report.