

Dear IBM Investor:
Over the past decade,
hundreds of thousands of
IBMers have transformed
your company. Today, IBM
has laid the foundation for
a new era of technology
and business.

It's easy to forget that we are still in the early stages of a long cycle of technological revolution. The driving forces of this change are well understood: the phenomenon of data, the value of cloud and the scaling of artificial intelligence.

As a result, we are experiencing a great wave of corporate transformations, as the most essential organizations in the world—transportation providers, hospital networks, financial services, telecommunications networks, government agencies and more—become digital.

But the most challenging and complex work of these digital transformations still lies ahead. We call this work “Chapter 2,” in which our clients modernize and move their mission-critical workloads to the cloud, and infuse AI deep into the decision-making workflows of their business. At the end of this journey is something we have termed the Cognitive Enterprise: an agile organization that is fueled by data, guided by AI insight and built for change on a hybrid cloud.

The IBM company itself has been transformed to enable our clients' digital reinvention. In my last letter to you as CEO, I will share our 2019 financial results, detail the many changes we have made to build a strong foundation for growth and prepare your company for the future, and share our plans for transitioning to new leadership in 2020.



Virginia M. Rometty
Chairman, President and
Chief Executive Officer

2019: Enabling sustainable growth

In 2019, IBM delivered a second consecutive year of revenue growth excluding the impact of currency and divestitures. We ended the year on a strong note, with accelerating revenue growth and our strongest year-to-year increase in gross profit margins in over a decade.

For the full year, the company achieved \$77.1 billion in revenue, operating gross profit margins of 48 percent and operating earnings per share of \$12.81. We had strong cash generation with net cash from operating activities of \$14.8 billion and free cash flow of \$11.9 billion. We returned \$7.1 billion in capital to our shareholders, including dividends of \$5.7 billion. This was the 24th consecutive year of raising our dividend, and the 104th consecutive year of providing one.

These results are the product of bold moves to transform your company from top to bottom, strengthening our integrated value proposition and positioning us for sustainable growth.

The new foundation of integrated value

The problems we solve for clients are complex equations that cannot be satisfied with technology alone. They require a partner that can also offer deep industry expertise and a relationship of trust.

IBM is the only company that combines the portfolio, people and sense of purpose necessary to meet today's enterprise demands. Over the last decade, we have forged the foundations of our end-to-end, integrated value proposition through a series of transformative actions.

1. Capital: A bold shift to drive innovation

Transformation requires investment. And since 2012, we have devoted significant capital to developing new capabilities. In all, we invested more than \$120 billion to transform our strategy, our portfolio and our workforce. At the same time, we returned \$97 billion to shareholders.

We invested nearly \$30 billion in capital expenditures, building our cloud and cognitive offerings and bolstering our security and services capabilities.

We have also invested \$45 billion in research and development, forging the futures of cloud, AI, blockchain and quantum computing. IBM inventors received 9,262 U.S. patents in 2019, the most ever awarded to a U.S. company. It was our 27th straight year of patent leadership.

We have bolstered our portfolio with 65 companies, including Red Hat, the largest acquisition in the history of IBM. In Red Hat, we acquired a powerful growth engine, and a company synonymous with the cloud, open source and interoperability. Its singular architecture allows clients to build an application once and run it anywhere. And it enables the seamless integration of multiple clouds, from any vendor, addressing a \$1.2 trillion hybrid cloud market opportunity.

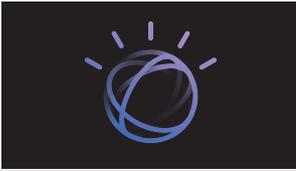
2. Portfolio: Built for the future

The shifts in capital allocation were designed to build a portfolio that is stronger and more aligned with the fastest growing segments of the market. Since 2012, we also divested businesses with annual revenues of more than \$10 billion (\$2 billion in 2019 alone) that do not strengthen our hand in Chapter 2. We did this while keeping annualized revenue growth approximately flat, excluding the impact of divestitures and currency. Today, we have reinvented 50 percent of our portfolio, including:

- **Cloud:** In 2013, cloud represented only 4 percent of IBM's revenue. Today, cloud is 27 percent—a \$21.2 billion business—and growing rapidly. In the past year, we've substantially enhanced our public cloud offerings, including dramatic improvements in ease of use, 99.999% availability and the strongest security posture in the industry. That's why clients with the most demanding regulatory and resiliency requirements, like BNP Paribas, are moving their most critical workloads to the IBM Cloud.
- **Data and AI:** Our investments in data and AI have cemented our position of enterprise market leadership. For the third straight year, IDC has named IBM the global leader in AI. We secured more than 1,800 AI patents in 2019 alone. Our Data Science Elite team is accelerating client journeys to AI. And there are more than 30,000 Watson client engagements across 20 different industries, helping clients like Yara build a digital farming platform, Woodside Energy optimize its operations and Vodafone Idea transform its core IT infrastructure.
- **Security:** IBM helps secure 95 percent of the Fortune Global 500 and manages more than 70 billion events every day. In 2019, we introduced Cloud Pak for Security, a powerful new security solution designed to solve a critical pain point in the industry: connecting and orchestrating disparate security tools.
- **Blockchain:** IBM is the global leader in enterprise blockchain solutions, with hundreds of client engagements infusing new levels of trust and transparency into the global supply chain. We have more than 2,000 blockchain experts. And we are working with more than 20 large consortium networks that are reshaping entire industries, like IBM Food Trust for reliable food supply and TradeLens for shipping.

Moments from IBM's transformation

As our company has led clients on their digital journeys, IBM has also transformed itself—through acquisitions, breakthrough technologies and social innovations.



IBM Watson

IBM Watson helped AI emerge from a long “winter” and is now deployed in customer service, healthcare, supply chain, weather forecasts, energy exploration and other fields—totaling more than 30,000 client engagements.



P-TECH

Pathways in Technology Early College High Schools (P-TECH) is a new education model co-developed by IBM working together with educators, policymakers and elected officials.



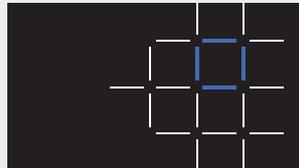
IBM Cloud

IBM Cloud has grown to be a more than \$21 billion business offering enterprises public, private and hybrid cloud solutions. In 2019, IBM introduced the world's first financial services-ready public cloud, secure and purpose-built for the industry.



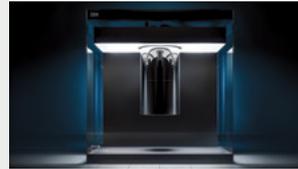
IBM Security

IBM Security was built for industry-leading compliance, threat monitoring and container security. In 2019, Cloud Pak for Security was introduced to orchestrate tools across the entire security stack.



IBM Blockchain

IBM Food Trust, TradeLens and other initiatives are streamlining supply chain processes and bringing trust and transparency to transactions.



IBM Q

A fundamentally different way of computing, quantum has the potential to transform business and solve some of the world's biggest problems. IBM has led in quantum research and development and now offers a fleet of 15 advanced quantum computers.



IBM Garage

A comprehensive approach to innovation and transformation, the IBM Garage process brings designers and developers together with clients and stakeholders. The process helps create and scale new ideas and achieve business value.



Principles for Trust & Transparency

For more than a century, IBM has earned the trust of clients and society. In 2018, we codified the core principles that guide everything we do, from handling client data to the responsible deployment of new technologies.



Red Hat

One of the largest technology acquisitions in history combined the power and flexibility of Red Hat's open hybrid cloud technologies with the scale and depth of IBM's innovation and industry expertise.



Strategic Divestitures

Over eight years, IBM has sold businesses with more than \$10 billion in revenue, including semiconductor manufacturing and x86 servers, in order to allocate capital to innovation.



Business Roundtable

In 2019, IBM signed the Business Roundtable Statement on the Purpose of a Corporation. The Business Roundtable is a group that brings together the CEOs of nearly 200 American companies.

- **IBM Services:** From digital strategy to infrastructure services, IBM Services exemplifies the end-to-end capability of our company. Over the last 10 years, we have built the world’s largest digital agency, with 57 studios and 17,000 IBM iX digital consultants. And we have scaled our global delivery network, with services professionals that have breadth of experience and industry expertise in areas like financial services, telecommunications and supply chain, around the world.
- **IBM Systems:** The recently launched IBM z15 is our most secure and capable mainframe ever, with encryption that can be applied across hybrid cloud environments, cloud-native development capabilities and an industry-first approach to instant recovery.
- **Quantum:** In 2019, IBM introduced a 53-qubit quantum computer, the largest universal quantum computing system available for commercial use. More than 100 global clients and 200,000 registered users have run over 160 billion experiments on the IBM Quantum Computation Center’s fleet of 15 quantum systems through the cloud, including Daimler AG, JPMorgan Chase and Anthem.

3. IBMers: Talent, skills and culture

AI and other advanced technologies are changing the very nature of work. To keep up with the rate and pace of these changes, IBM has revitalized the skills of our workforce. In the last five years, the percentage of IBMers with skills of the future increased to 90 percent.

At the heart of our workforce transformation is the constant acquisition of relevant skills. To support this work, we built a platform that allows IBMers to plainly see the skills they have, and the skills they need. And we developed an AI-based, personalized learning system to help them acquire those skills. More than 26 million learning hours were logged in 2019 alone.

As important, IBM is committed to fostering a culture in which all IBMers feel they can bring their best selves to work. Diversity and inclusion are essential to our business. They fuel innovation and drive employee satisfaction. And in 2019, we achieved record diversity across all representation groups and best-in-class inclusion scores. We were again widely recognized as one of the best places to work for mothers, veterans, LGBTQ employees and more.

IBM understands that diversity is a fact, but inclusion is a choice. We have made our choice. And that is just one reason why our employee engagement score is at an all-time high, improving 17 points since 2014.

4. Speed: Changing the way we work

Today, enterprise client expectations are dictated by their consumer technology experiences. In order to match the speed of development found in consumer markets, we needed to fundamentally change the way IBM worked.

This process began with the creation of IBM Design Thinking, an enterprise-grade variant of the well-known human-centered design process. We then adopted agile development practices, to create the working conditions for small, diverse teams to solve problems and introduce new solutions quickly.

IBM has hired more than 20,000 designers. We have more than 100,000 employees working in agile methodology. And we have converted more than 10 million square feet of offices into agile workspaces.

This led to a significant change in the way our clients experience IBM today: the IBM Garage. These are dedicated, physical spaces in which clients work side by side with IBMers to co-create solutions, applying IBM Design Thinking and agile methods. They can happen anywhere in the world, in dedicated IBM spaces or client offices.

In 2019, we conducted approximately 600 engagements in which we helped clients adopt these same practices. The end result has been record Net Promoter Scores from clients across all IBM businesses.

5. Good tech: A model of responsible stewardship for the digital age

Of all the work we have done to transform IBM, I am most proud of the way in which we are defining responsible stewardship in the digital age.

At IBM, we have always taken the long view. That means grounding strategy and business decisions in core values that endure through decades of political, technological and societal change. They are:

- Dedication to every client’s success.
- Innovation that matters, for our company and for the world.
- Trust and personal responsibility in all relationships.

Leading with values is not wide-eyed altruism. It is clear-eyed business strategy. Values attract the best employees. They sustain our client relationships. And they have guided our efforts to lead the industry in modeling what “good tech” looks like.

For example, our Principles for Trust and Transparency have become the global ethical standard of digital responsibility, inspiring similar doctrine in businesses and governments around the world:

- The purpose of new technology is to augment mankind, not replace it.
- Data and the insights it yields belong only to the owner of that data.
- AI should be open, transparent and explainable.

At IBM, we consider the full impact of our technology on society. And we readily accept our leadership role in making the digital era an inclusive era.

As such, we have pioneered programs that ensure the many—not just a few—benefit from the digital economy. To that end, we substantially expanded our 21st-century apprenticeship program and P-TECH six-year high school education model in 2019. Enrollment in the apprentice program grew twice as fast as expected. And P-TECH doubled the number of participating schools to 220, in 24 countries, with a pipeline of 150,000 students.

Our Call for Code and Code and Response programs continue to scale, tapping the talents of developers to address some of society’s most intractable challenges. In 2019, 180,000 developers from 165 countries created more than 5,000 applications focused on disaster relief.

In 2019, IBM published its 29th annual IBM and the Environment Report, and advanced our environmental leadership as a founding member of the Climate Leadership Council, where we have supported a carbon tax that will reduce carbon emissions globally through market-based incentives. At the same time, we remain on track to achieve a 40 percent reduction of carbon dioxide emissions associated with our own energy consumption by 2025. In addition, IBM developed a breakthrough method of recycling polyethylene terephthalate (PET), a widely used plastic with a high carbon footprint that is difficult to recycle. IBM’s new method will make it possible for more types of PET plastic to become 100 percent recyclable, helping to reduce the 8 million tons of plastics that enter our oceans each year.

New leadership for a new era

I am enormously proud of the work we have done to transform IBM for this moment. And with the foundation for growth now in place, it is the right time for a new leader to continue this critically important journey for IBM and our clients.

As such, I have elected to retire at the end of 2020 after nearly 40 years with the company. Effective April 6, 2020, Arvind Krishna, our Senior Vice President for Cloud and Cognitive, will become the next Chief Executive Officer of IBM and a member of the Board. Jim Whitehurst, CEO of Red Hat, will become President of IBM.

Arvind is a brilliant business leader and technologist who has played a significant role in developing our key technologies including artificial intelligence, cloud, quantum computing and blockchain. And Jim is a seasoned leader who built Red Hat into the world’s leading provider of open source enterprise IT software solutions and services. Together, this dream team of technological acumen and business savvy will build on IBM’s new foundations.

As we make this transition, I want you to know that my belief in IBM and IBMers has never been stronger. It has been the privilege of my life to lead this great company during this time of significant transformation. And, most importantly, I would like to thank our employees for their tireless dedication, our clients for their trust and partnership, and our investors for their continued belief in our company and its strategy.

At IBM, we believe in the fundamental promise of technology: that when we apply science to real-world problems, we can create a tomorrow that is better than today; a tomorrow that is more sustainable, more profitable and more equitable.

And I believe that IBM is essential to fulfilling that promise.



Virginia M. Rometty
Chairman, President and Chief Executive Officer

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 non-GAAP financial measures on a continuing operations basis, including operating earnings per share, operating gross profit margin, free cash flow, and revenue adjusted for divested businesses and constant currency. The rationale for management’s use of this non-GAAP information is included on pages 26, 27 and 58 of the company’s 2019 Annual Report, which is Exhibit 13 to the Form 10-K submitted with the SEC on February 25, 2020. For reconciliation of these non-GAAP financial measures to GAAP and other information, please refer to pages 39, 46, 59 and 139 of the company’s 2019 Annual Report.