Generating Higher Value at IBM

1. Several years ago, we saw change coming.

Value was shifting in the IT industry, driven by a new computing paradigm, new client needs and the rising tide of globalization.

• Change in computing architecture was rippling across the data center and the network, to a proliferation of technology infused into all aspects of work and life.

• Companies were seeking to integrate advanced technology with their business processes and operations, not primarily to reduce costs, but to enable innovation and growth.

• Enterprises and institutions were looking to tap into skills and expertise available all over the world and to integrate their operations globally.

2. We remixed our businesses, to move to the emerging higher-value spaces.

We exited commoditizing businesses like PCs and hard disk drives, and strengthened our position in areas like service-oriented architecture (SOA), information on demand, business process services and open, modular systems for businesses of all sizes. This has changed our business mix toward higher-value segments of the industry.

2006 Segment Pretax Income Mix

- Services: 37%
- Systems and Financing: 23%
- Software: 40%

3. And we decided to become a globally integrated enterprise, in order to improve IBM’s overall productivity and to participate in the world’s growth markets.

IBM operates in 170 countries, with about 65 percent of our employees outside the U.S., including 30 percent in Asia Pacific. Our non-U.S. operations generate about 60 percent of IBM’s revenue.

2006 Employee Population by Geographic Region

- Americas: 45%
- Europe, Middle East and Africa: 30%

2006 Revenue by Geographic Region (Excludes OEM)

- Americas: 45%
- Europe, Middle East and Africa: 35%

2006 IBM Revenue Growth (Excludes PCs)

- Brazil: 19%
- China: 16%
- India: 38%
- Russia: 21%
- Total: 21%

Over the next four years, IBM expects the IT markets in Brazil, China, India and Russia to grow revenue at more than two times the worldwide rate, creating a market opportunity of more than $150 billion by 2010.
4. As a result, IBM is a higher-performing enterprise today than it was a decade ago. Our business model is more aligned with our clients’ needs and generates better earnings, profits and cash.

We have achieved record profit…
The company’s gross profit margin and pretax income margin are the highest they have been in the past 10 years.

Margins

...and record cash performance.
Cash generated from every dollar of revenue has increased 18 percent since 2003.

Net Cash from Operations, Excluding Global Financing Receivables
(Dollars in billions)

record earnings per share…
Pretax earnings from continuing operations were $13.3 billion, an increase of 9 percent. Diluted earnings per share were $6.06, up 23 percent, marking 16 straight quarters of growth.

Earnings Per Share
(From continuing operations)

5. And that has enabled us to invest in future sources of growth and provide record return to investors…

Primary Uses of Cash Over the Past Five Years
(Dollars in billions)

...while continuing to invest in R&D — more than $28 billion over the past five years.