A Decade of Generating Higher Value at IBM

1 A decade ago, we saw change coming.

The IT industry and the broader economy were being transformed by the rising tide of global integration, by a new computing model and by new client needs for integration and innovation.

The global economy was integrating. The rapidly growing nations of the developing world were making historic investments in fundamental business infrastructure. And enterprises everywhere were seeking access to global skills and growth markets.

A new computing architecture was taking shape. It was built on pervasive instrumentation and interconnectivity, open standards, unprecedented computing power and advanced analytics. This model could transform oceans of data into intelligence.

Clients were shifting their focus from productivity to innovation. By integrating advanced technology far deeper into their business operations, they sought to unlock innovation and drive growth.

2 In response, we changed the mix of our businesses...

To capture the emerging higher-value opportunities, IBM divested commoditizing businesses like personal computers and hard disk drives, and strengthened its position through strategic investments and acquisitions in areas such as analytics, next-generation data centers, cloud computing and green solutions.

From 2000 to 2009 we made 108 strategic acquisitions to strengthen our portfolio of products and offerings. This has changed our business mix toward higher-value, more profitable segments of the industry.

<table>
<thead>
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<th>Segment Pre-tax Income* ($ in billions)</th>
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<tbody>
<tr>
<td>2000**</td>
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<tr>
<td>2.7 Hardware 1.2 Financing 4.5 Services 2.8 Software</td>
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<tr>
<td>24% 11% 40% 25%</td>
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<tr>
<td>2009</td>
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<tr>
<td>1.4 Hardware 1.7 Financing 8.1 Services 8.1 Software</td>
</tr>
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<td>7% 9% 42% 42%</td>
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*Sum of external segment pre-tax income not equal to IBM pre-tax income
**Excludes Enterprise Investments and stock-based compensation
Since 2005, global integration has enabled IBM to cut expenses by $5 billion and improve service quality, speed and risk management in very dynamic environments. We have shifted resources toward building client relationships and employee skills, while positioning IBM for new market opportunities, such as business analytics, smarter cities and the large-scale infrastructure build-outs underway in emerging markets. During this period, IBM has pioneered a new operating model, changing from a classic “multinational,” with smaller versions of the parent company replicated in countries around the world, to a global model with one set of processes, shared services and broadly distributed decision making, carried out by a highly skilled global workforce managed by a common set of values.

... and became a globally integrated enterprise, leveraging our scale to capture new growth.

Globally Integrated Enterprise
(21st century)
Locates operations and functions anywhere in the world based on the right cost, skills and business environment.

Multinational
(mid-20th century)
Creates smaller versions of itself in countries around the world and makes heavy local investments.

International
(mid-19th to early 20th century)
Most operations are centered in the home country, with overseas sales and distribution.

Globally Integrated Operations
IBM’s shift to a globally integrated model allowed the company to refocus our country organizations on generating growth and serving clients. Currently, nine out of every ten employees in our country organizations are focused on providing our clients with high-value, high-margin solutions. In the globally integrated model, even the smallest of our emerging country teams can leverage IBM’s global scale and expertise to deliver value of a depth and breadth unattainable in a multinational construct.

Growth Markets Share of Geographic Revenue
In 2009, Growth Markets—defined as those countries with the potential to grow at above-average rates over the coming decade—represented 19 percent of IBM’s geographic revenue and grew 8 points faster than Major Markets.
4 As a result, IBM today is a higher-performing enterprise.

Our business model is more aligned with our clients’ needs and generates better financial results.

We have achieved record earnings per share ...

Diluted earnings per share in 2009 were $10.01, marking seven consecutive years of double-digit growth. Pre-tax earnings from continuing operations were $18.1 billion, an increase of 9 percent.

... and record cash performance.

In 2009 our free cash flow, excluding the year-to-year change in Global Financing receivables, was $15.1 billion—an increase of $800 million from 2008.

Earnings Per Share

Financial Performance History

($ in billions)

Note: 2005–2008 EPS reflects the adoption of amendments to ASC 260, “Earnings Per Share”

5 We have therefore been able to invest in future sources of growth and provide record return to shareholders ...

Primary Uses of Cash

From 2000 to 2009

$161 billion

Reinvested

$96 billion

Returned to Shareholders

$65 billion

Acquisitions & Capital Expenditures

Share Repurchases & Dividends

... while continuing to invest in R&D—more than $56 billion from 2000 to 2009.
This has resulted in strong, steady performance in the current economic environment...

The transformation of our company has allowed us to achieve consistently strong results since 2002. And despite a challenging economy over the last two years, we reached the target of our 2010 EPS road map of $10 to $11 one year ahead of schedule.

Key Drivers for 2010

**Historical revenue growth**
We maintain historical revenue growth through annuity businesses, global presence and a balanced business mix.

**Margin expansion**
We focus on delivering higher value to clients and on increasing productivity, to improve profitability.

**Share repurchases**
Our strong cash generation lets us return value to shareholders by reducing shares outstanding while reinvesting for future growth.

**Growth initiatives and future acquisitions**
We invest in key growth initiatives and strategic acquisitions to complement and scale our product portfolio.

**Retirement-related costs**
Retirement-related costs vary based on market performance and plan redesigns.

*Note: 2006–2008 EPS reflects the adoption of amendments to ASC 260, “Earnings Per Share”*
... and our investments position us for growth in the next decade—the Decade of Smart.

We are focusing on four major growth opportunities in 2010:

**Growth markets:** IBM serves clients in more than 170 countries around the world. In both mature and growth economies, infrastructure represents a major technology and business opportunity, with more than $2 trillion in fiscal stimulus earmarked by governments.

**Analytics:** Enabling clients to get far more value from their information, IBM’s new analytics service line draws on 4,000 dedicated consultants, plus 200 mathematicians and advanced analytics experts in IBM Research. We have invested $10 billion in 14 acquisitions since 2005, creating seven analytics solution centers around the world.

**Cloud and next-generation data center:** These new models are enabling efficient consumption and delivery of IT-based services. More than 18 million people use LotusLive, IBM’s cloud-based collaboration suite. More than 200 IBM researchers are working on breakthroughs in areas like cloud security and privacy.

**Smarter planet:** We estimate that smarter planet increases IBM’s addressable opportunity by 40 percent over the decade ahead. The sampling on this map of recent partnerships with more than 300 clients illustrates the reach of smarter solutions across industries and markets.

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**Smarter medical research**

*Industry: Healthcare (United States)*

The University of North Carolina’s smart healthcare system allows researchers, clinicians and administrators to analyze and correlate data in new ways, leading to improved patient outcomes and compliance, and advances in research on diseases such as diabetes and cancer—shortening query times from weeks to seconds.

**Smarter microfinance**

*Industry: Banking & Financial Markets (India)*

Microfinance bank Grameen Koota uses an open-source banking platform for accurate, near-real-time information, enabling them to predict capital requirements; to expand their microloans, insurance accounts and other banking functions; and to grow from 70,000 to 350,000 low-income clients.

**Smarter oil and gas imaging**

*Industry: Chemicals & Petroleum (Venezuela)*

3-D seismic imaging technology helped Tricon Geophysics cut processing time by 50 percent and realize a 40-percent savings in power and cooling infrastructure, and operational costs.

**Smarter luggage**

*Industry: Transportation (Netherlands)*

An integrated baggage-control and passenger-check-in system at Amsterdam’s airport streamlines luggage tracking, offloading and redirection of bags on alternative flights, and fully automated security screening for all transfer baggage travelling through the airport.
Smarter mobile phone promotions
Industry: Telecommunications (Philippines)
To hold onto existing mobile phone customers and win new ones, Philippine telcos must micro-target promotions for new services, in real time. Globe Telecom’s smart Toolbox has cut the preparation time for launching service promotions from 40 weeks to three weeks, increasing Globe’s sales by 600 percent.

Smarter global financial systems
Industry: Electronics (Japan)
Panasonic’s Global Treasury System integrates financial management for 600+ subsidiaries around the world. By managing cash flow, currency exchange and settlements as a global, in-house bank, the company has significantly reduced financial costs, while giving it daily financial visibility.

Smarter patient care
Industry: Healthcare (People's Republic of China)
An intelligent medical records system at the Guang Dong Hospital of Traditional Chinese Medicine enables sharing between local facilities and large hospitals and across multiple departments. The result? Better patient care, improved diagnosis and treatment—with the promise of using deep analytics to drive cutting-edge research in global healthcare.