



2Q 2014 Earnings Presentation

July 17, 2014

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/2q14.html> The Non-GAAP Supplemental Materials are also included as Attachment II to the Company's Form 8-K dated July 17, 2014.



2Q 2014 Overview

| | <u>2Q14</u> | |
|--------------------------|-------------|--------------|
| | <u>\$</u> | <u>Yr/Yr</u> |
| Revenue | \$24.4 | (2%) |
| @CC excl. Cust. Care BPO | | (1%) |
| Operating (Non-GAAP) EPS | \$4.32 | 34% |

- 2Q and 1H results reflect portfolio dynamics:
 - Strategic imperatives deliver double-digit revenue growth
 - Core franchises stable
 - Some high value transactional businesses impacted by secular shifts
 - Divested customer care business
- Continuing investment aligned with strategic shifts of Data, Cloud, Engagement
- Expanded margins; yr/yr profit metrics reflect charge in prior year
- Continuing returns to shareholders

Continuing shift to growth and high value



Key Financial Metrics – 2Q 2014

\$ in Billions, except EPS

P&L Highlights

| | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> |
|----------------------|-------------|------------------------|
| Revenue | \$24.4 | (2%) |
| @CC | | (3%) |
| @CC excl. Cust. Care | | (1%) |
| PTI – Operating | \$5.4 | 18% |
| NI – Operating | \$4.3 | 21% |
| EPS – Operating | \$4.32 | 34% |

P&L Ratios (Operating)

| | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> |
|------------|-------------|------------------------|
| GP Margin | 49.8% | 0.1 pts |
| PTI Margin | 22.3% | 3.9 pts |
| Tax Rate | 20.0% | 2.0 pts |
| NI Margin | 17.8% | 3.5 pts |

Yr/Yr PTI and NI profit metrics reflect Workforce Rebalancing pre-tax charge of \$1B in 2Q13

Cash Highlights

| | <u>2Q14</u> | <u>Last 12 Mos.</u> |
|--------------------------------------|-------------|-------------------------|
| Free Cash Flow (excl GF Receivables) | \$3.0 | \$14.2 |
| Share Repurchase (Gross) | 3.7 | 19.5 |
| Dividends | 1.1 | 4.1 |
| Cash Balance @ June 30 | 9.7 | |



Key Financial Metrics – 1H 2014

\$ in Billions, except EPS

P&L Highlights

| | <u>1H14</u> | <u>B/(W) Yr/Yr</u> |
|-----------------------------|-------------|------------------------|
| Revenue | \$46.8 | (3%) |
| <i>@CC excl. Cust. Care</i> | | <i>(1%)</i> |
| PTI – Operating | \$8.7 | 1% |
| NI – Operating | \$7.0 | Flat |
| EPS – Operating | \$6.82 | 9% |

P&L Ratios (Operating)

| | <u>1H14</u> | <u>B/(W) Yr/Yr</u> |
|------------|-------------|------------------------|
| GP Margin | 48.7% | 0.5 pts |
| PTI Margin | 18.6% | 0.7 pts |
| Tax Rate | 20.0% | (0.2 pts) |
| NI Margin | 14.9% | 0.5 pts |

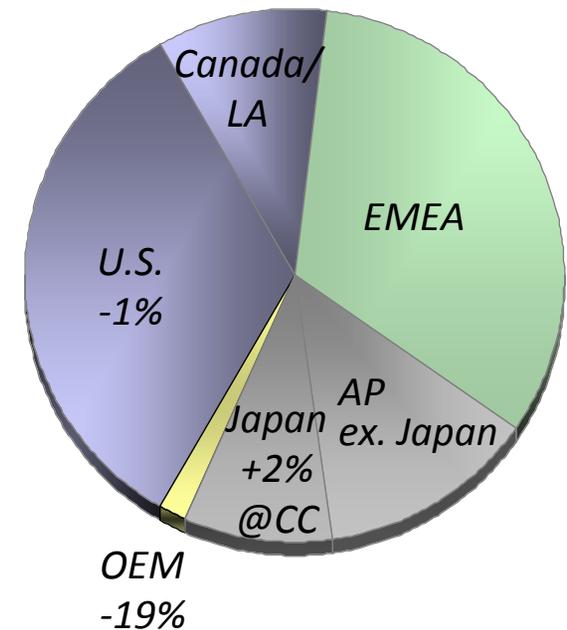
Cash Highlights

| | <u>1H14</u> |
|--------------------------------------|-------------|
| Free Cash Flow (excl GF Receivables) | \$3.6 |
| Share Repurchase (Gross) | 11.8 |
| Dividends | 2.1 |
| Cash Balance @ June 30 | 9.7 |



Revenue by Geography

| \$ in Billions | <u>B/(W) Yr/Yr</u> | | |
|-----------------------------|--------------------|-------------|-------------|
| | <u>2Q14</u> | <u>Rptd</u> | <u>@CC</u> |
| Americas | \$10.6 | (1%) | 1% |
| Europe/ME/A | 7.9 | 1% | (3%) |
| Asia Pacific | 5.3 | (9%) | (6%) |
| Total Geographies | \$23.9 | (2%) | (2%) |
| IBM | \$24.4 | (2%) | (3%) |
| <i>excl. Cust. Care BPO</i> | | <i>(1%)</i> | <i>(1%)</i> |
| <i>Major Markets</i> | | <i>Flat</i> | <i>(1%)</i> |
| <i>Growth Markets</i> | | <i>(7%)</i> | <i>(4%)</i> |
| <i>BRIC Countries</i> | | <i>(2%)</i> | <i>1%</i> |





Revenue and Gross Profit Margin by Segment

| \$ in Billions | Revenue | | | Operating Gross Profit Margin | |
|---|---------------|----------------------------|----------------------------|-------------------------------|------------------------|
| | 2Q14 | <u>B/(W) Rptd</u> | <u>Yr/Yr @CC</u> | 2Q14 | <u>B/(W) Yr/Yr Pts</u> |
| Global Technology Services <i>excl. Cust. Care BPO</i> | \$9.4 | (1%) 2% | (1%) 2% | 38.4% | 0.6 pts |
| Global Business Services | 4.5 | (2%) | (2%) | 30.0% | (1.2 pts) |
| Software | 6.5 | 1% | Flat | 88.8% | 0.0 pts |
| Systems & Technology | 3.3 | (11%) | (12%) | 33.9% | (2.8 pts) |
| Global Financing | 0.5 | 4% | 4% | 54.8% | 8.5 pts |
| Total Revenue & Op. GP Margin <i>excl. Cust. Care BPO</i> | \$24.4 | (2%) <i>(1%)</i> | (3%) <i>(1%)</i> | 49.8% | 0.1 pts |



Expense Summary

| \$ in Billions | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> | <u>B/(W) Yr/Yr Drivers</u> | | |
|---|--------------|------------------------|----------------------------|----------------|---------------|
| | | | <u>Currency</u> | <u>Acq.*</u> | <u>Base</u> |
| SG&A – Operating | \$5.5 | 16%** | 0 pts | (2 pts) | 17 pts |
| RD&E – Operating | 1.5 | 4% | 0 pts | (2 pts) | 6 pts |
| IP and Development Income | (0.2) | (23%) | | | |
| Other (Income)/Expense | (0.2) | 120% | | | |
| Interest Expense | 0.1 | (38%) | | | |
| Operating Expense & Other Income | \$6.7 | 14%** | (1 pts) | (2 pts) | 17 pts |

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

** Yr/Yr reflects Workforce Rebalancing charge of \$1.0B in 2Q13



Services Segments

Global Technology Services (GTS)

| \$ in Billions | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> | |
|---|-------------|--------------------|------------|
| | | <u>Rptd</u> | <u>@CC</u> |
| Revenue (External) <i>excl. Cust. Care BPO</i> | \$9.4 | (1%) 2% | (1%) 2% |
| Gross Margin (External) | 38.4% | 0.6 pts | |
| PTI Margin | 19.2% | 3.7 pts* | |

* GTS yr/yr reflects Workforce Rebalancing charge in 2Q13

Global Business Services (GBS)

| \$ in Billions | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> | |
|-------------------------|-------------|--------------------|------------|
| | | <u>Rptd</u> | <u>@CC</u> |
| Revenue (External) | \$4.5 | (2%) | (2%) |
| Gross Margin (External) | 30.0% | (1.2 pts) | |
| PTI Margin | 17.8% | 4.8 pts* | |

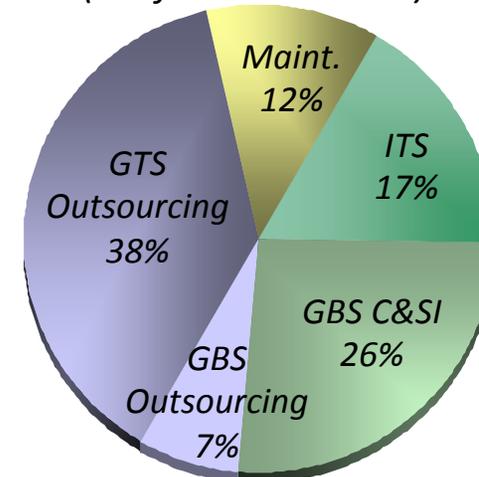
* GBS yr/yr reflects Workforce Rebalancing charge in 2Q13

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

| <u>GBS 2Q14 Revenue</u> | <u>Yr/Yr</u> | |
|----------------------------------|--------------|------------|
| | <u>Rptd</u> | <u>@CC</u> |
| GBS Outsourcing | (9%) | (9%) |
| Consulting & Systems Integration | 1% | Flat |

| | <u>2Q14</u> | <u>Yr/Yr</u> | |
|--|-------------|--------------|------------|
| | | <u>Rptd</u> | <u>@CC</u> |
| Backlog <i>adj. for Cust. Care BPO</i> | \$136B | (1%) | (3%) |

2Q14 Revenue
(% of Total Services)



Growth in total Services revenue, excluding divested business



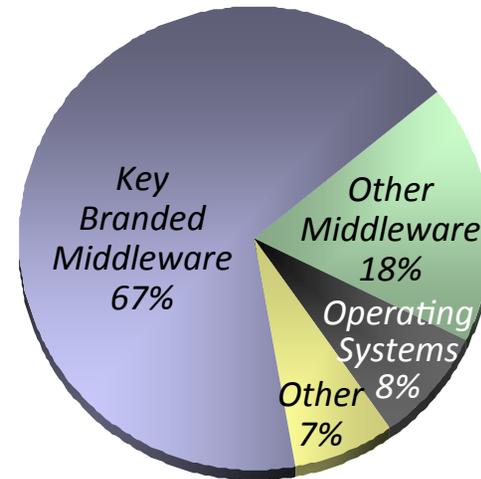
Software Segment

| \$ in Billions | <u>B/(W) Yr/Yr</u> | | |
|-------------------------|--------------------|-------------|------------|
| | <u>2Q14</u> | <u>Rptd</u> | <u>@CC</u> |
| Revenue (External) | \$6.5 | 1% | Flat |
| Gross Margin (External) | 88.8% | 0.0 pts | |
| PTI Margin | 36.5% | 2.4 pts* | |

* Yr/Yr reflects Workforce Rebalancing charge in 2Q13

| <u>2Q14 Revenue</u> | <u>Yr/Yr</u> | |
|------------------------|--------------|------------|
| | <u>Rptd</u> | <u>@CC</u> |
| WebSphere | 5% | 5% |
| Information Management | (1%) | (2%) |
| Tivoli | 4% | 3% |
| Workforce Solutions | (7%) | (8%) |
| Rational | (9%) | (10%) |
| Key Branded Middleware | 1% | Flat |
| Total Middleware | 3% | 3% |
| Total Software | 1% | Flat |

2Q14 Revenue
(% of Total Software)



Growth in Middleware; strength in strategic imperatives

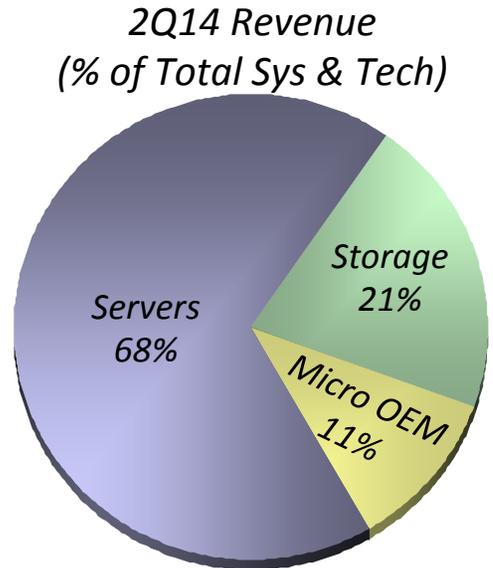


Systems & Technology Segment

| \$ in Billions | 2014 | B/(W) Yr/Yr | |
|-------------------------|-------|-------------|-------|
| | | Rptd | @CC |
| Revenue (External) | \$3.3 | (11%) | (12%) |
| Gross Margin (External) | 33.9% | (2.8 pts) | |
| PTI Margin | 0.7% | 4.3 pts* | |

* Yr/Yr reflects Workforce Rebalancing charge in 2Q13

| 2Q14 Revenue | Yr/Yr | |
|---------------------------------------|--------------|--------------|
| | Rptd | @CC |
| System z | (1%) | (1%) |
| Power Systems | (28%) | (29%) |
| System x | (3%) | (3%) |
| Storage | (12%) | (13%) |
| Total Systems | (11%) | (11%) |
| Microelectronics OEM | (18%) | (18%) |
| Total Systems & Technology | (11%) | (12%) |



Significant sequential improvement; on track to stabilize full year profit



Cash Flow Analysis

| \$ in Billions | 2014 | | YTD | |
|--|--------------|------------------------|--------------|------------------------|
| | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> | <u>2Q14</u> | <u>B/(W) Yr/Yr</u> |
| Net Cash from Operations | \$3.6 | \$0.4 | \$6.9 | (\$0.3) |
| Less: Global Financing Receivables | <u>(0.3)</u> | <u>0.1</u> | <u>1.5</u> | <u>0.4</u> |
| Net Cash from Operations (excluding GF Receivables) | 3.9 | 0.3 | 5.4 | (0.6) |
| Net Capital Expenditures | <u>(0.9)</u> | <u>0.0</u> | <u>(1.8)</u> | <u>(0.1)</u> |
| Free Cash Flow (excluding GF Receivables) | 3.0 | 0.3 | 3.6 | (0.8) |
| Acquisitions | (0.3) | (0.2) | (0.6) | (0.4) |
| Divestitures | 0.0 | 0.0 | 0.4 | 0.4 |
| Dividends | (1.1) | 0.0 | (2.1) | (0.1) |
| Share Repurchases (Gross) | (3.7) | (0.1) | (11.8) | (5.7) |
| Non-GF Debt | 1.4 | 0.5 | 5.0 | 4.8 |
| Other (includes GF A/R & GF Debt) | <u>0.7</u> | <u>1.3</u> | <u>4.1</u> | <u>1.2</u> |
| Change in Cash & Marketable Securities | \$0.0 | \$1.7 | (\$1.3) | (\$0.6) |



Balance Sheet Summary

| \$ in Billions | <u>June 13</u> | <u>Dec. 13</u> | <u>June 14</u> |
|----------------------------------|----------------|----------------|----------------|
| Cash & Marketable Securities | \$10.4 | \$11.1 | \$9.7 |
| Non-GF Assets* | 70.1 | 76.5 | 77.3 |
| Global Financing Assets | 34.7 | 38.7 | 37.3 |
| Total Assets | 115.2 | 126.2 | 124.3 |
| Other Liabilities | 63.1 | 63.6 | 60.3 |
| Non-GF Debt* | 9.3 | 12.2 | 17.1 |
| Global Financing Debt | 24.9 | 27.5 | 29.4 |
| Total Debt | 34.1 | 39.7 | 46.5 |
| Total Liabilities | 97.3 | 103.3 | 106.8 |
| Equity | 17.9 | 22.9 | 17.5 |
| Non-GF Debt / Capital | 39% | 39% | 56% |
| Global Financing Leverage | 7.2 | 7.2 | 7.1 |

* Includes eliminations of inter-company activity



1H 2014 Summary

- 1H results reflect portfolio dynamics:
 - Strategic imperatives deliver double-digit revenue growth
 - Core franchises stable
 - Some high value transactional businesses impacted by secular shifts
 - Divested customer care business

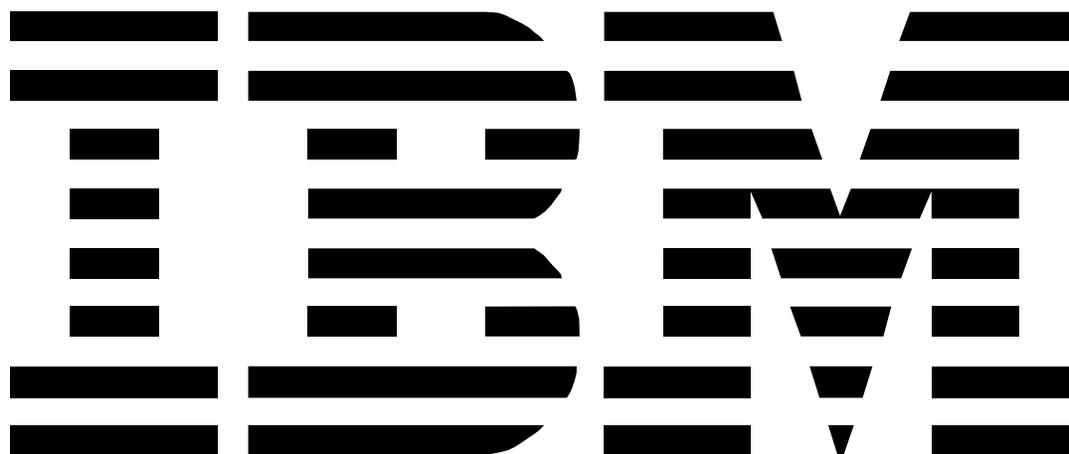
- Continuing investment aligned with strategic shifts of Data, Cloud, Engagement

- Expanded operating margins
 - Gross margin +50 bps, pre-tax margin +70 bps, net income margin +50 bps

- Continuing returns to shareholders

- Allocating capital and managing business for long-term
 - Along the way, continue to expect to deliver at least \$20.00 of Operating EPS in 2015

Continue to expect at least \$18.00 of Operating EPS in 2014



Supplemental Materials

Some columns and rows in these materials, including the supplemental exhibits, may not add due to rounding

- 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, Workforce Rebalancing,
 - Reconciliation of Operating Earnings Per Share
 - GAAP to Operating (Non-GAAP) Bridge – 2Q 2014
 - GAAP to Operating (Non-GAAP) Bridge – 2Q 2013
 - GAAP to Operating (Non-GAAP) Bridge – 2Q YTD 2014
 - GAAP to Operating (Non-GAAP) Bridge – 2Q YTD 2013
 - GAAP to Operating (Non-GAAP) Bridge – 2Q 2014 and 2Q 2013
 - GAAP to Operating (Non-GAAP) Bridge – 2Q YTD 2014 and 2Q YTD 2013
 - Reconciliation of B/(W) Yr/Yr Expense Drivers – 2Q14
 - Reconciliation of B/(W) Yr/Yr Expense Drivers – 2Q14
 - Reconciliation of Debt-to-Capital Ratio
 - Reconciliation of Free Cash Flow (excluding GF Receivables) – 12 months ended 6/30/14
 - Reconciliation of Revenue Growth

Currency – Year/Year Comparison

Quarterly Averages per US \$

| | <u>1Q14</u> | <u>Yr/Yr</u> | <u>2Q14</u> | <u>Yr/Yr</u> | <u>7/16 Spot</u> | <u>Yr/Yr @ 7/16 Spot</u> | | |
|-------|-------------|--------------|-------------|--------------|----------------------|--------------------------|-------------|-------------|
| | | | | | | <u>3Q14</u> | <u>4Q14</u> | <u>FY14</u> |
| Euro | 0.73 | 4% | 0.73 | 5% | 0.74 | 2% | (1%) | 3% |
| Pound | 0.60 | 6% | 0.59 | 9% | 0.58 | 10% | 6% | 8% |
| Yen | 103 | (11%) | 102 | (3%) | 102 | (3%) | (1%) | (5%) |

| | | | | | |
|--------------------|---------|-------|----------|--------|--------|
| IBM Revenue Impact | (2 pts) | 0 pts | ~0-1 pts | ~0 pts | ~0 pts |
|--------------------|---------|-------|----------|--------|--------|

| <u>2Q14</u> | <u>(US\$B)</u> | <u>Yr/Yr</u> |
|---------------------|----------------|--------------|
| Revenue As Reported | \$24.4 | (2%) |
| Currency Impact | (0.1) | 0 pts |
| Revenue @CC | | (3%) |

Supplemental Segment Information – 2Q 2014

Global Services Revenue

Global Services Backlog / Signings

| | <u>Revenue Growth</u> | | <u>\$ in Billions</u> | <u>Backlog</u> | | |
|--|-----------------------|------------|--|----------------|--------------|--------------|
| | <u>Yr/Yr</u> | <u>@CC</u> | | <u>2Q14</u> | <u>Yr/Yr</u> | <u>@CC</u> |
| GTS Outsourcing <i>excl. Cust. Care BPO</i> | (4%) 2% | (4%) 2% | Total Backlog <i>excl. Cust. Care BPO</i> | \$136 | (3%) (1%) | (5%) (3%) |
| Integrated Tech Services | 5% | 5% | <u>Change in Backlog due to Currency</u> | | | |
| Maintenance | (1%) | (1%) | Quarter-to-Quarter | \$1 | | |
| Total GTS <i>excl. Cust. Care BPO</i> | (1%) 2% | (1%) 2% | Year-to-Year | \$3 | | |
| GBS Outsourcing | (9%) | (9%) | Outsourcing Backlog | \$85 | (6%) | (8%) |
| GBS C&SI | 1% | Flat | <u>Signings</u> | | | |
| Total GBS | (2%) | (2%) | | <u>2Q14</u> | <u>Yr/Yr</u> | <u>@CC</u> |
| Total Outsourcing | (5%) | (5%) | Outsourcing | \$4.8 | (46%) | (46%) |
| Total Transactional | 2% | 2% | - GTS O/S, GBS O/S (AMS) | | | |
| Maintenance | (1%) | (1%) | Transactional | 6.2 | (17%) | (17%) |
| | | | - ITS, Consulting & AMS SI (incl. US Federal) | | | |
| | | | Total Signings | \$11.0 | (33%) | (33%) |

Note: Actual backlog calculated using June 30 currency spot rates

Supplemental Segment Information – 2Q 2014

Systems & Technology

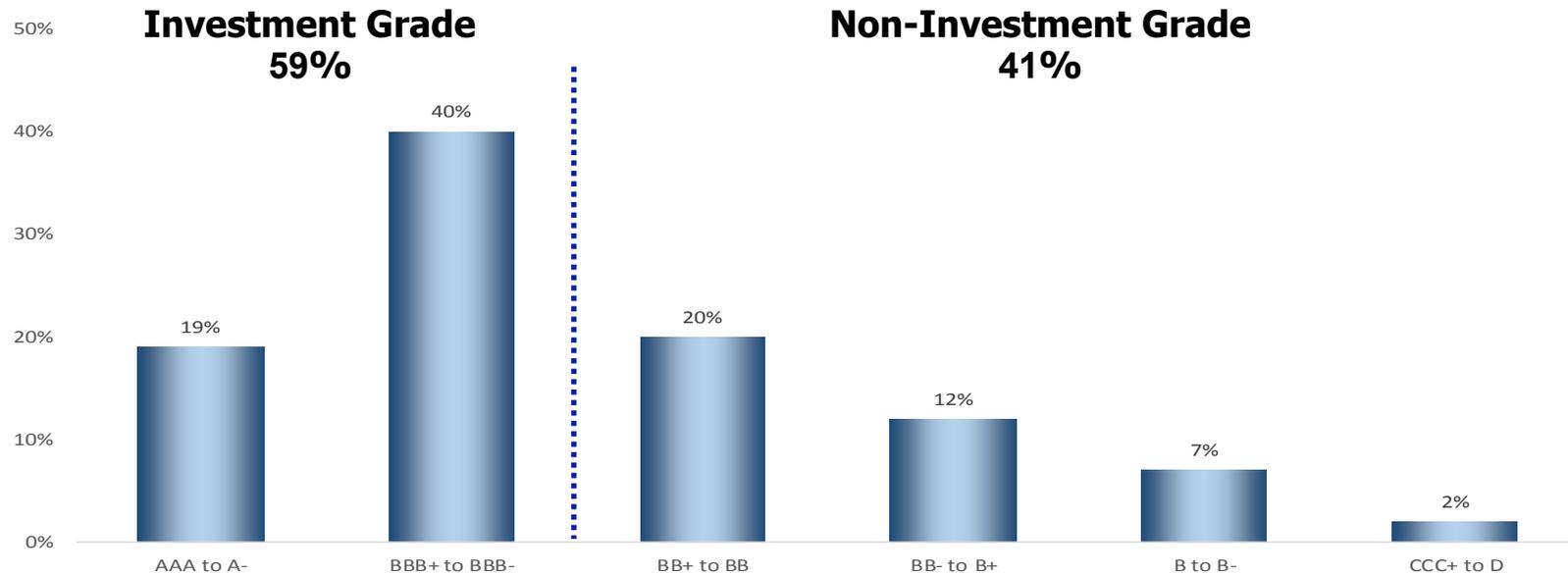
| | <u>Revenue Growth</u> | | |
|----------------------|-----------------------|------------|------------|
| | <u>Yr/Yr</u> | <u>@CC</u> | <u>GP%</u> |
| System z | (1%) | (1%) | ↑ |
| Power Systems | (28%) | (29%) | ↓ |
| System x | (3%) | (3%) | ↓ |
| Storage | (12%) | (13%) | ↓ |
| Total Systems | (11%) | (11%) | ↓ |
| Microelectronics OEM | (18%) | (18%) | |
| Total Sys & Tech | (11%) | (12%) | |

Software

| | <u>Revenue Growth</u> | |
|-------------------------|-----------------------|--------------|
| | <u>Yr/Yr</u> | <u>@CC</u> |
| WebSphere | 5% | 5% |
| Information Management | (1%) | (2%) |
| Tivoli | 4% | 3% |
| Workforce Solutions | (7%) | (8%) |
| Rational | <u>(9%)</u> | <u>(10%)</u> |
| Key Branded Middleware | 1% | Flat |
| Other Middleware | <u>16%</u> | <u>15%</u> |
| Total Middleware | 3% | 3% |
| Operating Systems | (13%) | (13%) |
| Other Software/Services | <u>(8%)</u> | <u>(8%)</u> |
| Total Software | 1% | Flat |

Global Financing Portfolio

2Q14 – \$30.1B Net External Receivables



| | <u>2Q14</u> | <u>1Q14</u> | <u>2Q13</u> |
|------------------------------------|-------------|-------------|-------------|
| Identified Loss Rate | 1.1% | 1.0% | 0.8% |
| Anticipated Loss Rate | 0.4% | 0.4% | 0.4% |
| Reserve Coverage | 1.5% | 1.4% | 1.2% |
| Client Days Delinquent Outstanding | 3.8 | 3.6 | 3.4 |
| Commercial A/R > 30 Days | \$ 30 M | \$ 36 M | \$ 67 M |

Cash Flow (FAS 95)

\$ in Billions

| | <u>QTD</u> <u>2014</u> | <u>QTD</u> <u>2013</u> | <u>YTD</u> <u>2014</u> | <u>YTD</u> <u>2013</u> |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
| Net Income from Operations | \$4.1 | \$3.2 | \$6.5 | \$6.3 |
| Depreciation / Amortization of Intangibles | 1.2 | 1.1 | 2.3 | 2.3 |
| Stock-based Compensation | 0.1 | 0.2 | 0.3 | 0.3 |
| Working Capital / Other | (1.6) | (0.9) | (3.7) | (2.8) |
| Global Financing A/R | (0.3) | (0.5) | 1.5 | 1.1 |
| Net Cash provided by Operating Activities | 3.6 | 3.2 | 6.9 | 7.2 |
| Capital Expenditures, net of payments & proceeds | (0.9) | (0.9) | (1.8) | (1.7) |
| Divestitures, net of cash transferred | 0.0 | 0.0 | 0.4 | 0.0 |
| Acquisitions, net of cash acquired | (0.3) | (0.1) | (0.6) | (0.2) |
| Marketable Securities / Other Investments, net | 0.2 | 0.2 | 1.0 | 0.0 |
| Net Cash used in Investing Activities | (1.0) | (0.9) | (1.0) | (1.9) |
| Debt, net of payments & proceeds | 2.4 | 1.0 | 6.6 | 1.4 |
| Dividends | (1.1) | (1.0) | (2.1) | (2.0) |
| Common Stock Repurchases | (3.7) | (3.6) | (11.8) | (6.1) |
| Common Stock Transactions - Other | 0.1 | 0.3 | 0.4 | 0.7 |
| Net Cash used in Financing Activities | (2.3) | (3.3) | (6.9) | (6.0) |
| Effect of Exchange Rate changes on Cash | 0.0 | 0.0 | 0.0 | (0.1) |
| Net Change in Cash & Cash Equivalents | \$0.3 | (\$1.0) | (\$1.0) | (\$0.9) |

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 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 the 2015 earnings per share roadmap, 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 SYNEX 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.

Workforce Rebalancing

Management presents certain financial results excluding the effects of charges in connection with workforce rebalancing actions. 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

| | 2014 <u>Expectations</u> |
|---|-------------------------------------|
| IBM GAAP EPS | \$17.00+ |
| IBM Operating EPS (Non-GAAP) | \$18.00+ |
| <hr/> | |
| Adjustments | |
| Acquisition-Related Charges * | \$0.72 |
| Amortization of Purchased Intangibles | \$0.69 |
| Other Acquisition-Related Charges | \$0.03 |
| Non-Operating Retirement-Related Items | \$0.28 |

* Includes acquisitions through June 30, 2014

The above serves to reconcile the Non-GAAP financial information contained in “2Q 2014 Summary” discussion in the company’s earnings presentation. See Slide 22 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 – 2Q 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 | \$11,975 | \$105 | \$45 | \$12,126 |
| SG&A | 5,603 | (98) | (27) | 5,478 |
| RD&E | 1,457 | 0 | 20 | 1,477 |
| Other Income & Expense | (201) | 0 | 0 | (201) |
| Total Operating Expense & Other Income | 6,804 | (98) | (7) | 6,699 |
| Pre-Tax Income | 5,171 | 203 | 52 | 5,427 |
| Tax *** | 1,034 | 41 | 10 | 1,085 |
| Net Income | 4,137 | 163 | 42 | 4,341 |
| Diluted Earnings Per Share | \$4.12 | \$0.16 | \$0.04 | \$4.32 |

* 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 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 "2Q 2014 Overview", "Key Financial Metrics - 2Q 2014" and "Expense Summary" discussions in the company's earnings presentation. See Slide 22 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 – 2Q 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 | \$12,132 | \$91 | \$156 | \$12,379 |
| SG&A | 6,680 | (91) | (93) | 6,496 |
| RD&E | 1,548 | 0 | (13) | 1,535 |
| Other Income & Expense | (91) | 0 | 0 | (91) |
| Total Operating Expense & Other Income | 7,988 | (91) | (106) | 7,791 |
| Pre-Tax Income | 4,144 | 182 | 262 | 4,588 |
| Tax *** | 918 | 9 | 82 | 1,009 |
| Net Income | 3,226 | 173 | 180 | 3,579 |
| Diluted Earnings Per Share | \$2.91 | \$0.15 | \$0.16 | \$3.22 |

* 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 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 – 2Q 2014” and “Expense Summary” discussions in the company’s earnings presentation. See Slide 22 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 – 2Q 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 | \$22,518 | \$209 | \$98 | \$22,825 |
| SG&A | 11,892 | (196) | (114) | 11, 583 |
| RD&E | 2,958 | 0 | 37 | 2,995 |
| Other Income & Expense | (326) | 0 | 0 | (326) |
| Total Operating Expense & Other Income | 14,367 | (196) | (77) | 14,094 |
| Pre-Tax Income | 8,151 | 405 | 175 | 8,731 |
| Tax *** | 1,630 | 81 | 35 | 1,746 |
| Net Income | 6,521 | 324 | 140 | 6,985 |
| Diluted Earnings Per Share | \$6.37 | \$0.31 | \$0.14 | \$6.82 |

* 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 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 -1H 2014” discussions in the company’s earnings presentation. See Slide 22 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 – 2Q 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 | \$22,810 | \$186 | \$320 | \$23,316 |
| SG&A | 12,257 | (183) | (197) | 11,878 |
| RD&E | 3,193 | 0 | (29) | 3,163 |
| Other Income & Expense | (151) | (7) | 0 | (158) |
| Total Operating Expense & Other Income | 15,060 | (190) | (226) | 14,644 |
| Pre-Tax Income | 7,750 | 376 | 546 | 8,672 |
| Tax *** | 1,492 | 63 | 162 | 1,717 |
| Net Income | 6,258 | 313 | 384 | 6,955 |
| Diluted Earnings Per Share | \$5.60 | \$0.28 | \$0.35 | \$6.23 |

* 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 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 – 1H 2014” discussions in the company’s earnings presentation. See Slide 22 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 – 2Q 2014 and 2Q 2013

| <u>2Q 2014</u> | <u>GAAP</u> | <u>Acquisition- related Adjustments*</u> | <u>Retirement- related Adjustments **</u> | <u>Operating (Non-GAAP)</u> |
|---------------------|-------------|--|---|---------------------------------|
| Gross Profit Margin | 49.1% | 0.4 pts | 0.2 pts | 49.8% |
| PTI Margin | 21.2% | 0.8 pts | 0.2 pts | 22.3% |
| Tax Rate *** | 20.0% | 0.0 pts | 0.0 pts | 20.0% |
| Net Income Margin | 17.0% | 0.7 pts | 0.2 pts | 17.8% |

| <u>2Q 2013</u> | <u>GAAP</u> | <u>Acquisition- related Adjustments*</u> | <u>Retirement- related Adjustments **</u> | <u>Operating (Non-GAAP)</u> |
|---------------------|-------------|--|---|---------------------------------|
| Gross Profit Margin | 48.7% | 0.4 pts | 0.6 pts | 49.7% |
| PTI Margin | 16.6% | 0.7 pts | 1.1 pts | 18.4% |
| Tax Rate *** | 22.1% | (0.7 pts) | 0.6 pts | 22.0% |
| Net Income Margin | 12.9% | 0.7 pts | 0.7 pts | 14.4% |

* 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 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 - 2Q 2014" and "1H 2014 Summary" discussions in the company's earnings presentation. See Slide 22 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 – 2Q YTD 2014 and 2Q YTD 2013

| <u>2Q 2014</u> | <u>GAAP</u> | <u>Acquisition- related Adjustments*</u> | <u>Retirement- related Adjustments **</u> | <u>Operating (Non-GAAP)</u> |
|---------------------|-------------|--|---|---------------------------------|
| Gross Profit Margin | 48.1% | 0.4 pts | 0.2 pts | 48.7% |
| PTI Margin | 17.4% | 0.9 pts | 0.4 pts | 18.6% |
| Tax Rate *** | 20.0% | 0.0 pts | 0.0 pts | 20.0% |
| Net Income Margin | 13.9% | 0.7 pts | 0.3 pts | 14.9% |
| | | | | |
| <u>2Q 2013</u> | | | | |
| Gross Profit Margin | 47.2% | 0.4 pts | 0.7 pts | 48.2% |
| PTI Margin | 16.0% | 0.8 pts | 1.1 pts | 17.9% |
| Tax Rate *** | 19.2% | (0.1 pts) | 0.7 pts | 19.8% |
| Net Income Margin | 12.9% | 0.6 pts | 0.8 pts | 14.4% |

* 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 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 – 1H 2014" discussions in the company's earnings presentation. See Slide 22 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 – 2Q14

| | <u>GAAP</u> | <u>Non-GAAP Adjustments</u> | <u>Operating (Non-GAAP)</u> |
|----------------------------------|-------------|---------------------------------|---------------------------------|
| SG&A | | | |
| Currency | 0 pts | 0 pts | 0 pts |
| Acquisitions | (2 pts) | 0 pts | (2 pts) |
| Base | 18 pts | (1 pts) | 17 pts |
| RD&E | | | |
| Currency | 0 pts | 0 pts | 0 pts |
| Acquisitions | (2 pts) | 0 pts | (2 pts) |
| Base | 8 pts | (2 pts) | 6 pts |
| Operating Expense & Other Income | | | |
| Currency | (1 pts) | 0 pts | (1 pts) |
| Acquisitions | (2 pts) | 0 pts | (2 pts) |
| Base | 18 pts | (1 pts) | 17 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 22 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 – 2Q14

| | <u>GAAP</u> | <u>Operating (Non-GAAP)</u> |
|--------------------------------------|-------------|---------------------------------|
| Operating Expense & Other Income | | |
| Base excluding workforce rebalancing | 7 pts | 5 pts |

The above serves to reconcile the Non-GAAP financial information contained in the “Expense Summary” discussion in the company’s earnings presentation. See Slides 22-23 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>June 2014</u> | <u>March 2014</u> | <u>Dec. 2013</u> |
|-------------------------------------|------------------|-------------------|------------------|
| Non-Global Financing Debt / Capital | 56% | 55% | 39% |
| IBM Consolidated Debt / Capital | 73% | 72% | 63% |

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 23 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>6/30/14</u> |
|---|-----------------------------------|
| Net Cash from Operations | \$17.2 |
| Less: Global Financing Receivables | <u>(0.9)</u> |
| Net Cash from Operations (excluding GF Receivables) | 18.1 |
| 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 – 2Q 2014” discussion in the company’s earnings presentation. See Slide 23 of this presentation for additional information on the use of these Non-GAAP financial measures.

Non-GAAP Supplemental Materials

Reconciliation of Revenue Growth

| | <u>2Q14 Yr/Yr</u> | | <u>1Q14 Yr/Yr</u> | |
|----------------|--------------------|---------------------------------|--------------------|---------------------------------|
| | <u>As Reported</u> | <u>At Constant Currency</u> | <u>As Reported</u> | <u>At Constant Currency</u> |
| Americas | | | (4%) | (2%) |
| BRIC Countries | | | (11%) | (6%) |
| Japan | (2%) | 2% | | |

The above serves to reconcile the Non-GAAP financial information contained in the “Revenue by Geography” discussions in the company’s earnings presentation. See Slide 22 of this presentation for additional information on the use of these Non-GAAP financial measures.

