

Introduction

Thank you, Amanda. I'm Patricia Murphy, Vice President of Investor Relations at IBM and I want to thank you for joining us today on short notice. We're here to talk about an important announcement and initiatives for IBM. I'm here with Arvind Krishna, IBM's Chief Executive Officer and Jim Kavanaugh, our Senior Vice President and CFO. Given the timing of the strategic announcement, we've also provided a view of our preliminary third quarter revenue and earnings per share in the press release issued earlier today. We're still working through the details and these results are preliminary. And so we will provide a more comprehensive view during our earnings call on October 19th. So we're limiting today's discussion to the more strategic announcement.

During today's call, we'll make some forward-looking statements and these statements involve factors that could cause actual results to differ. Information regarding these factors is in the company's filings with the SEC which you can get from the SEC or from the IBM website.

Accelerating IBM's Hybrid Cloud Platform Growth Strategy

Thanks, Patricia, and thanks to all of you to join us on short notice. Today is a landmark day for our company and I'm pleased to speak with all of you first. We are redefining the future of IBM and where we will put our focus moving forward. When I first talked to you in April, I said I was focused on prioritizing growth. Specifically, I said our focus was on helping our clients on the journey to cloud and AI, winning the architectural battle in cloud with Red Hat and continually delighting our clients and delivering sustainable growth for our company. Today's announcement positions us to deliver on that commitment. Our actions will better serve the evolving needs of our clients, accelerate our hybrid cloud platform growth strategy and drive sustainable growth.

Over the last few years, we have built the foundation to capitalize on the \$1 trillion hybrid cloud opportunity and that foundation is solidly in place. The acquisition of Red Hat has established us as a leading hybrid cloud platform provider. Adoption is accelerating and we are seeing an increase in demand for our platform and capabilities. With this acceleration and digital transformation, clients' needs are changing. They are purchasing and consuming infrastructure and application services in changing ways increasingly driven by separate buying cycles, distinct selection criteria and different decision makers. As a result, we have announced the separation of our Managed Infrastructure Services business via a tax-free spin-off.

Creating Two Market Leading Companies

We're creating a new public company initially called NewCo, we will get a name eventually, which will be entirely focused on managing and modernizing client owned infrastructures.

At IBM, we are sharpening our focus as a hybrid cloud platform and AI company. We'll advance our strategy to increase investments both organic and inorganic to bring innovations to market more quickly, and we are streamlining our operations for speed. These actions benefit our clients, our employees and our shareholders and place both IBM and NewCo on an improved growth trajectory. So, we are creating two market-leading companies focused on what they do best.

IBM is an innovation-based business solving the world's most critical technology problems. We will be maniacally focused on being the best hybrid cloud platform and AI company leveraging our leading open platform, our incumbency, and our expertise to help clients with their digital transformations. With the strong foundation we have built and increased focus, IBM will deliver sustainable revenue growth.

Meanwhile, NewCo will immediately be the world's leading Managed Infrastructure Services provider with \$19 billion of revenue over the past year. It's twice the size of its nearest competitor. This will be a company with unparalleled expertise in managing the complex and mission critical infrastructures of the world's most important businesses. NewCo will work with its clients to modernize their infrastructures with next generation services and a focus on service delivery excellence and the two companies will continue to share a strong bond through strategic partnerships.

Creating Value Through Focus

But as separate businesses, each can capitalize on the respective missions creating value through focus. Both companies will have increased clarity and agility to focus on their own operating and financial models and greater freedom to partner with other providers. Both companies can better align their investments and capital allocations to their respective strategic focus areas whether that's new market opportunities or operational priorities or shareholder returns. Ultimately, this will create immense value for clients, but also for investors with an improved growth profile of both companies.

Hybrid Cloud Delivers a Generational Leap in Client Value

Let me spend a few minutes on IBM's strategic focus, specifically hybrid cloud. Our clients find that an open hybrid cloud approach is 2.5 times more valuable than relying on public cloud alone. A hybrid cloud approach leads to greater innovation, higher developer productivity, increased efficiency and a greater ability to meet regulatory and security needs.

There're two dynamics that drive value; the percentage of workload running in a cloud environment and the maturity of the platform. We have talked before about the workloads in public cloud. It'll be no more than 25 percent by the end of this year. Why is that? Most of the workloads have been limited to greenfield cloud apps and lift and shift but moving to public cloud isn't enough. To unlock more value, clients need to address their entire environment. This includes containerizing applications and changing their operating model by bringing Agile and DevSecOps into their IT estate and then fully re-platforming applications onto an integrated hybrid cloud platform.

Hybrid Cloud is a Significant Market Opportunity

The fact that hybrid cloud is \$1 trillion addressable market for IBM post-spin is largely driven by the immense value that has unlocked for clients. 90 percent of enterprises already have hybrid environments, a combination of public and private, but 75 percent of the workloads are not in public cloud, with mission critical work either on-prem or in private clouds. What's the inhibitor? Often, it's compliance and security. 60 percent of the opportunity is in highly regulated industries like banking, government, telco and healthcare. And to address these fundamental client needs, we are focused on providing a hybrid cloud platform that's open, secure and highly managed, software that can leverage the platform and expertise to manage and de-risk a journey to hybrid.

IBM has Created the Foundation to Capitalize on this Opportunity

We have built this foundation over the last few years.

In the largest part of the opportunity, software and platforms, we acquired Red Hat. We containerize our software and to unlock the value of our vast software portfolio, we launched our Cloud Paks. More recently, we acquired two companies Spanugo and WDG Automation that add key hybrid cloud and AI capabilities and we also launched the Red Hat Marketplace.

In the services space, we are all in on application modernization. We now have the largest Red Hat consulting practice and we launched OpenShift everywhere. In the infrastructure layer, we recently launched LinuxONE with OpenShift on Z and built an industry specific cloud to help our financial services clients tackle the most stringent needs of their industry.

IBM's Core Strengths and Enhanced Focus Drive Success

This foundation provides tremendous value to our clients really helping them realize the 2.5 times additional value of hybrid cloud. With Red Hat, we have the most broadly adopted hybrid cloud platform. This was recognized in Forrester's latest Wave report which named IBM's Red Hat as a leading platform by far for both developers and operators. Our platform allows clients to build once run anywhere and provides clients with the broadest access to innovation through open source. Our full stack capabilities including software and IBM Z incumbency leverage that platform. A key differentiator is our ability to meet clients where they are in terms of the IT choices they've made and then help them move along their cloud journey with our deep vertical expertise.

With today's announcements, we'll have greater focus and flexibility to move faster, innovate more freely, and invest in the future of our business. This represents an important shift in our business model. We will go from having over half our revenue in services to one where the majority will come from software and solutions. This puts us on a clear trajectory for accelerated revenue and profit growth post separation.

Strong Track Record in Hybrid Cloud

One of the best indicators of progress is to look at the pace of client adoption. I'm happy to say we have made good headway. Clients are eager to tap into open source innovation and many leading companies are leveraging our hybrid cloud platform. Bank of America leveraging our financial services cloud and our hybrid cloud platform. Verizon leveraging our hybrid cloud platform for their 5G networks and innovation. Schlumberger using our hybrid cloud platform for taking their deep vertical capabilities in oil and gas into many more markets and geographies, many other clients as you can see there across telecom, energy, financials and many other industries are taking advantage of these capabilities.

As of June, we had over 2,400 clients on our hybrid cloud platform almost tripling if you look at the last 18 months to 24 months. Deal sizes are getting larger. Number of Red Hat large deals more than doubling. GBS is driving adoption of the platform with over 200 engagements that leverage Red Hat and we are expanding our partner network with more than 300 new partners added to IBM and Red Hat's hybrid cloud ecosystem.

IBM's Integrated Capabilities Drive Adoption . . .

So, let me spend a few minutes talking about our full stack capabilities that leverage the open hybrid cloud platform. It starts with Linux. I think you'll all agree that Linux is the de facto operating system standard and market share leader. Red Hat Linux along with containers and Kubernetes provides the architectural foundation. OpenShift is our core product that captures the value and works through the entire range of clients, IT infrastructures, on-prem, public cloud, private cloud, and of course, our own Z and Power. Our infrastructure is designed for the most critical and highly regulated workloads but leverages open source innovation.

Moving up the stack, IBM's Middleware portfolio has been containerized. Our family of Cloud Paks extends capabilities with cloud-ready open software packages integrated on OpenShift. This means clients can now deploy our software anywhere OpenShift runs. OpenShift saves time and promotes scalability by enabling consistent development, security and operational flexibility to develop and consume software in a new way. We uniquely meet clients where they are.

And with GBS' deep industry expertise, we help clients on their journey whether that's modernizing and migrating applications, building cloud native apps or managing these applications in a hybrid cloud environment. The value of a platform increases with adoption and we are building a large ecosystem of partners both best-of-breed ISVs and major system integrators.

. . . with Attractive Economics Across the Stack

Now, the economics of a platform approach are compelling. Every dollar spent on the platform creates additional value above and below. A lot of investor focus is on the infrastructure providers. They do generate \$1 to \$2 for every dollar spent on the platform, but a lot of value is generated above the platform layer. Another \$3 to \$5 is spent on software and another \$6 to \$8 on the cloud services. This of course is shared by IBM and our ecosystem partners, so everyone wins, helping to lift all boats.

Expanding IBM's Ecosystem

The ecosystem provides fuel to expand our reach and accelerate adoptions. These are just a subset of the partners that are working with us. You've seen us talk about many of these in the past and we'll continue to talk about more of them in the future. A number of them were present at our large user conference Think that was held last May. And you can see this combination of both independent software vendors and system integrators and many of the most important players in the industry provide the fuel to the platform.

Accelerating IBM's Performance

So, today's announcement accelerates our hybrid cloud platform growth strategy through focus. Having a clear focus is important, but I know it's only part of our journey. To bring our ambitions to life, we're also relentlessly pushing forward on the creation of a culture that fosters learning, radical candor, curiosity, speed, innovation. This is what I call a growth and entrepreneurial mindset. At the same time, we're taking actions to simplify and optimize our operating model for speed and growth. This includes streamlining our geographic model, transforming how we go to market that allows us to better engage with and support our clients and we will continue to consolidate our shared services model.

As we execute these structural actions, we expect to take a charge of \$2.3 billion by the end of the year. The savings from these actions will increase our financial flexibility and we will reinvest them to accelerate future growth. We'll make prudent acquisitions and increase our level of organic investment in technology to add critical skills and expertise and to expand our ecosystem. Our investment will be concentrated in areas that create value for our clients; hybrid cloud, data and AI, security, and emerging technologies like quantum. The end game is accelerated growth. With a growth mindset going all-in on hybrid cloud and AI and increased investments, we expect to drive sustainable mid-single digit revenue growth over the medium term.

NewCo: The #1 Managed Infrastructure Services Company

Let me spend a few minutes a NewCo. It's already a market leader in scale and capabilities. It will be laser focused on client owned infrastructure with a comprehensive end-to-end portfolio from traditional services like hosting and networking services to transformational services of infrastructure modernization and hybrid multi-cloud management. This is a business where scale matters. NewCo has a \$60 billion services backlog. It already serves more than 4,600 clients including 75 percent of the Fortune 100. Its global reach spans 115 countries and includes 90,000 talented employees who have deep expertise across industries while doing important technology intensive work.

NewCo's Future is Compelling

NewCo will build on its core strength managing complex and mission critical infrastructures with the highest level of service delivery and reliability. It has a unique operational footprint with the strong multi-local presence and a comprehensive base of technology intensive and highly regulated clients. It has differentiated capabilities to meet their clients where they are. As a standalone company, NewCo management will be able to build a more efficient operating model focused on service delivery excellence. NewCo will have greater agility to invest in the next generation of transformational infrastructure services that will extend its leadership. I mentioned earlier that client needs are diverging. NewCo will have full autonomy when it comes to adopting its go-to-market strategy that positions itself closer to its markets and infrastructure services customers. NewCo will be able to forge tighter alliances with cloud vendors and other providers that expand its ecosystem. All this will contribute to improved margin, profit and cash generation for NewCo.

Now, let me turn it over to Jim. He will provide a lot more detail on the profile of the two companies and the transaction details.

Two Market-Leading Companies

Thank you, Arvind. We're all obviously excited about today's announcement around the acceleration of our hybrid cloud growth strategy. By establishing these two market leading companies, we're creating value through focus which is what today is all about. Let me provide more detail on the scope of these businesses and their capital structures and for this audience I'll put the scope in the context of today's segments.

For NewCo, the Managed Infrastructure Services capabilities Arvind just described are within our Global Technology Services business, and to be more specific, it's infrastructure services without the IBM Public Cloud. Post separation IBM will consist of what's in today's Cloud & Cognitive Software, Global Business Services, Systems and Global Financing segments. It will also include the infrastructure capabilities aligned to our hybrid cloud platforms strategy, that's IBM cloud and the support services for our Systems businesses, both of which today are in Global Technology Services. We talk a lot on this call about the value of focus. IBM is focused on innovation and acceleration of our clients' digital transformations, while NewCo will be focused on infrastructure management and modernization and service delivery excellence. Each business will align its capital structure, investment profile and dividend policy to its respective strategic mission and financial model.

At IBM, we will increase investment in hybrid cloud and AI to accelerate our growth while continuing to de-lever toward a ratio consistent with a single A credit rating. NewCo will be focused on operational efficiency and cash flow generation. While there's still work to do on the carve-out financials including the balance sheet and EBITDA, our objective is to establish NewCo as investment grade. The companies are initially expected to pay a combined quarterly dividend that is no less than our pre-spin dividend per share. Each company's dividend policy will obviously be determined by its respective board of directors. But that said, I expect IBM will remain committed to a secure dividend and a sustainable dividend growth policy.

Transaction Details

In terms of the transaction details, the separation is being executed as a spin-off to IBM's shareholders which will be tax free for US Federal income tax purposes. We expect to close it by the end of next year and it's subject to customary closing conditions. That includes the SEC Form 10 registration, a tax opinion from legal counsel, and of course, final approval from our board of directors. The transaction will result in one-time charges for items such as non-US tax and activities associated with the separation and setup of an independent NewCo company. At this point, we expect to incur cash charges of about \$1.5 billion and non-cash charges of about \$1 billion.

Between now and the end of 2021, we've got a lot of work ahead of us. We'll be preparing the financials for the new business and having them audited, filing the Form 10 and working through the public listing process while creating the structure and operations for this new entity. We will provide additional detail and information at the appropriate time always in a form of transparency for you, our investors. In the meantime, we are operating as one IBM.

Summary

So before going into the Q&A, let me summarize a few key points I hope you take away. We have built a solid foundation of hybrid cloud platform and AI capabilities. We're all in on hybrid cloud platform strategy, increasing focus and investments to accelerate our performance and we're creating two market leaders with distinct strategies and value propositions. This is a win for our clients, our employees and our shareholders.

Now, I turn it over to Patricia to begin the Q&A session.