

INTERNATIONAL BUSINESS MACHINES CORP

Form 10-Q

April 24, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10 - Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED MARCH 31, 2012

1-2360

(Commission file number)

INTERNATIONAL BUSINESS MACHINES CORPORATION

(Exact name of registrant as specified in its charter)

New York

(State of incorporation)

13-0871985

(IRS employer identification number)

Armonk, New York

(Address of principal executive offices)

10504

(Zip Code)

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914-499-1900

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The registrant has 1,153,484,394 shares of common stock outstanding at March 31, 2012.

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Table of Contents**PART I - Financial Information****ITEM 1. Consolidated Financial Statements:****INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES****CONSOLIDATED STATEMENT OF EARNINGS
(UNAUDITED)**

| (Dollars in millions except per share amounts) | Three Months Ended March 31, | |
|---|------------------------------|-----------------|
| | 2012 | 2011 |
| Revenue: | | |
| Services | \$ 14,820 | \$ 14,696 |
| Sales | 9,356 | 9,387 |
| Financing | 497 | 524 |
| Total revenue | 24,673 | 24,607 |
| Cost: | | |
| Services | 9,985 | 10,116 |
| Sales | 3,325 | 3,390 |
| Financing | 244 | 243 |
| Total cost | 13,555 | 13,749 |
| Gross profit | 11,118 | 10,858 |
| Expense and other income: | | |
| Selling, general and administrative | 5,886 | 5,826 |
| Research, development and engineering | 1,601 | 1,587 |
| Intellectual property and custom development income | (255) | (262) |
| Other (income) and expense | (58) | (202) |
| Interest expense | 110 | 93 |
| Total expense and other income | 7,283 | 7,041 |
| Income before income taxes | 3,836 | 3,817 |
| Provision for income taxes | 769 | 954 |
| Net income | \$ 3,066 | \$ 2,863 |
| Earnings per share of common stock: | | |
| Assuming dilution | \$ 2.61 | \$ 2.31 |
| Basic | \$ 2.65 | \$ 2.34 |
| Weighted-average number of common shares outstanding: (millions) | | |
| Assuming dilution | 1,174.2 | 1,240.0 |
| Basic | 1,159.1 | 1,222.2 |
| Cash dividend per common share | \$ 0.75 | \$ 0.65 |

(Amounts may not add due to rounding.)

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(The accompanying notes are an integral part of the financial statements.)

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)**

| (Dollars in millions) | Three Months Ended March 31, | |
|--|------------------------------|----------|
| | 2012 | 2011 |
| Net income | \$ 3,066 | \$ 2,863 |
| Other comprehensive income/(loss), before tax: | | |
| Foreign currency translation adjustments | 387 | 477 |
| Net changes related to available-for-sale securities | | |
| Unrealized gains/(losses) arising during the period | 6 | (7) |
| Reclassification of (gains)/losses to net income | (14) | (203) |
| Subsequent changes in previously impaired securities arising during the period | 18 | 11 |
| Total net changes related to available-for-sale securities | 10 | (199) |
| Unrealized gains/(losses) on cash flow hedges | | |
| Unrealized gains/(losses) arising during the period | 51 | (237) |
| Reclassification of (gains)/losses to net income | (24) | 101 |
| Total unrealized gains/(losses) on cash flow hedges | 27 | (136) |
| Retirement-related benefit plans | | |
| Prior service costs/(credits) | 0 | (1) |
| Net (losses)/gains arising during the period | (6) | 20 |
| Curtailments and settlements | 0 | 9 |
| Amortization of prior service (credits)/cost | (37) | (39) |
| Amortization of net (gains)/losses | 619 | 473 |
| Total retirement-related benefit plans | 576 | 464 |
| Other comprehensive income/(loss), before tax | 1,000 | 606 |
| Income tax (expense)/benefit related to items of other comprehensive income | (229) | 20 |
| Other comprehensive income/(loss) | 770 | 624 |
| Total comprehensive income | \$ 3,837 | \$ 3,487 |

(Amounts may not add due to rounding)

(The accompanying notes are an integral part of the financial statements)

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(UNAUDITED)**

ASSETS

| (Dollars in millions) | At March 31, 2012 | At December 31, 2011 |
|--|----------------------|-------------------------|
| Assets: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 11,835 | \$ 11,922 |
| Marketable securities | 500 | 0 |
| Notes and accounts receivable - trade (net of allowances of \$272 in 2012 and \$256 in 2011) | 10,012 | 11,179 |
| Short-term financing receivables (net of allowances of \$282 in 2012 and \$311 in 2011) | 15,160 | 16,901 |
| Other accounts receivable (net of allowances of \$9 in 2012 and \$11 in 2011) | 1,669 | 1,481 |
| Inventories, at lower of average cost or market: | | |
| Finished goods | 696 | 589 |
| Work in process and raw materials | 2,058 | 2,007 |
| Total inventories | 2,754 | 2,595 |
| Deferred taxes | 1,617 | 1,601 |
| Prepaid expenses and other current assets | 5,299 | 5,249 |
| Total current assets | 48,847 | 50,928 |
| Property, plant and equipment | 40,441 | 40,124 |
| Less: Accumulated depreciation | 26,496 | 26,241 |
| Property, plant and equipment - net | 13,946 | 13,883 |
| Long-term financing receivables (net of allowances of \$58 in 2012 and \$38 in 2011) | 10,549 | 10,776 |
| Prepaid pension assets | 2,974 | 2,843 |
| Deferred taxes | 3,100 | 3,503 |
| Goodwill | 27,468 | 26,213 |
| Intangible assets - net | 3,641 | 3,392 |
| Investments and sundry assets | 4,822 | 4,895 |
| Total assets | \$ 115,347 | \$ 116,433 |

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)
(UNAUDITED)**

LIABILITIES AND EQUITY

| (Dollars in millions) | At March 31, 2012 | At December 31, 2011 |
|--|----------------------|-------------------------|
| Liabilities: | | |
| Current liabilities: | | |
| Taxes | \$ 2,184 | \$ 3,313 |
| Short-term debt | 6,293 | 8,463 |
| Accounts payable | 7,416 | 8,517 |
| Compensation and benefits | 4,370 | 5,099 |
| Deferred income | 13,269 | 12,197 |
| Other accrued expenses and liabilities | 4,677 | 4,535 |
| Total current liabilities | 38,209 | 42,123 |
| Long-term debt | 25,760 | 22,857 |
| Retirement and nonpension postretirement benefit obligations | 17,579 | 18,374 |
| Deferred income | 3,904 | 3,847 |
| Other liabilities | 9,112 | 8,996 |
| Total liabilities | 94,563 | 96,197 |
| Equity: | | |
| IBM stockholders' equity: | | |
| Common stock, par value \$0.20 per share, and additional paid-in capital | 48,800 | 48,129 |
| Shares authorized: 4,687,500,000 | | |
| Shares issued: 2012 - 2,188,158,632 | | |
| 2011 - 2,182,469,838 | | |
| Retained earnings | 107,036 | 104,857 |
| Treasury stock - at cost | (114,020) | (110,963) |
| Shares: 2012 - 1,034,674,238 | | |
| 2011 - 1,019,287,274 | | |
| Accumulated other comprehensive income/(loss) | (21,115) | (21,885) |
| Total IBM stockholders' equity | 20,701 | 20,138 |
| Noncontrolling interests | 82 | 97 |
| Total equity | 20,783 | 20,236 |
| Total liabilities and equity | \$ 115,347 | \$ 116,433 |

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31,**

(UNAUDITED)

| (Dollars in millions) | 2012 | 2011* |
|---|------------------|------------------|
| Cash flows from operating activities: | | |
| Net income | \$ 3,066 | \$ 2,863 |
| Adjustments to reconcile net income to cash provided by operating activities | | |
| Depreciation | 847 | 918 |
| Amortization of intangibles | 310 | 310 |
| Stock-based compensation | 168 | 170 |
| Net (gain)/loss on asset sales and other | (143) | (320) |
| Changes in operating assets and liabilities, net of acquisitions/divestitures | 43 | (147) |
| Net cash provided by operating activities | 4,291 | 3,792 |
| Cash flows from investing activities: | | |
| Payments for property, plant and equipment | (937) | (1,002) |
| Proceeds from disposition of property, plant and equipment | 95 | 87 |
| Investment in software | (160) | (143) |
| Acquisition of businesses, net of cash acquired | (1,319) | (51) |
| Non-operating finance receivables net | 636 | 541 |
| Purchases of marketable securities and other investments | (1,227) | (415) |
| Proceeds from disposition of marketable securities and other investments | 681 | 1,481 |
| Net cash provided by/(used in) investing activities | (2,230) | 498 |
| Cash flows from financing activities: | | |
| Proceeds from new debt | 3,906 | 1,054 |
| Payments to settle debt | (848) | (1,539) |
| Short-term borrowings/(repayments) less than 90 days net | (2,107) | 2,135 |
| Common stock repurchases | (3,015) | (4,045) |
| Common stock transactions other | 619 | 877 |
| Cash dividends paid | (870) | (795) |
| Net cash used in financing activities | (2,316) | (2,314) |
| Effect of exchange rate changes on cash and cash equivalents | 167 | 126 |
| Net change in cash and cash equivalents | (87) | 2,102 |
| Cash and cash equivalents at January 1 | 11,922 | 10,661 |
| Cash and cash equivalents at March 31 | \$ 11,835 | \$ 12,763 |

* Reclassified to conform with 2012 presentation.

(Amounts may not add due to rounding.)

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(The accompanying notes are an integral part of the financial statements.)

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**INTERNATIONAL BUSINESS MACHINES CORPORATION
AND SUBSIDIARY COMPANIES**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(UNAUDITED)

| (Dollars in millions) | Common Stock and Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income/(Loss) | Total IBM Stockholders Equity | Non- Controlling Interests | Total Equity |
|--|---|----------------------|-------------------|--|-------------------------------------|----------------------------------|-----------------|
| Equity - January 1, 2012 | \$ 48,129 | \$ 104,857 | \$ (110,963) | \$ (21,885) | \$ 20,138 | \$ 97 | \$ 20,236 |
| Net income plus other comprehensive income/(loss) | | | | | | | |
| Net income | | 3,066 | | | 3,066 | | 3,066 |
| Other comprehensive income/(loss) | | | | 770 | 770 | | 770 |
| Total comprehensive income/(loss) | | | | | \$ 3,837 | | \$ 3,837 |
| Cash dividends declared common stock | | (870) | | | (870) | | (870) |
| Common stock issued under employee plans (5,688,794 shares) | 495 | | | | 495 | | 495 |
| Purchases (864,073 shares) and sales (1,021,123 shares) of treasury stock under employee plans net | | (18) | (54) | | (72) | | (72) |
| Other treasury shares purchased, not retired (15,544,014 shares) | | | (3,003) | | (3,003) | | (3,003) |
| Changes in other equity | 176 | | | | 176 | | 176 |
| Changes in noncontrolling interests | | | | | | (15) | (15) |
| Equity - March 31, 2012 | \$ 48,800 | \$ 107,036 | \$ (114,020) | \$ (21,115) | \$ 20,701 | \$ 82 | \$ 20,783 |

| (Dollars in millions) | Common Stock and Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income/(Loss) | Total IBM Stockholders Equity | Non- Controlling Interests | Total Equity |
|---|---|----------------------|-------------------|--|-------------------------------------|----------------------------------|-----------------|
| Equity - January 1, 2011 | \$ 45,418 | \$ 92,532 | \$ (96,161) | \$ (18,743) | \$ 23,046 | \$ 126 | \$ 23,172 |
| Net income plus other comprehensive income/(loss) | | | | | | | |
| Net income | | 2,863 | | | 2,863 | | 2,863 |
| Other comprehensive income/(loss) | | | | 624 | 624 | | 624 |
| Total comprehensive income/(loss) | | | | | \$ 3,487 | | \$ 3,487 |

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| | | | | | | | | |
|--|-----------|-----------|--------------|-------------|-----------|--------|------|---------|
| Cash dividends declared common stock | | (795) | | | (795) | | | (795) |
| Common stock issued under employee plans (7,388,468 shares) | 784 | | | | 784 | | | 784 |
| Purchases (528,947 shares) and sales (1,813,043 shares) of treasury stock under employee plans net | | (9) | 102 | | 93 | | | 93 |
| Other treasury shares purchased, not retired (25,465,909 shares) | | | (4,019) | | (4,019) | | | (4,019) |
| Changes in other equity | 75 | | | | 75 | | | 75 |
| Changes in noncontrolling interests | | | | | | | (22) | (22) |
| Equity - March 31, 2011 | \$ 46,278 | \$ 94,590 | \$ (100,078) | \$ (18,119) | \$ 22,671 | \$ 104 | \$ | 22,776 |

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

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Notes to Consolidated Financial Statements:

1. Basis of Presentation: The accompanying Consolidated Financial Statements and footnotes of the International Business Machines Corporation (IBM or the company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial statements and footnotes are unaudited. In the opinion of the company's management, these statements include all adjustments, which are of a normal recurring nature, necessary to present a fair statement of the company's results of operations, financial position and cash flows.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the assets, liabilities, revenue, costs, expenses and accumulated other comprehensive income/(loss) that are reported in the Consolidated Financial Statements and accompanying disclosures. Actual results may be different. See the company's 2011 Annual Report on pages 58 to 61 for a discussion of the company's critical accounting estimates.

Interim results are not necessarily indicative of financial results for a full year. The information included in this Form 10-Q should be read in conjunction with the company's 2011 Annual Report.

Noncontrolling interest amounts in income of \$3.6 million and \$2.6 million, net of tax, for the three months ended March 31, 2012 and 2011, respectively, are included in the Consolidated Statement of Earnings within the other (income) and expense line item. Additionally, changes to noncontrolling interests which are presented in the Consolidated Statement of Changes in Equity on page 8 were \$(15) million and \$(22) million for the three months ended March 31, 2012 and 2011, respectively.

Within the financial statements and tables presented, certain columns and rows may not add due to the use of rounded numbers for disclosure purposes. Percentages presented are calculated from the underlying whole-dollar amounts. Certain prior year amounts have been reclassified to conform to the current year presentation. This is annotated where applicable.

2. Accounting Changes: In May 2011, the Financial Accounting Standards Board (FASB) issued amended guidance and disclosure requirements for fair value measurements. These amendments did not have a material impact on the consolidated financial results. These changes became effective January 1, 2012 on a prospective basis. See Note 3, Financial Instruments on pages 9 to 13 for fair value disclosures.

3. Financial Instruments:

Fair Value Measurements

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Accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under this guidance, the company is required to classify certain assets and liabilities based on the following fair value hierarchy:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that can be accessed at the measurement date;
- Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 Unobservable inputs for the asset or liability.

The guidance requires the use of observable market data if such data is available without undue cost and effort.

When available, the company uses unadjusted quoted market prices in active markets to measure the fair value and classifies such items within Level 1. If quoted market prices are not available, fair value is based upon internally developed models that use current market-based or independently sourced market parameters such as interest rates and currency rates. Items valued using internally generated models are classified according to the lowest level input or value driver that is significant to the valuation.

The determination of fair value considers various factors including interest rate yield curves and time value underlying the financial instruments. For derivatives and debt securities, the company uses a discounted cash flow analysis using discount rates commensurate with the duration of the instrument.

In determining the fair value of financial instruments, the company considers certain market valuation adjustments to the base valuations calculated using the methodologies described below for several parameters that market participants would consider in determining fair value:

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Notes to Consolidated Financial Statements (continued)

- Counterparty credit risk adjustments are applied to financial instruments, taking into account the actual credit risk of a counterparty as observed in the credit default swap market to determine the true fair value of such an instrument.
- Credit risk adjustments are applied to reflect the company's own credit risk when valuing all liabilities measured at fair value. The methodology is consistent with that applied in developing counterparty credit risk adjustments, but incorporates the company's own credit risk as observed in the credit default swap market.

As an example, the fair value of derivatives is derived utilizing a discounted cash flow model that uses observable market inputs such as known notional value amounts, yield curves, spot and forward exchange rates as well as discount rates. These inputs relate to liquid, heavily traded currencies with active markets which are available for the full term of the derivative.

Certain financial assets are measured at fair value on a nonrecurring basis. These assets include equity method investments that are recognized at fair value at the measurement date to the extent that they are deemed to be other-than-temporarily impaired. Certain assets that are measured at fair value on a recurring basis can be subject to nonrecurring fair value measurements. These assets include available-for-sale equity investments that are deemed to be other-than-temporarily impaired. In the event of an other-than-temporary impairment of a financial investment, fair value is measured using a model described above.

Non-financial assets such as property, plant and equipment, land, goodwill and intangible assets are also subject to nonrecurring fair value measurements if they are deemed to be impaired. The impairment models used for nonfinancial assets depend on the type of asset. See Note A, Significant Accounting Policies, on pages 76 to 86 in the company's 2011 Annual Report for further information. There were no material impairments of non-financial assets for the three months ended March 31, 2012 and 2011, respectively.

Accounting guidance permits the measurement of eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. This election is irrevocable. The company does not apply the fair value option to any eligible assets or liabilities.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

The following tables present the company's financial assets and financial liabilities that are measured at fair value on a recurring basis at March 31, 2012 and December 31, 2011.

| (Dollars in millions) At March 31, 2012 | Level 1 | Level 2 | Level 3 | Total |
|--|-----------------|-----------------|------------|---------------------|
| Assets: | | | | |
| Cash equivalents(1) | | | | |
| Time deposits and certificates of deposit | \$ | \$ | 1,604 | \$ 1,604 |
| Commercial paper | | 1,016 | | 1,016 |
| Money market funds | 1,171 | | | 1,171 |
| U.S. government securities | | 3,200 | | 3,200 |
| Canada government securities | | 1,454 | | 1,454 |
| Other securities | | 1 | | 1 |
| Total | 1,171 | 7,275 | | 8,446(6) |
| Debt securities - current (2) | | 500 | | 500(6) |
| Debt securities - noncurrent (3) | 1 | 7 | | 8 |
| Available-for-sale equity investments(3) | 27 | 32 | | 59 |
| Derivative assets (4) | | | | |
| Interest rate contracts | | 756 | | 756 |
| Foreign exchange contracts | | 393 | | 393 |
| Equity contracts | | 30 | | 30 |
| Total | | 1,179 | | 1,179(7) |
| Total assets | \$ 1,199 | \$ 8,993 | \$ | \$ 10,192(7) |
| Liabilities: | | | | |
| Derivative liabilities (5) | | | | |
| Foreign exchange contracts | \$ | \$ | 315 | \$ 315 |
| Equity contracts | | | 4 | 4 |
| Total liabilities | \$ | \$ | 319 | \$ 319(7) |

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.

(2) U.S. government securities reported as marketable securities in the Consolidated Statement of Financial Position.

(3) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

(4) The gross balances of derivative assets contained within prepaid expenses and other current assets, and investments and sundry assets in the Consolidated Statement of Financial Position at March 31, 2012 are \$451 million and \$728 million, respectively.

(5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at March 31, 2012 are \$223 million and \$96 million, respectively.

(6) Available-for-sale securities with carrying values that approximate fair value.

(7) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by \$230 million each.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

| (Dollars in millions) | | | | | |
|---|-----------------|-----------------|----------------|--------------|-----------------|
| At December 31, 2011 | Level 1 | Level 2 | Level 3 | Total | |
| Assets: | | | | | |
| Cash equivalents(1) | | | | | |
| Time deposits and certificates of deposit | \$ | \$ | 2,082 | \$ | 2,082 |
| Commercial paper* | | | 777 | | 777 |
| Money market funds | 1,886 | | | | 1,886 |
| U.S. government securities | | | 2,750 | | 2,750 |
| Canada government securities* | | | 983 | | 983 |
| Other securities | | | 8 | | 8 |
| Total | 1,886 | | 6,600 | | 8,486(5) |
| Debt securities - noncurrent (2) | 1 | | 7 | | 8 |
| Available-for-sale equity investments(2) | 69 | | 14 | | 83 |
| Derivative assets (3) | | | | | |
| Interest rate contracts | | | 783 | | 783 |
| Foreign exchange contracts | | | 510 | | 510 |
| Equity contracts | | | 7 | | 7 |
| Total | | | 1,300 | | 1,300(6) |
| Total assets | \$ 1,956 | \$ 7,921 | \$ | \$ | 9,877(6) |
| Liabilities: | | | | | |
| Derivative liabilities (4) | | | | | |
| Foreign exchange contracts | \$ | \$ | 523 | \$ | 523 |
| Equity contracts | | | 8 | | 8 |
| Total liabilities | \$ | \$ | 531 | \$ | 531(6) |

* Reclassified to conform with 2012 presentation.

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.

(2) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

(3) The gross balances of derivative assets contained within prepaid expenses and other current assets, and investments and sundry assets in the Consolidated Statement of Financial Position at December 31, 2011 are \$546 million and \$754 million, respectively.

(4) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at December 31, 2011 are \$365 million and \$166 million, respectively.

(5) Available-for-sale securities with carrying values that approximate fair value.

(6) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by \$324 million each.

There were no transfers between Levels 1 and 2 for the three months ended March 31, 2012 and for the year ended December 31, 2011.

Financial Assets and Liabilities Not Measured at Fair Value

Short-Term Receivables and Payables

Notes and other accounts receivable and other investments are financial assets with carrying values that approximate fair value. Accounts payable, other accrued expenses and short-term debt (excluding the current portion of long-term debt) are financial liabilities with carrying values that approximate fair value. If measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy.

Loans and Long-term Receivables

Fair values are based on discounted future cash flows using current interest rates offered for similar loans to clients with similar credit ratings for the same remaining maturities. At March 31, 2012 and December 31, 2011, the difference between the carrying amount and estimated fair value for loans and long-term receivables was immaterial. If measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

Long-term Debt

Fair value of publicly-traded long-term debt is based on quoted market prices for the identical liability when traded as an asset in an active market. For other long-term debt for which a quoted market price is not available, an expected present value technique that uses rates currently available to the company for debt with similar terms and remaining maturities is used to estimate fair value. The carrying amount of long-term debt is \$25,760 million and \$22,857 million and the estimated fair value is \$28,415 million and \$27,383 million at March 31, 2012 and December 31, 2011, respectively. If measured at fair value in the financial statements, long-term debt (including the current portion) would be classified as Level 2 in the fair value hierarchy.

Debt and Marketable Equity Securities

The company's cash equivalents and current debt securities are considered available-for-sale and recorded at fair value, which is not materially different from carrying value, in the Consolidated Statement of Financial Position. The following tables summarize the company's noncurrent debt and marketable equity securities which are also considered available-for-sale and recorded at fair value in the Consolidated Statement of Financial Position.

| (Dollars in millions) At March 31, 2012: | Adjusted Cost | | Gross Unrealized Gains | | Gross Unrealized Losses | | Fair Value |
|---|------------------|----|------------------------------|----|-------------------------------|-----|---------------|
| Debt securities noncurrent(1) | \$ | 7 | \$ | 1 | \$ | | \$ 8 |
| Available-for-sale equity investments(1) | \$ | 27 | \$ | 34 | \$ | (2) | \$ 59 |

(1) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

| (Dollars in millions) At December 31, 2011: | Adjusted Cost | | Gross Unrealized Gains | | Gross Unrealized Losses | | Fair Value |
|--|------------------|----|------------------------------|----|-------------------------------|-----|---------------|
| Debt securities noncurrent(1) | \$ | 7 | \$ | 1 | \$ | | \$ 8 |
| Available-for-sale equity investments(1) | \$ | 58 | \$ | 27 | \$ | (2) | \$ 83 |

(1) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

Based on an evaluation of available evidence as of March 31, 2012, the company believes that unrealized losses on debt and marketable equity securities are temporary and do not represent a need for an other-than-temporary impairment.

Sales of debt and marketable equity securities during the period were as follows:

(Dollars in millions)

For the three months ended March 31:

| | 2012 | | 2011 | |
|--------------------------------------|------|-----|------|-----|
| Proceeds | \$ | 45 | \$ | 315 |
| Gross realized gains (before taxes) | | 14 | | 203 |
| Gross realized losses (before taxes) | | (0) | | (0) |

The after-tax net unrealized holding gains/(losses) on available-for-sale debt and marketable equity securities that have been included in other comprehensive income/(loss) for the period and the after-tax net (gains)/losses reclassified from accumulated other comprehensive income/(loss) to net income were as follows:

(Dollars in millions)

For the three months ended March 31:

| | 2012 | | 2011 | |
|---|------|-----|------|-------|
| Net unrealized gains/(losses) arising during the period | \$ | 15 | \$ | 1 |
| Net unrealized (gains)/losses reclassified to net income* | | (8) | | (124) |

* There were no significant writedowns for the three months ended March 31, 2012 and 2011.

The contractual maturities of substantially all available-for-sale debt securities are less than one year at March 31, 2012.

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Notes to Consolidated Financial Statements (continued)

Derivative Financial Instruments

The company operates in multiple functional currencies and is a significant lender and borrower in the global markets. In the normal course of business, the company is exposed to the impact of interest rate changes and foreign currency fluctuations, and to a lesser extent equity and commodity price changes and client credit risk. The company limits these risks by following established risk management policies and procedures, including the use of derivatives, and, where cost effective, financing with debt in the currencies in which assets are denominated. For interest rate exposures, derivatives are used to better align rate movements between the interest rates associated with the company's lease and other financial assets and the interest rates associated with its financing debt. Derivatives are also used to manage the related cost of debt. For foreign currency exposures, derivatives are used to better manage the cash flow volatility arising from foreign exchange rate fluctuations.

As a result of the use of derivative instruments, the company is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, the company has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors. The company's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. The right of set-off that exists under certain of these arrangements enables the legal entities of the company subject to the arrangement to net amounts due to and from the counterparty reducing the maximum loss from credit risk in the event of counterparty default.

The company is also a party to collateral security arrangements with most of its major counterparties. These arrangements require the company to hold or post collateral (cash or U.S. Treasury securities) when the derivative fair values exceed contractually established thresholds. Posting thresholds can be fixed or can vary based on credit default swap pricing or credit ratings received from the major credit agencies. The aggregate fair value of all derivative instruments under these collateralized arrangements that were in a liability position at March 31, 2012 and December 31, 2011 was \$76 million and \$131 million, respectively, for which no collateral was posted at March 31, 2012 and December 31, 2011. Full collateralization of these agreements would be required in the event that the company's credit rating falls below investment grade or if its credit default swap spread exceeds 250 basis points, as applicable, pursuant to the terms of the collateral security arrangements. The aggregate fair value of derivative instruments in net asset positions as of March 31, 2012 and December 31, 2011 was \$1,179 million and \$1,300 million, respectively. This amount represents the maximum exposure to loss at the reporting date as a result of the counterparties failing to perform as contracted. This exposure was reduced by \$230 million and \$324 million at March 31, 2012 and December 31, 2011, respectively, of liabilities included in master netting arrangements with those counterparties. Additionally, at March 31, 2012 and December 31, 2011, this exposure was reduced by \$483 million and \$466 million of collateral, respectively, received by the company.

The company does not offset derivative assets against liabilities in master netting arrangements nor does it offset receivables or payables recognized upon payment or receipt of cash collateral against the fair values of the related derivative instruments. No amount was recognized in other receivables at March 31, 2012 or December 31, 2011 for the right to reclaim cash collateral. The amount recognized in accounts payable for the obligation to return cash collateral totaled \$422 million and \$466 million at March 31, 2012 and December 31, 2011, respectively. The company restricts the use of cash collateral received to rehypothecation, and therefore reports it in prepaid expenses and other current assets in the Consolidated Statement of Financial Position. No amount was rehypothecated at March 31, 2012 or at December 31, 2011. In addition to cash collateral, the company held \$61 million in non-cash collateral, primarily in U.S. Treasury securities. Per accounting guidance, non-cash collateral is not recorded on the Statement of Financial Position.

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The company may employ derivative instruments to hedge the volatility in stockholders' equity resulting from changes in currency exchange rates of significant foreign subsidiaries of the company with respect to the U.S. dollar. These instruments, designated as net investment hedges, expose the company to liquidity risk as the derivatives have an immediate cash flow impact upon maturity which is not offset by a cash flow from the translation of the underlying hedged equity. The company monitors this cash loss potential on an ongoing basis and may discontinue some of these hedging relationships by de-designating or terminating the derivative instrument in order to manage the liquidity risk. Although not designated as accounting hedges, the company may utilize derivatives to offset the changes in the fair value of the de-designated instruments from the date of de-designation until maturity.

In its hedging programs, the company uses forward contracts, futures contracts, interest-rate swaps and cross-currency swaps, depending upon the underlying exposure. The company is not a party to leveraged derivative instruments.

A brief description of the major hedging programs, categorized by underlying risk, follows.

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Notes to Consolidated Financial Statements (continued)

Interest Rate Risk

Fixed and Variable Rate Borrowings

The company issues debt in the global capital markets, principally to fund its financing lease and loan portfolio. Access to cost-effective financing can result in interest rate mismatches with the underlying assets. To manage these mismatches and to reduce overall interest cost, the company uses interest-rate swaps to convert specific fixed-rate debt issuances into variable-rate debt (i.e., fair value hedges) and to convert specific variable-rate debt issuances into fixed-rate debt (i.e., cash flow hedges). At March 31, 2012 and December 31, 2011, the total notional amount of the company's interest rate swaps was \$5.9 billion and \$5.9 billion, respectively. The weighted-average remaining maturity of these instruments at March 31, 2012 and December 31, 2011 was approximately 5.2 years and 5.5 years, respectively.

Forecasted Debt Issuance

The company is exposed to interest rate volatility on future debt issuances. To manage this risk, the company may use forward starting interest-rate swaps to lock in the rate on the interest payments related to the forecasted debt issuance. These swaps are accounted for as cash flow hedges. The company did not have any derivative instruments relating to this program outstanding at March 31, 2012 and December 31, 2011.

At March 31, 2012 and December 31, 2011, net losses of approximately \$3 million and \$5 million (before taxes), respectively, were recorded in accumulated other comprehensive income/(loss) in connection with cash flow hedges of the company's borrowings. Within these amounts, \$5 million and \$6 million of losses are expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying transactions.

Foreign Exchange Risk

Long-Term Investments in Foreign Subsidiaries (Net Investment)

A large portion of the company's foreign currency denominated debt portfolio is designated as a hedge of net investment in foreign subsidiaries to reduce the volatility in stockholders' equity caused by changes in foreign currency exchange rates in the functional currency of major foreign subsidiaries with respect to the U.S. dollar. The company also uses cross-currency swaps and foreign exchange forward contracts for this risk management purpose. At March 31, 2012 and December 31, 2011, the total notional amount of derivative instruments designated as net investment hedges was \$4.3 billion and \$5.0 billion, respectively. The weighted-average remaining maturity of these instruments at March 31,

2012 and December 31, 2011 was approximately 0.3 years and 0.4 years, respectively.

Anticipated Royalties and Cost Transactions

The company's operations generate significant nonfunctional currency, third-party vendor payments and intercompany payments for royalties and goods and services among the company's non-U.S. subsidiaries and with the parent company. In anticipation of these foreign currency cash flows and in view of the volatility of the currency markets, the company selectively employs foreign exchange forward contracts to manage its currency risk. These forward contracts are accounted for as cash flow hedges. The maximum length of time over which the company is hedging its exposure to the variability in future cash flows is four years. At March 31, 2012 and December 31, 2011, the total notional amount of forward contracts designated as cash flow hedges of forecasted royalty and cost transactions was \$11.0 billion and \$10.9 billion, respectively, with a weighted-average remaining maturity of 0.7 years and 0.7 years, respectively.

At March 31, 2012 and December 31, 2011, in connection with cash flow hedges of anticipated royalties and cost transactions, the company recorded net gains of \$113 million and \$88 million (before taxes), respectively, in accumulated other comprehensive income/(loss). Within these amounts \$167 million and \$191 million of gains, respectively, are expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying anticipated transactions.

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Notes to Consolidated Financial Statements (continued)

Foreign Currency Denominated Borrowings

The company is exposed to exchange rate volatility on foreign currency denominated debt. To manage this risk, the company employs cross-currency swaps to convert fixed-rate foreign currency denominated debt to fixed-rate debt denominated in the functional currency of the borrowing entity. These swaps are accounted for as cash flow hedges. The maximum length of time over which the company is hedging its exposure to the variability in future cash flows is three years. At March 31, 2012 and December 31, 2011, no instruments relating to this program were outstanding.

Subsidiary Cash and Foreign Currency Asset/Liability Management

The company uses its Global Treasury Centers to manage the cash of its subsidiaries. These centers principally use currency swaps to convert cash flows in a cost-effective manner. In addition, the company uses foreign exchange forward contracts to economically hedge, on a net basis, the foreign currency exposure of a portion of the company's nonfunctional currency assets and liabilities. The terms of these forward and swap contracts are generally less than one year. The changes in the fair values of these contracts and of the underlying hedged exposures are generally offsetting and are recorded in other (income) and expense in the Consolidated Statement of Earnings. At March 31, 2012 and December 31, 2011, the total notional amount of derivative instruments in economic hedges of foreign currency exposure was \$14.0 billion and \$13.6 billion, respectively.

Equity Risk Management

The company is exposed to market price changes in certain broad market indices and in the company's own stock primarily related to certain obligations to employees. Changes in the overall value of these employee compensation obligations are recorded in selling, general and administrative (SG&A) expense in the Consolidated Statement of Earnings. Although not designated as accounting hedges, the company utilizes derivatives, including equity swaps and futures, to economically hedge the exposures related to its employee compensation obligations. The derivatives are linked to the total return on certain broad market indices or the total return on the company's common stock. They are recorded at fair value with gains or losses also reported in SG&A expense in the Consolidated Statement of Earnings. At March 31, 2012 and December 31, 2011, the total notional amount of derivative instruments in economic hedges of these compensation obligations was \$1.1 billion and \$1.0 billion, respectively.

Other Risks

The company may hold warrants to purchase shares of common stock in connection with various investments that are deemed derivatives because they contain net share or net cash settlement provisions. The company records the changes in the fair value of these warrants in other (income) and expense in the Consolidated Statement of Earnings. The company did not have any warrants qualifying as derivatives outstanding at March 31, 2012 and December 31, 2011.

The company is exposed to a potential loss if a client fails to pay amounts due under contractual terms. The company utilizes credit default swaps to economically hedge its credit exposures. These derivatives have terms of one year or less. The swaps are recorded at fair value with gains and losses reported in other (income) and expense in the Consolidated Statement of Earnings. The company did not have any derivative instruments relating to this program outstanding at March 31, 2012 and December 31, 2011.

The following tables provide a quantitative summary of the derivative and non-derivative instrument related risk management activity as of March 31, 2012 and December 31, 2011 as well as for the three months ended March 31, 2012 and 2011, respectively:

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Notes to Consolidated Financial Statements (continued)

Fair Values of Derivative Instruments in the Consolidated Statement of Financial Position

As of March 31, 2012 and December 31, 2011

| (Dollars in millions) | Fair Value of Derivative Assets | | | Fair Value of Derivative Liabilities | | |
|--|---|-----------------|-----------------|---|-----------------|-----------------|
| | Balance Sheet Classification | 3/31/2012 | 12/31/2011 | Balance Sheet Classification | 3/31/2012 | 12/31/2011 |
| Designated as hedging instruments: | | | | | | |
| Interest rate contracts: | Prepaid expenses and other current assets | \$ 56 | \$ 50 | Other accrued expenses and liabilities | \$ | \$ |
| | Investments and sundry assets | 700 | 733 | Other liabilities | | |
| Foreign exchange contracts: | Prepaid expenses and other current assets | 238 | 407 | Other accrued expenses and liabilities | 194 | 273 |
| | Investments and sundry assets | 1 | | Other liabilities | 85 | 155 |
| Fair value of derivative assets | | \$ 996 | \$ 1,190 | Fair value of derivative liabilities | \$ 280 | \$ 428 |
| Not designated as hedging instruments: | | | | | | |
| Foreign exchange contracts: | Prepaid expenses and other current assets | \$ 128 | \$ 82 | Other accrued expenses and liabilities | \$ 25 | \$ 84 |
| | Investments and sundry assets | 26 | 21 | Other liabilities | 11 | 11 |
| Equity contracts: | Prepaid expenses and other current assets | 29 | 7 | Other accrued expenses and liabilities | 4 | 8 |
| Fair value of derivative assets | | \$ 183 | \$ 110 | Fair value of derivative liabilities | \$ 39 | \$ 103 |
| Total debt designated as hedging instruments: | | | | | | |
| | Short-term debt | N/A | N/A | | \$ | \$ |
| | Long-term debt | N/A | N/A | | 2,350 | 1,884 |
| Total | | \$ 1,179 | \$ 1,300 | | \$ 2,668 | \$ 2,415 |

N/A not applicable

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Notes to Consolidated Financial Statements (continued)

The Effect of Derivative Instruments in the Consolidated Statement of Earnings

For the three months ended March 31, 2012 and 2011

| (Dollars in millions) For the three months ended March 31: | Consolidated Statement of Earnings Line Item | Gain (Loss) Recognized in Earnings Recognized on Derivatives(1) | | Attributable to Risk Being Hedged(2) | |
|---|--|---|--------|---|-------|
| | | 2012 | 2011 | 2012 | 2011 |
| Derivative instruments in fair value hedges: | | | | | |
| Interest rate contracts | Cost of financing | \$ (24) | \$ (9) | \$ 57 | \$ 52 |
| | Interest expense | (19) | (6) | 45 | 34 |
| Derivative instruments not designated as hedging instruments:(1) | | | | | |
| Foreign exchange contracts | Other (income) and expense | (81) | 87 | N/A | N/A |
| Equity contracts | SG&A expense | 98 | 59 | N/A | N/A |
| Total | | \$ (26) | \$ 131 | \$ 102 | \$ 86 |

Gain (Loss) Recognized in Earnings and Other Comprehensive Income

| For the three months ended March 31: | Effective Portion Recognized in OCI | | Consolidated Statement of Earnings Line Item | Effective Portion Reclassified from AOCI | | (Ineffectiveness) and Amounts Excluded from Effectiveness Testing(3) | |
|--|--|----------|--|---|----------|--|--------|
| | 2012 | 2011 | | 2012 | 2011 | 2012 | 2011 |
| Derivative instruments in cash flow hedges: | | | | | | | |
| Interest rate contracts | \$ | \$ | Interest expense | \$ (2) | \$ (2) | \$ | \$ |
| Foreign exchange contracts | 51 | (237) | Other (income) and expense | 20 | (47) | 1 | 0 |
| | | | Cost of sales | 5 | (34) | | |
| | | | SG&A expense | 2 | (17) | | |
| Instruments in net investment hedges(4): | | | | | | | |
| Foreign exchange contracts | (37) | (151) | Interest expense | | 0 | 2 | (1) |
| Total | \$ 12 | \$ (388) | | \$ 24 | \$ (101) | \$ 3 | \$ (1) |

N/A not applicable

Note: AOCI represents Accumulated other comprehensive income/(loss) in the Consolidated Statement of Changes in Equity.

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- (1) The amount includes changes in clean fair values of the derivative instruments in fair value hedging relationships and the periodic accrual for coupon payments required under these derivative contracts.
- (2) The amount includes basis adjustments to the carrying value of the hedged item recorded during the period and amortization of basis adjustments recorded on de-designated hedging relationships during the period.
- (3) The amount of gain (loss) recognized in income represents ineffectiveness on hedge relationships.
- (4) Instruments in net investment hedges include derivative and non-derivative instruments.

For the three months ending March 31, 2012, and 2011, there were no significant gains or losses recognized in earnings representing hedge ineffectiveness or excluded from the assessment of hedge effectiveness (for fair value hedges), or associated with an underlying exposure that did not or was not expected to occur (for cash flow hedges); nor are there any anticipated in the normal course of business.

Refer to the 2011 IBM Annual Report, Note A, Significant Accounting Policies, on pages 83 and 84 for additional information on the company's use of derivative financial instruments.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

4. Financing Receivables: The following table presents financing receivables, net of allowances for credit losses, including residual values.

| (Dollars in millions) | At March 31, 2012 | | At December 31, 2011 | |
|--|----------------------|--------|-------------------------|--------|
| <u>Current:</u> | | | | |
| Net investment in sales-type and direct financing leases | \$ | 3,819 | \$ | 3,765 |
| Commercial financing receivables | | 5,476 | | 7,095 |
| Client loan receivables | | 4,822 | | 5,195 |
| Installment payment receivables | | 1,045 | | 846 |
| Total | \$ | 15,160 | \$ | 16,901 |
| <u>Noncurrent:</u> | | | | |
| Net investment in sales-type and direct financing leases | \$ | 5,293 | \$ | 5,406 |
| Commercial financing receivables | | 7 | | 34 |
| Client loan receivables | | 4,912 | | 4,925 |
| Installment payment receivables | | 337 | | 410 |
| Total | \$ | 10,549 | \$ | 10,776 |

Net investment in sales-type and direct financing leases relates principally to the company's systems products and are for terms ranging generally from two to six years. Net investment in sales-type and direct financing leases includes unguaranteed residual values of \$730 million and \$745 million at March 31, 2012 and December 31, 2011, respectively, and is reflected net of unearned income of \$732 million and \$733 million and net of the allowance for credit losses of \$117 million and \$118 million at those dates, respectively.

Commercial financing receivables, net of allowance for credit losses of \$39 million and \$53 million at March 31, 2012 and December 31, 2011, respectively, relate primarily to inventory and accounts receivable financing for dealers and remarketers of IBM and non-IBM products. Payment terms for inventory and accounts receivable financing generally range from 30 to 90 days.

Client loan receivables, net of allowance for credit losses of \$150 million and \$126 million at March 31, 2012 and December 31, 2011, respectively, are loans that are provided by Global Financing primarily to clients to finance the purchase of IBM and non-IBM software and services. Separate contractual relationships on these financing arrangements are for terms ranging generally from one to seven years.

Installment payment receivables, net of allowance for credit losses of \$33 million and \$51 million at March 31, 2012 and December 31, 2011, respectively, are loans that are provided primarily to clients to finance IBM and non-IBM hardware, software and services ranging generally from one to three years.

Client loan receivables and installment payment receivables financing contracts are priced independently at competitive market rates. The company has a history of enforcing the terms of these separate financing agreements.

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The company utilizes certain of its financing receivables as collateral for non-recourse borrowings. Financing receivables pledged as collateral for borrowings were \$373 million and \$324 million at March 31, 2012 and December 31, 2011, respectively.

The company did not have any financing receivables held for sale as of March 31, 2012 and December 31, 2011.

Financing Receivables by Portfolio Segment

The following tables present financing receivables on a gross basis excluding the allowance for credit losses and residual value, by portfolio segment and by class, excluding current commercial financing receivables and other miscellaneous current financing receivables at March 31, 2012 and December 31, 2011. The company determines its allowance for credit losses based on two portfolio segments: lease receivables and loan receivables, and further segments the portfolio via two classes: major markets and growth markets. For additional information on the company's accounting policies for the allowance for credit losses, see the company's 2011 Annual Report beginning on page 85.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

| (Dollars in millions) At March 31, 2012 | Major Markets | Growth Markets | Total |
|--|------------------|-------------------|-----------|
| Financing receivables: | | | |
| Lease Receivables | \$ 6,446 | \$ 1,949 | \$ 8,396 |
| Loan Receivables | 8,609 | 2,726 | 11,335 |
| Ending balance | \$ 15,055 | \$ 4,675 | \$ 19,730 |
| Collectively evaluated for impairment | \$ 14,901 | \$ 4,564 | \$ 19,465 |
| Individually evaluated for impairment | \$ 155 | \$ 111 | \$ 266 |
| Allowance for credit losses: | | | |
| Beginning balance at January 1, 2012 | | | |
| Lease Receivables | \$ 79 | \$ 40 | \$ 118 |
| Loan Receivables | 125 | 64 | 189 |
| Total | \$ 203 | \$ 104 | \$ 307 |
| Write-offs | (2) | 0 | (2) |
| Provision | (2) | 5 | 3 |
| Other | 2 | 1 | 3 |
| Ending balance at March 31, 2012 | \$ 202 | \$ 109 | \$ 311 |
| Lease Receivables | \$ 74 | \$ 43 | \$ 117 |
| Loan Receivables | \$ 128 | \$ 66 | \$ 194 |
| Collectively evaluated for impairment | \$ 92 | \$ 18 | \$ 109 |
| Individually evaluated for impairment | \$ 110 | \$ 91 | \$ 202 |

| (Dollars in millions) At December 31, 2011 | Major Markets | Growth Markets | Total |
|---|------------------|-------------------|-----------|
| Financing receivables: | | | |
| Lease receivables | \$ 6,510 | \$ 1,921 | \$ 8,430 |
| Loan receivables | 9,077 | 2,552 | 11,629 |
| Ending balance | \$ 15,587 | \$ 4,472 | \$ 20,060 |
| Collectively evaluated for impairment | \$ 15,321 | \$ 4,370 | \$ 19,692 |
| Individually evaluated for impairment | \$ 266 | \$ 102 | \$ 368 |
| Allowance for credit losses: | | | |
| Beginning balance at January 1, 2011 | | | |
| Lease receivables | \$ 84 | \$ 42 | \$ 126 |
| Loan receivables | 150 | 76 | 226 |
| Total | \$ 234 | \$ 119 | \$ 353 |
| Write-offs | (68) | (16) | (84) |
| Provision | 39 | 5 | 44 |
| Other | (1) | (4) | (5) |
| Ending balance at December 31, 2011 | \$ 203 | \$ 104 | \$ 307 |
| Lease receivables | \$ 79 | \$ 40 | \$ 118 |
| Loan receivables | \$ 125 | \$ 64 | \$ 189 |
| Collectively evaluated for impairment | \$ 82 | \$ 15 | \$ 96 |
| Individually evaluated for impairment | \$ 122 | \$ 89 | \$ 211 |

When determining the allowances, financing receivables are evaluated either on an individual or a collective basis. For individually evaluated receivables, the company determines the expected cash flow for the receivable and calculates an estimate of the potential loss and the probability of loss. For those accounts in which the loss is probable, the company records a specific reserve. In addition, the company records an unallocated reserve that is determined by applying a reserve rate to its different portfolios, excluding accounts that have been specifically reserved. This reserve rate is based upon credit rating, probability of default, term, characteristics (lease/loan) and loss history.

Financing Receivables on Non-Accrual Status

Certain receivables for which the company has recorded a specific reserve may also be placed on non-accrual status. Non-accrual assets are those receivables with specific reserves and other accounts for which it is likely that the company will be unable to collect all amounts due according to original terms of the lease or loan agreement. Income recognition is discontinued on these receivables.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

The following table presents the recorded investment in financing receivables which are on non-accrual status at March 31, 2012 and December 31, 2011.

| (Dollars in millions) | At March 31, 2012 | | At December 31, 2011 | |
|-------------------------|----------------------|-----|-------------------------|-----|
| Major markets | \$ | 27 | \$ | 46 |
| Growth markets | | 21 | | 20 |
| Total lease receivables | \$ | 48 | \$ | 66 |
| Major markets | \$ | 50 | \$ | 75 |
| Growth markets | | 22 | | 24 |
| Total loan receivables | \$ | 71 | \$ | 99 |
| Total receivables | \$ | 119 | \$ | 165 |

Impaired Loans

The company considers any loan with an individually evaluated reserve as an impaired loan. Depending on the level of impairment, loans will also be placed on non-accrual status (see section Financing Receivables on Non-Accrual Status).

The following tables present impaired client loan receivables.

| (Dollars in millions) | At March 31, 2012 | | At December 31, 2011 | |
|-----------------------|------------------------|----------------------|------------------------|----------------------|
| | Recorded Investment | Related Allowance | Recorded Investment | Related Allowance |
| Major markets | \$ 86 | \$ 72 | \$ 110 | \$ 70 |
| Growth markets | 66 | 53 | 62 | 53 |
| Total | \$ 151 | \$ 125 | \$ 172 | \$ 123 |

| (Dollars in millions) | Average Recorded Investment | Interest Income Recognized* | Interest Income Recognized on Cash Basis |
|---|-----------------------------------|-----------------------------------|---|
| For the three months ended March 31, 2012: | | | |
| Major markets | \$ 98 | \$ 0 | \$ 0 |
| Growth markets | 64 | 0 | 0 |
| Total | \$ 162 | \$ 0 | \$ 0 |

* Impaired loans are placed on non-accrual status, depending on the level of impairment.

| (Dollars in millions) For the three months ended March 31, 2011: | Average Recorded Investment | Interest Income Recognized* | Interest Income Recognized on Cash Basis |
|---|-----------------------------------|-----------------------------------|---|
| Major markets | \$ 176 | \$ 0 | \$ 0 |
| Growth markets | 134 | 0 | 0 |
| Total | \$ 310 | \$ 1 | \$ 0 |

* Impaired loans are placed on non-accrual status, depending on the level of impairment.

Credit Quality Indicators

The company's credit quality indicators which are based on rating agency data, publicly available information and information provided by customers, are reviewed periodically based on the relative level of risk. The resulting indicators are a numerical rating system that maps to Moody's Investors Service credit ratings as shown below. Moody's does not provide credit ratings to the company on its customers.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

The tables below present the gross recorded investment for each class of receivables, by credit quality indicator, at March 31, 2012 and December 31, 2011. Receivables with a credit quality indicator ranging from Aaa to Baa3 are considered investment grade. All others are considered non-investment grade.

| (Dollars in millions) At March 31, 2012: | Lease Receivables | | Loan Receivables | |
|---|-------------------|----------------|------------------|----------------|
| | Major Markets | Growth Markets | Major Markets | Growth Markets |
| Credit Rating: | | | | |
| Aaa Aa3 | \$ 576 | \$ 96 | \$ 769 | \$ 135 |
| A1 A3 | 1,478 | 290 | 1,974 | 405 |
| Baa1 Baa3 | 2,214 | 727 | 2,956 | 1,017 |
| Bal Ba2 | 1,263 | 433 | 1,687 | 605 |
| Ba3 B1 | 561 | 287 | 750 | 402 |
| B2 B3 | 288 | 98 | 385 | 137 |
| Caa D | 66 | 18 | 88 | 26 |
| Total | \$ 6,446 | \$ 1,949 | \$ 8,609 | \$ 2,726 |

At March 31, 2012, the industries which made up Global Financing's receivables portfolio consist of: Financial (40 percent), Government (15 percent), Manufacturing (13 percent), Retail (9 percent), Services (7 percent), Communications (5 percent) and Other (11 percent).

| (Dollars in millions) At December 31, 2011: | Lease Receivables | | Loan Receivables | |
|--|-------------------|----------------|------------------|----------------|
| | Major Markets | Growth Markets | Major Markets | Growth Markets |
| Credit Rating: | | | | |
| Aaa Aa3 | \$ 697 | \$ 139 | \$ 971 | \$ 185 |
| A1 A3 | 1,459 | 306 | 2,034 | 407 |
| Baa1 Baa3 | 2,334 | 654 | 3,255 | 869 |
| Bal Ba2 | 1,118 | 457 | 1,559 | 607 |
| Ba3 B1 | 534 | 252 | 744 | 335 |
| B2 B3 | 260 | 97 | 362 | 129 |
| Caa D | 108 | 15 | 151 | 20 |
| Total | \$ 6,510 | \$ 1,921 | \$ 9,077 | \$ 2,552 |

At December 31, 2011, the industries which make up Global Financing's receivables portfolio consist of: Financial (39 percent), Government (15 percent), Manufacturing (13 percent), Retail (9 percent), Services (7 percent), Communications (6 percent) and Other (11 percent).

Table of Contents**Notes to Consolidated Financial Statements (continued)****Past Due Financing Receivables**

The company views receivables as past due when payment has not been received after 90 days, measured from billing date.

| (Dollars in millions) At March 31, 2012: | Total Past Due > 90 days* | Current | Total Financing Receivables | Recorded Investment > 90 Days and Accruing |
|---|---------------------------------|-----------|-----------------------------------|---|
| Major markets | \$ 9 | \$ 6,438 | \$ 6,446 | \$ 6 |
| Growth markets | 10 | 1,939 | 1,949 | 7 |
| Total lease receivables | \$ 19 | \$ 8,377 | \$ 8,396 | \$ 13 |
| Major markets | \$ 25 | \$ 8,583 | \$ 8,609 | \$ 7 |
| Growth markets | 23 | 2,703 | 2,726 | 20 |
| Total loan receivables | \$ 48 | \$ 11,287 | \$ 11,335 | \$ 27 |
| Total | \$ 66 | \$ 19,664 | \$ 19,730 | \$ 40 |

* Does not include accounts that are fully reserved.

| (Dollars in millions) At December 31, 2011: | Total Past Due > 90 days* | Current | Total Financing Receivables | Recorded Investment > 90 Days and Accruing |
|--|---------------------------------|-----------|-----------------------------------|---|
| Major markets | \$ 6 | \$ 6,504 | \$ 6,510 | \$ 6 |
| Growth markets | 9 | 1,911 | 1,921 | 6 |
| Total lease receivables | \$ 16 | \$ 8,415 | \$ 8,430 | \$ 12 |
| Major markets | \$ 23 | \$ 9,054 | \$ 9,077 | \$ 7 |
| Growth markets | 22 | 2,530 | 2,552 | 19 |
| Total loan receivables | \$ 46 | \$ 11,584 | \$ 11,629 | \$ 26 |
| Total | \$ 62 | \$ 19,998 | \$ 20,060 | \$ 38 |

* Does not include accounts that are fully reserved.

Troubled Debt Restructurings

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The company assessed all restructurings that occurred on or after January 1, 2011 and determined that there were no troubled debt restructurings for the year ended December 31, 2011 and the three months ended March 31, 2012.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

5. Stock-Based Compensation: Stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized over the employee requisite service period. The following table presents total stock-based compensation cost included in the Consolidated Statement of Earnings:

| (Dollars in millions) | 2012 | | 2011 | |
|---------------------------------------|------|------|------|------|
| For the three months ended March 31: | | | | |
| Cost | \$ | 34 | \$ | 24 |
| Selling, general and administrative | | 119 | | 130 |
| Research, development and engineering | | 15 | | 16 |
| Pre-tax stock-based compensation cost | | 168 | | 170 |
| Income tax benefits | | (60) | | (61) |
| Total stock-based compensation cost | \$ | 108 | \$ | 108 |

The decrease in pre-tax stock-based compensation cost for the three months ended March 31, 2012, as compared to the corresponding period in the prior year, was primarily due to a decrease related to the company's assumption of stock-based awards previously issued by acquired entities (\$2 million).

As of March 31, 2012, the total unrecognized compensation cost of \$1,033 million related to non-vested awards is expected to be recognized over a weighted-average period of approximately three years.

There was no significant capitalized stock-based compensation cost at March 31, 2012 and 2011.

6. Segments: The tables on page 25 reflect the results of operations of the company's segments consistent with the management and measurement system utilized within the company. Performance measurement is based on pre-tax income. These results are used, in part, by senior management, both in evaluating the performance of, and in allocating resources to, each of the segments.

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Notes to Consolidated Financial Statements (continued)

SEGMENT INFORMATION

| (Dollars in millions) | Global Services | | Software | Systems and Technology | Global Financing | Total Segments |
|---|----------------------------|--------------------------|----------|------------------------|------------------|----------------|
| | Global Technology Services | Global Business Services | | | | |
| For the three months ended March 31, 2012: | | | | | | |
| External revenue | \$ 10,035 | \$ 4,637 | \$ 5,600 | \$ 3,749 | \$ 490 | \$ 24,511 |
| Internal revenue | 293 | 182 | 840 | 151 | 485 | 1,951 |
| Total revenue | \$ 10,328 | \$ 4,820 | \$ 6,439 | \$ 3,900 | \$ 975 | \$ 26,462 |
| Pre-tax income | \$ 1,480 | \$ 601 | \$ 1,945 | \$ (105) | \$ 512 | \$ 4,434 |
| Revenue year-to-year change | 1.6% | (1.8)% | 4.9% | (8.5)% | (3.8)% | (0.1)% |
| Pre-tax income year-to-year change | 19.6% | (6.1)% | 12.1% | nm | (1.3)% | 4.0% |
| Pre-tax income margin | 14.3% | 12.5% | 30.2% | (2.7)% | 52.6% | 16.8% |
| For the three months ended March 31, 2011: | | | | | | |
| External revenue | \$ 9,863 | \$ 4,710 | \$ 5,308 | \$ 4,019 | \$ 516 | \$ 24,416 |
| Internal revenue | 307 | 200 | 830 | 244 | 497 | 2,078 |
| Total revenue | \$ 10,170 | \$ 4,910 | \$ 6,138 | \$ 4,263 | \$ 1,013 | \$ 26,494 |
| Pre-tax income | \$ 1,238 | \$ 640 | \$ 1,735 | \$ 132 | \$ 519 | \$ 4,264 |
| Pre-tax income margin | 12.2% | 13.0% | 28.3% | 3.1% | 51.3% | 16.1% |

nm not meaningful

Reconciliations to IBM as Reported:

(Dollars in millions)

For the three months ended March 31:

| | 2012 | 2011* |
|--|-----------|-----------|
| Revenue: | | |
| Total reportable segments | \$ 26,462 | \$ 26,494 |
| Eliminations of internal transactions | (1,951) | (2,078) |
| Other revenue adjustments | 162 | 190 |
| Total IBM Consolidated | \$ 24,673 | \$ 24,607 |
| Pre-tax income: | | |
| Total reportable segments | \$ 4,434 | \$ 4,264 |
| Amortization of acquired intangible assets | (166) | (159) |

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| | | | | |
|---|----|-------|----|-------|
| Acquisition-related charges | | (7) | | (7) |
| Non-operating retirement-related (costs)/income | | (102) | | (4) |
| Eliminations of internal transactions | | (284) | | (309) |
| Unallocated corporate amounts | | (39) | | 31 |
| Total IBM Consolidated | \$ | 3,836 | \$ | 3,817 |

* Reclassified to conform with 2012 presentation.

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Notes to Consolidated Financial Statements (continued)

7. Equity Activity:

Taxes Related to Items of Other Comprehensive Income

| (Dollars in millions) | Before Tax | | Tax | | Net of Tax |
|--|------------|----|------------|----|------------|
| For the three months ended March 31, 2012 | Amount | | (Expense)/ | | Amount |
| Other comprehensive income/(loss): | | | Benefit | | |
| Foreign currency translation adjustments | \$ 387 | \$ | 11 | \$ | 398 |
| Net changes related to available-for-sale securities | | | | | |
| Unrealized gains/(losses) arising during the period | \$ 6 | \$ | (2) | \$ | 4 |
| Reclassification of (gains)/losses to net income | (14) | | 5 | | (8) |
| Subsequent changes in previously impaired securities arising during the period | 18 | | (7) | | 11 |
| Total net changes related to available-for-sale securities | \$ 10 | \$ | (4) | \$ | 6 |
| Unrealized gains/(losses) on cash flow hedges | | | | | |
| Unrealized gains/(losses) arising during the period | \$ 51 | \$ | (30) | \$ | 21 |
| Reclassification of (gains)/losses to net income | (24) | | 7 | | (17) |
| Total unrealized gains/(losses) on cash flow hedges | \$ 27 | \$ | (23) | \$ | 4 |
| Retirement-related benefit plans | | | | | |
| Prior service costs/(credits) | \$ 0 | \$ | 0 | \$ | 0 |
| Net (losses)/gains arising during the period | (6) | | 2 | | (4) |
| Curtailments and settlements | 0 | | 0 | | 0 |
| Amortization of prior service (credits)/costs | (37) | | 14 | | (24) |
| Amortization of net (gains)/losses | 619 | | (229) | | 390 |
| Total retirement-related benefit plans | \$ 576 | \$ | (213) | \$ | 363 |
| Other comprehensive income/(loss) | \$ 1,000 | \$ | (229) | \$ | 770 |

| (Dollars in millions) | Before Tax | | Tax | | Net of Tax |
|--|------------|----|------------|----|------------|
| For the three months ended March 31, 2011 | Amount | | (Expense)/ | | Amount |
| Other comprehensive income/(loss): | | | Benefit | | |
| Foreign currency translation adjustments | \$ 477 | \$ | 58 | \$ | 535 |
| Net changes related to available-for-sale securities | | | | | |
| Unrealized gains/(losses) arising during the period | \$ (7) | \$ | 2 | \$ | (5) |
| Reclassification of (gains)/losses to net income | (203) | | 78 | | (124) |
| Subsequent changes in previously impaired securities arising during the period | 11 | | (4) | | 7 |
| Total net changes related to available-for-sale securities | \$ (199) | \$ | 76 | \$ | (123) |
| Unrealized gains/(losses) on cash flow hedges | | | | | |
| Unrealized gains/(losses) arising during the period | \$ (237) | \$ | 77 | \$ | (160) |
| Reclassification of (gains)/losses to net income | 101 | | (35) | | 66 |
| Total unrealized gains/(losses) on cash flow hedges | \$ (136) | \$ | 42 | \$ | (95) |
| Retirement-related benefit plans | | | | | |
| Prior service costs/(credits) | \$ (1) | \$ | 0 | \$ | 0 |
| Net (losses)/gains arising during the period | 20 | | (7) | | 14 |

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| | | | | | | |
|---|----|------|----|-------|----|------|
| Curtailments and settlements | | 9 | | (3) | | 6 |
| Amortization of prior service (credits)/costs | | (39) | | 13 | | (26) |
| Amortization of net (gains)/losses | | 473 | | (160) | | 314 |
| Total retirement-related benefit plans | \$ | 464 | \$ | (156) | \$ | 307 |
| Other comprehensive income/(loss) | \$ | 606 | \$ | 20 | \$ | 624 |

Table of Contents**Notes to Consolidated Financial Statements (continued)**

8. Retirement-Related Benefits: The company offers defined benefit pension plans, defined contribution pension plans, as well as nonpension postretirement plans primarily consisting of retiree medical benefits. The following table provides the total retirement-related benefit plans impact on income before income taxes:

| (Dollars in millions) | | | | | Yr. to Yr. Percent Change |
|---|------|-----|------|-----|---------------------------------|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Retirement-related plans cost | | | | | |
| Defined benefit and contribution pension plans cost | \$ | 532 | \$ | 432 | 23.2% |
| Nonpension postretirement plans cost | | 84 | | 86 | (1.8) |
| Total | \$ | 616 | \$ | 517 | 19.0% |

The following table provides the components of the cost/(income) for the company's pension plans:

Cost/(Income) of Pension Plans

| (Dollars in millions) | U.S. Plans | | Non-U.S. Plans | |
|--|------------|---------|----------------|-------|
| For the three months ended March 31: | 2012 | 2011 | 2012 | 2011 |
| Service cost | \$ | \$ | \$ | \$ |
| Interest cost | 550 | 620 | 450 | 454 |
| Expected return on plan assets | (1,011) | (1,015) | (580) | (620) |
| Amortization of prior service costs/(credits) | 2 | 2 | (39) | (40) |
| Recognized actuarial losses | 336 | 211 | 259 | 245 |
| Curtailments and settlements | | | 1 | 0 |
| Multi-employer plans/other costs | | | 23 | 34 |
| Total net periodic pension (income)/cost of defined benefit plans | (122) | (182) | 227 | 204 |
| Cost of defined contribution plans | 264 | 265 | 163 | 146 |
| Total defined benefit and contribution plans cost recognized in the Consolidated Statement of Earnings | \$ | \$ | \$ | \$ |
| | 142 | 82 | 390 | 349 |

In 2012, the company expects to contribute to its non-U.S. defined benefit plans approximately \$800 million, which is the legally mandated minimum contribution. Total net contributions to the non-U.S. plans in the first three months of 2012 were \$159 million.

The following table provides the components of the cost for the company's nonpension postretirement plans:

Cost of Nonpension Postretirement Plans

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| (Dollars in millions) | U.S. Plan | | | | Non-U.S. Plans | | | |
|--|-----------|----|------|----|----------------|-----|------|-----|
| For the three months ended March 31: | 2012 | | 2011 | | 2012 | | 2011 | |
| Service cost | \$ | 9 | \$ | 8 | \$ | 2 | \$ | 3 |
| Interest cost | | 49 | | 59 | | 17 | | 17 |
| Expected return on plan assets | | | | | | (3) | | (3) |
| Amortization of prior service costs/(credits) | | | | | | (1) | | (1) |
| Recognized actuarial losses | | 6 | | | | 4 | | 3 |
| Total nonpension postretirement plan cost recognized in Consolidated Statement of Earnings | \$ | 64 | \$ | 67 | \$ | 20 | \$ | 19 |

The company received a \$16.5 million subsidy in the first quarter of 2012 in connection with the Medicare Prescription Drug Improvement and Modernization Act of 2003. A portion of this amount is used by the company to reduce its obligation and expense related to the plan, and the remainder is contributed to the plan to reduce contributions required by the participants. For further information related to the Medicare Prescription Drug Act, see page 134 in the company's 2011 Annual Report.

Table of Contents**Notes to Consolidated Financial Statements (continued)****9. Acquisitions/Divestitures:**

Acquisitions: During the three months ended March 31, 2012, the company completed five acquisitions at an aggregate cost of \$1,441 million.

The Software segment completed acquisitions of the following privately held companies: Green Hat, Emptoris Inc. (Emptoris) and Worklight, and also acquired DemandTec, a publicly held company. Systems and Technology (STG) completed an acquisition of a privately held company in the first quarter: Platform Computing. All acquisitions were for 100 percent of the acquired companies.

The table below reflects the purchase price related to these acquisitions and the resulting purchase price allocations as of March 31, 2012.

| (Dollars in millions) | Amortization Life (in yrs.) | Total Acquisitions |
|--------------------------------|--------------------------------|-----------------------|
| Current assets | | \$ 169 |
| Fixed assets/noncurrent assets | | 100 |
| Intangible assets | | |
| Goodwill | N/A | 1,067 |
| Completed technology | 7 | 252 |
| Client relationships | 7 | 115 |
| In-process R&D | N/A | 9 |
| Patents/trademarks | 1-7 | 22 |
| Total assets acquired | | 1,734 |
| Current liabilities | | (104) |
| Noncurrent liabilities | | (189) |
| Total liabilities assumed | | (292) |
| Total purchase price | | \$ 1,441 |

N/A - Not applicable

Each acquisition further complemented and enhanced the company's portfolio of product and services offerings. Green Hat helps customers improve the quality of software applications by enabling developers to use cloud computing technologies to conduct testing of a software application prior to its delivery. Emptoris expands the company's cloud-based analytics offerings that provide supply chain intelligence leading to better inventory management and cost efficiencies. Worklight delivers mobile application management capabilities to clients across a wide range of industries. The acquisition enhances the company's comprehensive mobile portfolio, which is designed to help global corporations leverage the proliferation of all mobile devices from laptops and smartphones to tablets. DemandTec delivers cloud-based analytics software to help organizations improve their price, promotion and product mix within the broad context of enterprise commerce. Platform Computing's focused technical and distributed computing management software helps clients create, integrate and manage shared computing environments that are used in compute-and-data intensive applications such as simulations, computer modeling and analytics. Purchase price consideration for all acquisitions as reflected in the table above, is paid primarily in cash. All acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents.

The acquisitions were accounted for as business combinations using the acquisition method, and accordingly, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired entity was recorded at their estimated fair values at the date of acquisition. The primary items that generated the goodwill are the value of the synergies between the acquired companies and IBM and the acquired assembled work-force, neither of which qualify as an amortizable intangible asset. The overall weighted-average life of the identified amortizable intangible assets acquired is 6.9 years. These identified intangible assets will be amortized on a straight-line basis over their useful lives. Goodwill of \$1,067 million has been assigned to the Software (\$846 million) and Systems and Technology (\$221 million) segments. It is expected that none of the goodwill will be deductible for tax purposes.

Table of Contents**Notes to Consolidated Financial Statements (continued)**

On April 13, 2012, the company announced that it had entered into a definitive agreement to acquire Varicent Software Incorporated (Varicent), a privately held company based in Toronto, Canada. Varicent is a leading provider of analytics software for compensation and sales performance management. The acquisition is expected to close in the second quarter of 2012.

10. Intangible Assets Including Goodwill: The following table details the company's intangible asset balances by major asset class:

| (Dollars in millions) Intangible asset class | Gross Carrying Amount | At March 31, 2012 Accumulated Amortization | Net Carrying Amount |
|---|--------------------------|--|------------------------|
| Capitalized software | \$ 1,487 | \$ (669) | \$ 817 |
| Client relationships | 1,852 | (754) | 1,098 |
| Completed technology | 2,389 | (833) | 1,556 |
| In-process R&D | 31 | (1) | 30 |
| Patents/trademarks | 234 | (99) | 135 |
| Other(a) | 29 | (23) | 6 |
| Total | \$ 6,021 | \$ (2,380) | \$ 3,641 |

| (Dollars in millions) Intangible asset class | Gross Carrying Amount | At December 31, 2011 Accumulated Amortization | Net Carrying Amount |
|---|--------------------------|---|------------------------|
| Capitalized software | \$ 1,478 | \$ (678) | \$ 799 |
| Client relationships | 1,751 | (715) | 1,035 |
| Completed technology | 2,156 | (745) | 1,411 |
| In-process R&D | 22 | (1) | 21 |
| Patents/trademarks | 207 | (88) | 119 |
| Other(a) | 29 | (22) | 7 |
| Total | \$ 5,642 | \$ (2,250) | \$ 3,392 |

(a) Other intangibles are primarily acquired proprietary and non-proprietary business processes, methodologies and systems.

The net carrying amount of intangible assets increased \$249 million during the first quarter of 2012, primarily due to intangible asset additions, partially offset by amortization. The aggregate intangible amortization expense was \$310 million and \$310 million for the quarters ended March 31, 2012 and 2011, respectively. In addition, in the first quarter, the company retired \$180 million of fully amortized intangible assets, impacting both the gross carrying amount and accumulated amortization by this amount.

The amortization expense for each of the five succeeding years relating to intangible assets currently recorded in the Consolidated Statement of Financial Position is estimated to be the following at March 31, 2012:

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| (Dollars in millions) | Capitalized Software | | Acquired Intangibles | | Total |
|-----------------------|-------------------------|-----|-------------------------|-----|--------|
| 2012 (for Q2-Q4) | \$ | 385 | \$ | 518 | \$ 903 |
| 2013 | | 313 | | 628 | 941 |
| 2014 | | 111 | | 524 | 635 |
| 2015 | | 8 | | 397 | 405 |
| 2016 | | | | 358 | 358 |

Table of Contents**Notes to Consolidated Financial Statements (continued)**

The change in the goodwill balances by reportable segment, for the three months ended March 31, 2012 and for the year ended December 31, 2011 are as follows:

| (Dollars in millions) Segment | Balance 01/01/12 | Goodwill Additions | Purchase Price Adjustments | Divestitures | Foreign Currency Translation And Other Adjustments | Balance 3/31/12 |
|----------------------------------|---------------------|-----------------------|----------------------------------|--------------|--|--------------------|
| Global Business Services | \$ 4,313 | \$ | \$ (0) | \$ | \$ 55 | \$ 4,368 |
| Global Technology Services | 2,646 | | | | 15 | 2,661 |
| Software | 18,121 | 846 | 2 | | 110 | 19,079 |
| Systems and Technology | 1,133 | 221 | (0) | | 6 | 1,360 |
| Total | \$ 26,213 | \$ 1,067 | \$ 2 | \$ | \$ 186 | \$ 27,468 |

| (Dollars in millions) Segment | Balance 01/01/11 | Goodwill Additions | Purchase Price Adjustments | Divestitures | Foreign Currency Translation And Other Adjustments | Balance 12/31/11 |
|----------------------------------|---------------------|-----------------------|----------------------------------|--------------|--|---------------------|
| Global Business Services | \$ 4,329 | \$ 14 | \$ (0) | \$ (10) | \$ (20) | \$ 4,313 |
| Global Technology Services | 2,704 | | (1) | (2) | (55) | 2,646 |
| Software | 16,963 | 1,277 | 10 | (2) | (127) | 18,121 |
| Systems and Technology | 1,139 | | (6) | | (0) | 1,133 |
| Total | \$ 25,136 | \$ 1,291 | \$ 2 | \$ (13) | \$ (203) | \$ 26,213 |

Purchase price adjustments recorded in the first three months of 2012 and full year 2011 were related to acquisitions that were completed on or prior to December 31, 2011 or December 31, 2010, respectively, and were still subject to the measurement period that ends at the earlier of 12 months from the acquisition date or when information becomes available. There were no goodwill impairment losses recorded during the first three months of 2012 or the full year of 2011 and the company has no accumulated impairment losses.

11. Restructuring-Related Liabilities: The following table provides a roll forward of the current and noncurrent liability balances for special actions taken in the following periods: (1) the second quarter of 2005 associated with Global Services, primarily in Europe, (2) the fourth quarter of 2002 associated with the acquisition of the PricewaterhouseCoopers consulting business, (3) the second quarter of 2002 associated with the Microelectronics Division and the rebalancing of the company's workforce and leased space resources, (4) the 2002 actions associated with the hard disk drive business for reductions in workforce, manufacturing capacity and space, (5) the actions taken in 1999, and (6) the actions that were executed prior to 1994.

| (Dollars in millions) | Liability as of 01/01/12 | Payments | Other Adjustments* | Liability as of 3/31/2012 |
|-----------------------|--------------------------------|----------|-----------------------|---------------------------------|
| Current: | | | | |
| Workforce | \$ 33 | \$ (9) | \$ 8 | \$ 32 |
| Space | 4 | (1) | 1 | 4 |

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| | | | | | | | | |
|------------------|----|-----|----|------|----|---|----|-----|
| Total current | \$ | 38 | \$ | (10) | \$ | 8 | \$ | 36 |
| Noncurrent: | | | | | | | | |
| Workforce | \$ | 344 | \$ | | \$ | 7 | \$ | 351 |
| Space | | 3 | | | | | | 3 |
| Total noncurrent | \$ | 347 | \$ | | \$ | 7 | \$ | 354 |

* Principally includes the reclassification of noncurrent to current, foreign currency translation adjustments and interest accretion.

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Notes to Consolidated Financial Statements (continued)

12. Contingencies: As a company with a substantial employee population and with clients in more than 170 countries, IBM is involved, either as plaintiff or defendant, in a variety of ongoing claims, demands, suits, investigations, tax matters and proceedings that arise from time to time in the ordinary course of its business. The company is a leader in the information technology industry and, as such, has been and will continue to be subject to claims challenging its IP rights and associated products and offerings, including claims of copyright and patent infringement and violations of trade secrets and other IP rights. In addition, the company enforces its own IP against infringement, through license negotiations, lawsuits or otherwise. Also, as is typical for companies of IBM's scope and scale, the company is party to actions and proceedings in various jurisdictions involving a wide range of labor and employment issues (including matters related to contested employment decisions, country-specific labor and employment laws, and the company's pension, retirement and other benefit plans), as well as actions with respect to contracts, product liability, securities, foreign operations, competition law and environmental matters. These actions may be commenced by a number of different parties, including competitors, clients, current or former employees, government and regulatory agencies, stockholders and representatives of the locations in which the company does business. Some of the actions to which the company is party may involve particularly complex technical issues, and some actions may raise novel questions under the laws of the various jurisdictions in which these matters arise.

The company records a provision with respect to a claim, suit, investigation or proceeding when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Any recorded liabilities, including any changes to such liabilities for the quarter ended March 31, 2012 were not material to the Consolidated Financial Statements.

In accordance with the relevant accounting guidance, the company provides disclosures of matters for which the likelihood of material loss is at least reasonably possible. In addition, the company also discloses matters based on its consideration of other matters and qualitative factors, including the experience of other companies in the industry, and investor, customer and employee relations considerations.

With respect to certain of the claims, suits, investigations and proceedings discussed herein, the company believes at this time that the likelihood of any material loss is remote, given, for example, the procedural status, court rulings, and/or the strength of the company's defenses in those matters. With respect to the remaining claims, suits, investigations and proceedings discussed in this Note, the company is unable to provide estimates of reasonably possible losses or range of losses, including losses in excess of amounts accrued, if any, for the following reasons. Claims, suits, investigations and proceedings are inherently uncertain, and it is not possible to predict the ultimate outcome of these matters. It is the company's experience that damage amounts claimed in litigation against it are unreliable and unrelated to possible outcomes, and as such are not meaningful indicators of the company's potential liability. Further, the company is unable to provide such an estimate due to a number of other factors with respect to these claims, suits, investigations and proceedings, including considerations of the procedural status of the matter in question, the presence of complex or novel legal theories, and/or the ongoing discovery and development of information important to the matters. The company reviews claims, suits, investigations and proceedings at least quarterly, and decisions are made with respect to recording or adjusting provisions and disclosing reasonably possible losses or range of losses (individually or in the aggregate), to reflect the impact and status of settlement discussions, discovery, procedural and substantive rulings, reviews by counsel and other information pertinent to a particular matter.

Whether any losses, damages or remedies finally determined in any claim, suit, investigation or proceeding could reasonably have a material effect on the company's business, financial condition, results of operations or cash flows will depend on a number of variables, including: the timing and amount of such losses or damages; the structure and type of any such remedies; the significance of the impact any such losses, damages or remedies may have in the Consolidated Financial Statements; and the unique facts and circumstances of the particular matter that may give rise to additional factors. While the company will continue to defend itself vigorously, it is possible that the company's business, financial condition, results of operations or cash flows could be affected in any particular period by the resolution of one or more of these matters.

The following is a summary of the more significant legal matters involving the company.

The company is a defendant in an action filed on March 6, 2003 in state court in Salt Lake City, Utah by the SCO Group (SCO v. IBM). The company removed the case to Federal Court in Utah. Plaintiff is an alleged successor in interest to some of AT&T's UNIX IP rights, and alleges copyright infringement, unfair competition, interference with contract and breach of contract with regard to the company's distribution of AIX and Dynix and contribution of code to Linux. The company has asserted counterclaims, including breach of contract, violation of the Lanham Act, unfair competition, intentional torts, unfair and deceptive trade practices, breach of the General Public License that governs open source distributions, promissory estoppel and copyright infringement. Motions for summary judgment were heard in March 2007, and the court has not yet issued its decision. On September 14, 2007, plaintiff filed for bankruptcy protection, and all proceedings in this case were stayed. On August 25, 2009, the U.S. Bankruptcy Court for the District of Delaware approved the appointment of a Chapter

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Notes to Consolidated Financial Statements (continued)

In Trustee of SCO. The court in another suit, the SCO Group, Inc. v. Novell, Inc., held a trial in March 2010. The jury found that Novell is the owner of UNIX and UnixWare copyrights; the judge subsequently ruled that SCO is obligated to recognize Novell's waiver of SCO's claims against IBM and Sequent for breach of UNIX license agreements. On August 30, 2011, the Tenth Circuit Court of Appeals affirmed the district court's ruling and denied SCO's appeal of this matter. In November 2011, SCO filed a motion in Federal Court in Utah seeking to reopen the SCO v. IBM case.

On May 13, 2010, IBM and the State of Indiana (acting on behalf of the Indiana Family and Social Services Administration) sued one another in a dispute over a 2006 contract regarding the modernization of social service program processing in Indiana. The State terminated the contract, claiming that IBM was in breach, and the State is seeking damages. IBM believes the State's claims against it are without merit and is seeking payment of termination amounts specified in the contract. Trial began in late February 2012 in Marion County, Indiana Superior Court and concluded in early April. The parties were directed to submit post-trial briefs, after which time the court will issue its decision.

The company was named as a co-defendant in numerous purported class actions filed on and after March 18, 2011 in federal and state courts in California in connection with an information technology outsourcing agreement between Health Net, Inc. and IBM. The matters were consolidated in the United States District Court for the Eastern District of California, and plaintiffs filed a consolidated complaint on July 15, 2011. The consolidated complaint alleges that the company violated the California Confidentiality of Medical Information Act in connection with hard drives that are unaccounted for at one of Health Net's data centers in California; plaintiffs have been notified by Health Net that certain of their personal information is believed to be contained on those hard drives. Plaintiffs seek damages, as well as injunctive and declaratory relief. IBM has also received a request for information regarding this matter from the California Attorney General. On January 12, 2012, the court granted IBM's motion to dismiss the complaint for lack of standing, and on February 22, 2012, the case against IBM was dismissed.

IBM United Kingdom Limited (IBM UK) initiated legal proceedings in May 2010 before the High Court in London against the IBM UK Pensions Trust (the UK Trust) and two representative beneficiaries of the UK Trust membership. IBM UK is seeking a declaration that it acted lawfully both in notifying the Trustee of the UK Trust that it was closing its UK defined benefit plans to future accruals for most participants and in implementing the company's new retirement policy. The trial in the High Court is scheduled to begin in February 2013. In addition, IBM UK is a defendant in approximately 275 individual actions brought since early 2010 by participants of the defined benefits plans who left IBM UK. These actions, which allege constructive dismissal and age discrimination, are pending before the Employment Tribunal in Southampton UK and are currently stayed pending resolution of the above-referenced High Court proceedings. In a separate but related proceeding, in March 2011, the Trustee of the IBM UK Trust was granted leave to initiate a claim before the High Court in London against IBM UK and one member of the UK Trust membership, seeking an order modifying certain documents and terms relating to retirement provisions in IBM UK's largest defined benefit plan dating back to 1983. The trial of these proceedings is scheduled to begin in May 2012.

In March 2011, the company announced that it has agreed to settle a civil enforcement action with the SEC relating to activities by employees of IBM Korea, LG IBM, IBM (China) Investment Company Limited and IBM Global Services (China) Co., Ltd., during the period from 1998 through 2009, allegedly in violation of the Foreign Corrupt Practices Act of 1977. As part of the settlement, IBM has consented to the entry of a judgment relating to the books and records and internal control provisions of the securities laws. IBM has also agreed to pay a total of \$10 million, categorized by the SEC as follows: (i) \$5.3 million, representing profits gained as a result of the conduct alleged in the SEC's complaint, (ii) prejudgment interest on that amount of \$2.7 million, and (iii) a civil penalty of \$2 million. The settlement is subject to court approval.

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The company is a defendant in numerous actions filed after January 1, 2008 in the Supreme Court for the State of New York, county of Broome, on behalf of hundreds of plaintiffs. The complaints allege numerous and different causes of action, including for negligence and recklessness, private nuisance and trespass. Plaintiffs in these cases seek medical monitoring and claim damages in unspecified amounts for a variety of personal injuries and property damages allegedly arising out of the presence of groundwater contamination and vapor intrusion of groundwater contaminants into certain structures in which plaintiffs reside or resided, or conducted business, allegedly resulting from the release of chemicals into the environment by the company at its former manufacturing and development facility in Endicott. These complaints also seek punitive damages in an unspecified amount. The first trial in these cases is scheduled to begin in October 2012.

The company is party to, or otherwise involved in, proceedings brought by U.S. federal or state environmental agencies under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), known as Superfund, or laws similar to CERCLA. Such statutes require potentially responsible parties to participate in remediation activities regardless of fault or ownership of sites. The company is also conducting environmental investigations, assessments or

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Notes to Consolidated Financial Statements (continued)

remediations at or in the vicinity of several current or former operating sites globally pursuant to permits, administrative orders or agreements with country, state or local environmental agencies, and is involved in lawsuits and claims concerning certain current or former operating sites.

The company is also subject to ongoing tax examinations and governmental assessments in various jurisdictions. Along with many other U.S. companies doing business in Brazil, the company is involved in various challenges with Brazilian authorities regarding non-income tax assessments and non-income tax litigation matters. These matters include claims for taxes on the importation of computer software. In November 2008, the company won a significant case in the Superior Chamber of the federal administrative tax court in Brazil, and in late July 2009, the company received written confirmation regarding this decision. The total potential amount related to the remaining matters for all applicable years is approximately \$600 million. The company believes it will prevail on these matters and that this amount is not a meaningful indicator of liability.

13. Commitments: The company's extended lines of credit to third-party entities include unused amounts of \$4,247 million and \$4,040 million at March 31, 2012 and December 31, 2011, respectively. A portion of these amounts was available to the company's business partners to support their working capital needs. In addition, the company has committed to provide future financing to its clients in connection with client purchase agreements for approximately \$2,731 million and \$2,567 million at March 31, 2012 and December 31, 2011, respectively.

The company has applied the guidance requiring a guarantor to disclose certain types of guarantees, even if the likelihood of requiring the guarantor's performance is remote. The following is a description of arrangements in which the company is the guarantor.

The company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the company, under which the company customarily agrees to hold the party harmless against losses arising from a breach of representations and covenants related to such matters as title to the assets sold, certain intellectual property (IP) rights, specified environmental matters, third-party performance of non-financial contractual obligations and certain income taxes. In each of these circumstances, payment by the company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the company to challenge the other party's claims. While typically indemnification provisions do not include a contractual maximum on the company's payment, the company's obligations under these agreements may be limited in terms of time and/or nature of claim, and in some instances, the company may have recourse against third parties for certain payments made by the company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements, due to the conditional nature of the company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the company under these agreements have not had a material effect on the company's business, financial condition or results of operations.

In addition, the company guarantees certain loans and financial commitments. The maximum potential future payment under these financial guarantees was \$38 million and \$42 million at March 31, 2012 and December 31, 2011, respectively. The fair value of the guarantees recognized in the Consolidated Statement of Financial Position is not material.

Changes in the company's warranty liability for standard warranties and deferred income for extended warranty contracts are presented in the following tables:

Standard Warranty Liability

| (Dollars in millions) | 2012 | | 2011 | |
|--|------|-------|------|-------|
| Balance at January 1 | \$ | 407 | \$ | 375 |
| Current period accruals | | 88 | | 93 |
| Accrual adjustments to reflect actual experience | | (3) | | 3 |
| Charges incurred | | (102) | | (105) |
| Balance at March 31 | \$ | 390 | \$ | 366 |

Table of Contents**Notes to Consolidated Financial Statements (continued)****Extended Warranty Liability**

| (Dollars in millions) | 2012 | | 2011 | |
|--|------|------|------|------|
| Aggregate deferred revenue at January 1 | \$ | 636 | \$ | 670 |
| Revenue deferred for new extended warranty contracts | | 54 | | 66 |
| Amortization of deferred revenue | | (76) | | (84) |
| Other* | | 3 | | 5 |
| Aggregate deferred revenue at March 31 | \$ | 616 | \$ | 658 |
| Current portion | \$ | 292 | \$ | 319 |
| Noncurrent portion | | 323 | | 338 |
| Aggregate deferred revenue at March 31 | \$ | 616 | \$ | 658 |

* Other primarily consists of foreign currency translation adjustments.

14. Subsequent Events: On April 17, 2012, the company announced that it had signed a definitive agreement with Toshiba TEC for the sale of its Retail Store Solutions business to Toshiba TEC, and a multi-year business partner agreement between the company and Toshiba TEC to integrate retail store solutions for Smarter Commerce. The transaction price is \$850 million, and the company will receive approximately \$800 million in cash, net of closing date working capital adjustments. In addition, the company will receive a 19.9 percent ownership for three years in the new holding company that Toshiba TEC will establish for the business. This transaction is subject to regulatory requirements and customary closing conditions and is expected to close in phases, with the initial closing expected in late second quarter or early third quarter of 2012, and subsequent closings by the end of the year. The company expects to recognize a total pre-tax gain on the sale between \$450 million and \$550 million. This gain will be recognized consistent with the closing schedule for the transaction.

On April 24, 2012, the company announced that the Board of Directors approved a quarterly dividend of \$0.85 per common share. The dividend is payable June 9, 2012 to shareholders of record on May 10, 2012. The dividend declaration represents an increase of \$0.10 and is 13 percent higher than the prior quarterly dividend of \$0.75 per common share.

On April 24, 2012, the company announced that the Board of Directors authorized \$7 billion in additional funds for use in the company's common stock repurchase program.

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Item 2.

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION
FOR THE THREE MONTHS ENDED MARCH 31, 2012**

Snapshot

Financial Results Summary:

| (Dollars in millions except per share amounts) For the three months ended March 31: | 2012 | 2011 | Yr. to Yr. Percent/ Margin Change |
|--|----------------|-----------------|--|
| Revenue | \$ 24,673 | \$ 24,607 | 0.3%* |
| Gross profit margin | 45.1% | 44.1% | 0.9pts. |
| Total expense and other income | \$ 7,283 | \$ 7,041 | 3.4% |
| Total expense and other income to revenue ratio | 29.5% | 28.6% | 0.9pts. |
| Provision for income taxes | \$ 769 | \$ 954 | (19.4)% |
| Net income | \$ 3,066 | \$ 2,863 | 7.1% |
| Net income margin | 12.4% | 11.6% | 0.8pts. |
| Earnings per share: | | | |
| Assuming dilution | \$ 2.61 | \$ 2.31 | 13.0% |
| Basic | \$ 2.65 | \$ 2.34 | 13.2% |
| Weighted-average shares outstanding: | | | |
| Assuming dilution | 1,174.2 | 1,240.0 | (5.3)% |
| Basic | 1,159.1 | 1,222.2 | (5.2)% |
| | 3/31/12 | 12/31/11 | |
| Assets | \$ 115,347 | \$ 116,433 | (0.9)% |
| Liabilities | \$ 94,563 | \$ 96,197 | (1.7)% |
| Equity | \$ 20,783 | \$ 20,236 | 2.7% |

* 1.0 percent adjusted for currency

Currency:

The references to adjusted for currency or at constant currency in the Management Discussion do not include operational impacts that could result from fluctuations in foreign currency rates. Certain financial results are adjusted based on a simple mathematical model that translates current period results 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 country currency. This information is provided so that certain financial results can be viewed without

the impact of fluctuations in foreign currency rates, thereby facilitating period-to-period comparisons of business performance. See Currency Rate Fluctuations on page 54 for additional information.

Operating (non-GAAP) Earnings:

In an effort to provide better transparency into the operational results of the business, the company separated business results into operating and non-operating categories beginning January 1, 2011. Operating earnings is a non-GAAP measure that excludes the effects of certain acquisition-related charges and retirement-related costs, and their related tax impacts. For acquisitions, operating earnings 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 defined benefit plan and nonpension postretirement benefit plan service cost, amortization of prior service cost and the cost of defined contribution plans in operating earnings. Non-operating retirement-related cost includes defined benefit plan and nonpension postretirement benefit plan interest cost, expected return on plan assets, amortized actuarial gains/losses, the impacts of any plan curtailments/settlements and multi-employer plan costs, pension insolvency costs and other costs. Non-operating costs are primarily related to changes in pension plan assets and liabilities which are tied to financial market performance and the company considers these costs to be outside the operational performance of the business.

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Overall, the company believes that providing investors with a view of operating earnings 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 its 2015 earnings per share Road Map, the company is utilizing an operating view to establish its objectives and track its progress. The company's segment financial results reflect operating earnings, consistent with the company's management and measurement systems.

The following table provides the company's non-GAAP operating earnings for the first quarter of 2012 and 2011.

| (Dollars in millions except per share amounts) | | | | | Yr. to Yr. Percent Change |
|---|-------------|-------|-------------|-------|--|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Net income as reported | \$ | 3,066 | \$ | 2,863 | 7.1% |
| Non-operating adjustments (net of tax): | | | | | |
| Acquisition-related charges | | 126 | | 117 | 7.7 |
| Non-operating retirement-related costs/(income) | | 73 | | 10 | nm |
| Operating (non-GAAP) earnings* | \$ | 3,265 | \$ | 2,990 | 9.2% |
| Diluted operating (non-GAAP) earnings per share: | \$ | 2.78 | \$ | 2.41 | 15.4% |

nm - not meaningful

* See page 61 for a more detailed reconciliation of net income to operating earnings.

Financial Performance Summary:

In the first quarter of 2012, the company reported \$24.7 billion in revenue, expanded gross, pre-tax and net income margins and delivered double-digit diluted earnings per share growth of 13.0 percent as reported and 15.4 percent on an operating (non-GAAP) basis. The company generated \$4.3 billion in cash from operations in the quarter driving significant shareholder returns of \$3.9 billion in common stock repurchases and dividends, while also enabling the ongoing transformation of the business - acquiring key capabilities and focusing the portfolio on areas where the company can add the most value. In the first quarter, the company closed five acquisitions for a total of \$1.4 billion increasing its capabilities in the key growth initiatives. As a result of its performance, in April 2012, the company increased its full year 2012 earnings per share expectation from the expectation disclosed in January 2012 to at least \$14.27 per share as reported and at least \$15.00 per share for operating (non-GAAP) earnings per share.

Performance in the first quarter was led by the company's growth initiatives. The growth markets initiative is based on expanding into new markets, building out the IT infrastructures and leading in targeted industries. The company has consistently delivered strong performance and share gains, and in the first quarter, growth markets revenue increased 8.5 percent (9 percent adjusted for currency) with 40 growth market countries delivering double-digit constant currency revenue growth. In business analytics, to help its clients deal with the massive amounts of structured and unstructured data, the company has built a broad portfolio of analytics solutions through organic investment and acquisitions, and currently has more than 9000 consultants in Global Business Services. In the first quarter, business analytics revenue increased 14 percent (15 percent adjusted for currency). Cloud computing provides an efficient and flexible delivery platform that improves the economics of information technology. The company's SmartCloud portfolio addresses the full scope of enterprise client requirements. Total cloud revenue doubled in the first quarter when compared to the prior year with strong contribution from all areas - private cloud, public cloud and the company's

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industry-based solutions. With revenue growth of over 25 percent in the first quarter, Smarter Planet continues to deliver strong growth driven by the Smarter Cities solutions and continued strength in smarter commerce offerings. Overall, within the company's offerings in business analytics, cloud and Smarter Planet, approximately half of the revenue is software. Therefore, the success the company is having in its growth initiatives is improving the business mix and margin expansion.

Segment performance was led by Software which increased revenue 5.5 percent (7 percent adjusted for currency) driven by key branded middleware which increased 6.6 percent (8 percent adjusted for currency) and gained share for the 18th consecutive quarter. Software pre-tax income increased 12 percent versus the first quarter of 2011. Global Services expanded margins and increased total services pre-tax income by 11 percent as the company leverages its productivity initiatives and mixes to higher margin offerings and markets. Total Global Services revenue was again led by performance in the growth markets, which increased 9.4 percent (10 percent adjusted for currency). Systems and Technology revenue declined, as expected, 6.7 percent (6 percent adjusted for currency) compared to a very strong growth of 19 percent in the first quarter of 2011. In the quarter, the

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company extended its leadership in the UNIX market, as it continued the success in competitive displacements in the Power Systems business.

The consolidated gross profit margin increased 0.9 points versus the first quarter of 2011 to 45.1 percent. The operating (non-GAAP) gross margin increased 1.2 points to 45.7 percent. Performance was driven by a combination of margin expansion in both Global Services segments, and an improving segment mix due to the relative strength of the Software business.

Total expense and other income increased 3.4 percent in the first quarter compared to the prior year. Total operating (non-GAAP) expense and other income increased 2.8 percent compared to the first quarter of 2011. The year-to-year drivers for both categories were approximately:

- Base expense 3 points
- Acquisitions* 2 points
- Currency** (2) points

* Includes acquisitions completed in prior 12-month period.

** Reflects impacts of translation and hedging programs.

Pre-tax income grew 0.5 percent and the pre-tax margin was 15.5 percent. Net income increased 7.1 percent and the net income margin of 12.4 percent increased 0.8 points year to year. The effective tax rate for the first quarter was 20.1 percent, compared with 25.0 percent in the prior year, reflecting a one-time benefit from a tax restructuring in Latin America. Operating (non-GAAP) pre-tax income grew 3.1 percent and the pre-tax margin was 16.7 percent, an increase of 0.5 points versus the prior year. Operating (non-GAAP) net income increased 9.2 percent and the operating (non-GAAP) net income margin of 13.2 percent increased 1.1 points versus the prior year. The operating (non-GAAP) effective tax rate was 20.6 percent versus 25.0 percent in the first quarter of 2011.

Diluted earnings per share improved 13.0 percent reflecting the growth in net income and the benefits of the common stock repurchase program. In the first quarter, the company repurchased 15.5 million shares of its common stock. Diluted earnings per share of \$2.61 increased \$0.30 from the prior year. Operating (non-GAAP) diluted earnings per share of \$2.78 increased \$0.37 versus the first quarter of 2011 driven by the following factors:

- Revenue increase at actual rates: \$0.01
- Margin expansion: \$0.21
- Common stock repurchases: \$0.15

At March 31, 2012, the company's balance sheet and liquidity positions remain strong and are well-positioned to support the company's objectives. Cash and marketable securities at quarter end were \$12,335 million. Key drivers in the balance sheet and total cash flows are highlighted below.

Total assets decreased \$1,086 million (\$1,879 million adjusted for currency) from December 31, 2011 driven by:

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- Decreases in total receivables (\$2,947 million) and deferred taxes (\$387 million); partially offset by
- Increased goodwill (\$1,255 million), marketable securities (\$500 million), intangible assets (\$249 million) and inventory (\$159 million).

Total liabilities decreased \$1,634 million (\$1,858 million adjusted for currency) from December 31, 2011 driven by:

- Decreases in taxes (\$1,129 million), accounts payable (\$1,101 million), retirement and nonpension postretirement (\$795 million) and compensation and benefits (\$729 million); partially offset by
- Increased total deferred income (\$1,129 million) and total debt (\$733 million).

Total equity of \$20,783 million increased \$548 million from December 31, 2011 as a result of:

- Higher retained earnings (\$2,178 million), common stock (\$671 million), foreign currency translation adjustments (\$398 million) and retirement-related benefit plans (\$363 million); partially offset by
- Increased treasury stock (\$3,057 million) driven by share repurchases.

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The company generated \$4,291 million in cash flow provided by operating activities, an increase of \$499 million compared to the first quarter of 2011, driven primarily by lower net income tax payments in the first quarter of 2012 versus 2011 and improved net income. Net cash used in investing activities of \$2,230 million increased \$2,728 million primarily due to cash used for acquisitions (\$1,267 million), purchases of marketable securities and other investments (\$812 million), and decreased cash from sales of marketable securities and other investments (\$800 million). Net cash used in financing activities of \$2,316 million was flat compared to the prior year, primarily due to a net decrease in cash used for common stock transactions (\$772 million), offset by lower net cash proceeds from total debt (\$698 million).

In January 2012, the company disclosed that it was expecting GAAP earnings of at least \$14.16 and operating (non-GAAP) earnings of at least \$14.85 per diluted share for the full year 2012. In April 2012, the company increased its expectation for GAAP earnings per diluted share to at least \$14.27 and its expectation for operating (non-GAAP) earnings per diluted share to at least \$15.00 for the full year.

First Quarter in Review

Results of Operations

Segment Details

The following is an analysis of the first-quarter 2012 versus the first-quarter 2011 reportable segment external revenue and gross margin results. Segment pre-tax income includes transactions between the segments that are intended to reflect an arms-length transfer price and excludes certain unallocated corporate items.

| (Dollars in millions) | | | Yr. to Yr. Percent/Margin Change | Yr. to Yr. Percent Change Adjusted For Currency |
|--------------------------------------|-----------|-----------|--|--|
| For the three months ended March 31: | 2012 | 2011 | | |
| Revenue: | | | | |
| Global Technology Services | \$ 10,035 | \$ 9,863 | 1.7% | 2.6% |
| Gross margin | 35.3% | 33.8% | 1.5pts. | |
| Global Business Services | 4,637 | 4,710 | (1.5)% | (1.0)% |
| Gross margin | 28.0% | 27.4% | 0.7pts. | |
| Software | 5,600 | 5,308 | 5.5% | 6.6% |
| Gross margin | 87.0% | 87.0% | (0.1)pts. | |
| Systems and Technology | 3,749 | 4,019 | (6.7)% | (6.4)% |
| Gross margin | 34.2% | 37.8% | (3.6)pts. | |
| Global Financing | 490 | 516 | (5.1)% | (3.9)% |
| Gross margin | 50.7% | 53.5% | (2.8)pts. | |
| Other | 162 | 190 | (14.9)% | (14.6)% |
| Gross margin | (74.8)% | (93.3)% | 18.5pts. | |
| Total consolidated revenue | \$ 24,673 | \$ 24,607 | 0.3% | 1.0% |
| Total consolidated gross profit | \$ 11,118 | \$ 10,858 | 2.4% | |

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| | | | |
|--|-----------|-----------|---------|
| Total consolidated gross margin | 45.1% | 44.1% | 0.9pts. |
| Non-operating adjustments: | | | |
| Amortization of acquired intangible assets | 88 | 85 | 3.6% |
| Acquisition-related charges | 0 | 0 | 1.1 |
| Retirement-related costs/(income) | 71 | 14 | nm |
| Operating (non-GAAP) gross profit | \$ 11,278 | \$ 10,957 | 2.9% |
| Operating (non-GAAP) gross margin | 45.7% | 44.5% | 1.2pts. |

nm - not meaningful

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The following table presents each reportable segment's external revenue as a percentage of total segment external revenue and each reportable segment's pre-tax income as a percentage of total segment pre-tax income.

| For the three months ended March 31: | Revenue | | Pre-tax income | |
|--------------------------------------|---------|--------|----------------|--------|
| | 2012 | 2011 | 2012 | 2011 |
| Global Technology Services | 40.9% | 40.4% | 33.4% | 29.0% |
| Global Business Services | 18.9 | 19.3 | 13.6 | 15.0 |
| Total Global Services | 59.9 | 59.7 | 46.9 | 44.0 |
| Software | 22.8 | 21.7 | 43.9 | 40.7 |
| Systems and Technology | 15.3 | 16.5 | (2.4) | 3.1 |
| Global Financing | 2.0 | 2.1 | 11.6 | 12.2 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |

Global Services

The Global Services segments, Global Technology Services (GTS) and Global Business Services (GBS), delivered \$14,673 million of revenue in the first quarter of 2012, an increase of 0.7 percent (1 percent adjusted for currency) year to year. Performance in the quarter was led by the growth markets with total services revenue up 9.4 percent (10 percent adjusted for currency) driven by strong backlog growth. The services segments also had strong performance in the other growth initiatives: business analytics, cloud, and smarter planet offerings. Total outsourcing revenue of \$6,952 million, which includes GTS Outsourcing and GBS Application Management Services Outsourcing, increased 1.5 percent (2 percent adjusted for currency) and total transactional revenue of \$5,883 million, which includes Consulting and Systems Integration within GBS and Integrated Technology Services within GTS, increased 0.1 percent (1 percent adjusted for currency) year to year.

| (Dollars in millions) | 2012 | 2011 | Yr. to Yr. Percent Change | Yr. to Yr. Percent Change Adjusted For Currency |
|------------------------------------|-----------|-----------|---------------------------------|--|
| | | | | |
| Global Services external revenue: | \$ 14,673 | \$ 14,573 | 0.7% | 1.5% |
| Global Technology Services | \$ 10,035 | \$ 9,863 | 1.7% | 2.6% |
| Outsourcing | 5,904 | 5,794 | 1.9 | 2.8 |
| Integrated Technology Services | 2,295 | 2,224 | 3.2 | 4.1 |
| Maintenance | 1,837 | 1,845 | (0.4) | 0.5 |
| Global Business Services | \$ 4,637 | \$ 4,710 | (1.5)% | (1.0)% |
| Outsourcing | 1,049 | 1,055 | (0.6) | 0.1 |
| Consulting and Systems Integration | 3,589 | 3,654 | (1.8) | (1.4) |

Global Technology Services revenue of \$10,035 million increased 1.7 percent (3 percent adjusted for currency) versus the first quarter of 2011. The revenue growth rate year to year in the first quarter of 2012 at constant currency was consistent with the last three quarters. Revenue performance was led by the growth markets which were up 8.8 percent (10 percent adjusted for currency). GTS Outsourcing revenue increased 1.9 percent (3 percent adjusted for currency) in the first quarter and gained share. Integrated Technology Services (ITS) revenue increased 3.2 percent (4 percent adjusted for currency) in the first quarter of 2012 compared to the first quarter of 2011, led by the growth markets which increased 14 percent year to year, adjusted for currency.

Global Business Services revenue of \$4,637 million decreased 1.5 percent (1 percent adjusted for currency) versus the first quarter of 2011 and growth continued to be impacted by weakness in Japan and the Public Sector. Application Outsourcing revenue decreased 0.6 percent (flat adjusted for currency) and Consulting and Systems Integration (C&SI) revenue, which includes Consulting, Application Management Services systems integration and the U.S. Federal business, decreased 1.8 percent (1 percent adjusted for currency) year to year. GBS is leading many of the engagements across the company in the higher value solutions of business analytics and Smarter Planet. In the first quarter of 2012, GBS business analytics revenue increased 16 percent and Smarter Planet revenue grew 18 percent year to year. Geographically, the growth markets continued to perform well with revenue up 11.5 percent (12 percent adjusted for currency), while the major markets continued to be effected by Japan, and by the Public Sector, which declined more sharply in the first quarter. Revenue declines in Japan and in the

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Public Sector, which combined represent over one-third of total GBS revenue, impacted the overall GBS constant currency growth rate in the first quarter of 2012 by 6 points.

| (Dollars in millions) | | | Yr. to Yr Percent/ Margin Change |
|--------------------------------------|----------|----------|---|
| For the three months ended March 31: | 2012 | 2011 | |
| Global Technology Services: | | | |
| External gross profit | \$ 3,540 | \$ 3,330 | 6.3% |
| External gross profit margin | 35.3% | 33.8% | 1.5pts. |
| Pre-tax income | \$ 1,480 | \$ 1,238 | 19.6% |
| Pre-tax margin | 14.3% | 12.2% | 2.2pts. |
| Global Business Services: | | | |
| External gross profit | \$ 1,301 | \$ 1,290 | 0.8% |
| External gross profit margin | 28.0% | 27.4% | 0.7pts. |
| Pre-tax income | \$ 601 | \$ 640 | (6.1)% |
| Pre-tax margin | 12.5% | 13.0% | (0.6)pts. |

GTS gross profit increased 6.3 percent in the first quarter of 2012 and gross profit margin improved 1.5 points year to year. The gross margin expansion was driven primarily by improved gross profit performance in outsourcing. Pre-tax income increased 19.6 percent to \$1,480 million in the first quarter of 2012 and pre-tax margin expanded 2.2 points to 14.3 percent year to year. GTS continued to benefit from efforts to deliver productivity and efficiency, within the segment, and in conjunction with the company's enterprise productivity initiatives. In addition, GTS continues to yield higher margins in the faster growing growth markets. GTS is also realizing the benefits from a systematic and disciplined approach to solving problems in a select set of lower margin contracts within its large overall portfolio of outsourcing contracts.

GBS gross profit increased 0.8 percent in the first quarter of 2012 and gross margin improved 0.7 points to 28.0 percent, with margin improvement in Application Outsourcing partially offset by a lower margin in C&SI. GBS segment pre-tax income declined 6.1 percent to \$601 million with a pre-tax margin of 12.5 percent. GBS pre-tax income was also impacted by Japan in the first quarter. Two large contracts in Japan impacted segment pre-tax income by approximately \$60 million.

Total Global Services segment pre-tax income was \$2,081 million in the first quarter of 2012, an increase of \$204 million or 10.8 percent year to year. The combined pre-tax margin expanded 1.3 points versus the first quarter of 2011 as the Services business leverages productivity initiatives and mixes to higher margin offerings and markets.

Global Services Backlog

The estimated Global Services backlog at March 31, 2012 was \$139 billion, a decrease of 1.9 percent (increase of 1 percent adjusted for currency) compared to the March 31, 2011 balance, and a decrease of 0.9 percent (1 percent adjusted for currency) compared to the December 31, 2011 balance. Total growth markets backlog at March 31, 2012 increased 14 percent, adjusted for currency, compared to the March 31, 2011 balance, reflecting strong demand for both outsourcing and transactional services in these markets. The estimated outsourcing backlog at March 31, 2012 was \$91 billion, a decrease of 4.9 percent (2 percent adjusted for currency) from the March 31, 2011 level, and a decrease of 1.9 percent (2 percent adjusted for currency) from the December 31, 2011 balance.

| (Dollars in billions) At March 31: | | | Yr. to Yr. Percent Change | Yr. to Yr. Percent Change Adjusted For Currency |
|---------------------------------------|----------|----------|---------------------------------|--|
| | 2012 | 2011 | | |
| Backlog: | | | | |
| Total backlog | \$ 139.4 | \$ 142.2 | (1.9)% | 0.7% |
| Outsourcing backlog | \$ 90.8 | \$ 95.5 | (4.9)% | (2.3)% |

Total Global Services backlog includes GTS Outsourcing, ITS, GBS Outsourcing, Consulting and Systems Integration and Maintenance. Outsourcing backlog includes GTS Outsourcing and GBS Outsourcing. Total backlog is intended to be a statement of overall work under contract and therefore does include Maintenance. Backlog estimates are subject to change and are affected by several factors, including terminations, changes in the scope of contracts, periodic revalidations, adjustments for revenue not materialized and adjustments for currency.

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Global Services signings are management's initial estimate of the value of a client's commitment under a Global Services contract. There are no third-party standards or requirements governing the calculation of signings. The calculation used by management involves estimates and judgments to gauge the extent of a client's commitment, including the type and duration of the agreement, and the presence of termination charges or wind-down costs.

Signings include GTS Outsourcing, ITS, GBS Outsourcing and Consulting and Systems Integration contracts. Contract extensions and increases in scope are treated as signings only to the extent of the incremental new value. Maintenance is not included in signings as maintenance contracts tend to be more steady state, where revenues equal renewals.

Contract portfolios purchased in an acquisition are treated as positive backlog adjustments provided those contracts meet the company's requirements for initial signings. A new signing will be recognized if a new services agreement is signed incidental or coincidental to an acquisition or divestiture.

| (Dollars in millions) | | | Yr. to Yr. Percent Change | Yr. to Yr. Percent Change Adjusted For Currency |
|--------------------------------------|-----------|-----------|---------------------------------|--|
| For the three months ended March 31: | 2012 | 2011 | | |
| Total signings: | \$ 11,776 | \$ 10,508 | 12.1% | 15.0% |
| Outsourcing signings | \$ 5,456 | \$ 4,716 | 15.7% | 19.7% |
| Transactional signings | 6,319 | 5,791 | 9.1 | 11.2 |

Software

| (Dollars in millions) | | | Yr. to Yr. Percent Change | Yr. to Yr. Percent Change Adjusted For Currency |
|--------------------------------------|----------|----------|---------------------------------|---|
| For the three months ended March 31: | 2012 | 2011* | | |
| Software external revenue: | \$ 5,600 | \$ 5,308 | 5.5% | 6.6% |
| Middleware: | \$ 4,539 | \$ 4,350 | 4.3% | 5.4% |
| Key branded middleware: | 3,469 | 3,255 | 6.6 | 7.6 |
| WebSphere Family | | | 16.3 | 17.3 |
| Information Management | | | 5.2 | 6.3 |
| Lotus | | | (0.5) | 0.5 |
| Tivoli | | | 4.6 | 5.7 |
| Rational | | | 1.2 | 2.3 |
| Other middleware | 1,070 | 1,095 | (2.2) | (1.2) |
| Operating systems | 590 | 542 | 8.9 | 10.0 |
| Other | 471 | 417 | 13.0 | 14.1 |

* Reclassified to conform with 2012 presentation

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Software revenue of \$5,600 million increased 5.5 percent (7 percent adjusted for currency) in the first quarter of 2012 as the business addressed opportunities in business analytics, cloud and Smarter Planet. The company continues to invest in the Software business to increase its capabilities in these key growth initiatives and completed four acquisitions (Green Hat, Emptoris, Worklight, DemandTec) in the first quarter of 2012.

Key branded middleware revenue increased 6.6 percent (8 percent adjusted for currency) and gained share for the 18th straight quarter as Software revenue continues to mix to the fast growing branded middleware. In the first quarter of 2012, branded middleware accounted for 62 percent of total software revenue, an increase of 1 point from the first quarter of 2011. A third party named the company the worldwide market share leader in the application infrastructure and middleware segment. This marks the 11th consecutive year of software leadership for the company.

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WebSphere revenue increased 16.3 percent (17 percent adjusted for currency) and gained share for the 14th consecutive quarter. Revenue growth was driven by strong contribution from the application server products, which increased 16 percent (17 percent adjusted for currency), and continued momentum in the Smarter Commerce offerings, which increased 18 percent (19 percent adjusted for currency). In the first quarter of 2012, the company strengthened its Smarter Commerce integrated portfolio by completing the acquisitions of DemandTec, a leader of pricing and promotion optimization solutions, and Emptoris, which helps clients reduce procurement costs and risks.

Information Management revenue increased 5.2 percent (6 percent adjusted for currency) and gained share in the first quarter of 2012. Business analytics revenue increased 18 percent (19 percent adjusted for currency) led by Cognos. The revenue performance in Cognos was driven by the successful integration of its predictive capabilities into recent product introductions covering both Business Intelligence and Financial Performance Management. Within Distributed Database, the Software business continued to expand the global Netezza customer base, with approximately two-thirds of new clients from outside North America. For the first quarter of 2012, Netezza had a win-rate of nearly 80 percent in head-to-head proof of concept engagements.

Lotus revenue decreased 0.5 percent (increased 1 percent adjusted for currency) in the first quarter of 2012 year to year and held share.

Tivoli revenue increased 4.6 percent (6 percent adjusted for currency) in the first quarter of 2012 and held share. Revenue performance was led by Storage software with growth of 18 percent (19 percent adjusted for currency) in the quarter. Security software, including QILabs, delivered revenue growth of 6 percent (7 percent adjusted for currency), as clients turn to Tivoli for intelligence, integration and expertise across its comprehensive framework of solutions.

Rational revenue increased 1.2 percent (2 percent adjusted for currency) and gained share in the first quarter of 2012. Revenue growth was driven by Telelogic, which increased 10 percent (12 percent adjusted for currency).

Operating systems revenue increased 8.9 percent (10 percent adjusted for currency) in the first quarter of 2012, driven primarily by growth in Power Systems.

Other software revenue increased 13.0 percent (14 percent adjusted for currency) year over year, driven by growth in software-related services.

| (Dollars in millions) | | | Yr. to Yr. Percent/ Margin Change |
|--------------------------------------|----------|----------|--|
| For the three months ended March 31: | 2012 | 2011 | |
| Software: | | | |
| External gross profit | \$ 4,870 | \$ 4,620 | 5.4% |
| External gross profit margin | 87.0% | 87.0% | (0.1)pts. |
| Pre-tax income | \$ 1,945 | \$ 1,735 | 12.1% |
| Pre-tax margin | 30.2% | 28.3% | 1.9pts. |

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Software gross profit increased 5.4 percent to \$4,870 million in the first quarter of 2012 with a gross profit margin of 87.0 percent, essentially flat year to year. Software delivered segment pre-tax income of \$1,945 million in the first quarter of 2012, an increase of 12.1 percent compared to the first quarter of 2011. Segment pre-tax margin expanded 1.9 points to 30.2 percent. The relative strength of the Software business and its success in the key growth initiatives is contributing significantly to the company's overall gross and pre-tax margin expansion.

Table of ContentsSystems and Technology

| (Dollars in millions) | | | Yr. to Yr. Percent Change | Yr. to Yr. Percent Change Adjusted For Currency |
|--|----------|----------|---------------------------------|---|
| For the three months ended March 31: | 2012 | 2011 | | |
| Systems and Technology external revenue: | \$ 3,749 | \$ 4,019 | (6.7)% | (6.4)% |
| System z | | | (24.7)% | (24.2)% |
| Power Systems | | | 0.2 | 0.7 |
| System x | | | 0.2 | (0.1) |
| Storage | | | (3.8) | (3.0) |
| Retail Store Solutions | | | (12.5) | (11.8) |
| Total Systems | | | (5.9) | (5.5) |
| Microelectronics OEM | | | (12.6) | (12.6) |

Systems and Technology revenue decreased 6.7 percent (6 percent adjusted for currency) in the first quarter of 2012 versus the same period in 2011. The decline in performance in the first quarter of 2012 was a result of very strong revenue growth in the first quarter of 2011 of 19 percent. Growth markets revenue increased 5.7 percent (5 percent adjusted for currency) in the first quarter, while the major markets decreased 11.1 percent (10 percent adjusted for currency) in the first quarter of 2012 on a year-to-year basis.

System z revenue decreased 24.7 percent (24 percent adjusted for currency) in the first quarter of 2012 versus the first quarter of 2011. MIPS (millions of instructions per second) shipments decreased 5 percent in the first quarter of 2012 versus the same period of 2011 and the company mixed towards specialty engines. The decline in revenue and MIPS in the first quarter was expected and was a result of the strong prior year performance in which revenue increased 41 percent. The performance in the quarter was consistent with prior mainframe product cycles.

Power Systems revenue increased 0.2 percent (1 percent adjusted for currency) in the first quarter of 2012 versus the first quarter of 2011, which grew 19 percent, with particular strength in high performance computing solutions. The company extended its market leadership this quarter, the 16th consecutive quarter of year-to-year share gains. In the first quarter of 2012, the company had over 250 competitive displacements resulting in over \$200 million of business; approximately 60 percent were from Hewlett Packard with most of the balance from Oracle/Sun.

System x revenue increased 0.2 percent (flat adjusted for currency) in the first quarter of 2012 versus the first quarter of 2011. In the first quarter of 2012, System x revenue increased 19 percent (17 percent adjusted for currency) in the growth markets; the 10th consecutive quarter of double-digit revenue growth in these emerging markets.

Storage revenue decreased 3.8 percent (3 percent adjusted for currency) in the first quarter versus the comparable period in 2011. Total disk revenue decreased 2 percent (1 percent adjusted for currency) in the first quarter of 2012 versus the first quarter of 2011. Tape revenue decreased 12 percent (11 percent adjusted for currency) in the first quarter of 2012 compared to the prior year. The value in storage solutions continues to shift to software, as storage software revenue increased 18 percent in the first quarter compared to the prior year.

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Retail Stores Solutions revenue decreased 12.5 percent (12 percent adjusted for currency) in the first quarter of 2012 versus the same period in 2011.

Microelectronics OEM revenue decreased 12.6 percent (13 percent adjusted for currency) in the first quarter of 2012 versus the comparable period of 2011.

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| (Dollars in millions) | | | | | Yr. to Yr. Percent/ Margin Change |
|--------------------------------------|------|--------|------|-------|--|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Systems and Technology: | | | | | |
| External gross profit | \$ | 1,281 | \$ | 1,520 | (15.7)% |
| External gross profit margin | | 34.2% | | 37.8% | (3.6)pts. |
| Pre-tax income | \$ | (105) | \$ | 132 | nm |
| Pre-tax margin | | (2.7)% | | 3.1% | (5.8)pts. |

nm not meaningful

System and Technology's gross margin decreased 3.6 points in the first quarter of 2012 versus the prior year. The decrease was driven by margin declines in Storage (1.6 points), System x (0.6 points), Microelectronics (0.5 points) and Power Systems (0.4 points), as well as revenue mix (0.7 points). These declines were partially offset by a gross margin improvement in System z (0.4 points).

Systems and Technology's pre-tax income decreased \$236 million to a loss of \$105 million in the first quarter of 2012 when compared to the prior year. Pre-tax margin declined 5.8 points in the first quarter of 2012 versus the first quarter of 2011.

Global Financing

See pages 56 to 61 for a discussion of Global Financing's segment results.

Geographic Revenue

In addition to the revenue presentation by reportable segment, the company also measures revenue performance on a geographic basis. The following geographic, regional and country-specific revenue performance excludes OEM revenue, which is discussed separately below.

| (Dollars in millions) | | | | | Yr. to Yr. Percent Change | Yr. to Yr. Percent Change Adjusted For Currency |
|--------------------------------------|------|--------|------|--------|---------------------------------|---|
| For the three months ended March 31: | 2012 | | 2011 | | | |
| Total Revenue | \$ | 24,673 | \$ | 24,607 | 0.3% | 1.0% |
| Geographies: | \$ | 24,164 | \$ | 23,992 | 0.7% | 1.5% |
| Americas | | 10,477 | | 10,339 | 1.3 | 1.9 |
| Europe/Middle East/Africa | | 7,578 | | 7,760 | (2.4) | 1.1 |
| Asia Pacific | | 6,109 | | 5,893 | 3.7 | 1.4 |

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| | | |
|----------------|--------|--------|
| Major markets | (1.3)% | (0.5)% |
| Growth markets | 8.5% | 9.0% |
| BRIC countries | 9.5% | 11.4% |

Total geographic revenue increased 0.7 percent (1 percent adjusted for currency) to \$24,164 million in the first quarter of 2012, led by strong performance in the growth markets. Adjusted for currency the revenue growth rate in the first quarter was consistent with the growth rate in the fourth quarter of 2011.

Revenue from the major markets decreased 1.3 percent (flat adjusted for currency) in the first quarter of 2012 compared to the first quarter of 2011. Within the Americas, performance was led by Canada with growth of 7.7 percent (9 percent adjusted for currency). In Europe, adjusted for currency, revenue performance was in line with the fourth quarter of 2011 with the most consistent performance coming from the U.K. and Spain. The U.K increased 7.8 percent (10 percent adjusted for currency), its 10th consecutive quarter of growth, adjusted for currency. Spain continues to leverage its global relationships and delivered its 6th consecutive quarter of revenue growth, adjusted for currency. Germany revenue in the first quarter of 2012 decreased 3.1 percent as reported and increased 1 percent at constant currency.

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Revenue from the growth markets increased 8.5 percent (9 percent adjusted for currency) and gained share for the 7th consecutive quarter as the company accelerates its market expansion initiative. On a constant currency basis, revenue growth outpaced the major markets by 10 points in the first quarter. In the BRIC countries (Brazil, Russia, India and China) revenue increased 9.5 percent (11 percent adjusted for currency) with double-digit growth in China, India and Russia. With approximately 60 percent of the growth markets business being outside the BRIC countries, all together, the company had double-digit revenue growth in 40 growth market countries, adjusted for currency, in the first quarter of 2012. The growth markets strategy to expand into new markets, build out IT infrastructures and lead in targeted industries is continuing to drive strong performance and share gains.

Americas revenue increased 1.3 percent (2 percent adjusted for currency) in the first quarter of 2012 compared to the first quarter of 2011 which grew 9.0 percent (8 percent adjusted for currency). The U.S. was essentially flat versus a growth of 6.7 percent in the prior year. Revenue in the Latin America growth markets increased 6.9 percent (10 percent adjusted for currency).

Europe/Middle East/Africa (EMEA) revenue decreased 2.4 percent (increased 1 percent adjusted for currency) in the first quarter of 2012 compared to the first quarter of 2011. Within the major market countries, revenue performance was mixed with the U.K. up 7.8 percent (10 percent adjusted for currency), Spain down 1.8 percent (up 3 percent adjusted for currency), Germany down 3.1 percent (up 1 percent adjusted for currency), Italy down 6.1 percent (2 percent adjusted for currency) and France down 14.3 percent (10 percent adjusted for currency). The EMEA growth markets increased 4.0 percent (8 percent adjusted for currency) in the first quarter of 2012.

Asia Pacific revenue increased 3.7 percent (1 percent adjusted for currency) year over year. The growth markets increased 10.2 percent (9 percent adjusted for currency), led by growth in China of 16.1 percent (13 percent adjusted for currency) and India of 3.5 percent (15 percent adjusted for currency). Japan decreased 3.9 percent (7 percent adjusted for currency).

OEM revenue of \$509 million in the first quarter of 2012 decreased 17.1 percent (17 percent adjusted for currency) driven by the Microelectronics OEM business.

Expense

Total Expense and Other Income

| (Dollars in millions) | | | | | Yr. to Yr. Percent Change |
|---|------|-------|------|-------|---------------------------------|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Total consolidated expense and other (income) | \$ | 7,283 | \$ | 7,041 | 3.4% |
| Non-operating adjustments: | | | | | |
| Amortization of acquired intangible assets | | (78) | | (73) | 6.3 |
| Acquisition-related charges | | (7) | | (7) | 1.3 |
| Non-operating retirement-related (costs)/income | | (32) | | 10 | nm |
| Total operating (non-GAAP) expense and other (income) | \$ | 7,166 | \$ | 6,971 | 2.8% |
| Total consolidated expense-to-revenue ratio | | 29.5% | | 28.6% | 0.9pts. |

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| | | | |
|---|-------|-------|---------|
| Operating (non-GAAP) expense-to-revenue ratio | 29.0% | 28.3% | 0.7pts. |
|---|-------|-------|---------|

nm not meaningful

Total expense and other (income) increased 3.4 percent in the first quarter compared to the prior year. Total operating (non-GAAP) expense and other (income) increased 2.8 percent compared to the first quarter of 2011, respectively. The key drivers of the year-to-year change in total expense and other (income) for both expense presentations were approximately:

- Base expense 3 points
- Acquisitions* 2 points
- Currency ** (2) points

* Includes acquisitions completed in prior 12-month period.

** Reflects impacts of translation and hedging programs.

For additional information regarding total expense and other income for both expense presentations, see the following analyses by category.

Table of ContentsSelling, general and administrative expense

| (Dollars in millions) | | | Yr. to Yr. Percent Change |
|--|----------|----------|---------------------------------|
| For the three months ended March 31: | 2012 | 2011* | |
| Selling, general and administrative expense: | | | |
| Selling, general and administrative other | \$ 4,922 | \$ 4,922 | 0.0% |
| Advertising and promotional expense | 316 | 323 | (2.3) |
| Workforce rebalancing charges | 226 | 223 | 1.1 |
| Retirement-related costs | 217 | 167 | 29.7 |
| Amortization of acquired intangible assets | 78 | 73 | 6.3 |
| Stock-based compensation | 119 | 130 | (8.5) |
| Bad debt expense | 10 | (13) | nm |
| Total consolidated selling, general and administrative expense | \$ 5,886 | \$ 5,826 | 1.0% |
| Non-operating adjustments: | | | |
| Amortization of acquired intangibles assets | (78) | (73) | 6.3 |
| Acquisition-related charges | (6) | (3) | 112.5 |
| Non-operating retirement-related (costs)/income | (36) | (10) | nm |
| Operating (non-GAAP) selling, general and administrative expense | \$ 5,766 | \$ 5,740 | 0.5% |

nm not meaningful

* Reclassified to conform with 2012 presentation.

Total Selling, general and administrative (SG&A) expense increased 1.0 percent (2 percent adjusted for currency) in the first quarter of 2012 versus the first quarter of 2011. The increase was driven by acquisition-related spending (2 points), partially offset by currency impacts (1 point), while base expense was flat. Operating (non-GAAP) SG&A expense increased 0.5 percent (2 percent adjusted for currency) primarily driven by the same factors. Bad debt expense increased \$22 million in the first quarter of 2012. The accounts receivable provision coverage is 1.6 percent at March 31, 2012, an increase of 10 basis points from year-end 2011.

Other (income) and expense

| (Dollars in millions) | | | Yr. to Yr. Percent Change |
|--|---------|----------|---------------------------------|
| For the three months ended March 31: | 2012 | 2011 | |
| Other (income) and expense: | | | |
| Foreign currency transaction losses/(gains) | \$ (71) | \$ 96 | nm% |
| (Gains)/losses on derivative instruments | 60 | (40) | nm |
| Interest income | (31) | (36) | (15.0) |
| Net (gains)/losses from securities and investment assets | (6) | (215) | (97.1) |
| Other | (11) | (8) | 41.5 |
| Total consolidated other (income) and expense | \$ (58) | \$ (202) | (71.2)% |
| Non-operating adjustment: | | | |
| Acquisition-related charges | (1) | (4) | (82.1) |
| Operating (non-GAAP) other (income) and expense | \$ (59) | \$ (206) | (71.4)% |

nm not meaningful

Other (income) and expense was income of \$58 million and \$202 million in the first quarter of 2012 and 2011, respectively. The decrease in income of \$144 million in the first quarter of 2012 was primarily driven by lower gains from securities and investment asset sales (\$209 million) and increased losses on derivative instruments (\$101 million). In the first quarter of 2011, the company had investment gains of over \$200 million, primarily from the sale of Lenovo shares. This decline in income was partially offset by higher gains from foreign currency transactions (\$168 million) due to foreign currency rate volatility year to year.

Table of ContentsResearch, Development and Engineering

| (Dollars in millions) | | | | | Yr. to Yr. Percent Change |
|--|------|-------|------|-------|---------------------------------|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Total consolidated research, development and engineering | \$ | 1,601 | \$ | 1,587 | 0.9% |
| Non-operating adjustment: | | | | | |
| Non-operating retirement-related (costs)/income | | 4 | | 19 | (77.5) |
| Operating (non-GAAP) research, development and engineering | \$ | 1,605 | \$ | 1,606 | (0.1)% |

The company continues to invest in research and development, focusing its investments on high value, high growth opportunities and to extend its technology leadership. Total Research, development and engineering (RD&E) expense increased 0.9 percent in the first quarter of 2012 versus the first quarter of 2011 primarily driven by: acquisitions (up 2 points), partially offset by base expense (down 1 point) and currency impacts (down 1 point). Operating (non-GAAP) RD&E expense decreased 0.1 percent in the first quarter of 2012 compared to the prior year, primarily driven by acquisitions (up 2 points), partially offset by base expense (down 2 points) and currency impacts (down 1 point).

Intellectual Property and Custom Development Income

| (Dollars in millions) | | | | | Yr. to Yr. Percent Change |
|--|------|-----|------|-----|---------------------------------|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Intellectual Property and Custom Development Income: | | | | | |
| Sales and other transfers of intellectual property | \$ | 67 | \$ | 66 | 1.5% |
| Licensing/royalty-based fees | | 66 | | 53 | 24.5 |
| Custom development income | | 123 | | 144 | (14.2) |
| Total | \$ | 255 | \$ | 262 | (2.5)% |

The timing and amount of Sales and other transfers of IP may vary significantly from period to period depending upon the timing of divestitures, economic conditions, industry consolidation and the timing of new patents and know-how development. There were no significant IP transactions in the first quarter of 2012 and 2011.

Interest Expense

| (Dollars in millions) | | | | | Yr. to Yr. Percent Change |
|--------------------------------------|------|-----|------|----|---------------------------------|
| For the three months ended March 31: | 2012 | | 2011 | | |
| Interest expense | \$ | 110 | \$ | 93 | 17.7% |

The increase in interest expense was driven by higher average debt levels, partially offset by lower average interest rates in the first quarter of 2012 versus the first quarter of 2011. Interest expense is presented in cost of financing in the Consolidated Statement of Earnings only if the related external borrowings are to support the Global Financing external business. See pages 59 and 60 for additional information regarding

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Global Financing debt and interest expense. Overall interest expense (excluding capitalized interest) for the first quarter 2012 was \$252 million, an increase of \$17 million year to year.

Table of ContentsRetirement-Related Plans

The following table provides the total pre-tax cost for all retirement-related plans. These amounts are included in the Consolidated Statement of Earnings within the caption (e.g., Cost, SG&A, RD&E) relating to the job function of the plan participants.

| (Dollars in millions) | | | Yr. to Yr. Percent Change |
|--|----------|----------|---------------------------------|
| For the three months ended March 31: | 2012 | 2011 | |
| Retirement-related plans cost: | | | |
| Service cost | \$ 124 | \$ 141 | (12.5)% |
| Amortization of prior service cost/(credits) | (37) | (39) | (2.8) |
| Cost of defined contribution plans | 427 | 410 | 4.1 |
| Total operating costs | \$ 513 | \$ 513 | (0.3)% |
| Interest cost | \$ 1,066 | \$ 1,149 | (7.2)% |
| Expected return on plan assets | (1,593) | (1,638) | (2.7) |
| Recognized actuarial losses | 606 | 459 | 32.0 |
| Plan amendments/curtailments/settlements | 1 | 0 | nm |
| Multi-employer plan/other costs | 23 | 34 | (31.4) |
| Total non-operating costs/(income) | \$ 102 | \$ 4 | nm |
| Total retirement-related plans cost | \$ 616 | \$ 517 | 19.0% |

nm not meaningful

In the first quarter, total retirement-related plans cost increased by \$98 million compared to the first quarter of 2011, primarily driven by an increase in recognized actuarial losses.

As discussed in the Snapshot on pages 35 and 36, the company characterizes certain retirement-related costs as operating and others as non-operating. Utilizing this characterization, operating retirement-related costs in the first quarter were \$513 million, essentially flat compared to the first quarter of 2011. Non-operating costs of \$102 million increased \$98 million in the first quarter compared to the prior year driven primarily by an increase in recognized actuarial losses (\$147 million) and lower expected return on plan assets (\$44 million), partially offset by lower interest cost (\$83 million).

See Note 8, Retirement-Related Benefits on page 27 for additional plan cost detail.

Taxes

The effective tax rate for the first quarter of 2012 was 20.1 percent compared to an effective tax rate of 25.0 percent for the first quarter of 2011. The operating (non-GAAP) tax rate for the first quarter of 2012 was 20.6 percent compared to 25.0 percent for the first quarter of 2011.

The decline in the rate year to year was primarily due to discrete period tax events in the first quarter of 2012 driven by a one-time benefit associated with a tax restructuring in Latin America.

With limited exception, the company is no longer subject to U.S. federal, state and local or non-U.S. income tax audits by taxing authorities for years through 2007. The years subsequent to 2007 contain matters that could be subject to differing interpretations of applicable tax laws and regulations as it relates to the amount and/or timing of income, deductions and tax credits. Although the outcome of tax audits is always uncertain, the company believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result for these years.

The amount of unrecognized tax benefits at December 31, 2011 decreased by \$26 million in the first quarter of 2012 to \$5,549 million. The total amount of unrecognized tax benefits that, if recognized, would favorably affect the effective tax rate is \$5,057 million at March 31, 2012.

In April 2010, the company appealed the determination of a non-U.S. local taxing authority with respect to certain foreign tax losses. The tax benefit of these losses, approximately \$1,455 million, has been included in unrecognized tax benefits. This

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amount includes the portion of these losses that had been utilized against a prior year liability. In April 2011, the company received notification that the appeal had been denied. In June 2011, the company filed a lawsuit challenging this decision. The first court hearing was held in September 2011 with a second hearing scheduled for May 2012.

In October 2011, the IRS commenced its audit of the company's U.S. tax returns for 2008 through 2010.

Earnings Per Share

Basic earnings per share is computed on the basis of the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted-average number of shares of common stock outstanding plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and stock awards.

| For the three months ended March 31: | 2012 | 2011 | Yr. to Yr. Percent Change |
|---|-------------|-------------|--|
| Earnings per share of common stock: | | | |
| Assuming dilution | \$ 2.61 | \$ 2.31 | 13.0% |
| Basic | \$ 2.65 | \$ 2.34 | 13.2% |
| Diluted operating (non-GAAP) | \$ 2.78 | \$ 2.41 | 15.4% |
| Weighted-average shares outstanding: (in millions): | | | |
| Assuming dilution | 1,174.2 | 1,240.0 | (5.3)% |
| Basic | 1,159.1 | 1,222.2 | (5.2)% |

Actual shares outstanding at March 31, 2012 were 1,153.5 million. The weighted-average number of common shares outstanding assuming dilution during the first quarter of 2012 was 65.8 million lower than the same period in 2011, primarily as a result of the company's common stock repurchase program.

Financial PositionDynamics

At March 31, 2012, the company's balance sheet and liquidity positions remain strong. Cash and marketable securities at quarter end were \$12,335 million. At March 31, 2012, a significant portion of the investment portfolio was invested in U.S. sovereign instruments, with no holdings of European sovereign debt securities. Total debt of \$32,053 million increased \$733 million from prior year-end levels driven by an increase in long term debt of \$2,903 million due to new debt issuances, partially offset by a decrease in commercial paper to \$300 million compared to \$2,300 million at December 31, 2011. The company continues to have substantial flexibility in the market. In the first three months, the company generated \$4,291 million in cash from operations, an increase of \$499 million compared to the first quarter of 2011 (see cash flow

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analysis on pages 50 and 51). The company has consistently generated strong cash flow from operations and continues to have access to additional sources of liquidity through the capital markets and its \$10 billion global credit facility. The company's strong cash flow and substantial cash position permits the company to invest and deploy capital to areas with the most attractive long-term opportunities.

The assets and debt associated with the Global Financing business are a significant part of the company's financial position. The financial position amounts appearing on pages 5 and 6 are the consolidated amounts including Global Financing. The amounts appearing in the separate Global Financing section, beginning on page 56, are supplementary data presented to facilitate an understanding of the Global Financing business.

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| (Dollars in millions) | At March 31, 2012 | | At December 31, 2011 | |
|-----------------------|----------------------|--------|-------------------------|--------|
| Current assets | \$ | 48,847 | \$ | 50,928 |
| Current liabilities | | 38,209 | | 42,123 |
| Working capital | \$ | 10,638 | \$ | 8,805 |
| Current ratio | | 1.28:1 | | 1.21:1 |

Working capital increased \$1,833 million from the year-end 2011 position. The key changes are described below:

Current assets decreased \$2,082 million (\$2,564 million adjusted for currency), due to:

- A decline of \$2,720 million (\$2,992 million adjusted for currency) in short-term receivables primarily due to collections of higher year-end balances, partially offset by
- An increase in cash and cash equivalents and marketable securities of \$413 million (see cash analysis below); and
- An increase of \$159 million (\$150 million adjusted for currency) in inventories, primarily in Systems and Technology.

Current liabilities decreased \$3,914 million (\$4,088 million adjusted for currency), as a result of:

- A decrease in short-term debt of \$2,169 million primarily driven by a decrease in commercial paper
- A decrease of \$1,129 million in taxes payable primarily due to tax payments in Japan and the U.S.
- A decrease in accounts payable of \$1,101 million reflecting declines from typically higher year-end balances; and

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- A decrease in compensation and benefits of \$729 million reflecting declines from typically higher year-end balances, partially offset by

- An increase in deferred income of \$1,072 million (\$969 million adjusted for currency) primarily due to annual Global Services and Software customer contract renewals.

Cash Flow

The company's cash flow from operating, investing and financing activities, as reflected in the Consolidated Statement of Cash Flows on page 7, is summarized in the table below. These amounts include the cash flows associated with the Global Financing business.

(Dollars in millions)

For the three months ended March 31:

| | 2012 | 2011 |
|--|----------|----------|
| Net cash provided by/(used in): | | |
| Operating activities | \$ 4,291 | \$ 3,792 |
| Investing activities | (2,230) | 498 |
| Financing activities | (2,316) | (2,314) |
| Effect of exchange rate changes on cash and cash equivalents | 167 | 126 |
| Net change in cash and cash equivalents | \$ (87) | \$ 2,102 |

Net cash from operating activities increased by \$499 million as compared to the first quarter of 2011 driven by the following factors:

- Improved net income of \$204 million.

- An increase in cash provided by operating assets and liabilities of \$190 million due to:

- Lower net taxes of \$489 million during the first three months of 2012 compared to 2011; partially offset by

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- A decrease in cash provided by accounts receivable of \$234 million.

Net cash used in investing activities increased \$2,728 million driven by:

- An increase of \$1,267 million in cash used for acquisitions; and
- A net decrease of \$1,612 million from purchases and sales of marketable securities and other investments.

Net cash from financing activities was essentially flat as compared to the first three months of 2011 driven by the following factors:

- Lower cash proceeds from debt of \$951 million as compared to \$1,649 million in 2011, partially offset by
- A net decrease of \$772 million in cash used for share repurchase and other common stock transactions as compared to the first three months of 2011.

Noncurrent Assets and Liabilities

| (Dollars in millions) | At March 31, 2012 | At December 31, 2011 |
|---|----------------------|-------------------------|
| Noncurrent assets | \$ 66,500 | \$ 65,505 |
| Long-term debt | 25,760 | 22,857 |
| Noncurrent liabilities (excluding debt) | 30,595 | 31,217 |

The increase in noncurrent assets of \$995 million (an increase of \$685 million adjusted for currency) was driven by:

- An increase of \$1,504 million (\$1,318 million adjusted for currency) in goodwill and intangible assets driven by acquisitions; partially offset by

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- A decrease of \$403 million in noncurrent deferred taxes (\$345 million adjusted for currency) primarily driven by retirement related activity; and

- A decrease of \$227 million in long term financing receivables (\$236 million adjusted for currency) driven by maturities exceeding originations.

Long-term debt increased by \$2,903 million primarily driven by new debt issuances of \$3,120 million.

Other noncurrent liabilities, excluding debt, decreased \$622 million (\$707 million adjusted for currency) primarily driven by:

- A decrease in retirement and nonpension benefit obligations of \$795 million (\$766 million adjusted for currency) primarily driven by contributions to non-U.S. plans and returns on plan assets; partially offset by

- An increase of \$116 million (\$23 million adjusted for currency) in other noncurrent liabilities primarily due to an increase in tax related liabilities.

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The company's funding requirements are continually monitored and strategies are executed to manage the overall asset and liability profile. Additionally, the company maintains sufficient flexibility to access global funding sources as needed.

| (Dollars in millions) | At March 31, 2012 | | At December 31, 2011 | |
|-------------------------------------|----------------------|--------|-------------------------|--------|
| Total company debt | \$ | 32,053 | \$ | 31,320 |
| Total Global Financing segment debt | \$ | 23,597 | \$ | 23,332 |
| Debt to support external clients | | 20,287 | | 20,051 |
| Debt to support internal clients | | 3,310 | | 3,281 |

Global Financing provides financing predominantly for the company's external client assets, as well as for assets under contract by other IBM units. These assets, primarily for Global Services, generate long-term, stable revenue streams similar to the Global Financing asset portfolio. Based on their attributes, these Global Services assets are leveraged with the balance of the Global Financing asset base. The debt analysis above is further detailed in the Global Financing section on pages 59 and 60.

Given the significant Global Financing leverage, the company presents a debt-to-capitalization ratio which excludes Global Financing debt and equity as management believes this is more representative of the company's core business operations. This ratio can vary from period to period as the company manages its global cash and debt positions.

Core debt-to-capitalization ratio (excluding Global Financing debt and equity) was 32.7 percent at March 31, 2012 compared to 32.0 percent at December 31, 2011. The increase was driven by an increase in non-Global Financing debt of \$469 million, partially offset by an increase in non-Global Financing equity of \$437 million from December 31, 2011 balances.

Consolidated debt-to-capitalization ratio was 60.7 percent at March 31, 2012 and December 31, 2011.

Equity

Total equity increased by \$548 million from December 31, 2011 as a result of an increase in retained earnings of \$2,178 million, an increase of \$671 million in common stock and lower accumulated other comprehensive losses of \$770 million, partially offset by an increase in treasury stock of \$3,057 million, primarily related to common stock repurchases in the first three months of 2012.

Looking Forward

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The company measures the success of its business model over the long term, not any individual quarter or year. The company's strategies, investments and actions are all taken with an objective of optimizing long-term performance.

In May 2010, the company met with investors and introduced a road map for earnings per share in 2015. The objective of the road map for growth is to achieve at least \$20 of operating (non-GAAP) earnings per diluted share in 2015. The company has identified the major drivers of financial performance: revenue growth, margin expansion and common stock share repurchase. The revenue growth will come from a combination of base revenue growth, a shift to faster growing businesses and from acquisitions closed between 2010 and 2015. The company expects continued opportunity in the growth markets and in the higher value solutions, including business analytics, Smarter Planet and cloud computing, where the company believes its enterprise clients will continue to focus. The contribution from margin expansion will be driven by the mix of higher margin businesses and enterprise productivity. The company will also continue to return value to its shareholders, with approximately \$50 billion of share repurchase and \$20 billion of dividends expected during the road map period. Overall, the company expects fairly balanced contribution from revenue growth, margin expansion and share repurchase.

In January 2012, the company disclosed that it was expecting GAAP earnings of at least \$14.16 and operating (non-GAAP) earnings of at least \$14.85 per diluted share for the full year 2012. In April 2012, the company increased its expectation for GAAP earnings per diluted share to at least \$14.27 and its expectation for operating (non-GAAP) earnings per diluted share to at least \$15.00 for the full year. The operating (non-GAAP) earnings per share expectation exclude acquisition-related charges of \$0.47 per share and non-operating retirement-related costs of \$0.26 per share. This expectation results in an increase year to year of 9 percent in GAAP earnings per share and an increase of 12 percent year to year in operating (non-GAAP) earnings per share. Looking forward, the company expects approximately 10 percent year to year growth in earnings per share on both an as reported and operating (non-GAAP) basis in each of the next three quarters of 2012. The company's first quarter revenue growth rate of 1 percent was consistent with the fourth quarter of 2011 growth rate of 1 percent, both adjusted for currency.

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This trajectory should improve in the second half of 2012 as the business in Japan stabilizes and the company announces its new product offerings starting with the PureSystems announcement. In addition, at the April 16, 2012 spot rates, currency will be a headwind of 3 points in the second and third quarters, before easing to neutral in the fourth quarter. These dynamics, plus the continued strength of the company's operating model and growth initiatives will drive performance.

From a segment perspective, in the first quarter, the Global Services business increased pre-tax income by 10.8 percent, expanded pre-tax margin by 1.3 points and grew backlog by 1 percent, adjusted for currency, versus the prior year. Looking forward, the company expects the Global Services business to deliver double-digit profit growth for the year. The Software business delivered another strong quarter in the first quarter of 2012 capitalizing on the momentum and a strong set of opportunities it had coming off an excellent performance in 2011. In the first quarter, the company continued to strengthen the portfolio through a series of acquisitions that will contribute to the Software business performance in future periods. The Systems and Technology business will face a tough comparison in the first half of 2012 driven primarily by the System z mainframe product cycle performance in the first half of 2011. In April 2012, the company established a new class of computing with the introduction of PureSystems—a new family of expert integrated systems that leverages decades of innovation with market-leading software to help clients address the economics and complexity of deploying new IT infrastructure. PureSystems has the potential to lower total IT cost by more than 50 percent over three years, enabling clients to reinvest these savings. The company expects the Systems and Technology business to deliver revenue growth in the second half of the year based on new product announcements—PureSystems is the first announcement and to also deliver double-digit profitability in the second half.

Overall, the company's expectation for 2012 is consistent with its business model: revenue growth, margin expansion driven by a mix to software and continued productivity and prudent use of cash to drive investments, acquisitions and share repurchase. The company will continue to improve its portfolio through acquisitions and divestitures and will continue to invest in market opportunities and drive productivity. The company will continue to rebalance its workforce to opportunities and skills aligned with its key investments and hire resources to drive growth initiatives. The company expects a higher level of workforce rebalancing charges in 2012 compared to 2011; potentially higher than the amount incurred in 2010. The company expects to offset this expense within net income consistent with its earnings expectation for 2012.

The company's effective tax rate in the first quarter was 20.1 percent, down 4.9 points compared to the first quarter of 2011. The lower tax rate was primarily due to a one-time benefit associated with a tax restructuring in Latin America. The company expects its full year 2012 effective tax rate on an as reported and operating (non-GAAP) basis to be in the range of 24 percent; excluding the one-time benefit in the first quarter, the effective tax rate on an as reported and operating (non-GAAP) basis to be in the range of 25 percent.

The company expects 2012 pre-tax retirement-related plan cost to be approximately \$2.3 billion, an increase of approximately \$500 million compared to 2011. This estimate reflects current pension plan assumptions at December 31, 2011. Within total retirement-related plan cost, operating retirement-related plan cost is expected to be approximately \$1.9 billion, approximately flat versus 2011. Non-operating retirement-related plan cost is expected to be approximately \$0.4 billion versus income of \$0.1 billion in 2011.

The economy could impact the credit quality of the company's receivables, and therefore the allowance for credit losses. The company will continue to apply its rigorous credit policies and analysis, and will also continue to monitor the current economic environment, particularly in Europe. At March 31, 2012, total receivables in Portugal, Italy, Ireland, Greece and Spain were approximately \$2.6 billion, net of allowances, and represented approximately 7 percent of total net trade and financing accounts receivables. The company will continue to monitor potential exposures in these countries in conjunction with the application of its credit policies.

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Currency Rate Fluctuations

Changes in the relative values of non-U.S. currencies to the U.S. dollar affect the company's financial results and financial position. At March 31, 2012, currency changes resulted in assets and liabilities denominated in local currencies being translated into more dollars than at year-end 2011. The company uses financial hedging instruments to limit specific currency risks related to financing transactions and other foreign currency-based transactions. Further discussion of currency and hedging appears in the 2011 IBM Annual Report in Note D, Financial Instruments, on pages 96 to 100.

Foreign currency fluctuations often drive operational responses that mitigate the simple mechanical translation of earnings. During periods of sustained movements in currency, the marketplace and competition adjust to the changing rates. For example, when pricing offerings in the marketplace, the company may use some of the advantage from a weakening U.S. dollar to improve its position competitively, and price more aggressively to win the business, essentially passing on a portion of the currency advantage to its customers. Competition will frequently take the same action. Consequently, the company believes that some of the currency-based changes in cost impact the prices charged to clients. The company also maintains currency hedging programs for cash management purposes which mitigate, but do not eliminate, the volatility of currency impacts on the company's financial results.

The company translates revenue, cost and expense in its non-U.S. operations at current exchange rates in the reported period. References to adjusted for currency or constant currency reflect adjustments based upon a simple constant currency mathematical translation of local currency results using the comparable prior period's currency conversion rate. However, this constant currency methodology that the company utilizes to disclose this information does not incorporate any operational actions that management may take in reaction to fluctuating currency rates. Based on the currency rate movements in the first three months of 2012, total revenue increased 0.3 percent as reported and 1.0 percent at constant currency versus the first three months of 2011. On a pre-tax income basis, these translation impacts offset by the net impact of hedging activities resulted in a theoretical maximum (assuming no pricing or sourcing actions) increase of approximately \$45 million in the first three months of 2012. The same mathematical exercise resulted in approximately an \$80 million increase in the first three months of 2011. The company views these amounts as a theoretical maximum impact to its as-reported financial results. Considering the operational responses mentioned above, movements of exchange rates, and the nature and timing of hedging instruments, it is difficult to predict future currency impacts on any particular period, but the company believes it could be substantially less than the theoretical maximum given the competitive pressure in the marketplace.

For non-U.S. subsidiaries and branches that operate in U.S. dollars or whose economic environment is highly inflationary, translation adjustments are reflected in results of operations. Generally, the company manages currency risk in these entities by linking prices and contracts to U.S. dollars. The company continues to monitor the economic conditions in Venezuela. On December 30, 2010, the official rate for essential goods was eliminated, with no change to the SITME rate. The SITME rate remained constant throughout 2011 and the first three months of 2012. Future gains or losses from devaluation of the SITME rate are not expected to have a material impact given the size of the company's operations in Venezuela (less than 1 percent of total 2010 and 2011 revenue, respectively).

Liquidity and Capital Resources

In the company's 2011 Annual Report, on pages 56 to 58, there is a discussion of the company's liquidity including two tables that present five years of data. The table presented on page 56 includes net cash from operating activities, cash and marketable securities and the size of the company's global credit facilities for each of the past five years. For the three months ended, or as of, as applicable, March 31, 2012, those amounts are \$4.3 billion for net cash from operating activities, \$12.3 billion of cash and marketable securities and \$10 billion in global credit

facilities, respectively.

The major rating agencies' ratings on the company's debt securities at March 31, 2012 appear in the table below and remain unchanged from December 31, 2011. The company's debt securities do not contain any acceleration clauses which could change the scheduled maturities of the obligation. In addition, the company does not have ratings trigger provisions in its debt covenants or documentation, which would allow the holders to declare an event of default and seek to accelerate payments thereunder in the event of a change in credit rating. The company's contractual agreements governing derivative instruments contain standard market clauses which can trigger the termination of the agreement if the company's credit rating were to fall below investment grade. At March 31, 2012, the fair value of those instruments that were in a liability position was \$319 million, before any applicable netting, and this position is subject to fluctuations in fair value period to period based on the level of the company's outstanding instruments and market conditions. The company has no other contractual arrangements that, in the event of a change in credit rating, would result in a material adverse effect on its financial position or liquidity.

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| | STANDARD AND POOR S | MOODY S INVESTORS SERVICE | FITCH RATINGS |
|-----------------------|---------------------------|---------------------------------|------------------|
| Senior long-term debt | A+ | Aa3 | A+ |
| Commercial paper | A-1 | Prime-1 | F1 |

The table appearing on page 57 of the 2011 Annual Report presents the format in which management reviews cash flows for each of the past five years and is accompanied by a description of the way cash flow is managed, measured and reviewed. The company prepares its Consolidated Statement of Cash Flows in accordance with applicable accounting standards for cash flow presentation on page 7 of this Form 10-Q and highlights causes and events underlying sources and uses of cash in that format on pages 50 and 51. The following is management's view of cash flows for the first three months of 2012 and 2011 prepared in a manner consistent with the table and description on pages 56 and 57 of the 2011 Annual Report:

(Dollars in millions)

For the three months ended March 31:

| | 2012 | | 2011 | |
|--|------|---------|------|---------|
| Net cash from operating activities per GAAP: | \$ | 4,291 | \$ | 3,792 |
| Less: the change in Global Financing receivables | | 1,424 | | 1,936 |
| Net cash from operating activities, excluding Global Financing receivables | | 2,867 | | 1,856 |
| Capital expenditures, net | | (1,002) | | (1,058) |
| Free cash flow | | 1,865 | | 798 |
| Acquisitions | | (1,319) | | (51) |
| Share repurchase | | (3,015) | | (4,045) |
| Dividends | | (870) | | (795) |
| Non-Global Financing debt | | 657 | | 1,027 |
| Other (includes Global Financing receivables and Global Financing debt) | | 3,094 | | 4,660 |
| Change in cash, cash equivalents and short-term marketable securities | \$ | 413 | \$ | 1,594 |

Free cash flow for the first three months of 2012 increased \$1,067 million versus the first three months of 2011; excluding the impact of net income tax settlement payments in the first quarter of 2011, free cash flow would have increased at a double-digit rate year to year. The increase was driven by net income and working capital efficiencies.

Events that could temporarily change the historical cash flow dynamics discussed above and in the 2011 Annual Report include significant changes in operating results, material changes in geographic sources of cash, unexpected adverse impacts from litigation or future pension funding during periods of severe downturn in the capital markets. Whether any litigation has such an adverse impact will depend on a number of variables, which are more completely described in Note 12, Contingencies, on pages 31 to 33 of this Form 10-Q. The company expects to make legally mandated pension plan contributions to certain non-U.S. plans of approximately \$800 million in 2012. The company is not quantifying any further impact from pension funding because it is not possible to predict future movements in the capital markets or pension plan funding regulations.

The company's U.S. cash flows continue to be sufficient to fund its current domestic operations and obligations, including investing and financing activities such as dividends and debt service. The company's U.S. operations generate substantial cash flows, and, in those circumstances where the company has additional cash requirements in the U.S., the company has several liquidity options available. These options include the ability to borrow funds at reasonable interest rates, utilizing its committed global credit facility, repatriating certain foreign earnings and calling intercompany loans that are in place with certain foreign subsidiaries.

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The company does earn a significant amount of its pre-tax income outside the U.S. The company's policy is to indefinitely reinvest the undistributed earnings of its foreign subsidiaries, and accordingly, no provision for federal income taxes has been made on accumulated earnings of foreign subsidiaries. The company periodically repatriates a portion of these earnings to the extent that it does not incur an additional U.S tax liability. Quantification of the deferred tax liability, if any, associated with indefinitely reinvested earnings is not practicable. While the company currently does not have a need to repatriate funds held by its foreign subsidiaries, if these funds are needed for operations and obligations in the U.S., the company could elect to repatriate these funds which could result in a reassessment of the company's policy and increased tax expense.

Table of Contents**Global Financing**

Global Financing is a reportable segment that is measured as a stand-alone entity. Global Financing facilitates clients' acquisition of IBM systems, software and services with the objective of generating consistently strong returns on equity.

Results of Operations

| (Dollars in millions) | Three Months Ended | | | | |
|-----------------------|--------------------|-------|-----------|-------|------|
| | 2012 | | March 31, | | 2011 |
| External revenue | \$ | 490 | \$ | 516 | |
| Internal revenue | | 485 | | 497 | |
| Total revenue | | 975 | | 1,013 | |
| Cost | | 303 | | 335 | |
| Gross profit | \$ | 672 | \$ | 678 | |
| Gross profit margin | | 68.9% | | 66.9% | |
| Pre-tax income | \$ | 512 | \$ | 519 | |
| After-tax income* | \$ | 343 | \$ | 341 | |
| Return on equity* | | 41.5% | | 41.1% | |

* See page 60 for the details of the after-tax income and the return on equity calculation.

The decrease in revenue in the first quarter, as compared to the same period in 2011, was due to:

- A decline in external revenue of 5.1 percent (4 percent adjusted for currency), due to decreases in financing revenue (down 5.2 percent to \$391 million) and in used equipment sales revenue (down 4.4 percent to \$98 million); and
- A decline in internal revenue of 2.5 percent primarily driven by a decrease in financing revenue (down 7.5 percent to \$141 million).

The decrease in external financing revenue was primarily due to lower asset yields. The decrease in internal financing revenue was primarily due to a decrease in remarketing lease revenue.

Global Financing gross profit decreased 0.9 percent compared to the same period in 2011 due to a decrease in financing gross profit, partially offset by an increase in used equipment sales gross profit. Gross profit margin increased 2.0 points due to increases in both used equipment sales and financing margins.

Global Financing pre-tax income decreased 1.3 percent in the first quarter of 2012 versus the same period in 2011. The decrease was driven by the decrease in gross profit of \$6 million and higher financing receivables provisions of \$16 million, partially offset by a decrease in selling, general and administrative expenses of \$16 million. The increase in financing receivables provisions was primarily due to lower reserve requirements in the prior year. The overall allowance for credit losses coverage rate is 1.3 percent, a decrease of 0.2 points versus the first quarter of 2011, but flat versus the December 31, 2011 coverage rate.

Pre-tax margin of 52.6 percent increased 1.3 points versus the first quarter of 2011.

The increase in return on equity for the first quarter of 2012 compared to the same period in 2011 was primarily driven by higher after-tax income.

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Balance Sheet

| (Dollars in millions) | At March 31, | | At December 31, | |
|--|---------------------|--------|------------------------|--------|
| | 2012 | | 2011 | |
| Cash and cash equivalents | \$ | 1,288 | \$ | 1,308 |
| Net investment in sales-type and direct financing leases | | 9,149 | | 9,209 |
| Equipment under operating leases: | | | | |
| External clients (a) | | 1,497 | | 1,567 |
| Internal clients (b) (c) | | 175 | | 219 |
| Client loans | | 11,110 | | 11,363 |
| Total client financing assets | | 21,931 | | 22,358 |
| Commercial financing receivables | | 5,483 | | 7,130 |
| Intercompany financing receivables(b) (c) | | 4,289 | | 4,586 |
| Other receivables | | 338 | | 334 |
| Other assets | | 707 | | 712 |
| Total assets | \$ | 34,036 | \$ | 36,427 |
| Intercompany payables (b) | \$ | 3,653 | \$ | 6,213 |
| Debt (d) | | 23,597 | | 23,332 |
| Other liabilities | | 3,427 | | 3,633 |
| Total liabilities | | 30,676 | | 33,178 |
| Total equity | | 3,360 | | 3,249 |
| Total liabilities and equity | \$ | 34,036 | \$ | 36,427 |

(a) Includes intercompany mark-up, priced on an arms-length basis, on products purchased from the company's product divisions, which is eliminated in IBM's consolidated results.

(b) Entire amount eliminated for purposes of IBM's consolidated results and therefore does not appear on pages 5 and 6.

(c) These assets, along with all other financing assets in this table, are leveraged at the value in the table using Global Financing debt.

(d) Global Financing debt is comprised of intercompany loans and external debt. A portion of Global Financing debt is in support of the company's internal business, or related to intercompany mark-up embedded in the Global Financing assets. See table on page 60.

Sources and Uses of Funds

The primary use of funds in Global Financing is to originate client and commercial financing assets. Client financing assets for end users consist primarily of IBM systems, software and services, but also include non-IBM equipment, software and services to meet IBM clients' total solutions requirements. Client financing assets are primarily sales-type, direct financing and operating leases for systems products, as well as loans for systems, software and services with terms generally from one to seven years. Global Financing's client loans are primarily for software and services and are unsecured. These loans are subjected to additional credit analysis to evaluate the associated risk and, when deemed necessary, actions are taken to mitigate risks in the loan agreements which include covenants to protect against credit deterioration during the life of the obligation. Client financing also includes internal activity as described on page 24 of the 2011 IBM Annual Report.

Commercial financing receivables arise primarily from inventory and accounts receivable financing for dealers and remarketers of IBM and non-IBM products. Payment terms for inventory financing and accounts receivable financing generally range from 30 to 90 days. These short-term receivables are primarily unsecured and are also subjected to additional credit analysis in order to evaluate the associated risk.

At March 31, 2012, substantially all financing assets are IT related assets, and approximately 62 percent of the external portfolio is with investment grade clients with no direct exposure to consumers or mortgage assets.

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Originations

The following are total external financing originations:

| (Dollars in millions) | Three Months Ended | | | |
|-----------------------|--------------------|--------|----------------|--------|
| | 2012 | | March 31, 2011 | |
| Client financing | \$ | 3,191 | \$ | 3,086 |
| Commercial financing | | 8,499 | | 7,724 |
| Total | \$ | 11,690 | \$ | 10,811 |

Cash collections of both commercial and client financing assets exceeded new financing originations in both the first quarter of 2012 and 2011, which resulted in a net decline in total financing assets for these periods. The increase in originations was due to improving volumes in both client and commercial financing.

Cash generated by Global Financing was primarily deployed to pay the intercompany payables and dividends to IBM.

Global Financing Receivables and Allowances

The following table presents external financing receivables excluding residual values and the allowance for credit losses:

| (Dollars in millions) | At March 31, | | At December 31, | |
|---|--------------|--------|-----------------|--------|
| | 2012 | | 2011 | |
| Gross financing receivables | \$ | 25,418 | \$ | 27,366 |
| Specific allowance for credit losses | | 220 | | 226 |
| Unallocated allowance for credit losses | | 120 | | 124 |
| Total allowance for credit losses | | 340 | | 350 |
| Net financing receivables | \$ | 25,078 | \$ | 27,016 |
| Allowance for credit losses coverage | | 1.3% | | 1.3% |

Roll Forward of Global Financing Receivables Allowance for Credit Losses (includes current and non current financing receivables)

| (Dollars in millions) | Allowance | Additions/ | Other** | March 31, 2012 |
|-----------------------|-----------|--------------|---------|----------------|
| January 1, 2012 | Used* | (Reductions) | | |
| \$ 350 | \$ (8) | \$ (6) | \$ 4 | \$ 340 |

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* Represents reserved receivables, net of recoveries, that were disposed of during the period.

** Primarily represents translation adjustments.

The percentage of Global Financing receivables reserved remained at 1.3 percent for periods ending December 31, 2011 and March 31, 2012. Specific reserves decreased 3 percent from \$226 million at December 31, 2011 to \$220 million at March 31, 2012. Unallocated reserves decreased 3 percent from \$124 million at December 31, 2011 to \$120 million at March 31, 2012 due primarily to the decline in gross financing receivables.

Global Financing's bad debt expense was a decrease of \$6 million for the three months ended March 31, 2012, compared with a decrease of \$21 million for the three months ended March 31, 2011. The year-to-year increase was attributed primarily to lower reserve requirements in the three months ended March 31, 2011.

Residual Value

Residual value is a risk unique to the financing business and management of this risk is dependent upon the ability to accurately project future equipment values at lease inception. Global Financing has insight into product plans and cycles for the IBM products under lease. Based upon this product information, Global Financing continually monitors projections of future equipment values and compares them with the residual values reflected in the portfolio.

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Global Financing optimizes the recovery of residual values by selling assets sourced from end of lease, leasing used equipment to new clients, or extending lease arrangements with current clients. Sales of equipment, which are primarily sourced from equipment returned at the end of a lease, represented 45.4 percent of Global Financing's revenue in the first quarter of 2012 and 44.2 percent in the first quarter of 2011. The gross margin on these sales was 59.1 percent and 56.1 percent in the first quarter of 2012 and 2011, respectively. The margin increase was driven by an increase in the internal sales margin.

The table below presents the recorded amount of unguaranteed residual value for sales-type, direct financing and operating leases at January 1, 2012 and March 31, 2012. In addition, the table presents the residual value as a percentage of the related original amount financed and a run out of when the unguaranteed residual value assigned to equipment on lease at March 31, 2012 is expected to be returned to the company. In addition to the unguaranteed residual value, on a limited basis, Global Financing will obtain guarantees of the future value of the equipment to be returned at end of lease. While primarily focused on IBM products, guarantees are also obtained for certain OEM products. These third-party guarantees are included in minimum lease payments as provided for by accounting standards in the determination of lease classifications for the covered equipment and provide protection against risk of loss arising from declines in equipment values for these assets.

The residual value guarantee increases the minimum lease payments that are utilized in determining the classification of a lease as a sales-type lease, direct financing lease or operating lease. The aggregate asset values associated with the guarantees for sales-type leases were \$171 million and \$182 million for the financing transactions originated during the quarters ended March 31, 2012 and March 31, 2011, respectively. The associated aggregate guaranteed future values at the scheduled end of lease were \$11 million and \$8 million for the financing transactions originated during the quarters ended March 31, 2012 and March 31, 2011, respectively. The cost of guarantees was \$1.1 million and \$0.8 million for the quarters ended March 31, 2012 and March 31, 2011, respectively.

Unguaranteed Residual Value

| (Dollars in millions) | At January 1, 2012 | At March 31 2012 | 2012 | Estimated Run Out of March 31, 2012 Balance | | | 2015 and Beyond |
|--|--------------------------|------------------------|--------|--|--------|--------|--------------------|
| | | | | 2013 | 2014 | | |
| Sales-type and direct financing leases | \$ 745 | \$ 730 | \$ 126 | \$ 186 | \$ 254 | \$ 164 | |
| Operating leases | 296 | 297 | 106 | 103 | 68 | 20 | |
| Total unguaranteed residual value | \$ 1,041 | \$ 1,027 | \$ 232 | \$ 289 | \$ 322 | \$ 184 | |
| Related original amount financed | \$ 18,635 | \$ 18,466 | | | | | |
| Percentage | 5.6% | 5.6% | | | | | |

Debt

| | At March 31, 2012 | At December 31, 2011 |
|----------------------|----------------------|-------------------------|
| Debt-to-equity ratio | 7.0x | 7.2x |

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The company funds Global Financing through borrowings using a debt-to-equity ratio target of approximately 7 to 1. The debt used to fund Global Financing assets is composed of intercompany loans and external debt. The terms of the intercompany loans are set by the company to substantially match the term and currency underlying the financing receivable and are based on arm's-length pricing. Both assets and debt are presented in the Global Financing balance sheet on page 57.

Global Financing provides financing predominantly for the company's external client assets, as well as for assets under contract by other IBM units. As previously stated, the company measures Global Financing as a stand-alone entity, and accordingly, interest expense relating to debt supporting Global Financing's external client and internal business is included in the Global Financing Results of Operations on page 56 and in Segment Information on page 25.

In the company's Consolidated Statement of Earnings on page 3, however, the external debt-related interest expense supporting Global Financing's internal financing to the company is reclassified from cost of financing to interest expense.

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The following table provides additional information on total company debt. In this table, intercompany activity includes internal loans and leases at arm's length pricing in support of Global Services' long-term contracts and other internal activity. The company believes these assets should be appropriately leveraged in line with the overall Global Financing business model.

| (Dollars in millions) | At March 31, 2012 | | At December 31, 2011 | |
|----------------------------------|-------------------|-----------|----------------------|-----------|
| Global Financing Segment | | \$ 23,597 | | \$ 23,332 |
| Debt to support external clients | \$ 20,287 | | \$ 20,051 | |
| Debt to support internal clients | 3,310 | | 3,281 | |
| Non-Global Financing Segments | | 8,456 | | 7,987 |
| Debt supporting operations | 11,766 | | 11,269 | |
| Intercompany activity | (3,310) | | (3,281) | |
| Total company debt | | \$ 32,053 | | \$ 31,320 |

Liquidity and Capital Resources

As a segment of the company, Global Financing is supported by the company's overall liquidity position and access to capital markets. Cash generated by Global Financing was primarily deployed to pay intercompany payables and dividends to the company in order to maintain an appropriate debt-to-equity ratio.

Return on Equity

| (Dollars in millions) | Three Months Ended March 31, | |
|--|---------------------------------|----------|
| | 2012 | 2011 |
| Numerator : | | |
| Global Financing after tax income* | \$ 343 | \$ 341 |
| Annualized after-tax income (A) | \$ 1,373 | \$ 1,363 |
| Denominator : | | |
| Average Global Financing equity (B)** | \$ 3,305 | \$ 3,315 |
| Global Financing return on equity(A)/(B) | 41.5% | 41.1% |

* Calculated based upon an estimated tax rate principally based on Global Financing's geographic mix of earnings as IBM's provision for income taxes is determined on a consolidated basis.

** Average of the ending equity for Global Financing for the last 2 quarters.

Looking Forward

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Global Financing's financial position provides flexibility and funding capacity which enables the company to be well positioned in the current environment. Global Financing's assets and new financing volumes are primarily IBM products and services financed to the company's clients and business partners, and substantially all financing assets are IT related assets which provide a stable base of business for future growth. Global Financing's offerings are competitive and available to clients as a result of the company's borrowing cost and access to the capital markets. Overall, Global Financing's originations will be dependent upon the demand for IT products and services as well as client participation rates.

IBM continues to access both the short-term commercial paper market and the medium- and long-term debt markets. A protracted period where IBM could not access the capital markets would likely lead to a slowdown in originations.

Interest rates and the overall economy (including currency fluctuations) will have an effect on both revenue and gross profit. The company's interest rate risk management policy, however, combined with the Global Financing pricing strategy should mitigate gross margin erosion due to changes in interest rates.

The economy could impact the credit quality of the Global Financing receivables portfolio and therefore the level of provision for credit losses. Global Financing will continue to apply rigorous credit policies in both the origination of new business and the evaluation of the existing portfolio.

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As discussed on pages 58 and 59, Global Financing has historically been able to manage residual value risk both through insight into the company's product cycles, as well as through its remarketing business.

Global Financing has policies in place to manage each of the key risks involved in financing. These policies, combined with product and client knowledge, should allow for the prudent management of the business going forward, even during periods of uncertainty with respect to the global economy.

GAAP Reconciliation

The tables below provide a reconciliation of the company's income statement results as reported under GAAP to its operating earnings presentation which is a non-GAAP measure. The company's calculation of operating earnings, as presented, may differ from similarly titled measures reported by other companies. Please refer to the Snapshot section beginning on page 35 for the company's rationale for presenting operating earnings information.

| (Dollars in millions except per share amounts) For the three months ended March 31, 2012 | GAAP | Acquisition-related adjustments | Retirement-related adjustments | Operating (Non-GAAP) |
|---|-----------|------------------------------------|-----------------------------------|-------------------------|
| Gross profit | \$ 11,118 | \$ 89 | \$ 71 | \$ 11,278 |
| Gross profit margin | 45.1% | 0.4pts. | 0.3pts. | 45.7% |
| S,G&A | \$ 5,886 | \$ (84) | \$ (36) | \$ 5,766 |
| R,D&E | 1,601 | 0 | 4 | 1,605 |
| Other (income) and expense | (58) | (1) | 0 | (59) |
| Total expense and other (income) | 7,283 | (85) | (32) | 7,166 |
| Pre-tax income | 3,836 | 173 | 102 | 4,111 |
| Pre-tax income margin | 15.5% | 0.7pts. | 0.4pts. | 16.7% |
| Provision for income taxes* | \$ 769 | \$ 47 | \$ 30 | \$ 846 |
| Effective tax rate | 20.1% | 0.3pts. | 0.2pts. | 20.6% |
| Net income | \$ 3,066 | \$ 126 | \$ 73 | \$ 3,265 |
| Net income margin | 12.4% | 0.5pts. | 0.3pts. | 13.2% |
| Diluted earnings per share | \$ 2.61 | \$ 0.11 | \$ 0.06 | \$ 2.78 |

| (Dollars in millions except per share amounts) For the three months ended March 31, 2011 | GAAP | Acquisition-related adjustments | Retirement-related adjustments | Operating (Non-GAAP) |
|---|-----------|------------------------------------|-----------------------------------|-------------------------|
| Gross profit | \$ 10,858 | \$ 85 | \$ 14 | \$ 10,957 |
| Gross profit margin | 44.1% | 0.3pts. | 0.1pts. | 44.5% |
| S,G&A | \$ 5,826 | \$ (76) | \$ (10) | \$ 5,740 |
| R,D&E | 1,587 | | 19 | 1,606 |
| Other (income) and expense | (202) | (4) | | (206) |
| Total expense and other (income) | 7,041 | (80) | 10 | 6,971 |
| Pre-tax income | 3,817 | 165 | 4 | 3,986 |
| Pre-tax income margin | 15.5% | 0.7pts. | 0.0pts. | 16.2% |
| Provision for income taxes* | \$ 954 | \$ 48 | \$ (6) | \$ 997 |
| Effective tax rate | 25.0% | 0.2pts. | (0.2)pts. | 25.0% |
| Net income | \$ 2,863 | \$ 117 | \$ 10 | \$ 2,990 |
| Net income margin | 11.6% | 0.5pts. | 0.0pts. | 12.1% |
| Diluted earnings per share | \$ 2.31 | \$ 0.09 | \$ 0.01 | \$ 2.41 |

* The tax impact on operating (non-GAAP) pre-tax income is calculated under the same accounting principles applied to the GAAP pre-tax income which employs an annual effective tax rate method to the results.

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Forward-Looking and Cautionary Statements

Except for the historical information and discussions contained herein, statements contained in this release may constitute forward-looking statements within the meaning of 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. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, including the following: a downturn in economic environment and corporate IT spending budgets; the company's failure to meet growth and productivity objectives; a failure of the company's innovation initiatives; risks from investing in growth opportunities; failure of the company's intellectual property portfolio to prevent competitive offerings and the failure of the company to obtain necessary licenses; cybersecurity and data privacy considerations; fluctuations in financial results and purchases; impact of local legal, economic, political and health conditions; adverse effects from environmental matters, tax matters and the company's pension plans; ineffective internal controls; the company's use of accounting estimates; the company's ability to attract and retain key personnel and its reliance on critical skills; impacts of relationships with critical suppliers and business with government clients; currency fluctuations and customer financing risks; impact of changes in market liquidity conditions and customer credit risk on receivables; reliance on third party distribution channels; the company's ability to successfully manage acquisitions and alliances; risk factors related to IBM securities; and other risks, uncertainties and factors discussed in the company's Form 10-Q, Form 10-K and in the company's other filings with the U.S. Securities and Exchange Commission (SEC) or in materials incorporated therein by reference. The company assumes no obligation to update or revise any forward-looking statements.

Item 4. Controls and Procedures

The company's management evaluated, with the participation of the Chief Executive Officer and Chief Financial Officer, the effectiveness of the company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the company's disclosure controls and procedures were effective as of the end of the period covered by this report. There has been no change in the company's internal control over financial reporting that occurred during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting.

Part II Other Information

Item 1. Legal Proceedings

Refer to Note 12, Contingencies, on pages 31 to 33 of this Form 10-Q.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds and Issuer Repurchases of Equity Securities**

The following table provides information relating to the company's repurchase of common stock for the first quarter of 2012.

| Period | | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Approximate Dollar Value of Shares that May Yet Be Purchased Under The Program* |
|------------------|-------------------|----------------------------------|------------------------------|--|---|
| January 1, 2012 | January 31, 2012 | 6,468,710 | \$ 185.52 | 6,468,710 | \$ 7,460,210,832 |
| February 1, 2012 | February 29, 2012 | 4,644,212 | \$ 194.02 | 4,644,212 | \$ 6,559,138,543 |
| March 1, 2012 | March 31, 2012 | 4,431,092 | \$ 203.45 | 4,431,092 | \$ 5,657,616,496 |
| Total | | 15,544,014 | \$ 193.17 | 15,544,014 | |

* On April 26, 2011, the Board of Directors authorized \$8.0 billion in funds for use in the company's common stock repurchase program. On October 25, 2011 the Board of Directors authorized an additional \$7.0 billion in funds for use in such program. The April 26, 2011 authorization was fully utilized in February 2012. In each case, the company stated that it would repurchase shares on the open market or in private transactions depending on market conditions and that it expects to use cash from operations for the repurchases. The common stock repurchase program does not have an expiration date. This table does not include shares tendered to satisfy the exercise price in connection with cashless exercises of employee stock options or shares tendered to satisfy tax withholding obligations in connection with employee equity awards.

Item 6. Exhibits

| Exhibit Number | |
|----------------|--|
| 10.1 | Form of Noncompetition Agreement. |
| 11 | Statement re: computation of per share earnings. |
| 12 | Statement re: computation of ratios. |
| 31.1 | Certification by principal executive officer pursuant to Rule 13A-14(a) or 15D-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification by principal financial officer pursuant to Rule 13A-14(a) or 15D-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification by principal executive officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification by principal financial officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statement of Earnings for the three month period ended March 31, 2012 and 2011, (ii) the Consolidated Statement of Comprehensive Income for the three month period ended March 31, 2012 and 2011, (iii) the Consolidated Statement of Financial Position at March 31, 2012 and December 31, 2011, (iii) the Consolidated Statement of Cash Flows for the three months ended March 31, 2012 and 2011, (iv) the Consolidated Statement of Changes in Equity for the three months ended March 31, 2012 and 2011 and (v) the notes to the Consolidated Financial Statements.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

International Business Machines Corporation
(Registrant)

Date: April 24, 2012

By: /s/ James J. Kavanaugh
James J. Kavanaugh
Vice President and Controller