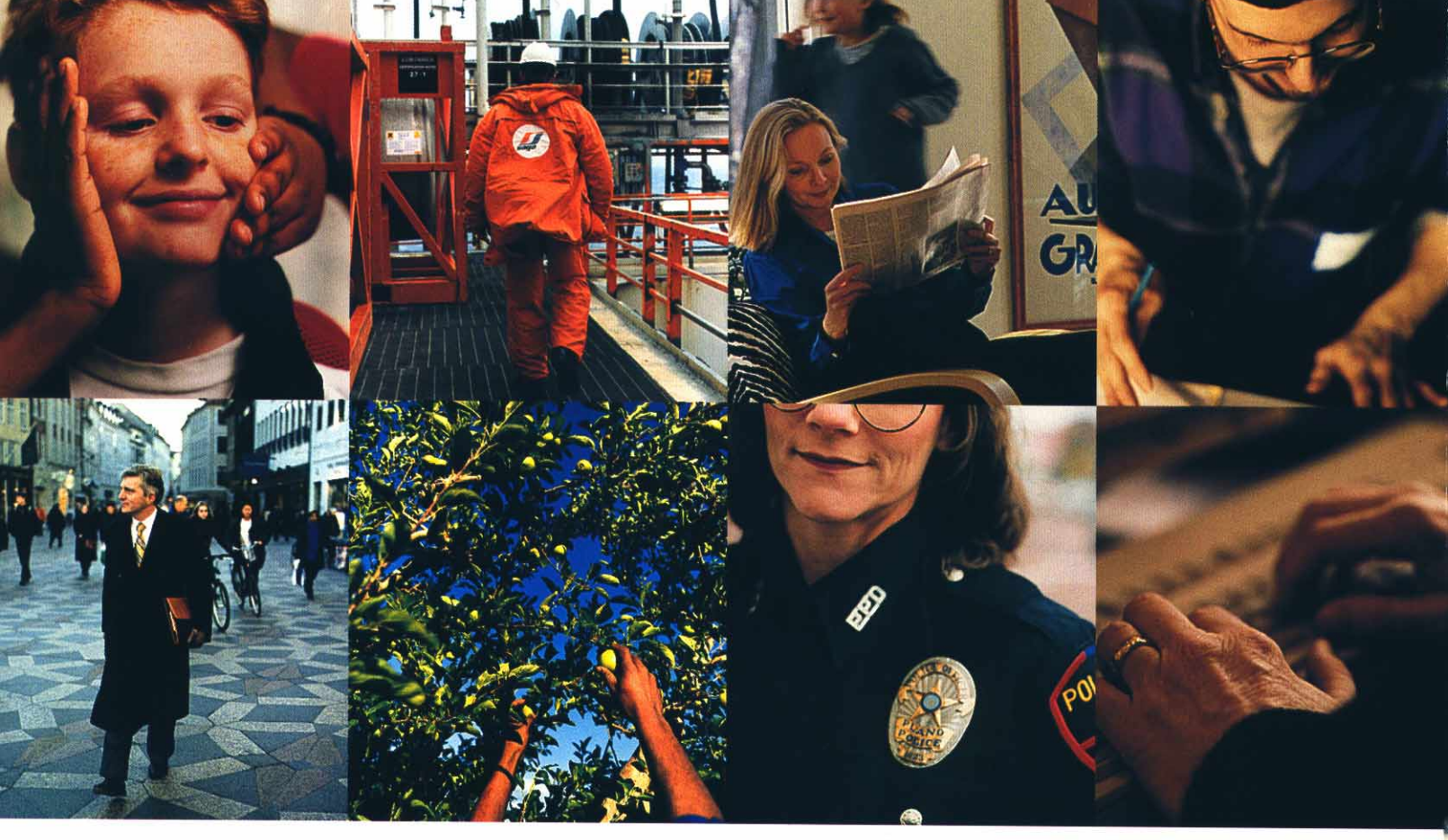
IBM Annual Report 1996



What do

you do?

It's often the first question asked when people meet. It establishes common ground. It gets to the center of how we define ourselves, how we conduct our life's work, our pastimes.

At IBM, it's a question we frequently ask our customers. And in many ways, it's the most important one, especially now, at this moment when all of us are rushing forward into a networked world.

That's because the benefit of all this connectivity – to people, to the world's enterprises, to knowledge – isn't in the technology, as dazzling as it may be. It's in how we apply it, how we use it to vastly improve the way we work, learn, buy, sell, entertain and communicate. The things that fill our lives. The things we do. Every day.

Dear Fellow Investors:

Last year I told you that the transformation of IBM had progressed to the point where it was time for everyone in the company to focus on our strategic vision – a networked world that transforms the way people work, interact, learn and do business.

I said our vision wasn't some slogan or a flashy-but-improbable dream. Rather, it was our view, grounded in decades of experience, of where technology and commerce around the world were headed, and that we would help our customers use network computing to improve what they do and how they do it.

And, I said, implementing this strategic vision would fuel future IBM growth.

We are indeed growing. For the second consecutive year, IBM reported record revenue – $75.9 billion, up 6 percent. Revenue increased 9 percent after adjusting for the effects of currency, our highest rate of growth since 1985.

Our earnings, however, were essentially flat, excluding one-time charges associated with acquisitions last year and in 1995. We're not happy with flat earnings. There were two primary problems: Our European business was weak, and our semiconductor business was buffeted by factors largely outside our control, especially declining memory chip prices.

We ended the year with more than $8 billion in cash – and that's after $6 billion in capital expenditures to strengthen our existing businesses; $1 billion for acquisitions like Tivoli, a leader in systems management software, and Edmark, a leading maker of education software for children; and nearly $6 billion to repurchase IBM common stock.

Our stock price rose 66 percent in 1996. As a result, our ultimate report card, IBM's market value, grew $27 billion last year. That brings the total increase since our major restructuring in 1993 to more than $50 billion.

Perhaps the most encouraging sign that our strategies are taking hold is the broad base of our growth and our continued strength in businesses that represent the greatest long-term growth potential:

– Services revenue increased 25 percent to nearly $16 billion – the fourth consecutive year services grew more than 20 percent. We signed contracts worth $27 billion in 1996. The total value of professional services business already booked for 1997 and beyond in areas like systems integration and outsourcing of customers' data center operations is more than $38 billion.

– Software revenue grew 3 percent, driven largely by strong sales of Lotus and Tivoli products. Revenue from Tivoli's flagship systems management products was greater in the fourth quarter of 1996 than for all of 1995. The installed base of Lotus Notes doubled for the second consecutive year to a total of about 9 million.

– We continued to improve the competitiveness of our hardware lines, from the new Aptiva S Series for the home to large-scale enterprise servers (mainframes). In fact, shipments of mainframe computing power grew 50 percent. We were the first major company to introduce a network computer – the IBM Network Station, a new kind of desktop device that provides access to networked applications and processing power while dramatically reducing the cost of desktop computing.

– Our PC business, after several lackluster years, righted itself. Shipments expanded significantly worldwide and we grew share. Our storage business also refocused itself and turned in an exceptional performance, particularly in hard disk drive sales.

– We continued to grow rapidly in the world's emerging markets. Last year we became the leading PC vendor in China. Our operations in Central Europe and Russia have built a network of more than 1,000 business partners.

As part of the $4.7 billion IBM invests in research and development, we support projects and programs that further our understanding of how the world and the universe work, and explore phenomena that may one day lead to advanced information technologies.

LOUIS V. GERSTNER, JR.
Chairman and Chief Executive Officer

To further fuel growth, we hired more than 26,000 people last year, and we will hire thousands more in 1997. Our total workforce grew to 241,000 at the end of 1996, up from 225,000 in 1995. I'd like to add here that I am very happy – and proud – that our transformation has created job growth.

For the second consecutive year we increased our capital expenditures, nearly all of it for strategically important areas like expanded disk drive manufacturing capacity. We also spent $4.7 billion on research and development. I note here that for the fourth year in a row, IBM received more U.S. patents than any other company, and we surpassed our own record for patents awarded in any year. This says something good about our future.

Even as we grow we are relentlessly continuing to fine-tune our operations to improve our efficiency and productivity, mostly through our reengineering efforts.

Overall, it was a solid year.

Now, it's at this point in annual letters to shareholders where a CEO might be tempted to announce some bold new direction. I'm going to resist the temptation and report to you that I believe we should stay the course. To be sure, our transformation is far from complete. We must and we will pick up the pace and intensity of everything we do.

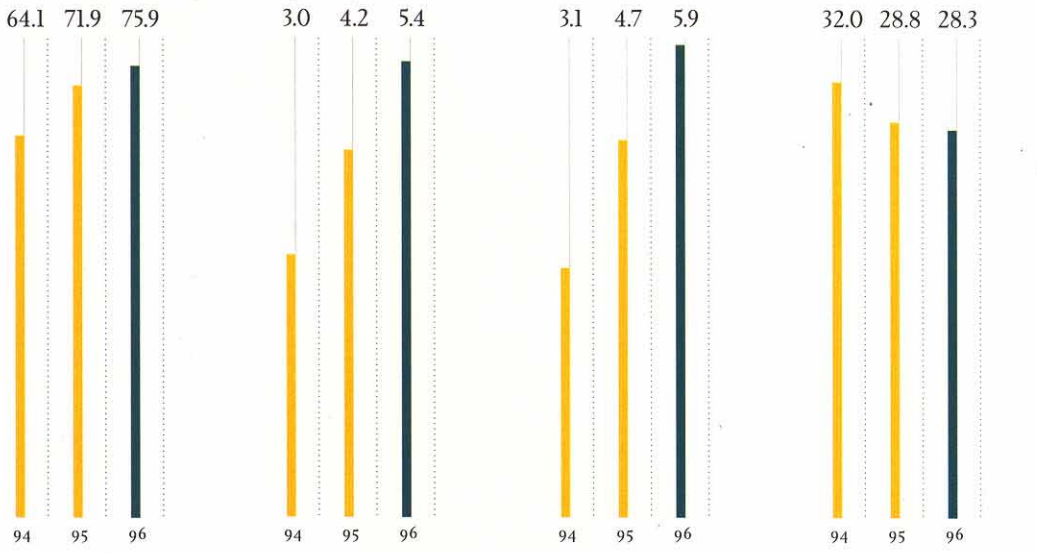
But I believe that we have made enormous progress over the last four years – in part because of the grit and determination and talent and teamwork of IBM employees, and also because we set a strategic direction for the company that was right for us, right for our industry and, most importantly, right for our customers.

I have met with thousands of customers, and throughout 1996, the single most-asked question I got was: "Exactly what is network computing and is it something I should be paying attention to?"

It sure is.

The term says it all. Network computing is a new model of computing based on networks, most notably the Internet. It is not the same as merely hooking computers

SERVE AT ROOM TEMPERATURE Atoms, by nature, are a lively lot. At room temperature they tend to jitter and jump. But now, IBM researchers in Zurich have discovered a way to move individual molecules at room-temperature (rather than in a deep freeze). With this advance, molecules can potentially be used to build the ultimate in miniaturized structures, such as computers measured in nanometers (1 millionth of a millimeter). To demonstrate their technique, they constructed the world's smallest abacus. Individual molecules served as the abacus' beads.



together so they can talk to each other. We've been doing that for a long time.

Rather, network computing is a big change in *how* computing is used and *where* it takes place.

It changes where computing takes place because it shifts most of the work – the processing, the data, the applications – from desktop machines to computers, called "servers," laboring behind the scenes in the network. This saves customers a lot of money because they don't have to replace desktop computers and desktop software every time a new upgrade comes along. All of that can be done once, on the server. This also gives our business customers greater control of their critical business data because the information is no longer distributed – sometimes haphazardly – over hundreds or thousands of individual PCs.

Network computing changes how computing is used because it connects tens of millions of people to other people, to information and to the world's businesses and institutions. Networks within companies – they're called "intranets" – enable employees to work faster and smarter as teams, unencumbered by time zones and borders. Networks also improve efficiency and speed between a company and its suppliers, distributors, retailers and other business partners. And by setting up a single storefront on the Internet, a company can offer its goods and services to millions of potential buyers. We call all of this electronic business – "e-business."

What's the value of a wired world? What will these connected millions of people (soon to be a billion!) do? What will they want? What will they pay for?

The answer, we believe, is: all the things people do every day. Buy things and sell things. Renew driver licenses. Bank and pay bills. Explore literature. Learn, teach, work together, access entertainment. Make money. In other words, people will value applications – interactive, transaction-intensive applications that enable them to get meaningful things done.

NEW MATH It took two years of non-stop number crunching – but when the bits had settled, a massively parallel computer and a team of IBM researchers had identified an elusive atomic particle called a "glueball." The calculation was the largest single numerical feat in the history of computing, and the first instance of a particle being discovered by a computer.

(Dollars in millions except per share amounts)

For the year:	1996	1995
Revenue	$ 75,947	$ 71,940
Earnings before income taxes	$ 8,587	$ 7,813
Income taxes	$ 3,158	$ 3,635
Net earnings	$ 5,429	$ 4,178
Per share of common stock	$ 10.24	$ 7.23
Cash dividends paid on common stock	$ 686	$ 572
Per share of common stock	$ 1.30	$ 1.00
Investment in plant, rental machines and other property	$ 5,883	$ 4,744
Average number of common shares outstanding (in millions)	528	569
At end of year:		
Total assets	$ 81,132	$ 80,292
Net investment in plant, rental machines and other property	$ 17,407	$ 16,579
Working capital	$ 6,695	$ 9,043
Total debt	$ 22,829	$ 21,629
Stockholders' equity	$ 21,628	$ 22,423
Number of employees in IBM/wholly owned subsidiaries	240,615	225,347
Number of common stock holders	622,594	668,931

The driving force behind the creation of most applications – and certainly of the best applications – is customers who have decided to seek competitive advantage by fundamentally changing the way they work.

Think about it: If a billion people are going to do online banking, banks have to change the way they deal with their customers. If a billion people are going to access education, universities have to change the way they teach. If workers inside an enterprise are going to use an intranet to change how they work (and not just look at online newsletters), that enterprise has to change how it operates.

If all this happens – and I believe it will, but not as quickly as some in our industry predict – the Information Revolution will be as important and all-encompassing as the invention of the printing press and the Industrial Revolution.

Every day we see new leaders emerge in specific industries – not because they are the biggest or have the most money and the best traditions, but because they were the first to embrace e-business with applications that helped people do what they want to do.

We're adapting and enabling every hardware and software product in our portfolio for "the Net." Today, all our server platforms, from PC servers to supercomputers, are web servers and offer price/performance competitive with any in the industry. Together with Tivoli, we're enabling multi-platform systems management across the corporate infrastructure and out to the web. All our key software products – for example, databases and transaction systems – are web-enabled. Our Lotus team continues to innovate and extend its lead in groupware. More important, Notes and Domino have become the platform of choice for building Internet applications.

All of this work to transform enterprise computing is really important to our customers. Some 70 percent of the world's business information is already managed by IBM databases. IBM transaction processing software handles more than 20 billion mission-critical business transactions

ENERGY CONSUMPTION THEORY How much energy does it take to move a bit (the smallest unit of information handled by a computer)? "None," says IBM researcher Dr. Rolf Landauer, who published a paper that outlines how the energy and matter used in sending information need not be "thrown away" at the receiving end. That means, Laudauer posits, they can be recycled.

a day. We're working to make these systems stronger and more scalable to handle the incredible workload network computing will generate.

We are also inventing new technologies for the wired world, beginning with the innovations needed to make technology more secure, more reliable, and much easier to use.

But if you really want to track IBM's moves and progress in the networked world, look first to the e-business solutions we are building for, and with, our customers. Solutions require more than raw technology. They are combinations of hardware, software and services that we integrate to attack a customer's business issues. Many are covered in the pages of this Annual Report.

Backed with $1 billion of our R&D funds, more than 70,000 IBM professionals are developing solutions with some of our largest customers in 11 industries. At the same time, we're working with more than 45,000 business partners to develop e-business solutions for small and mid-sized businesses.

The networked world is also creating huge demand for services, our fastest-growing business. Customers want help in everything from consulting and systems integration to network services and education. We have more than 90,000 people in services. We hired 15,000 in 1996 alone.

Our industry is about to crack the trillion-dollar mark. We see the industry growing by about $400 billion – to $1.2 trillion in the next four years. About half of that growth – $200 billion – will be driven by network computing. And the majority of *that* growth will be in solutions and services.

Those are big stakes.

And I like the cards in IBM's hand. The industry is coming back our way, to our traditional strengths, to the things that IBM does best – solving customer problems with innovative technology. We have the right strategies and are focused on them and have committed resources – people and money – to implementing them.

What makes me most optimistic, however, is that within the corridors of IBM, this is all energizing stuff. We have a lot of bright people who have the wherewithal to make a difference – who understand the stakes, the demands, the pace. We are energized not because we like doing the same old things, but because we can apply our whole array of resources and smarts to an entirely new set of challenges.

We understand that leadership is not a birthright. There is only one way to claim it – or reclaim it – and that is to take it.

I am convinced that IBM people, working side by side with our customers, will do it.

* * *

As I mentioned in my letter last year, this networked world is not without its problems. It raises important public policy issues like privacy, security and access for all.

Technology can help resolve some of these issues. We're developing new technologies – encryption software is one example – and we're working with government leaders and others in our industry to reach agreement on how best to use them.

But I also believe responsible public policy can only be developed through vigorous, open discussion. And since the networked world will touch everyone – parents, businesspeople, educators, students and citizens – it's important that we all speak up.

IBM has established a website (www.ibm.com/ibm/publicaffairs) where we offer thoughts on – and propose solutions to – many of these issues, from personal privacy and security to the effects of technology on education and health care. I hope you'll visit the website and join in the debate.

Louis V. Gerstner, Jr.
Chairman and Chief Executive Officer

DIFFUSE INTERSTELLAR BANDS It's a puzzle of cosmic proportion: many of the universe's bright, young stars seem to be missing light in certain colors of the spectrum – diffuse interstellar bands (if you're up on your astro-physical lingo). Two IBM scientists now propose that hydrogen, the most common molecule in the universe, is the culprit – scattering the light in a process similar to what makes the Earth's sky seem blue. Their model may help astronomers explain unusual light emissions in the known universe. (You mean the sky's not really blue?)

What do you do? I guide. I build. I experiment. I teach. I analyze. I dream. I govern. I prote

Konatsu Kenji, Minako Sakai, Shizuka Takashima
passenger traffic agents, Japan Airlines, Tokyo

Japan delivered by way of a website. Just click. And peruse a flight schedule. Click. Get information about tours. Click. Book your reservation (even select your seat). Welcome to www.jal.co.jp – built by JAL and IBM on an ambitious three-month timeline (integrating Internet-based systems into existing reservation systems is a task that usually takes far longer). JAL's system is up and running, serving and pleasing thousands of customers every month.


people from there to here."
. I draw. I illustrate. I plan. I negotiate. I strategize. I coach. I solve. I support. I connect. I photograph
I landscape. I explore.

Now that tens of millions of people are connected, what's next?

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alk. | direct. | act. | host. | process. | order. | check. | record. | instruct. | dance. | orchestrate. | compose. | tinker. | organize. | arrange. | advise. | govern. | promise.

A year ago, hallway conversations started with, "If the Internet takes off..." Today, the conversations start quite differently: "How can we make money on the Net?"

Ponder the facts: There are more than 40 million people connected to the Net – and their numbers are climbing fast. Unquestionably, consumers on the Net are a large, untapped market. Yet they're only part of the picture. By connecting companies to other companies, the Net is also reshaping business-to-business commerce – it's an opportunity that's 10 times larger, in fact, than the consumer market. In total, electronic commerce purchases are forecast to exceed $300 billion by the year 2000.

What's going on? The Net is an efficient way to set up a retail outlet within a mouse-click reach of every consumer. Suddenly, the Davids of business have a way to slay the Goliaths of business. Companies can open new markets with brainpower and processing power, not just manpower. And entrepreneurial teams can strike from nowhere to capture market share.

At IBM, we're developing technologies to enable Net-based electronic commerce. More than that, we're helping thousands of businesses make their first strategic moves onto the Net:

The Net means convenience. For instance, in 1996, IBM worked with Charles Schwab to build a web-based brokerage service, so customers can execute stock trades from home.

The Net lets our customers efficiently reach out to their customers. In November, L.L. Bean's enhanced website, based on IBM's Net.Commerce software, came online in time for the holidays. More than just a website, it connects to an intelligent inventory database. As consumers click to place an order, the most up-to-date information is fed to them, drawing on the latest inventory information about what colors, sizes and items are in stock.

It can complement traditional sales processes. IBM's Auto Loan Exchange solution is changing the way cars are financed. Customers can apply for a loan right from the

In May, we announced IBM Cryptolope containers. Cryptolopes seal intellectual property in a digital package so people can buy and sell content securely over the Internet.

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showroom floor via the Internet. Electronic applications are whisked away, and approvals returned in minutes rather than in the hours, or days, it traditionally takes.

The Net makes it easy to handle routine tasks, too. For example, it's changing how people interact with governments. From Ontario, Canada, to Copenhagen, IBM systems let citizens renew their driver licenses, register their vehicles, apply for jobs, and get up-to-date information, all on the Net, without having to wait in a single line.

Similar transformations are shaking up business-to-business transactions.

With work under way in 24 laboratories worldwide, IBM is developing key technologies and infrastructures that will bring efficiency and security to business-to-business commerce.

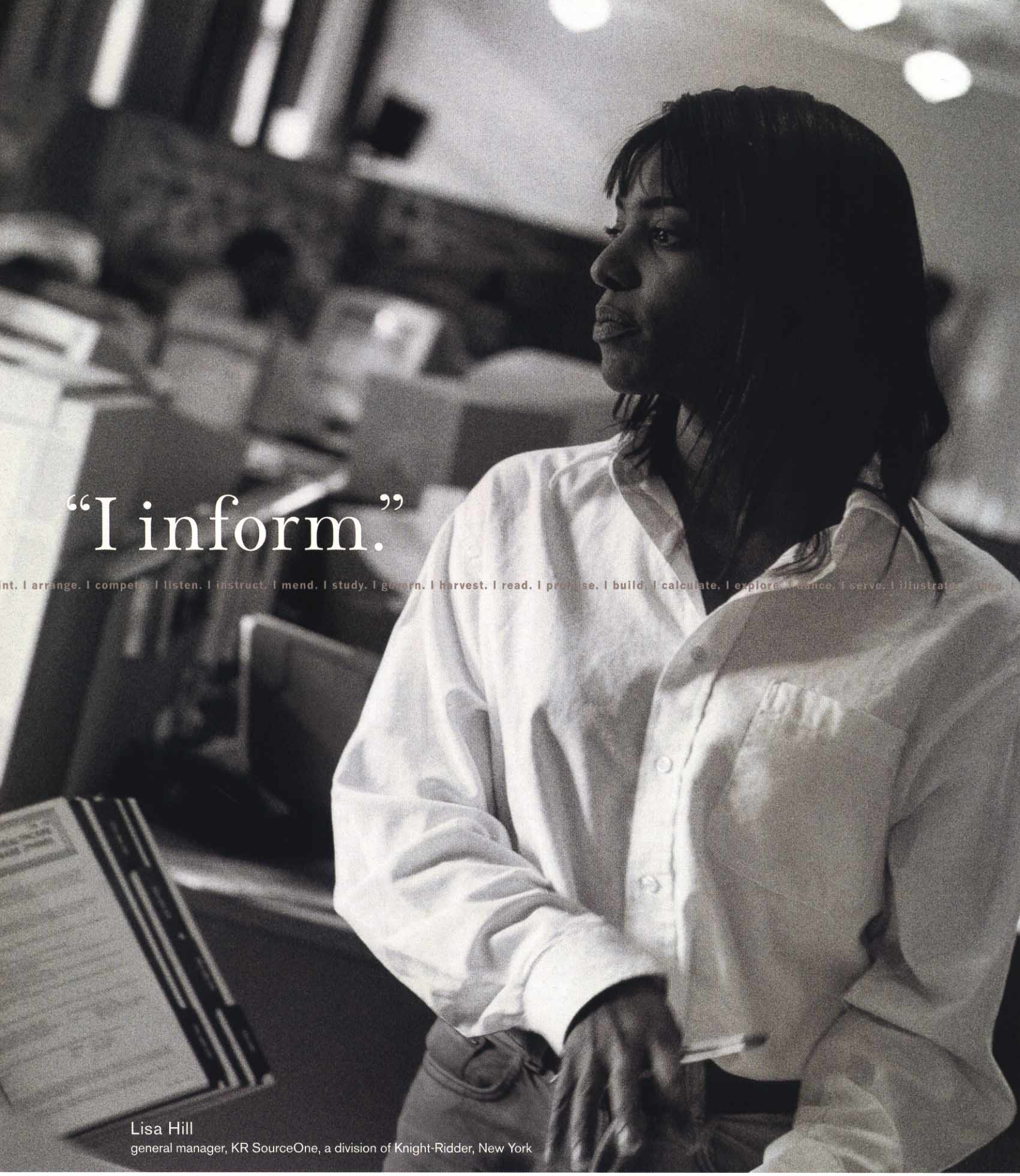
CommercePoint is an end-to-end IBM solution that ensures security through the whole buying and selling process. It includes services such as World Distributor – based on the power of Lotus Notes and Domino – that give wholesalers a complete system for electronic commerce.

Our World.Registry service issues digital certificates that verify the identities of all parties involved in an online transaction.

IBM is working with entities large and small to bring efficiency to the procurement process. The government of Singapore, as just one example, adopted IBM technology to streamline its civil service's purchasing processes – from catalog searches, to placing orders, to post-order tracking.

In the last couple of years, we've seen business pioneers make their move to the Net. In 1997, we think the Net is going to reach the heart of the business world. Mainstream businesses. We'll be there with them.

In October, we partnered with American Express to pilot smart cards for ticketless air travel. No paper boarding pass. No delay. Passengers proceed directly to the gate after showing identification.



It's 2 a.m. You're in pursuit of a particular document for some research you're doing. What to do? If you're a Knight-Ridder customer, you turn to the Internet, to a research tool Knight-Ridder built with IBM. Drawing on the strength of Lotus Notes and Domino, KR SourceOne lets you instantly search an online catalog of more than 1.5 million business and research documents. You place your order (it's tracked through the whole process by Notes). Your request is sent to the appropriate archive, your document is retrieved and sent to your e-mail address.

Online bandits. Hackers. Impostors. In the wired world, just like the real world, there are some bad seeds. Just ask Danish Payment Systems. Their job has been to process 300 million card transactions each year. They're now expanding their business to secure electronic commerce transactions. Working with IBM, they've developed a system based on the international Secure Electronic Transaction (SET) technology developed by MasterCard, VISA, IBM, and other financial and technology companies. It ensures that buyers are, in fact, who they claim they are. That vendors get paid for goods they sell. And that every aspect of the transaction — from customer information to card number — is kept completely secure.

It used to be that managing a team meant bringing in some comfortable chairs, desk lamps, an experienced manager – and witnessing productivity soar.

Today, it's not so easy.

Teams span buildings, sometimes oceans. They're far more fleeting – squadrons are assembled to attack an issue, then redeployed once the mission is accomplished. And many include partners, vendors and suppliers.

In such a world, networks can be a team leader's secret weapon. They can provide the physical connection between people. But teams need more than that; they need tools to enhance and support the way people work together. They need groupware.

When we merged with Lotus in 1995, we gained a valuable team of inventors who pioneered groupware more than a decade ago. Lotus Notes is a "human-transaction system." It connects people to people, and people to knowledge.

For the first time, Notes made it possible for companies to facilitate and accelerate teamwork across the enterprise. To streamline processes (from submitting expense reports to building aircraft engines). To share ideas, documents, findings, research. Suddenly, things that took days could be done in hours. The idea caught on, and millions of customers adopted Notes.

Then along came the Internet – and the network computing model for business. The Internet represented a way to connect team members. Company-to-company networks built on Internet standards (but protected by the security of corporate firewalls) represented a breakthrough way to connect teams within one company to teams within another. But, there was one thing missing – the groupware to help people do what they do.

aint. I arrange. I compete. I listen. I instruct. I mend. I study. I govern. I harvest. I read. I promise. I build. I calculate. I explore. I dance. I serve. I illustrate. I shop.

(Unite

What's the best way to get everyone to work together?

In July, we unveiled the WOMplex. The "WOM" stands for Web Object Manager, a unique and powerful IBM technology that enables websites to serve millions of visitors in a highly customized way.

Last year, that void was filled with Lotus Domino. It's a web-application server that extends Notes applications to the Internet, to intercompany networks and intracompany networks. Now a company can build virtually any kind of application. It's instantly deployable on the company network, and making it accessible on the Internet – so outside partners can use it – requires only a few lines of code.

Clearly, Notes and Domino appeal to customers – and by the looks of it, to competitors, as well. Some are scrambling to put together Notes-like and Domino-like offerings. But, as you'd expect from the team whose original thinking spurred a whole new model of computing a decade ago, Lotus is not standing still.

IBM and Lotus strongly believe there is no such thing as one-solution-fits-all, and that's particularly true in groupware. On one end, there will be customers who want to use fully loaded personal computers – known affectionately in industry lingo as "fat clients" – decked out with full-blown applications. On the other end are customers who want to use very "thin clients" – lean network computers that depend on the network and servers to bear the burden of work. And there will be a whole range of systems in between. Lotus is making software for the whole spectrum.

Lotus recently announced a set of Java-based productivity components that work seamlessly with Notes applications and web browsers. The idea is to create small, efficient tools tailored to very specific tasks – writing, sending e-mail, keeping a schedule, conferencing. Users will be able to draw on these tools while working in a Notes application or browsing the web.

These next-generation tools will enable people to work together even more effectively. Across time zones. And borders. To think together, work together and create.

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teams.)

In October, Lotus debuted Weblicator, which brings world-class replication technology to standard web browsers. Users can download copies of websites and browse them later without being connected to the Internet.

Team leader Patrick Veronica and two teammates
Capespan International, Cape Town, South Africa

Fruit is picked in a quiet orchard in South Africa. Over the next few weeks, it traverses the equator, and is delivered into the experienced hands of Valentino, who has been selling fruit for 45 years in Rome's *Campo dei Fiori* market. Capespan International is the company that makes sure it arrives without a blemish (Valentino is pretty choosy). This is accomplished through the IBM Global Network, which connects Capespan to 80 fruit agents who work with some 3,500 European fruit vendors. From fruit growers to agents to people like Valentino, everyone knows where a shipment is, at any given time. Handoffs run like clockwork, so fruit arrives when it's at the height of flavor.

"We catch the bad guys."

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Frank McElligott
Beth Chaney
officers, Plano, Texas, police department

Plano, Texas, was just named one of America's 10 safest cities. Its population is skyrocketing, yet crime is down. The local police intend to keep it that way. They've worked with IBM to create a sophisticated intranet that stores vital information about criminal records, crime reports, mug shots and gang activity. That data can be pulled up by investigators from their workstations or at the crime scene on a laptop. And it's shared, thanks to the network, with neighboring police departments – so that all officers in the region have the latest information to fight crime.

Pablo Guardiola Santillan
glassmaker, Grupo Vitro, Monterrey, Mexico

Grupo Vitro makes glass. Glass for blenders. Glass of every shape and size. It's a complicated operation. Hundreds of suppliers. Thousands of products. Thousands of customers. And to manage it? Hours of phone calls. Mounds of paperwork. Faxes, lots of faxes. Until last year. By setting up an "extranet" for its customers, Grupo Vitro has eliminated a lot of complexity. Customers can place orders directly over the Internet without having to fill out paperwork (they can even check on the progress of orders). This has reduced Grupo Vitro's costs because a lot less management time is spent pushing paper. And customers get around-the-clock service.

What's the best way to take advantage of the Net?

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der. I cook. I critique. I sing. I sculpt. I organize. I produce. I dance. I edit. I judge. I plan. I fly. I edit. I consult. I photograph. I landscape. I chart. I assist. I calcula

If you're a consumer, it's easy to join the networked world: Get a web browser, and get connected.

If you run a business, it's a bit more complex. Do you want to use the Net to sell your goods or services? Provide better customer service? Align internal teams with outside vendors?

The hard part is, to achieve any of these you probably have to change how your business thinks. Old models out, new models in. And you already have quite an investment in technology that you can't (and don't want to) throw out.

In the process of building some of the world's most depended-on systems, we've learned customers basically have two choices: 1) Start with the bits, bytes, hardware and software of network computing – and work backward to a solution. 2) Start with core business issues, and work your way outward.

The second works far better. Which is how the 70,000 professionals in our solutions teams approach their work. They ask a lot of questions about a customer's business problems, and then develop the right technology strategies to tackle them. They focus on specific industries – finance, manufacturing, health care, petroleum, education, insurance – and they're fluent in the language of each.

Sometimes customers come to us with a very specific problem. For instance, last May, North America's National Hockey League asked us to find a way to leverage one of its most critical assets – information. The solution? A website (www.nhl.com) designed by IBM that will use IBM Digital Library technology to archive photos, video clips, scores, plus a wealth of NHL statistics on virtually every factor that affects the outcome of a game. While they're logged on, visitors can also purchase NHL merchandise, thanks to IBM e-commerce technology. With nearly 3 million hits a day, the site is becoming a significant revenue generator. We consult on thousands of these kinds of unique problems every year.

Sometimes we fill a need within an industry:

– For instance, IBM's Global Campus solution helps colleges and universities unleash the power of networks. Currently, 36 universities in the United States, Australia,

In August, we opened an online laboratory to give the world free test drives of new IBM web technologies. When software from the alphaWorks site (www.alphaWorks.ibm.com) hits the market as a real product, the wired world's feedback is built in.

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Latin America and Europe are developing programs with IBM Global Campus.

– With the energy network exchange service from IBM and Siemens, electric utility companies use the Internet to post "wanted" and "for sale" ads for electric transmission capacity.

– IBM Health Data Network solutions connect health care professionals, hospitals and insurance companies in a single network that streamlines paperwork and improves the health care every patient gets. To date, we connect more than 4,000 physicians and more than 600 hospitals and clinics – and their patients – with Health Data Network solutions.

Sometimes we build solutions that bring many players within an industry together. We help establish common frameworks and standards. Our role as an adviser gives us a vantage point to find solutions to problems all organizations within an industry face:

– For example, in 1996, 16 banks and IBM came together to form the Integrion Financial Network to deliver home banking to more than half of the retail banking population in North America.

– Last year, we opened World Avenue, an online shopping mall designed to help retailers get on the Net more quickly and more affordably than they could on their own.

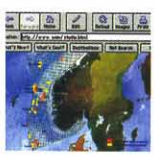
In all these cases, our solutions teams worked with customers to develop the strategic plan. Of course, once a smart plan is in place, there is still more work to do. The solution must be built, managed and maintained. Which is why there are more than 90,000 IBM professionals in our services business. They handle everything needed to build a solution from the ground up – from integrating piece parts, to testing the solution, maintaining it, and training people how best to take advantage of it. We can also outsource solutions altogether. These services are in high demand. IBM services revenue has grown by more than 20 percent each year for the last four years in a row.

In December, we introduced the SecureWay Key Management Framework, a collection of applications, services and cryptographic engines that help make the Internet safe for electronic commerce.

Halvor Jahre
geologist, Saga Petroleum ASA, the middle of the North Sea

Research. Exploration. Drilling. When you're out here, missteps cost millions. IBM's Petrobank and PetroConnect solutions are helping companies share the insights they've gained through exploration efforts. Information goes into a common database. Teams log on to our PetroConnect solution on the Internet and download new data sets and archived data. Companies have found cooperating on these activities dramatically reduces data acquisition costs, yet doesn't compromise their competitive advantage. The result is they're able to make better decisions about where and how to drill without having to embark on costly exploration themselves. Avoiding an unnecessary

well can save upward of $6 million. Multiply that over the entire oil-producing region, and you can start to see just how much this solution is changing the world.



A world-renowned outfitter of gear and apparel for the outdoors, L.L. Bean has always been extraordinarily dedicated to its customers. This year, L.L. Bean worked with IBM and took that dedication online. At www.llbean.com you can now buy L.L. Bean merchandise – boots, sweaters and jackets to brave the elements. As you place your order, the website draws on inventory information stored in a smart database. The result is a friendly, customized shopping experience that lets you choose colors, sizes and styles – with up-to-the-minute knowledge of what's in stock.

Thomas Fowler IV
assistant professor of architecture, California Polytechnic State University, San Luis Obispo

Architecture professor Thomas Fowler believes that self-discovery is the best way to learn architectural design. He has pioneered web-based curricula that architects can take – anytime, anywhere – to continue their education.

Thomas' work is part of a larger effort in the California State University system. CSU is taking advantage of IBM's Global Campus solution to build the virtual classroom of tomorrow. Aspiring to be one of the most innovative academic institutions in the country, the university intends, by the year 2000, to be not merely on the technology curve – but far in front of it.

What do the world's best network solutions have in common?

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view. | document. | train. | mobilize. | experiment. | bank. | trade. | safeguard. | inspire. | illustrate. | pioneer. | report. | investigate. | coordinate. | experience. | disc

Consider the beauty of the Net. You're sitting at a PC running Windows. Or UNIX. Or OS/2. MacOS. Or even a web-enabled TV. You click (say, to view a flight schedule to Paris). Your request is sent over the Net, across the world, where another PC, a mainframe or a supercomputer is awakened. And your schedule appears.

Now, there are a couple of very neat things about this (beside the fact you're going to Paris).

For one, by way of the Internet, now virtually any two systems in the world can talk to each other. Another benefit: the PC on your desk no longer has to shoulder all the work. It doesn't have to do all the processing. Or store all the data. Or run its own applications. That can all happen on the other side of the Net – on the server.

At IBM, we're working on the full range of technologies for the networked world. Most of our work is behind the scenes, in the network, on servers.

Enterprise servers. In 1996, IBM made much progress on this front:

– In September, we introduced our third generation of microprocessor-based mainframes, the S/390 Parallel Enterprise Server. With twice the performance of our previous high-end server, it can be linked to other S/390 systems to deliver more than 10,000 MIPS (millions of instructions per second).

– In June, we announced the AS/400 Advanced Series that supports Lotus Notes and provides easy Internet access.

– In October, we introduced new RS/6000 servers, including Internet-ready systems equipped with Notes and electronic-commerce software.

– Garnering several awards, including *PC World*'s "Best Enterprise Server" award, our PC server family grew aggressively in 1996.

Enterprise software. Our strategy here has been to open up our offerings, so they run not only on IBM hardware, but also on other industry-leading hardware and software platforms, including Windows NT.

– In 1996, we introduced a beta version of an entirely new kind of database, our DB2 Universal Database, that

In December, IBM set a new world record in magnetic data-storage density – 5 billion bits of data per square inch – the equivalent of 312,500 double-spaced typewritten pages (a stack 104 feet high) in one square inch of disk surface. Drives of this density should appear within three to five years.

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I imagine. I compose. I remedy. I understand. I share. I deliver. I educate. I guide. I believe. I revolutionize. I transmit. I compete. I contribute. I assemble. I unite. I i

will help customers conduct business through the Internet, intranets and local networks.

– We have ported our CICS transaction processing software to run on all leading platforms.

– With our acquisition of Tivoli last year, we've extended our strength in host-based systems management to multiplatform distributed systems.

– In September, we introduced OS/2 Warp 4, which incorporates Netscape Navigator, Sun's Java technology and IBM's speech-recognition software.

Storage. More than 40 years ago, IBM invented magnetic disk storage. Today, our lead extends from the smallest storage devices (which reside in tiny portable computers) to massive storage systems (which safely house the world's largest digital libraries). Through an alliance with Storage Technology Corp. last year, we've greatly strengthened our position in large-scale storage systems.

Security. Before people and enterprises embrace networks as carriers of their communications and records, they must have confidence that their information is secure. In September, we began a pilot program with MasterCard using Secure Electronic Transaction (SET) technology. The software secures credit card transactions over the Internet.

Primary invention. IBM is investing in industry standard technologies that will make the wired world thrive. Standards like Java. Its elegant promise – "write once, run everywhere" – means developers can create network applications easily, without having to splinter programming resources across development platforms. We will invest more than $200 million in the next few years to make Java ready for enterprises. We have work under way in 19 development laboratories with more than 1,000 programmers all over the world. We are building Java into all our operating systems, working with Sun to speed Java's performance, building development tools and creating a library of Java programs.

In July, the U.S. Department of Energy contracted IBM to build a really big computer – in fact, the world's fastest supercomputer. Capable of performing more than 3 trillion calculations per second (3 teraflops), the RS/6000 SP will simulate nuclear explosions, reducing the need for live nuclear tests.

Advanced Systems Development Corporation (ASDC)
Beijing, China

IBM emerging markets software development team
Seattle, Washington

Consider it an intercontinental tag-team. The race is on to establish Java as a worldwide standard for developing network applications. Which is why we have 1,000 developers in 19 labs working on key Java architectures and components. A particularly notable pair: our development team in Seattle and the one in Beijing. The Seattle team works during the day on Java-based software. When its day ends, programmers at ASDC (an IBM–Tsinghua University joint venture) pick up where their Seattle colleagues left off, continuing the development effort – without missing a beat – halfway around the globe.

Matthias Köhn
team leader, IBM, and architect to Mercedes-Benz AG

Stefan Gleißner
team leader, Mercedes-Benz AG
Stuttgart, Germany

When people think network, they think of offices. They think of universities. But few think of cars. Mercedes did. And asked IBM to start a joint development project in cooperation with Daimler-Benz Research. Together, we're developing a new network computing architecture for Mercedes-Benz' next-generation cars. All the major systems – engine, lights, climate control, security, navigation and communication – will talk to each other via an in-car network. In the near future, these systems will draw information from the Internet and other communication networks. Drivers will get real-time traffic reports and weather conditions, and send and receive messages.

Robert Lowden
digital background painter on *Prince of Egypt*, DreamWorks SKG, Universal City, California

The team at DreamWorks isn't bound by traditional Hollywood ways of thinking. The animators there, as one example, work in both traditional film media and digital media – but everything ends up as a digital asset on a DreamWorks system they call Nile. Thousands of those assets are interwoven and processed to create a final motion picture. DreamWorks and IBM are working together to integrate Nile with IBM's Digital Library to store, archive and find every asset DreamWorks creates. The system is the backbone of DreamWorks' Digital Studio – by far, the most advanced of its kind in Hollywood.

Tools should conform to the way people work, not the other way around. As we approach the day when information technology touches the lives of hundreds of millions of people, using the technology must be as natural as picking up a phone or popping a bank card into an ATM.

Digital appliances. We're creating a whole new range of easy-to-use and affordable end-user devices:

– In 1996, the ThinkPad 560 hit the market. At 4.1 pounds (1.86 kilograms), it's one of the lightest notebook computers around, yet it sports one of the largest, sharpest screens.

– We extended our Aptiva line of computers. The sculptural Aptiva S Series is the first home computer that lets people place the monitor and the media drives on their desk, and tuck the tower someplace out of the way.

– Last September, we launched the world's first network computer – the IBM Network Station – a device streamlined and optimized for the Net. For about $700, it's the most affordable way for businesses to offer network access on a large scale.

– We're building embedded microelectronics for a whole range of digital devices, multimedia kiosks, television set-top boxes and mobile systems. We continue to advance our MPEG technologies that bring clear, vibrant video to the desktop.

Putting the user in control. As the network becomes more pervasive, it will become even less visible. People won't think about being "online" or "offline" – they'll just go about life, and the Net will play an active role.

understand. I share. I deliver. I educate. I guide. I believe. I revolutionize. I transmit. I compete. I inform. I serve. I administer. I broadcast. I save. I persuade. I mark

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What's the best way to make technology useful?

IBM researchers have demonstrated technologies that allow an "electronic wallet" to receive pages, act as a universal credit card, scan in a receipt, transmit messages or be used as a phone. Future applications: it would allow someone to enter and start a car, pay a toll and transmit information to another person without removing the wallet from a pocket.

A sizable portion of our $4.7 billion R&D budget is dedicated to create this kind of world, including usability testing and interface design research.

We're developing online agent technologies to take ease-of-use to the next level. Lotus Notes agents already handle mundane tasks such as filing documents, sending e-mail and researching topics. Our web browser agent helps people steer clear of traffic-jammed sites. Other IBM agents alleviate e-mail overload. They sort the incoming items and take action.

Other R&D teams work on human-centered interfaces. In October, we introduced VoiceType Simply Speaking, software that allows users to open an application, dictate a memo or edit a document without touching a keyboard. Also, in 1996, we shipped more advanced versions of our speech recognition product for specific industries. Our MedSpeak/Radiology technology, for instance, saves radiologists time and boosts their productivity.

With the largest R&D budget in our industry, we can – and do – invest in exploration. Most of this research is directly applicable to our business. Some, at least at the outset, appears unrelated to what we do. We've learned that this work often ends up being quite relevant. Surprisingly so. You'll see the fruits of these explorations this year – and for many years to come.

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it easy.)

Think of yourself as a human modem. IBM Personal Area Network technology uses the electrical conductivity of the human body to transmit data. Using a small transmitter and a receiving device, two people can exchange information, such as an electronic business card, with a handshake.

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"We share."

Kim Johnson Gross
author of *Chic Simple* books, and family, Westchester County, New York

Kim Johnson Gross writes books. Books about how to simplify life. One secret: Fill your day with objects that are beautiful, yet extraordinarily useful. Kim, her husband and their two kids live that thinking every day, down to the computer they use. Their Aptiva S Series has been used for homework, researching topics on the Internet for a term paper, writing client proposals, balancing several budgets, and writing more than a chapter or two of Kim's books. It even enabled her to go on an online book tour – without ever having to leave the house. Not bad for a little black box on its first month on the job.

Edmark makes kids' software – brain-building programs that teach kids the critical art of thinking. And even though the company is staffed with educators, engineers and experts of all types, they always put things out to a vote by the people who count most. Kids. Every year, Edmark spends countless hours in user tests with kids, from kindergartners to teenagers, soliciting their feedback, ideas and criticism – all in the pursuit of building top educational software. This year, Edmark became an IBM company. We're proud to have them as part of the family.

What's a corporation's responsibility to the world?

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In the beginning, IBM had a fairly basic goal: to run a business that helped our customers run theirs. In those early years, we also cemented a few basic credos that symbolized our corporate culture: Respect. Reverence for thoughtful works. And giving back. Giving back our time. Giving back financial and technical help to the communities where we work and raise our families. And giving back to the people who need our help the most.

We've never wavered. In a world blessed with many generous companies and benevolent enterprises, IBM is the largest corporate contributor. Over the last decade, IBM has contributed more than $1.3 billion to nonprofit organizations, schools and universities – close to 4 million hours of volunteer time in the United States alone, and millions more hours around the world.

This basic commitment to being a responsible corporate citizen touches every IBM office, plant and laboratory all over the globe – in 163 countries, to be exact.

In ravaged Tuzla, Bosnia-Herzegovina, IBM established a computer training center to help women who lost families to the war. Ninety women per quarter use IBM personal computers and ThinkPads to build computer literacy and something more: the skills to give back, to pass that new-found knowledge on to others. Similar job-training programs help people build more productive lives in Australia, Spain and South Africa.

Through the IBM Environmental Research Program, the company has provided $16 million in technology grants to 14 universities and research institutions that are studying global environmental problems. At the Australian Institute of Marine Science, researchers use IBM visualization software to enhance conservation of coral reefs. At the University of Chile, researchers use IBM technology in the struggle to protect valuable agricultural land in the country's arid subtropics. In Belgium, at the University of Liège, teams use IBM systems to study water contamination in coastal/river basins and to help formulate strategies to protect water quality.

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I serve. I administer. I broadcast. I save. I persuade. I market. I help. I deliver. I educate. I guide. I believe. I revolutionize. I transmit. I compete. I contribute. I asse

But perhaps our most enduring efforts are in education. In March, in the United States, IBM hosted the National Education Summit. Attended by the nation's governors, business leaders and President Clinton, the summit addressed ways to raise national education standards and achievement. Our Reinventing Education initiative puts states and large school systems on the leading edge of technology so they can help students meet tougher academic standards. We have committed $35 million to help school systems remove the barriers to student achievement. Our involvement goes far beyond "checkbook philanthropy" – we are actively involved with each of these school systems, helping address its core challenges.

Here are a few of the major projects underway with some of the most innovative schools in the nation:

– In Broward County, Florida, the school district makes better use of data about test scores, scheduling and staffing – at both school and district levels. The system integrates data and presents it in an easy-to-analyze format, enabling, for the first time, quick decision making.

– In Chicago and the state of West Virginia, IBM teams help educators use the World Wide Web as an online resource for implementing science and math reforms.

– In Cincinnati, IBM is creating an entirely new online learning system to help students work at their own pace.

– In Dallas, we're working with educators to build the nation's first integrated math and science software curricula to foster critical thinking and problem solving through hands-on science.

In February 1997, IBM embarked on the second phase of the program – Reinventing Education 2 – building on all our experience in helping raise achievement in the U.S. public school system.

Of course, funding is only part of the solution. You need people. And you also need time. Last year, IBM employees were once again generous, lending their support and their thinking to some particularly vexing problems. A comfortable sign that even though many things about our company are transforming, our values endure.

"We teach our computers to read."

Judy Zalkin's fourth-grade class
Barton Elementary School, Philadelphia, Pennsylvania

It is inspiring to see young minds learn to take abstract letters and turn them into words, words into sentences, and sentences into thoughts. But for some, learning to read, for whatever reason, turns sour. Words remain jumbled. Context, lost. At Barton Elementary School – in a school district that's part of IBM's Reinventing Education effort – kids who need help are getting it from an IBM software program. "Watch Me Read" takes advantage of advanced voice-recognition technology pioneered in IBM's research labs. Students read aloud to their online tutor. Along the way, the tutor coaches them, gently corrects them and rewards them.


neer. I venture. I model. I troubleshoot. I interact. I sign. I improvise. I inform. I serve. I administer. I broadcast. I save. I market. I help.

rk. I dream. I create. I write. I sculpt. I harvest. I manage. I paint. I explore. I learn. I study. I pretend. I research. I protect. **We think.** I sell. I buy. I shop. I listen. I a

At IBM, we strive to lead in the creation, development and manufacture of the industry's most advanced information technologies, including computer systems, software, networking systems, storage devices and microelectronics.

We translate these advanced technologies into value for our customers through our professional solutions and services businesses worldwide.

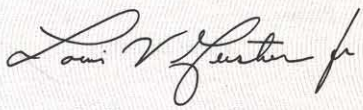
Responsibility for the integrity and objectivity of the financial information presented in this Annual Report rests with IBM management. The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, applying certain estimates and judgments as required.

IBM maintains an effective internal control structure. It consists, in part, of organizational arrangements with clearly defined lines of responsibility and delegation of authority, and comprehensive systems and control procedures. We believe this structure provides reasonable assurance that transactions are executed in accordance with management authorization, and that they are appropriately recorded, in order to permit preparation of financial statements in conformity with generally accepted accounting principles and to adequately safeguard, verify and maintain accountability of assets. An important element of the control environment is an ongoing internal audit program.

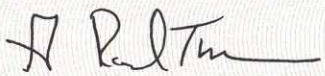
To assure the effective administration of internal control, we carefully select and train our employees, develop and disseminate written policies and procedures, provide appropriate communication channels, and foster an environment conducive to the effective functioning of controls. We believe that it is essential for the company to conduct its business affairs in accordance with the highest ethical standards, as set forth in the IBM Business Conduct Guidelines. These guidelines, translated into numerous languages, are distributed to employees throughout the world, and reemphasized through internal programs to assure that they are understood and followed.

Price Waterhouse LLP, independent accountants, is retained to examine IBM's financial statements. Its accompanying report is based on an examination conducted in accordance with generally accepted auditing standards, including a review of the internal control structure and tests of accounting procedures and records.

The Audit Committee of the Board of Directors is composed solely of outside directors, and is responsible for recommending to the Board the independent accounting firm to be retained for the coming year, subject to stockholder approval. The Audit Committee meets periodically and privately with the independent accountants, with our internal auditors, as well as with IBM management, to review accounting, auditing, internal control structure and financial reporting matters.



LOUIS V. GERSTNER, JR.
Chairman of the Board and
Chief Executive Officer



G. RICHARD THOMAN
Senior Vice President and
Chief Financial Officer

To the Stockholders and Board of Directors of International Business Machines Corporation:

In our opinion, the accompanying consolidated financial statements, appearing on pages 56 through 85, present fairly, in all material respects, the financial position of International Business Machines Corporation and its subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse LLP

PRICE WATERHOUSE LLP
1177 Avenue of the Americas
New York, NY 10036
January 20, 1997

Overview

IBM's financial performance in 1996 reflects continued progress towards its strategic goals of revenue growth, an expanded portfolio of industry-specific customer solutions, especially through network computing, and an increasingly competitive cost and expense structure.

The company reported record revenue of nearly $ 76 billion, 30 percent net earnings growth over 1995 and ended the year with over $ 8 billion in cash. The company also continued to align itself for strategic growth by investing almost $ 20 billion in critical high-growth and advanced technology businesses, research and development, acquisitions and repurchases of its common shares.

The growth in revenue was principally due to the continued transition of revenue mix to the company's high-growth businesses. Revenue from services, personal computers and distributed software offerings grew strongly year over year. At the same time, while System/390* revenue declined due to pricing pressures, its total installed base grew nearly 25 percent, well above the 14 percent growth rate of just two years ago as customers continued to move to integrated network solutions.

The company's results were also affected adversely by the continued weakness of the European economy and the continued strengthening of the U.S. dollar. Without the currency effect, year-to-year revenue growth would have been 9 percent compared with the reported growth of 6 percent.

Looking Forward

While excellent progress was made in 1996, the company must continue to implement strategic actions to further improve its competitiveness. These actions include an on-going focus on revenue growth and stable net income margins, while at the same time maintaining a strong balance sheet and cash flows for long-term growth.

Results of Operations

(Dollars in millions except per share amounts)	1996	1995	1994
Revenue	$ 75,947	$ 71,940	$ 64,052
Cost	45,408	41,573	38,768
Gross profit	30,539	30,367	25,284
Gross profit margin	40.2%	42.2%	39.5%
Total expense	21,952	22,554	20,129
Net earnings before income taxes	$ 8,587	$ 7,813	$ 5,155
Net earnings	$ 5,429	$ 4,178	$ 3,021
Net earnings per share of common stock	$ 10.24	$ 7.23	$ 5.02

Revenue grew 5.6 percent as reported and 8.6 percent when currency impacts are removed. This increase was primarily driven by the high-growth areas of the company's product portfolio: services, personal computers and distributed software offerings including those from Lotus Development Corporation (Lotus) and Tivoli Systems, Inc. (Tivoli).

The following table provides the company's percent of revenue by category:

	1996	1995	1994
Hardware sales	47.8%	49.5%	50.5%
Services	20.9	17.7	15.2
Software	17.2	17.6	17.7
Maintenance	9.2	10.3	11.3
Rentals and financing	4.9	4.9	5.3
Total	100.0%	100.0%	100.0%

The overall gross profit margin at 40.2 percent decreased 2.0 points from 1995, following a 2.7 point increase in 1995 over 1994. The 1996 decline was primarily a result of the company's continued shift to the higher growth sources of revenue, most notably, services and personal computers. These businesses have lower gross profit margins than the company's more traditional high-end hardware offerings. The increase in 1995 was primarily driven by improved margins in hardware sales resulting from cost improvements across most major product lines.

The following table is provided for informational purposes only, to exclude the effects of certain items on the company's net earnings.

(Dollars in millions except per share amounts)	1996	1995*	1994
Net earnings after tax as reported	$ 5,429	$ 4,178	$ 3,021
Purchased in-process research and development (pages 54 and 55)	435	1,840	–
Effects of Federal Systems Company (FSC) sale (page 55)	–	–	(248)
Software amortization change	–	–	192
Adjusted net earnings	$ 5,864	$ 6,018	$ 2,965
Adjusted net earnings per share of common stock	$ 11.06	$ 10.46	$ 4.92

*Reclassified to conform to 1996 presentation.

Hardware Sales

(Dollars in millions)	1996	1995	1994
Revenue	$ 36,316	$ 35,600	$ 32,344
Cost	23,396	21,862	21,300
Gross profit	$ 12,920	$ 13,738	$ 11,044
Gross profit margin	35.6%	38.6%	34.1%

Information on revenue by classes of similar products or services is included in note W, "Segment Information," on pages 82 and 83. The product trends addressed in this discussion and in that disclosure are indicative, in all material respects, of hardware sales activity.

Revenue from hardware sales increased 2.0 percent from 1995, following an increase of 10.1 percent in 1995 from 1994. Gross profit dollars from hardware sales decreased 6.0 percent from 1995, following an increase of 24.4 percent in 1995 from 1994.

Revenue from servers decreased 1.4 percent from 1995, following a 9.0 percent increase versus 1994. The 1996 decrease was primarily driven by lower revenue from System/390, although total delivery of mainframe computing power, including shipments placed with end-users through both operating leases and service offerings, increased 49 percent as measured in MIPS (millions of instructions per second) versus last year. The System/390 revenue decrease was partially offset by higher revenue from AS/400*, RISC System/6000* and personal computer servers. The 1995 increase reflected higher revenue across all server products when compared to 1994 levels.

Personal system client revenue grew 13.8 percent from 1995, following a 15.1 percent increase in 1995 from 1994. The 1996 increase was driven by higher revenue from personal computers, especially consumer products, partially offset by lower revenue from RISC System/6000. The 1995 increase over 1994 resulted from higher revenue across all personal system client products.

Storage products revenue, including products sold primarily through the Original Equipment Manufacturer (OEM) channel, decreased 4.1 percent in 1996 from 1995, following an increase of 4.8 percent in 1995 from 1994. The decline in 1996 is a result of lower revenue associated with high-end storage products due to continuing price competition. This decrease was partially offset by strong revenue growth in hard disk drive (HDD) storage and tape products when compared to 1995 levels. These product areas in 1996 accounted for more revenue than high-end storage products. The 1995 increase versus 1994 was primarily driven by strong growth in HDD storage products, partially offset by lower revenue from high-end storage and tape products.

OEM hardware revenue declined 9.1 percent in 1996 versus 1995, following a 35.5 percent increase in 1995 over 1994. The 1996 decrease was driven by lower semiconductor revenue due to continuing industry-wide pricing pressures.

The decrease in the 1996 hardware sales gross profit margin was driven by the mix of revenue to lower gross profit products, such as personal computers, and by lower OEM semiconductor margins. The increase in the 1995 hardware gross profit margin was driven by improved gross profit margins on System/390, personal computers, RISC System/6000 servers and OEM products. The overall hardware sales margin continues to be adversely impacted by pricing pressures across all products.

Services

(Dollars in millions)	1996	1995	1994
Revenue	$ 15,873	$ 12,714	$ 9,715
Cost	12,647	10,042	7,769
Gross profit	$ 3,226	$ 2,672	$ 1,946
Gross profit margin	20.3%	21.0%	20.0%

Services revenue increased 24.8 percent in 1996 from 1995 and 30.9 percent in 1995 over 1994. These increases are primarily in the areas of managed operations of systems and networks, systems integration design and development, availability services and consulting engagements. In 1996, the company signed services contracts worth more than $ 27 billion. To meet the growing demands in its services businesses, the company hired more than 15,000 new employees while maintaining a consistent level of gross profitability.

Software

(Dollars in millions)	1996	1995	1994
Revenue	$ 13,052	$ 12,657	$ 11,346
Cost	4,082	4,428	4,680
Gross profit	$ 8,970	$ 8,229	$ 6,666
Gross profit margin	68.7%	65.0%	58.8%

Software revenue increased 3.1 percent in 1996 from 1995, following an increase of 11.6 percent in 1995 from 1994. The increase in 1996 was driven by distributed software offerings including Lotus Notes*, cc:Mail* and systems management software from Tivoli, partially offset by lower host-based computer software revenue associated with System/390 and AS/400. The increase in 1995 was primarily due to revenue from Lotus products in the second half of 1995, after the acquisition.

Software gross profit dollars increased 9.0 percent in 1996 from 1995, following an increase of 23.4 percent in 1995 from 1994. The increase in 1995 from 1994 was affected by a change in the amortization period for software products in 1994. Excluding the effect of this change, the gross profit dollars would have increased 18.2 percent. The increase in gross profit dollars in both 1996 and 1995 was driven primarily by the company's continuing shift towards a more iterative software development process. As a result, a larger percentage of software development spending was expensed, and less was capitalized ($ .3 billion in 1996, compared to $ .8 billion in 1995), yielding lower costs of amortization.

Maintenance

(Dollars in millions)	1996	1995	1994
Revenue	$ 6,981	$ 7,409	$ 7,222
Cost	3,659	3,651	3,635
Gross profit	$ 3,322	$ 3,758	$ 3,587
Gross profit margin	47.6%	50.7%	49.7%

Maintenance revenue decreased 5.8 percent in 1996 from 1995, following an increase of 2.6 percent in 1995 from 1994. Gross profit dollars decreased 11.6 percent, following an increase of 4.8 percent in 1995 from 1994. Revenue and gross profit margins in 1996 were lower due to continued price reductions.

Rentals and Financing

(Dollars in millions)	1996	1995	1994
Revenue	$ 3,725	$ 3,560	$ 3,425
Cost	1,624	1,590	1,384
Gross profit	$ 2,101	$ 1,970	$ 2,041
Gross profit margin	56.4%	55.4%	59.6%

Rentals and financing revenue increased 4.6 percent in 1996 from 1995, following an increase of 3.9 percent in 1995 over 1994. In both 1996 and 1995, revenue increased as new originations of operating leases for high-end products outpaced the expiration of older leases. The mix of operating lease originations and hardware sales of these products remained constant year to year. Gross profit dollars increased 6.6 percent from 1995, following a decline of 3.4 percent in 1995 from 1994. The increase was primarily a result of higher margins on operating leases and lower interest rates. The decrease in 1995 was a reflection of both declining volumes and rental prices on high-end products. The financing results are discussed in more detail in note M, "Customer Financing," on pages 70 through 72.

Operating Expenses

(Dollars in millions)	1996	1995*	1994
Selling, general and administrative	$ 16,854	$ 16,766	$ 15,916
Percentage of revenue	22.2%	23.3%	24.8%
Research, development and engineering	$ 4,654	$ 4,170	$ 4,363
Percentage of revenue	6.1%	5.8%	6.8%
Purchased in-process research and development	$ 435	$ 1,840	$ –

*Reclassified to conform to 1996 presentation.

Selling, general and administrative (SG&A) expense remained essentially flat in 1996 compared to 1995. The company's shift towards investments in more variable based high-yield programs, such as advertising, business partner programs, expenditures associated with new acquisitions and investments and its continued focus on reducing fixed infrastructure costs yielded a 1.1 point improvement in the expense to revenue ratio in 1996. The 1996 and 1995 results included $ 669 million and $ 626 million, respectively, associated with infrastructure reductions. The 1995 results also included a one-time gain of $ 175 million due to the settlement of certain contractual obligations resulting from the 1994 FSC sale. The company continues to focus on productivity, reengineering, expense controls and prioritization of spending in order to maintain competitive expense to revenue levels.

Research, development and engineering expense increased 11.6 percent in 1996 from 1995, following a decrease of 4.4 percent in 1995 from 1994. The increase in 1996 is primarily a result of the company's change in the software development process as discussed in the Software section on page 47. In addition, the on-going activities of Lotus and Tivoli are included in 1996 results, as compared to 1995 which included only Lotus activity from July to December 1995.

Purchased in-process research and development in 1996 and 1995 was primarily associated with the Tivoli and Lotus acquisitions, respectively.

Provision for Income Taxes

The provision for income taxes resulted in an effective tax rate of 37 percent for 1996, as compared to the 1995 effective tax rate of 47 percent. Without the effect of expensing the purchased in-process research and development with no corresponding tax effect, the 1996 and 1995 effective tax rates would have been 35 percent and 38 percent, respectively. The reduction in the 1996 tax rate is due to the company's continued expansion into markets with lower effective tax rates, as well as the use of foreign tax credits to offset the tax effect of dividend repatriation from non-U.S. affiliates.

The company accounts for income taxes under Statement of Financial Accounting Standards (SFAS) 109, "Accounting for Income Taxes," which provides that a valuation allowance should be recognized to reduce the deferred tax asset to the amount that is more likely than not to be realized. In assessing the likelihood of realization, management considered estimates of future taxable income, which are based primarily on recent financial performance.

Fourth Quarter

For the quarter ended December 31, 1996, the company had revenue of $ 23.1 billion, a 5.6 percent increase over the same period of 1995. Net earnings in the fourth quarter were $ 2,023 million ($ 3.93 per common share), compared to net earnings of $ 1,711 million ($ 3.09 per common share) in the fourth quarter of 1995.

Fourth-quarter revenue increased in the United States, Asia-Pacific and Latin America, and declined in Canada. Specifically, revenue from the United States increased 12.1 percent year over year to $ 8.8 billion. Revenue from the company's Europe, Middle East, and Africa unit was $ 8.1 billion, essentially flat from 1995 to 1996. Asia-Pacific revenue grew 6.2 percent to $ 4.3 billion, while revenue in Latin America was $ 1.1 billion, an increase of 3.9 percent. Revenue from Canada declined 2.4 percent to $ .8 billion.

Currency had an approximately 3 percentage point negative impact on the company's revenue results in the fourth quarter. This compares with an approximately 2 percentage point positive revenue effect in the fourth quarter of 1995. At constant currency in the fourth quarter of 1996, European revenue would have grown 3 percent and Asia-Pacific revenue would have increased 14 percent.

Hardware sales revenue was $ 11.7 billion, an increase of 1.7 percent compared to the fourth quarter of 1995. Personal computer revenue grew year over year in both commercial and consumer categories. AS/400, storage product and networking hardware revenue also increased. System/390 and OEM hardware revenue declined, while RISC System/6000 revenue was essentially flat.

Services revenue was $ 5.0 billion, an increase of 22.3 percent compared to the fourth quarter of last year. This increase reflects the continued strength across the company's services categories, including managed operations of systems and networks, systems integration design and development and availability services.

Software revenue grew 3.9 percent year over year to $ 3.7 billion. The increase was driven by strong growth of Lotus and Tivoli distributed software products, offset by lower host-based computer software revenue.

Maintenance revenue decreased 5.8 percent from 1995's fourth quarter, due to continuing competitive pricing pressures. Rentals and financing grew 9.4 percent from 1995's fourth quarter due to increased operating leases of high-end products.

The company's overall gross profit margin was 40.3 percent in the fourth quarter, compared to 41.7 percent in the same period of 1995. This decrease was a result of the continuing shift of revenue to lower margin offerings including services and personal systems.

Total expenses declined 2.3 percent year over year, while the expense-to-revenue ratio decreased from 29.8 percent to 27.8 percent. This decline reflects the continuing efforts to shift toward investments in more variable based spending programs and reductions in infrastructure expenditures.

Financial Condition

The company for the third consecutive year generated over $ 10 billion in cash flow from operations which funded significant investments in plant, rental machines and other property, strategic acquisitions, such as Tivoli and Object Technology International, Inc., as well as common share repurchases. The company ended 1996 with $ 8.1 billion in cash, up $ .4 billion from year-end 1995.

The company has access to global funding sources. During 1996, the company issued debt in a variety of geographies to a diverse set of investors. Significant funding was issued in the United States, Japan and Europe. Funding was obtained across the range of debt maturities from short-term commercial paper to long-term debt. In December 1996, the company issued $ 850 million of debt which matures in 100 years. More information about company debt is provided in note F, "Debt," on pages 64 and 65.

In December 1993, the company entered into a $ 10 billion committed global credit facility to enhance the liquidity of funds. This facility was amended in March 1996, and extended to March 2001. As of December 31, 1996, $ 9.4 billion was unused and available.

At year-end 1996, the company had an outstanding balance of $ 1.1 billion of assets under management from the securitization of loans, leases and trade receivables, compared to the year-end 1995 level of $ 1.2 billion. The company retains access to additional funds through securitization, as discussed in note T, "Sale and Securitization of Receivables," on page 80.

The rating agencies continued their review of the company's debt. In December 1996, Fitch Investors Service upgraded its credit ratings for the company and its rated subsidiaries' senior long-term debt to AA- from A+. Fitch also upgraded the company's preferred stock to A+ from A. They continue to rate commercial paper at F-1+.

In January 1997, Standard and Poor's revised its outlook on the company and its rated subsidiaries to positive from stable and affirmed its ratings of senior debt at A, commercial paper at A-1, and preferred stock at A-.

Moody's Investors Service rates the senior long-term debt of the company and its rated subsidiaries as A1, the commercial paper as Prime-1, and the company's preferred stock as "a1."

Duff & Phelps rates the company and its rated subsidiaries' senior long-term debt as A+, commercial paper as Duff 1, and the company's preferred stock as A.

Cash Flows

The company's cash flows from operating, investing and financing activities as prescribed by generally accepted accounting principles and reflected in the Consolidated Statement of Cash Flows on page 58, are summarized in the following table:

(Dollars in millions)	1996	1995	1994
Net cash provided from (used in):			
Operating activities	$ 10,275	$ 10,708	$ 11,793
Investing activities	(5,723)	(5,052)	(3,426)
Financing activities	(3,952)	(6,384)	(6,412)
Effect of exchange rate changes on cash and cash equivalents	(172)	65	106
Net change in cash and cash equivalents	$ 428	$ (663)	$ 2,061

Working Capital

	At December 31:	
(Dollars in millions)	1996	1995
Current assets	$ 40,695	$ 40,691
Current liabilities	34,000	31,648
Working capital	$ 6,695	$ 9,043
Current ratio	1.20:1	1.29:1

The company continued to maintain a strong current ratio of 1.20 to 1. Current assets remained essentially flat due to aggressive inventory and accounts receivable management. The company's overall inventories declined $ .5 billion driven primarily by inventory management process improvements, particularly in personal computers. While trade accounts receivable was essentially unchanged from December 31, 1995, collections improved, resulting in a nearly $ 1 billion reduction, which offset record fourth-quarter revenue.

Current liabilities were higher primarily due to increases in short-term debt associated with customer financing. Short-term borrowings were used to take advantage of generally more favorable interest rates.

Investments

The company's investments for plant, rental machines and other property were $ 5.9 billion for 1996, an increase of $ 1.1 billion from 1995. The increase reflects continued investment in the company's rapidly growing services business, particularly management of customers' information technology, as well as storage products and the advanced technology area of microelectronics.

In addition to software development expenses included in research, development and engineering, the company capitalized $ .3 billion of software costs during 1996 versus $ .8 billion capitalized in 1995. Amortization of capitalized software costs amounted to $ 1.4 billion for 1996, a decrease of $ .3 billion from 1995.

Investments and sundry assets were $ 21.6 billion at the end of 1996, an increase of $ 1.0 billion from 1995, primarily the result of increases in prepaid pension assets, the company's investment in business alliances and goodwill associated with strategic acquisitions, primarily Tivoli. See note E, "Investments and Sundry Assets," on page 64 for additional information.

Debt and Equity

(Dollars in millions)	1996	1995
"Core" debt	$ 2,202	$ 1,907
Customer financing debt	20,627	19,722
Total debt	$ 22,829	$ 21,629
Stockholders' equity	$ 21,628	$ 22,423
Debt/capitalization	51.4%	49.1%
"Core" debt/capitalization	10.7%	8.5%
Customer financing debt/equity	6.3:1	6.3:1

Total debt increased $ 1.2 billion from year-end 1995, driven by an increase of $ .9 billion in debt to support the growth in customer financing assets and $ .3 billion in "core" debt. The company's "core" debt to capitalization ratio is at a conservative 10.7 percent and the customer financing debt to equity has been maintained at 6.3 to 1.

Stockholders' equity declined 3.5 percent to $ 21.6 billion from December 31, 1995. The company's strong net earnings were reduced by the company's significant common share repurchases, dividend payments and the stronger dollar effect on the company's foreign net assets. See page 59, "Consolidated Statement of Stockholders' Equity," for additional information.

Currency Rate Fluctuations

Since approximately 84 percent of the company's non-U.S. revenue was derived from affiliates operating in local currency environments, the company's results are affected by changes in the relative values of non-U.S. currencies to the U.S. dollar. Worldwide currencies weakened versus the U.S. dollar in 1996, which resulted in assets and liabilities denominated in local currencies being translated into fewer dollars. The currency rate changes also resulted in an unfavorable impact on revenue of approximately 3 percent in 1996, compared to a favorable impact in 1995 and 1994 of 4 percent and 2 percent, respectively.

In high-inflation environments, primarily parts of Latin America, translation adjustments are reflected in period income, as required by SFAS 52, "Foreign Currency Translation." Generally, the company minimizes currency risk in these countries by linking prices and contracts to U.S. dollars, by financing operations locally and through foreign currency hedge contracts.

The company uses a variety of financial hedging instruments to minimize currency risks related to customer financing transactions and the repatriation of dividends and royalties. Further discussion on currency and hedging appears in note U, "Financial Instruments," on pages 80 through 82.

Financing Risks

Customer financing is an integral part of the company's total worldwide offerings. Financial results of customer financing can be found in note M, "Customer Financing," on pages 70 through 72. Inherent in customer financing are certain risks: credit, interest rate, currency and residual value. The company manages credit risk through comprehensive credit evaluations and pricing practices. To manage the risks associated with an uncertain interest rate environment, the company pursues a funding strategy of substantially matching the terms of its debt with the terms of its assets. Currency risks are managed by denominating liabilities in the same currency as the assets.

Residual value risk is managed by developing projections of future equipment values at lease inception, reevaluating these projections periodically, and effectively deploying remarketing capabilities to recover residual values and potentially earn a profit. In 1996 and 1995, the remarketing effort generated profits. The following table depicts an approximation of the unguaranteed residual value maturities for the company's sales-type leases, as well as a projection of net book value of operating leases at the end of the lease terms as of December 31, 1994, 1995 and 1996. The following table excludes approximately $ 50 million of estimated residual value associated with non-information technology equipment.

	Total			Run Out of 1996 Residual Value Balance			
(Dollars in millions)	1994	1995	1996	1997	1998	1999	2000 and beyond
Sales-type leases	$ 535	$ 470	$ 471	$ 130	$ 155	$ 160	$ 26
Operating leases	140	295	480	160	165	140	15
Total residual value	$ 675	$ 765	$ 951	$ 290	$ 320	$ 300	$ 41

Acquisitions and Divestitures

On March 1, 1996, the company acquired all outstanding shares of Tivoli for approximately $ 800 million ($ 716 million in net cash). On July 5, 1995, the company acquired all outstanding shares of Lotus for approximately $ 3.2 billion ($ 2.9 billion in net cash). The company engaged a nationally recognized, independent appraisal firm to express an opinion on the fair market value of the assets of each of the acquisitions to serve as a basis for allocation of the purchase price to the various classes of assets. The company allocated the total purchase prices as follows:

(Dollars in millions)	1996 Tivoli	1995 Lotus
Tangible and intangible net assets	$ 140	$ 1,157
Purchased in-process research and development	417	1,840
Goodwill	280	540
Deferred tax liabilities related to identifiable intangible assets	(37)	(291)
Total	$ 800	$ 3,246

Purchased in-process research and development represented the value of software products still in the development stage and not considered to have reached technological feasibility.

In addition, the acquisition of Object Technology International, Inc., resulted in a valuation of purchased in-process research and development amounting to $ 18 million, bringing the total amount of purchased in-process research and development in 1996 to $ 435 million. In accordance with applicable accounting rules, the $ 435 million was expensed upon acquisition in the first quarter of 1996 and the $ 1,840 million was expensed upon acquisition in the third quarter of 1995.

The sale of FSC to Loral Corporation for $ 1.503 billion in cash had a closing date of March 1, 1994, and was effective January 1, 1994. This transaction resulted in an after-tax net gain of $ 248 million ($ .43 per common share) in the company's first-quarter 1994 results. In the fourth quarter of 1995, the company recorded a before-tax gain of $ 175 million due to the conclusion of contractual obligations between the company and Loral Corporation.

Employees

				Percentage Changes	
	1996	1995	1994	1996-95	1995-94
IBM/wholly owned subsidiaries	240,615	225,347	219,839	6.8	2.5
Less than wholly owned subsidiaries	28,033	26,868	23,200	4.3	15.8
Complementary	37,000	38,000	35,000	(2.6)	8.6

As of December 31, 1996, employees of IBM and its wholly owned subsidiaries increased 15,268 from 1995 mainly due to hiring in high-growth areas of the business – services, personal computers and Lotus, as well as expansion in emerging geographic markets and acquisition of business entities such as Tivoli.

The moderate growth in less than wholly owned subsidiaries was due primarily to investments in the company's growing worldwide services business, as well as in emerging geographic markets such as China.

The company's complementary work force comprises equivalent full-time employees hired under temporary, part-time and limited-term employment arrangements to meet specific business needs in a flexible and cost-effective manner.

CONSOLIDATED STATEMENT OF EARNINGS

International Business Machines Corporation and Subsidiary Companies

(Dollars in millions except per share amounts)

For the year ended December 31:	Notes	1996	1995*	1994
Revenue:				
Hardware sales		$ 36,316	$ 35,600	$ 32,344
Services		15,873	12,714	9,715
Software		13,052	12,657	11,346
Maintenance		6,981	7,409	7,222
Rentals and financing	M	3,725	3,560	3,425
Total revenue		75,947	71,940	64,052
Cost:				
Hardware sales		23,396	21,862	21,300
Services		12,647	10,042	7,769
Software		4,082	4,428	4,680
Maintenance		3,659	3,651	3,635
Rentals and financing		1,624	1,590	1,384
Total cost		45,408	41,573	38,768
Gross profit		30,539	30,367	25,284
Operating expenses:				
Selling, general and administrative	H	16,854	16,766	15,916
Research, development and engineering	I	4,654	4,170	4,363
Purchased in-process research and development	I	435	1,840	–
Total operating expenses		21,943	22,776	20,279
Operating income		8,596	7,591	5,005
Other income, principally interest		707	947	1,377
Interest expense	J	716	725	1,227
Earnings before income taxes		8,587	7,813	5,155
Provision for income taxes	G	3,158	3,635	2,134
Net earnings		5,429	4,178	3,021
Preferred stock dividends and transaction costs		20	62	84
Net earnings applicable to common shareholders		$ 5,409	$ 4,116	$ 2,937
Net earnings per share of common stock		$ 10.24	$ 7.23	$ 5.02
Average number of common shares outstanding: 1996 – 528,352,094; 1995 – 569,384,029; 1994 – 584,958,699				

*Reclassified to conform to 1996 presentation.

The notes on pages 60 through 85 are an integral part of this statement.

(Dollars in millions)

At December 31:	Notes	1996	1995
Assets			
Current assets:			
Cash and cash equivalents		$ 7,687	$ 7,259
Marketable securities	U	450	442
Notes and accounts receivable – trade, net of allowances		16,515	16,450
Sales-type leases receivable		5,721	5,961
Other accounts receivable		931	991
Inventories	C	5,870	6,323
Prepaid expenses and other current assets		3,521	3,265
Total current assets		40,695	40,691
Plant, rental machines and other property	D	41,893	43,981
Less: Accumulated depreciation		24,486	27,402
Plant, rental machines and other property – net		17,407	16,579
Software, less accumulated amortization (1996, $12,199; 1995, $11,276)		1,435	2,419
Investments and sundry assets	E	21,595	20,603
Total assets		$ 81,132	$ 80,292
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes		$ 3,029	$ 2,634
Short-term debt	F	12,957	11,569
Accounts payable		4,767	4,511
Compensation and benefits		2,950	2,914
Deferred income		3,640	3,469
Other accrued expenses and liabilities		6,657	6,551
Total current liabilities		34,000	31,648
Long-term debt	F	9,872	10,060
Other liabilities	K	14,005	14,354
Deferred income taxes	G	1,627	1,807
Total liabilities		59,504	57,869
Contingencies	L		
Stockholders' equity:			
Preferred stock, par value $.01 per share – shares authorized: 150,000,000 shares issued: 1996 – 2,610,711; 1995 – 2,610,711	P	253	253
Common stock, par value $1.25 per share – shares authorized: 750,000,000 shares issued: 1996 – 509,070,542; 1995 – 548,199,013	P&V	7,752	7,488
Retained earnings		11,189	11,630
Translation adjustments		2,401	3,036
Treasury stock, at cost (shares: 1996 – 1,089,533; 1995 – 424,583)		(135)	(41)
Net unrealized gain on marketable securities		168	57
Total stockholders' equity		21,628	22,423
Total liabilities and stockholders' equity		$ 81,132	$ 80,292

The notes on pages 60 through 85 are an integral part of this statement.

CONSOLIDATED STATEMENT OF CASH FLOWS
International Business Machines Corporation and Subsidiary Companies

(Dollars in millions)

For the year ended December 31:	1996	1995	1994
Cash flow from operating activities:			
Net earnings	$ 5,429	$ 4,178	$ 3,021
Adjustments to reconcile net earnings to cash provided from operating activities:			
Depreciation	3,676	3,955	4,197
Amortization of software	1,336	1,647	2,098
Effect of restructuring charges	(1,491)	(2,119)	(2,772)
Purchased in-process research and development	435	1,840	–
Deferred income taxes	11	1,392	825
Gain on disposition of fixed and other assets	(300)	(339)	(11)
Other changes that (used) provided cash:			
Receivables	(650)	(530)	653
Inventories	196	107	1,518
Other assets	(980)	(1,100)	187
Accounts payable	319	659	305
Other liabilities	2,294	1,018	1,772
Net cash provided from operating activities	10,275	10,708	11,793
Cash flow from investing activities:			
Payments for plant, rental machines and other property	(5,883)	(4,744)	(3,078)
Proceeds from disposition of plant, rental machines and other property	1,314	1,561	900
Acquisition of Lotus Development Corporation – net	–	(2,880)	–
Acquisition of Tivoli Systems, Inc. – net	(716)	–	–
Investment in software	(295)	(823)	(1,361)
Purchases of marketable securities and other investments	(1,613)	(1,315)	(3,866)
Proceeds from marketable securities and other investments	1,470	3,149	2,476
Proceeds from the sale of Federal Systems Company	–	–	1,503
Net cash used in investing activities	(5,723)	(5,052)	(3,426)
Cash flow from financing activities:			
Proceeds from new debt	7,670	6,636	5,335
Short-term borrowings less than 90 days – net	(919)	2,557	(1,948)
Payments to settle debt	(4,992)	(9,460)	(9,445)
Preferred stock transactions – net	–	(870)	(10)
Common stock transactions – net	(5,005)	(4,656)	318
Cash dividends paid	(706)	(591)	(662)
Net cash used in financing activities	(3,952)	(6,384)	(6,412)
Effect of exchange rate changes on cash and cash equivalents	(172)	65	106
Net change in cash and cash equivalents	428	(663)	2,061
Cash and cash equivalents at January 1	7,259	7,922	5,861
Cash and cash equivalents at December 31	$ 7,687	$ 7,259	$ 7,922
Supplemental data:			
Cash paid during the year for:			
Income taxes	$ 2,229	$ 1,453	$ 649
Interest	$ 1,563	$ 1,720	$ 2,132

The notes on pages 60 through 85 are an integral part of this statement.

(Dollars in millions)	Preferred Stock	Common Stock	Retained Earnings	Translation Adjustments	Treasury Stock	Net Unrealized Gain on Marketable Securities	Total
1994							
Stockholders' equity, January 1, 1994	$ 1,091	$ 6,980	$ 10,009	$ 1,658	$ –	$ –	$ 19,738
Net earnings			3,021				3,021
Cash dividends declared – common stock			(585)				(585)
Cash dividends declared – preferred stock			(84)				(84)
Preferred stock purchased and retired (105,000 shares)	(10)						(10)
Common stock issued under employee plans (6,120,255 shares)		318					318
Common stock issued to U.S. pension plan fund (671,030 shares)		39					39
Purchases (1,401,740 shares) and sales (934,919 shares) of treasury stock under employee plans – net			(9)		(34)		(43)
Tax reductions – employee plans		5					5
Other				1,014			1,014
Stockholders' equity, December 31, 1994	1,081	7,342	12,352	2,672	(34)	–	23,413
1995							
Net earnings			4,178				4,178
Cash dividends declared – common stock			(572)				(572)
Cash dividends declared – preferred stock			(20)				(20)
Common stock purchased and retired (50,906,300 shares)		(655)	(4,209)				(4,864)
Preferred stock purchased and retired (8,534,289 shares)	(828)		(42)				(870)
Common stock issued under employee plans (4,271,948 shares)		279					279
Purchases (4,662,047 shares) and sales (4,706,964 shares) of treasury stock under employee plans – net			(57)		(7)		(64)
Conversion of debentures (6,653,121 shares)		471					471
Tax reductions – employee plans		51					51
Other				364		57	421
Stockholders' equity, December 31, 1995	253	7,488	11,630	3,036	(41)	57	22,423
1996							
Net earnings			5,429				5,429
Cash dividends declared – common stock			(686)				(686)
Cash dividends declared – preferred stock			(20)				(20)
Common stock purchased and retired (48,975,700 shares)		(710)	(5,046)				(5,756)
Common stock issued under employee plans (9,847,229 shares)		811	(13)				798
Purchases (4,457,166 shares) and sales (3,792,216 shares) of treasury stock under employee plans – net			(105)		(94)		(199)
Tax reductions – employee plans		163					163
Other				(635)		111	(524)
Stockholders' equity, December 31, 1996	$ 253	$ 7,752	$ 11,189	$ 2,401	$ (135)	$ 168	$ 21,628

The notes on pages 60 through 85 are an integral part of this statement.

A Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of International Business Machines Corporation and its majority owned subsidiary companies. Investments in business entities in which IBM does not have control, but has the ability to exercise significant influence over operating and financial policies (generally 20–50 percent ownership), are accounted for by the equity method. Other investments are accounted for by the cost method.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions the company may undertake in the future, actual results ultimately may differ from the estimates.

Revenue

Revenue from hardware sales or sales-type leases is recognized when the product is shipped. Revenue from one-time-charge licensed software is recognized when the program is shipped with an appropriate deferral for post-contract customer support. This deferral is earned over the support period. Revenue from monthly software licenses is recognized as license fees accrue; from maintenance and services over the contractual period or as the services are performed; from rentals and operating leases, monthly as the fees accrue; and from financing at level rates of return over the term of the lease or receivable. Revenue is reduced for estimated customer returns and allowances.

Income Taxes

Income tax expense is based on reported earnings before income taxes. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. In accordance with SFAS 109, "Accounting for Income Taxes," these deferred taxes are measured by applying currently enacted tax laws.

Translation of Non-U.S. Currency Amounts

Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment are translated to U.S. dollars at year-end exchange rates. Income and expense items are translated at average rates of exchange prevailing during the year. Translation adjustments are accumulated in a separate component of stockholders' equity. Inventories and plant, rental machines and other non-monetary assets and liabilities of non-U.S. subsidiaries and branches that operate in U.S. dollars, or whose economic environment is highly inflationary, are translated at approximate exchange rates prevailing when acquired. All other assets and liabilities are translated at year-end exchange rates. Inventories charged to cost of sales and depreciation are translated at historical exchange rates. All other income and expense items are translated at average rates of exchange prevailing during the year. Gains and losses that result from translation are included in earnings.

Financial Instruments

In the normal course of business, the company enters into a variety of derivative financial instruments solely for the purpose of currency exchange rate and interest rate risk management. Refer to note U, "Financial Instruments," on pages 80 though 82 for descriptions of these financial instruments, including the methods used to account for them.

In assessing the fair value of its financial instruments, both derivative and non-derivative, the company uses a variety of methods and assumptions, which are based on market conditions and risks existing at each balance sheet date. Quoted market prices or dealer quotes for the same or similar instrument were used for the majority of marketable securities, long-term investments and long-term debt. Other techniques, such as option pricing models, estimated discounted value of future cash flows, replacement cost and termination cost, have been used to determine fair value for the remaining financial instruments. These values represent a general approximation of possible value and may never actually be realized.

Cash Equivalents

All highly liquid investments with a maturity of three months or less at date of purchase are carried at fair value and considered to be cash equivalents.

Inventories

Raw materials, work in process and finished goods are stated at the lower of average cost or market.

Depreciation

Plant, rental machines and other property are carried at cost, and depreciated over their estimated useful lives using the straight-line method.

Software

Costs related to the conceptual formulation and design of licensed programs are expensed as research and development. Costs incurred subsequent to establishment of technological feasibility to produce the finished product are capitalized. The annual amortization of the capitalized amounts is the greater of the amount computed based on the estimated revenue distribution over the products' revenue-producing lives, or the straight-line method, and is applied over periods ranging up to four years. Periodic reviews are performed to ensure that unamortized program costs remain recoverable from future revenue. Costs to support or service licensed programs are charged against income as incurred, or when related revenue is recognized, whichever occurs first.

Retirement Plans and Nonpension Postretirement Benefits

Current service costs of retirement plans and postretirement healthcare and life insurance benefits are accrued in the period. Prior service costs resulting from amendments to the plans are amortized over the average remaining service period of employees expected to receive benefits.

Goodwill

Goodwill is charged to earnings on a straight-line basis over the periods estimated to be benefited, currently not exceeding five years.

Common Stock

Common stock refers to the $ 1.25 par value capital stock as designated in the company's Certificate of Incorporation. Net earnings per common share amount is computed by dividing earnings after deduction of preferred stock dividends and transaction costs by the average number of common shares outstanding in the period.

B Accounting Changes

The company implemented new accounting standards in 1996, 1995 and 1994. None of these standards had a material effect on the financial position or results of operations of the company.

In 1996, the company adopted the American Institute of Certified Public Accountants Statement of Position (SOP) 96-1, "Environmental Remediation Liabilities." This SOP provides authoritative guidance on the recognition, measurement, display and disclosure of environmental remediation liabilities.

In 1996, the company implemented the disclosure-only provisions of SFAS 123, "Accounting for Stock-Based Compensation." See note O, "Stock-Based Compensation Plans," on pages 73 through 75 for further information.

In June 1996, the Financial Accounting Standards Board issued SFAS 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This standard provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. While the standard requires implementation in 1997, the company is already generally in compliance.

Effective January 1, 1995, the company implemented SFAS 114, "Accounting by Creditors for Impairment of a Loan," and SFAS 118, "Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures." These standards prescribe impairment measurements and reporting related to certain loans.

The company implemented SFAS 116, "Accounting for Contributions Received and Contributions Made," effective January 1, 1995. This standard requires that the fair value of contributions, including unconditional promises to give, be recognized as expense in the period made.

In 1995, the company implemented SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." This standard prescribes the method for asset impairment evaluation for long-lived assets and certain identifiable intangibles that are either held and used or to be disposed of. The company was generally in conformance with this standard prior to adoption.

In 1995, the company adopted the American Institute of Certified Public Accountants SOP 93-7, "Reporting on Advertising Costs." This SOP provides guidance on financial reporting of advertising costs in annual financial statements. The company was generally in conformance with this SOP prior to adoption. See note H, "Selling and Advertising," on page 68 for additional disclosure on advertising expenses.

Effective January 1, 1994, the company implemented SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." This standard addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. See note U, "Financial Instruments," on pages 80 though 82 for further information.

C Inventories

(Dollars in millions)	At December 31: 1996	1995
Finished goods	$ 1,413	$ 1,241
Work in process	4,377	4,990
Raw materials	80	92
Total	$ 5,870	$ 6,323

D Plant, Rental Machines and Other Property

(Dollars in millions)	At December 31: 1996	1995
Land and land improvements	$ 1,208	$ 1,348
Buildings	12,073	12,653
Plant, laboratory and office equipment	24,824	26,658
	38,105	40,659
Less: Accumulated depreciation	22,935	25,604
	15,170	15,055
Rental machines	3,788	3,322
Less: Accumulated depreciation	1,551	1,798
	2,237	1,524
Total	$ 17,407	$ 16,579

E Investments and Sundry Assets

(Dollars in millions)	At December 31: 1996	1995
Net investment in sales-type leases*	$ 13,345	$ 14,007
Less: Current portion – net	5,721	5,961
	7,624	8,046
Deferred taxes	3,246	3,376
Prepaid pension cost	3,324	2,535
Non-current customer loan receivables	2,622	2,390
Installment payment receivables	830	844
Investments in business alliances	884	509
Goodwill, less accumulated amortization (1996, $1,300; 1995, $913)	1,067	870
Other investments and sundry assets	1,998	2,033
Total	$ 21,595	$ 20,603

*These leases relate principally to IBM equipment and are generally for terms ranging from three to five years. Net investment in sales-type leases includes unguaranteed residual values of approximately $471 million and $470 million at December 31, 1996 and 1995, respectively, and is reflected net of unearned income at these dates of approximately $2,000 million and $2,100 million, respectively. Scheduled maturities of minimum lease payments outstanding at December 31, 1996, expressed as a percentage of the total, are approximately as follows: 1997, 47 percent; 1998, 30 percent; 1999, 16 percent; 2000, 5 percent; and 2001 and beyond, 2 percent.

F Debt

Short-term debt

(Dollars in millions)	At December 31: 1996	1995
Commercial paper	$ 6,069	$ 4,933
Short-term loans	3,966	3,755
Long-term debt: Current maturities	2,922	2,881
Total	$ 12,957	$ 11,569

The weighted-average interest rates for commercial paper at December 31, 1996 and 1995, were approximately 5.6 percent and 5.7 percent, respectively. The weighted-average interest rates for short-term loans at December 31, 1996 and 1995, were approximately 5.7 percent and 6.6 percent, respectively.

Long-term debt

(Dollars in millions)	Maturities	At December 31: 1996	1995
U.S. Dollars:			
Debentures:			
7%	2025	$ 600	$ 600
7%	2045	150	150
7-1/8%	2096	850	–
7-1/2%	2013	550	550
8-3/8%	2019	750	750
Notes:			
5-1/2% to 7-1/2%	1997-2002	3,025	3,025
7-1/2% to 9-1/2%	1997-2000	174	186
Medium-term note program: 6.0% average	1997-2009	1,851	1,730
Other U.S. dollars: 5.9% to 8.9%	1997-2012	330	416
		8,280	7,407
Other currencies (average interest rate at December 31, 1996, in parentheses):			
Japanese yen (2.8%)	1997-2014	4,028	4,149
Swiss francs	1996	–	43
Canadian dollars (11.0%)	1997-1999	5	431
French francs (10.1%)	1997-2002	282	358
Australian dollars (6.7%)	1997-1998	44	320
Other (11.6%)	1996-2017	188	256
		12,827	12,964
Less: Net unamortized discount		33	23
		12,794	12,941
Less: Current maturities		2,922	2,881
Total		$ 9,872	$ 10,060

Annual maturities in millions of dollars on long-term debt outstanding at December 31, 1996, are as follows: 1997, $2,922; 1998, $1,462; 1999, $1,469; 2000, $2,478; 2001, $386; 2002 and beyond, $4,110.

G Taxes

(Dollars in millions)	1996	1995	1994
For the year ended December 31:			
Earnings before income taxes:			
U.S. operations	$ 3,025	$ 2,149	$ 1,574
Non-U.S. operations	5,562	5,664	3,581
	$ 8,587	$ 7,813	$ 5,155
The provision for income taxes by geographic operations is as follows:			
U.S. operations	$ 1,137	$ 1,538	$ 654
Non-U.S. operations	2,021	2,097	1,480
Total provision for income taxes	$ 3,158	$ 3,635	$ 2,134
The components of the provision for income taxes by taxing jurisdiction are as follows:			
U.S. federal:			
Current	$ 727	$ 85	$ 49
Deferred	83	1,075	74
	810	1,160	123
U.S. state and local:			
Current	158	65	68
Deferred	(353)	–	–
	(195)	65	68
Non-U.S.:			
Current	2,262	2,093	1,192
Deferred	281	317	751
	2,543	2,410	1,943
Total provision for income taxes	3,158	3,635	2,134
Social security, real estate, personal property and other taxes	2,584	2,566	2,465
Total taxes	$ 5,742	$ 6,201	$ 4,599

The effect of tax law changes on deferred tax assets and liabilities did not have a significant impact on the company's effective tax rate.

The significant components of activities that gave rise to deferred tax assets and liabilities included on the balance sheet were as follows:

Deferred Tax Assets

(Dollars in millions)	At December 31: 1996	1995*
Employee benefits	$ 3,554	$ 3,374
Capitalized research and development	1,478	1,772
Restructuring charges	1,323	2,003
Asset impairments	1,304	1,424
Alternative minimum tax credits	1,016	859
Deferred income	993	306
General business credits	452	452
Foreign tax loss carryforwards	368	303
Equity alliances	340	407
Intracompany sales and services	194	325
State and local tax loss carryforwards	166	236
Depreciation	123	172
Foreign tax credits	–	1,183
Other	2,411	2,463
Gross deferred tax assets	13,722	15,279
Less: Valuation allowance	2,239	3,868
Net deferred tax assets	$ 11,483	$ 11,411

Deferred Tax Liabilities

Sales-type leases	$ 3,126	$ 2,898
Retirement benefits	1,967	1,919
Depreciation	1,702	1,787
Software costs deferred	648	967
Other	1,465	1,320
Gross deferred tax liabilities	$ 8,908	$ 8,891

*Reclassified to conform to 1996 presentation.

The estimated reversal periods for the largest deductible temporary differences are: Employee benefits – 1 to 30 years; Capitalized research and development – 1 to 7 years; Restructuring – 1 to 5 years.

The valuation allowance applies to U.S. federal tax credits, state and local net deferred tax assets and net operating loss carryforwards, and net operating losses in certain foreign jurisdictions that may expire before the company can utilize them. The net change in the total valuation allowance for the year ended December 31, 1996, was principally due to the use of available foreign tax credits in conjunction with the repatriation of dividends from foreign subsidiaries and any resulting benefit in the current year was substantially reduced by the additional tax cost associated with the dividend repatriation. It is reasonably possible that the deferred tax asset valuation allowance could continue to decrease in the near term, depending on the company's ability to generate sufficient taxable income in multiple tax jurisdictions.

The consolidated effective income tax rate was 37 percent in 1996, 47 percent in 1995 and 41 percent in 1994.

A reconciliation of the company's effective tax rate to the statutory U.S. federal tax rate is as follows:

For the year ended December 31:	1996	1995	1994
Statutory rate	35%	35%	35%
Foreign tax differential	2	2	5
State and local	1	1	1
U.S. valuation allowance	(6)	(2)	–
Other	3	2	–
Effective rate before purchased in-process research and development	35%	38%	41%
Purchased in-process research and development	2	9	–
Effective rate	37%	47%	41%

For tax return purposes, the company has available tax credit carryforwards of approximately $ 1,673 million, of which $ 1,016 million have an indefinite carryforward period, $ 184 million expire in 1999 and the remainder thereafter. The company also has state and local and foreign tax loss carryforwards, the tax effect of which is $ 534 million. Most of these carryforwards have an indefinite carryforward period.

Undistributed earnings of non-U.S. subsidiaries included in consolidated retained earnings amounted to $ 12,111 million at December 31, 1996, $ 12,565 million at December 31, 1995 and $ 11,280 million at December 31, 1994. These earnings, which reflect full provision for non-U.S. income taxes, are indefinitely reinvested in non-U.S. operations or will be remitted substantially free of additional tax.

H Selling and Advertising

Selling and advertising expenses are charged against income as incurred. Advertising and promotional expense included in SG&A expense amounted to $ 1,569 million, $ 1,315 million and $ 977 million in 1996, 1995 and 1994, respectively.

I Research, Development and Engineering

Research, development and engineering expenses amounted to $ 4,654 million in 1996, $ 4,170 million in 1995 and $ 4,363 million in 1994. Expenditures for product-related engineering included in these amounts were $ 720 million, $ 783 million and $ 981 million in 1996, 1995 and 1994, respectively.

Expenditures of $ 3,934 million in 1996, $ 3,387 million in 1995 and $ 3,382 million in 1994 were made for research and development activities covering basic scientific research and the application of scientific advances to the development of new and improved products and their uses. Of these amounts, software-related activities were $ 1,726 million, $ 1,157 million and $ 793 million in 1996, 1995 and 1994, respectively.

Purchased in-process research and development was $ 435 million and $ 1,840 million, for 1996 and 1995, respectively.

J Interest on Debt

Interest paid and accrued on borrowings of the company and its subsidiaries amounted to $ 1,565 million in 1996, $ 1,600 million in 1995 and $ 2,006 million in 1994. Of these amounts, $ 31 million in 1996, $ 23 million in 1995 and $ 20 million in 1994 were capitalized. The remainder was charged to cost of rentals and financing, and interest expense. The year-to-year decrease in interest expense was primarily a result of lower average interest rates which were 7.0 percent, 7.2 percent and 8.0 percent in 1996, 1995 and 1994, respectively.

K Other Liabilities and Environmental

Other liabilities consists principally of accruals for nonpension postretirement benefits for U.S. employees and indemnity and retirement plan reserves for non-U.S. employees. More detailed discussion of these liabilities appears in note R, "Nonpension Postretirement Benefits," on pages 78 and 79, and note Q, "Retirement Plans," on pages 76 through 78. In addition, accruals associated with prior year infrastructure reduction actions amounted to $ 2.8 billion at December 31, 1996.

In addition, the company continues to participate in environmental assessments and cleanups at a number of locations, including operating facilities, previously owned facilities and Superfund sites. The company accrues for all known environmental liabilities for remediation cost when a cleanup program becomes probable and costs can be reasonably estimated. Estimated environmental costs associated with post-closure activities, such as the removal and restoration of chemical storage facilities and monitoring, are accrued when the decision is made to close a facility. The amounts accrued, which do not reflect any insurance recoveries, were $ 244 million and $ 223 million at December 31, 1996 and 1995, respectively.

The amounts accrued do not cover sites that are in the preliminary stages of investigation where neither the company's percentage of responsibility nor the extent of cleanup required has been identified. Also excluded is the cost of internal environmental protection programs that are primarily preventive in nature. Estimated environmental costs are not expected to materially impact the financial position or results of the company's operations in future periods. However, environmental cleanup periods are protracted in length, and environmental costs in future periods are subject to changes in environmental remediation regulations.

L Contingencies

On February 25, 1993, a consolidated and amended class action complaint was filed against the company in the United States District Court for the Southern District of New York alleging violations of Section 12 of the Securities Act of 1933 and Section 10 of the Securities Exchange Act of 1934. The complaint alleges, among other matters, that the company disseminated false and misleading statements concerning its financial condition and dividends during certain periods of 1992, as a result of which plaintiffs were injured in connection with their purchases of IBM stock during the period of September 30, 1992, through December 14, 1992. The plaintiffs seek money damages. On February 3, 1997, Judge Jed S. Rakoff issued an order granting the company's motion for summary judgment in this case in its entirety. The company does not believe that the ultimate outcome of this matter will have a material effect on its results of operations or its financial position.

M Customer Financing

The primary focus of IBM's worldwide customer financing offerings is to support customers in their acquisitions of the company's products and services. This support is provided both by IBM and through its financing subsidiaries, the results of which are presented in this note in a consistent manner.

The following schedules reflect the financial position, net earnings and cash flows for customer financing in comparison to the company's consolidated results with customer financing results reflected on an equity basis. This involves presenting within a single line item the investment and related return from customer financing as reflected in the company's consolidated financial statements. For the statement of financial position, customer financing's assets net of related liabilities, and after elimination of applicable intracompany transactions, are shown separately as a single line item, Investment in customer financing. Eliminations primarily pertain to internal mark-ups to fair value on equipment held on operating leases. With respect to the statement of earnings, net earnings for customer financing before applicable taxes and after elimination of related intracompany transactions, are included in the line description, Other income. The provision for income taxes for customer financing is based on the statutory income tax rate of each country, calculated on a separate return basis. For the statement of cash flows, certain cash flow activities are reclassified to be consistent with the classification of such activities reflected in the company's Consolidated Statement of Cash Flows. Such reclassifications primarily pertain to cash flow activity related to financing receivables.

Because customer financing is different in nature from the company's manufacturing, development and services businesses, management believes that the aforementioned type of comparative disclosure enhances the understanding and analysis of the consolidated financial statements.

Statement of Financial Position

At December 31: (Dollars in millions)	Customer Financing 1996	Customer Financing 1995*	IBM with Customer Financing on an Equity Basis 1996	IBM with Customer Financing on an Equity Basis 1995*
Assets:				
Cash and cash equivalents	$ 1,433	$ 808	$ 6,254	$ 6,451
Notes and accounts receivable	–	–	10,063	10,981
Net investment in capital leases	13,430	14,096	–	–
Working capital financing receivables	4,030	3,886	–	–
Loans receivable	6,428	5,481	–	–
Inventories	98	87	5,788	6,252
Plant, rental machines and other property, net of accum. depreciation	3,988	2,924	15,229	15,101
Other assets	2,386	1,564	15,010	14,501
Investment in customer financing	–	–	5,613	4,768
Total assets	$ 31,793	$ 28,846	$ 57,957	$ 58,054
Liabilities and stockholders' equity:				
Taxes, accrued expenses and other liabilities	$ 7,915	$ 5,992	$ 34,127	$ 33,724
Debt	20,627	19,722	2,202	1,907
Total liabilities	28,542	25,714	36,329	35,631
Stockholders' equity/invested capital	3,251	3,132	21,628	22,423
Total liabilities and stockholders' equity	$ 31,793	$ 28,846	$ 57,957	$ 58,054

*Reclassified to conform to 1996 presentation.

Statement of Earnings

For the year ended December 31: (Dollars in millions)	Customer Financing 1996	Customer Financing 1995	Customer Financing 1994	IBM with Customer Financing on an Equity Basis 1996	IBM with Customer Financing on an Equity Basis 1995	IBM with Customer Financing on an Equity Basis 1994
Finance and other income:						
Finance income	$ 2,048	$ 2,110	$ 2,026	$ –	$ –	$ –
Rental income, net	509	415	338	590	469	589
Sales	809	1,001	1,160	71,798	67,588	59,991
Other income	320	367	933	1,381	1,473	1,423
Total finance and other income	3,686	3,893	4,457	73,769	69,530	62,003
Interest and other costs and expenses	2,426	2,782	3,245	65,182	61,717	56,848
Net earnings before income taxes	1,260	1,111	1,212	8,587	7,813	5,155
Provision for income taxes	531	428	505	3,158	3,635	2,134
Net earnings	$ 729	$ 683	$ 707	$ 5,429	$ 4,178	$ 3,021

Statement of Cash Flows

For the year ended December 31:	Customer Financing			IBM with Customer Financing on an Equity Basis		
(Dollars in millions)	1996	1995	1994	1996	1995	1994
Net cash provided from operating activities	$ 5,314	$ 3,712	$ 2,669	$ 8,217	$ 9,250	$ 8,393
Net cash used in investing activities	(5,544)	(3,968)	(249)	(3,435)	(3,338)	(2,446)
Net cash provided from (used in) financing activities	872	(198)	(3,294)	(4,824)	(6,186)	(3,118)
Effect of exchange rate changes on cash and cash equivalents	(17)	(42)	82	(155)	107	24
Net change in cash and cash equivalents	625	(496)	(792)	(197)	(167)	2,853
Cash and cash equivalents at January 1	808	1,304	2,096	6,451	6,618	3,765
Cash and cash equivalents at December 31	$ 1,433	$ 808	$ 1,304	$ 6,254	$ 6,451	$ 6,618

Customer financing debt at December 31, 1996, consisted of borrowings with external financial institutions of $ 14,127 million and intracompany borrowings of $ 6,500 million. Intracompany borrowings are made pursuant to loan agreements between the parties at interest rates approximating market rates.

Customer financing earnings yielded a return on average invested capital of 22.7 percent in 1996, compared to 22.6 percent in 1995. Included within these results are intracompany services and fees received for tax benefits provided to the company resulting from tax deferrals generated by financing transactions. Such fees are eliminated from the Consolidated Statement of Earnings. The 1994 earnings included income resulting from IBM Credit Corporation's litigation settlement with Comdisco, Inc., and from IBM Credit Corporation's sale of IBM Credit Investment Management Corporation.

N Rental Expense and Lease Commitments

Rental expense, including amounts charged to inventories and fixed assets and excluding amounts previously reserved, was $ 1,210 million in 1996, $ 1,145 million in 1995 and $ 1,276 million in 1994. The table below depicts gross minimum rental commitments under non-cancelable leases, amounts related to vacant space which the company had previously reserved and sublease income commitments. These amounts generally reflect activities related to office space.

(Dollars in millions)	1997	1998	1999	2000	2001	Beyond 2001
Gross rental commitments	$ 1,129	$ 1,005	$ 888	$ 761	$ 580	$ 1,722
Vacant space	322	283	231	215	167	438
Sublease income commitments	119	110	96	84	66	129

O Stock-Based Compensation Plans

The company applies Accounting Principles Board (APB) Opinion 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for its stock-based compensation plans. A description of the terms of the company's stock-based compensation plans follows:

Long-Term Performance Plan

Incentive awards are provided to officers and other key employees under the terms of the IBM 1994 Long-Term Performance Plan (the "Plan"), which was approved by stockholders in April 1994. The Plan is administered by the Executive Compensation and Management Resources Committee of the Board of Directors. The committee determines the type and terms of the award to be granted, including vesting provisions. Awards may include stock options, stock appreciation rights (SARs), restricted stock, cash, stock or any combination thereof. The number of shares that may be issued under the Plan for awards granted wholly or partly in stock during the five-year term of the Plan is 29.1 million, which approximated 5 percent of the outstanding common stock as determined on February 10, 1994. Prior to April 25, 1994, awards were issued under the IBM 1989 Long-Term Performance Plan. There were approximately 13.0 million, 21.0 million and 27.8 million unused shares available for granting under the 1994 Long-Term Performance Plan as of December 31, 1996, 1995 and 1994, respectively.

Awards under the Plan resulted in compensation expense of $ 203.9 million, $ 106.3 million and $ 139.1 million, that was included in net earnings before income taxes, in 1996, 1995 and 1994, respectively. Such awards include those that settle in cash, such as SARs, and restricted stock grants.

Stock Option Grants

Stock options granted under the Plan allow the purchase of IBM's common stock at 100 percent of the market price on the date of grant and typically expire 10 years from the date of grant. The following table summarizes option activity of the Plan during 1996, 1995 and 1994:

	1996		1995		1994	
	Wtd. Avg. Exercise Price	No. of Shares under Option	Wtd. Avg. Exercise Price	No. of Shares under Option	Wtd. Avg. Exercise Price	No. of Shares under Option
Balance at January 1	$ 78	34,282,903	$ 68	34,063,317	$ 83	29,260,724
Options granted	126	7,679,529	77	6,468,702	54	6,863,219
Options exercised	71	(9,651,311)	51	(3,695,789)	44	(235,044)
Options terminated	121	(1,593,460)	103	(2,553,327)	91	(1,825,582)
Balance at December 31	$ 88	30,717,661	$ 78	34,282,903	$ 68	34,063,317
Exercisable at December 31	$ 83	15,301,922	$ 91	19,176,410	$ 103	16,666,537

The shares under option at December 31, 1996, were at the following exercise prices:

	Options Outstanding			Options Currently Exercisable	
Exercise Price Range	No. of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Contractual Life (in years)	No. of Options	Wtd. Avg. Exercise Price
$ 43 – 99	18,570,322	$ 64	7	10,678,111	$ 65
$ 100 – 139	11,398,198	122	7	3,890,671	117
$ 140 & over	749,141	160	2	733,140	160
	30,717,661			15,301,922	

IBM Employees Stock Purchase Plan

The IBM Employees Stock Purchase Plan (ESPP) enables substantially all regular employees to purchase full or fractional shares of IBM common stock through payroll deductions of up to 10 percent of eligible compensation. The price an employee pays is 85 percent of the average market price on the last day of an applicable pay period.

During 1996, 1995 and 1994, employees purchased 3,230,928; 4,479,340 and 6,576,030 shares, all of which were treasury shares, for which $ 324 million, $ 344 million and $ 350 million was paid to IBM, respectively.

There were approximately 20.1 million, 23.3 million and 15.1 million reserved unissued shares available for purchase, as previously approved by stockholders, at December 31, 1996, 1995 and 1994, respectively.

Pro Forma Disclosure

In applying APB Opinion 25, no expense was recognized for stock options granted under the Plan and for employee stock purchases under the ESPP. Beginning in 1995, SFAS 123, "Accounting for Stock-Based Compensation," required that a fair market value of all awards of stock-based compensation be determined using standard techniques and that pro forma net earnings and earnings per share be disclosed as if the resulting stock-based compensation amounts were recorded in the Consolidated Statement of Earnings as follows:

(Dollars in millions except per share amounts)	1996		1995	
	As reported	Pro forma	As reported	Pro forma
Net earnings applicable to common shareholders	$ 5,409	$ 5,267	$ 4,116	$ 4,020
Net earnings per share of common stock	$ 10.24	$ 9.97	$ 7.23	$ 7.06

The above pro forma amounts, for purposes of SFAS 123, reflect the portion of the estimated fair value of awards earned in 1996 and 1995. The aggregate fair value of awards granted is earned ratably over the vesting or service period and is greater than that included in the pro forma amounts.

The company used the Black-Scholes model to value the stock options granted in 1996 and 1995. The weighted average assumptions used to estimate the value of the options included in the pro forma amounts, and the weighted average estimated fair value of an option granted are as follows:

	1996	1995
Term (years)*	5/6	5/6
Volatility**	22.0%	21.0%
Risk-free interest rate (zero coupon U.S. Treasury note)	6.0%	7.0%
Dividend yield	1.2%	2.0%
Weighted average fair value	$ 40	$ 23

*Option term is based on tax incentive options (5 years) and non-tax incentive options (6 years).
**To determine volatility the company measured the daily price changes of the stock over the most recent 5 and 6 year periods.

P Stock Repurchases

In 1996 and 1995, the Board of Directors authorized the company to purchase up to $ 13.5 billion of IBM common stock. During 1996 and 1995, the company repurchased 49,465,200 common shares at a cost of $ 5,810 million and 50,906,300 common shares at a cost of $ 4,864 million, respectively. The repurchases resulted in a reduction of $ 61,831,500 and $ 63,632,875 in the stated capital (par value) associated with common stock in 1996 and 1995, respectively. The repurchased shares were retired and restored to the status of authorized but unissued shares. At December 31, 1996, approximately $ 2.8 billion of Board authorized repurchases remained. The company plans to purchase shares on the open market from time to time, depending on market conditions.

During 1995, the IBM Board of Directors authorized the company to purchase all of its outstanding Series A 7 1/2 percent preferred stock depositary shares. The company repurchased 8,534,289 shares at a cost of $ 870 million during 1995, which resulted in a reduction of $ 85,343 in the stated capital (par value) associated with preferred stock. The repurchased shares were retired and restored to the status of authorized but unissued shares. No shares were repurchased in 1996. The company plans to purchase remaining shares on the open market and in private transactions from time to time, depending on market conditions.

Q Retirement Plans

The company and its subsidiaries have defined benefit and defined contribution retirement plans covering substantially all regular employees. The cost of the defined contribution plans was not material. The aggregate worldwide cost of the defined benefit plans for 1996, 1995 and 1994 was $ (137) million, $ 165 million and $ 678 million, respectively, as follows:

Net Periodic Pension Cost

	U.S. Plan			Non-U.S. Plans		
	1996	1995	1994	1996	1995	1994
Expected long-term rate of return on plan assets	9.25%	9.25%	9.5%	6.5-10%	6.25-10%	5.5-9%
(Dollars in millions)						
Service cost	$ 412	$ 315	$ 542	$ 378	$ 386	$ 467
Interest cost on the projected benefit obligation	2,125	2,098	2,033	1,292	1,325	1,107
Return on plan assets:						
Actual	(4,849)	(5,500)	327	(2,543)	(1,848)	329
Deferred	2,148	2,958	(2,826)	1,075	403	(1,540)
Net amortizations	(121)	(123)	(65)	28	12	19
Settlement (gains)/curtailment losses	–	–	–	(102)	128	269
Net periodic pension cost	$ (285)	$ (252)	$ 11	$ 128	$ 406	$ 651
Total net periodic pension cost for all non-U.S. plans				$ 148	$ 417	$ 667

Net periodic pension cost is determined using the Projected Unit Credit actuarial method. Settlement gains in 1996 reflect principally the transfer of assets to defined contribution plans upon election by the employees in certain countries. Curtailment losses in 1995 and 1994 resulted from the significant reductions in the expected years of future service caused by termination programs and represent the immediate recognition of associated prior service cost and a portion of previously unrecognized actuarial losses.

In 1994, the company introduced a non-qualified U.S. Supplemental Executive Retirement Plan (SERP) effective January 1, 1995, which will be phased in over three years. The SERP, which is unfunded, provides eligible executives defined pension benefits outside the IBM Retirement Plan, based on average earnings, years of service and age at retirement. At December 31, 1996 and 1995, the projected benefit obligation was $ 93 million and $ 82 million, respectively. The net unrecognized costs of the SERP were $ 57 million and $ 64 million, and the amounts included in the Consolidated Statement of Financial Position were pension liabilities of $ 36 million and $ 18 million as of December 31, 1996 and 1995, respectively. These amounts are in addition to the U.S. retirement plan financial information included herein.

The table below provides information on the status of the U.S. and material non-U.S. defined benefit retirement plans:

Funded Status

	U.S. Plan		Non-U.S. Plans	
	1996	1995	1996	1995
Assumptions:				
Discount rate	7.75%	7.25%	4.5-8.5%	4.5-9.0%
Long-term rate of compensation increase	5%	5%	2.3-6.5%	1.5-6.5%
(Dollars in millions)				
Actuarial present value of benefit obligations:				
Vested benefit obligation	$ (26,355)	$ (26,413)	$ (17,380)	$ (17,788)
Accumulated benefit obligation	$ (27,698)	$ (28,070)	$ (18,273)	$ (18,771)
Projected benefit obligation	$ (29,729)	$ (30,235)	$ (19,739)	$ (20,294)
Plan assets at fair value	34,281	31,209	20,808	19,693
Projected benefit obligation less than (in excess of) plan assets	4,552	974	1,069	(601)
Unrecognized net (gain) loss	(1,421)	1,976	(1,539)	(436)
Unrecognized prior service cost	193	230	248	267
Unrecognized net asset established at January 1, 1986	(1,052)	(1,193)	(110)	(143)
Prepaid pension cost (pension liability) recognized in the Consolidated Statement of Financial Position	$ 2,272	$ 1,987	$ (332)	$ (913)

The U.S. plan's projected benefit obligation decreased in 1996 primarily as a result of a change in the discount rate assumption, as required under SFAS 87, "Employers' Accounting for Pensions," which decreased the projected benefit obligation by approximately $ 1,700 million. The effect on the company's results of operations and financial position from changes in the estimates and assumptions used in computing pension expense and prepaid pension cost or pension liability is mitigated by the delayed recognition provisions of SFAS 87 with the exception of the effects of settlement gains, curtailment losses and early terminations, which are recognized immediately.

It is the company's practice to fund amounts for pensions sufficient to meet the minimum requirements set forth in applicable employee benefit laws and with regard to local tax laws. Additional amounts are contributed from time to time when deemed appropriate by the company. Liabilities for amounts in excess of these funding levels are accrued and reported in the company's Consolidated Statement of Financial Position. The assets of the various plans include corporate equities, government securities, corporate debt securities and income-producing real estate.

U.S. Plan: U.S. regular, full-time and part-time employees are covered by a noncontributory plan which is funded by company contributions to an irrevocable trust fund, which is held for the sole benefit of employees. In 1994, the company announced major changes to the plan that took effect in 1995. Under a new formula, which is being phased in over five years, retirement benefits will be determined based on points accumulated for each year worked and final average compensation period. To preserve benefits of employees close to retirement, service and earnings credit will continue to accrue under the prior formula through the year 2000, and upon retirement, these employees will receive the benefit from either the new or prior formulas, whichever is higher. Benefits become vested upon the completion of five years of service. The number of individuals receiving benefits at December 31, 1996 and 1995, was 101,293 and 92,133, respectively.

Non-U.S. Plans: Most subsidiaries and branches outside the U.S. have retirement plans covering substantially all regular employees, under which funds are deposited under various fiduciary-type arrangements, annuities are purchased under group contracts or reserves are provided. Retirement benefits are based on years of service and the employee's compensation, generally during a fixed number of years immediately prior to retirement. The ranges of assumptions used for the non-U.S. plans reflect the different economic environments within various countries.

R Nonpension Postretirement Benefits

The company and its U.S. subsidiaries have defined benefit postretirement plans that provide medical, dental and life insurance for retirees and eligible dependents. Plan cost maximums for those who retired prior to January 1, 1992, will take effect beginning with the year 2001. Plan cost maximums for all other employees take effect upon retirement.

The table below provides information on the status of the U.S. plans:

Funded Status

	1996	1995
Assumed discount rate	7.75%	7.25%
(Dollars in millions)		
Accumulated postretirement benefit obligation:		
Retirees	$ (5,454)	$ (5,661)
Fully eligible active plan participants	(512)	(704)
Other active plan participants	(487)	(653)
Total	(6,453)	(7,018)
Plan assets at fair value	559	886
Accumulated postretirement benefit obligation in excess of plan assets	(5,894)	(6,132)
Unrecognized net loss	378	718
Unrecognized prior service cost	(902)	(660)
Accrued postretirement benefit cost recognized in the Consolidated Statement of Financial Position	$ (6,418)	$ (6,074)

The accumulated postretirement benefit obligation was determined by application of the terms of medical, dental and life insurance plans, including the effects of established maximums on covered costs, together with relevant actuarial assumptions. These actuarial assumptions included a projected healthcare cost trend rate of 6 percent. In 1996, the accumulated postretirement benefit obligation decreased by $ 565 million primarily from the change, as required by SFAS 106, "Employers' Accounting for Postretirement Benefits Other than Pensions," in the assumed discount rate.

The effect of a 1 percent annual increase in the assumed healthcare cost trend rate would increase the accumulated postretirement benefit obligation at December 31, 1996, by approximately $ 27 million; the 1996 annual costs would not be materially affected.

It is the company's practice to fund amounts for postretirement benefits with an independent trustee, as deemed appropriate from time to time. The plan assets include various domestic fixed income securities. The accounting for the plan is based on the written plan.

Net periodic postretirement benefit cost for U.S. retirees for the years ended December 31 included the following components:

	1996	1995	1994
Expected long-term rate of return on plan assets	9.25%	9.25%	9.5%
(Dollars in millions)			
Service cost	$ 43	$ 40	$ 51
Interest cost on the accumulated postretirement benefit obligation	478	520	512
Actual return on plan assets	(68)	(198)	22
Net amortizations and deferrals	(87)	(7)	(163)
Net periodic postretirement benefit cost	$ 366	$ 355	$ 422

Certain of the company's non-U.S. subsidiaries have similar plans for retirees. However, most retirees outside the United States are covered by government-sponsored and administered programs, and the obligations and cost of these programs are not significant to the company.

S Lines of Credit

The company maintains a $ 10.0 billion committed global credit facility. Unused committed lines of credit from this global facility and other existing committed and uncommitted lines of credit at December 31, 1996, were $ 13.9 billion, compared to $ 14.6 billion at December 31, 1995. Interest rates on borrowings vary from country to country depending on local market conditions.

T Sale and Securitization of Receivables

At year-end 1996, the company had a net balance of $ 1.1 billion in assets under management from the securitization of loans, leases and trade receivables, compared to $ 1.2 billion at year-end 1995. The company received total cash proceeds of approximately $ 4.0 billion and $ 3.4 billion in 1996 and 1995, respectively, from the sale and securitization of these receivables and assets. No material gain or loss resulted from these transactions. Recourse amounts associated with the aforementioned sales and securitization activities are expected to be minimal, and adequate reserves are in place to cover potential losses.

U Financial Instruments

The following presents information on certain significant on- and off-balance sheet financial instruments, including derivatives.

Financial Instruments On-Balance Sheet (excluding derivatives)

Financial assets with carrying values approximating fair value include cash and cash equivalents, marketable securities, notes and other accounts receivable and other investments. Financial liabilities with carrying values approximating fair value include accounts payable and other accrued expenses and liabilities, as well as short-term and long-term debt.

The following table summarizes the company's marketable securities and other investments, all of which were considered available for sale.

Marketable securities and other investments

At December 31:	Carrying Value	
(Dollars in millions)	1996	1995
Current marketable securities:		
U.S. government securities	$ 108	$ 222
Time deposits and other bank obligations	283	93
Non-U.S. government securities and other fixed-term obligations	59	127
Total	$ 450	$ 442
Non-current marketable securities:*		
U.S. government securities	$ 99	$ –
Time deposits and other bank obligations	127	97
Non-U.S. government securities and other fixed-term obligations	155	72
Total	$ 381	$ 169
Other investments:*		
Alliance investments on cost method	$ 320	$ 128

*Included within Investments and sundry assets on the Consolidated Statement of Financial Position.

Financial Instruments Off-Balance Sheet (excluding derivatives)

IBM has guaranteed certain loans and financial commitments of affiliates. The fair market values of these financial guarantees were $ 787 million and $ 794 million at December 31, 1996 and 1995, respectively. Additionally, the company is contingently liable for commitments of various ventures to which it is a party, certain receivables sold with recourse and other contracts. These commitments, which in the aggregate were approximately $ 400 million and $ 200 million at December 31, 1996 and 1995, respectively, are not expected to have a material adverse effect on the company's financial position or results of operations.

The company's dealers had unused lines of credit available from IBM for working capital financing of approximately $ 2.1 billion and $ 1.0 billion at December 31, 1996 and 1995, respectively.

Derivative Financial Instruments

The following table summarizes the notional value, carrying value and fair value of the company's derivative financial instruments on and off the balance sheet. The notional value at year end provides an indication of the extent of the company's involvement in such instruments, but does not represent exposure to market risk.

	At December 31, 1996			At December 31, 1995		
(Dollars in millions)	Notional Value	Carrying Value	Fair Value*	Notional Value	Carrying Value	Fair Value*
Interest rate and currency contracts	$ 18,700	$ (70)	$ (117)	$ 13,600	$ (88)	$ (161)
Option contracts	10,100	92	81	4,800	18	41
Total	$ 28,800	$ 22	$ (36)	$ 18,400	$ (70)	$ (120)

Bracketed amounts are liabilities.

*The estimated fair value of derivatives both on- and off-balance sheet at December 31, 1996 and 1995, consists of assets of $258 million and $153 million and liabilities of $294 million and $273 million, respectively.

The majority of the company's derivative transactions relates to the matching of liabilities to assets associated with its worldwide customer financing business. The company issues debt, using the most efficient capital markets and products, which may result in a currency or interest rate mismatch. Interest rate swaps or currency swaps are then used to match the interest rates and currencies of its debt to the related customer financing receivables. These swap contracts are principally one to five years in duration. The company uses an internal regional center to manage the cash of its subsidiaries. This regional center principally uses currency swaps to convert cash flows in a cost-effective manner, predominantly for the company's European subsidiaries. The terms of the swaps are generally less than one year.

Interest and currency rate differentials accruing under interest rate and currency swap contracts related to the customer financing business are recognized over the life of the contracts in interest expense, and the effects of contracts related to intracompany funding are recognized over the life of the contract in interest income. When the terms of the underwriting instrument are modified, or if it ceases to exist for whatever reason, all changes in fair value of the swap contracts are recognized in income each period until they mature.

Additionally, the company uses derivatives to limit its exposure to loss resulting from fluctuations in foreign currency exchange rates on anticipated cash transactions between foreign subsidiaries and the parent company. The company receives significant dividends, intracompany royalties and net payments for goods and services from its non-U.S. subsidiaries. In anticipation of these foreign currency flows, and given the volatility of the currency markets, the company selectively employs foreign currency options to manage the currency risk. The terms of these instruments are generally less than one year.

For purchased options that hedge anticipated transactions, gains and losses are deferred and recognized in other income in the same period that the underlying transaction occurs, expires or is otherwise terminated. At December 31, 1996 and 1995, there were no material deferred gains or losses. The premiums associated with entering into option contracts are generally amortized over the life of the options and are not material to the company's results. Unamortized premiums are included in prepaid assets. All written options are marked to market monthly and are not material to the company's results.

The company has used derivative instruments as an element of its risk management strategy for many years. Although derivatives entail a risk of non-performance by counterparties, the company manages this risk by establishing explicit dollar and term limitations that correspond to the credit rating of each carefully selected counterparty. The company has not sustained a material loss from these instruments nor does it anticipate any material adverse effect on its results of operations or financial position in the future.

V Subsequent Event

On January 28, 1997, the IBM Board of Directors declared a two-for-one common stock split, subject to the approval of stockholders of an increase in the number of common shares authorized from 750 million to 1,875 million.

The record date for the split is currently expected to be on or after May 9, 1997, with distribution of the split shares to follow on or after May 27, 1997.

W Segment Information

IBM is in the business of providing customer solutions through the use of advanced information technologies. The company operates primarily in the single industry segment that creates value by offering a variety of solutions that include, either singularly or in some combination, services, software, systems, products, financing and technologies. The schedule on page 83 shows revenue by classes of similar products or services. Financial information by geographic area is summarized in note X, "Geographic Areas," on pages 84 and 85.

For purposes of classifying similar information technology products, general purpose computer systems that operate on a large class of applications are classified as processor servers when the systems are simultaneously used by multiple users at one time, or as clients when the systems are used by one user at a time. Servers include the System/390, AS/400, RISC System/6000 and personal computer server products. Personal systems clients include personal computers and RISC System/6000 client products. Other clients include display-based terminals and consumer and financial systems. Storage consists of externally attached direct access storage devices, tape storage devices and HDD storage files sold to external customers. Other peripherals consists of advanced function printers and telecommunication devices. OEM hardware consists primarily of revenue from the sale of semiconductors.

These hardware classes of products represent groupings that perform similar functions, as opposed to the complete spectrum of products associated with IBM's product divisions. Accordingly, they do not represent the full range of any division's offerings, which could include related peripherals, software and maintenance.

Services represents a wide range of service offerings including consulting, education, systems integration design and development, managed operations of systems and networks and availability services. Software includes applications and systems software for both host and distributed systems. Maintenance consists of separately billed charges for maintenance. Financing and other is composed primarily of financing revenue and products and supplies not otherwise classified.

Some products logically fit in more than one class and are assigned to a specific class based on a variety of factors. Over time, products tend to overlap, merge into or split from existing classes as a result of changing technologies, market perceptions and/or customer use. For example, market demand may create requirements for technological enhancements to permit a peripheral product to be functionally integrated with a display, a telecommunication device and a processor to form a workstation. Such interchangeability and technological progress tend to make year-to-year comparisons less valid than they would be in an industry less subject to rapid change.

Revenue by Classes of Similar Products or Services

	Consolidated			U.S. Only		
(Dollars in millions)	1996	1995*	1994*	1996	1995*	1994*
Information technology:						
Processors:						
Servers**	$ 12,421	$ 12,597	$ 11,553	$ 4,365	$ 4,464	$ 3,958
Clients:						
Personal systems**	12,747	11,199	9,731	5,090	4,401	4,046
Other clients**	1,178	1,478	1,538	429	480	463
Peripherals:						
Storage**	4,632	4,828	4,608	2,390	1,970	1,767
Other peripherals**	2,304	2,085	2,006	860	764	810
OEM hardware	2,697	2,968	2,191	1,738	1,975	1,285
Services	15,873	12,714	9,715	6,129	4,606	3,709
Software	13,052	12,657	11,346	4,377	4,117	3,926
Maintenance	6,981	7,409	7,222	2,525	2,618	2,648
Financing and other	4,062	4,005	4,142	1,492	1,394	1,506
Total	$ 75,947	$ 71,940	$ 64,052	$ 29,395	$ 26,789	$ 24,118

*Reclassified to conform to 1996 presentation.
**Hardware only, includes applicable rental revenue, excludes functions not embedded, software and maintenance.

X Geographic Areas

Sales and services in the United States and Canada are managed as a single enterprise. However, in compliance with SFAS 14, "Financial Reporting for Segments of a Business Enterprise," the United States is reported as a separate geographic area. Canadian operations are included in the "Americas" area.

Non-U.S. subsidiaries operating in local currency environments account for approximately 84 percent of the company's non-U.S. revenue. The remaining 16 percent is from subsidiaries and branches operating in U.S. dollars or in highly inflationary environments.

In the Europe/Middle East/Africa area, European operations accounted for approximately 95 percent of revenue in 1996, 1995 and 1994.

Interarea transfers consist principally of completed machines, subassemblies and parts and software. Machines, subassemblies and parts are generally transferred at an intracompany selling price. Software transfers represent license fees paid by non-U.S. subsidiaries. The intracompany selling price that relates to fixed asset transfers is capitalized and depreciated by the importing area.

(Dollars in millions)	1996	1995	1994
United States			
Revenue – Customers	$ 29,395	$ 26,789	$ 24,118
Interarea transfers	10,196	10,553	6,336
Total	$ 39,592	$ 37,342	$ 30,454
Net earnings	1,782	599	969
Assets at December 31	39,724	38,584	37,156
Europe/Middle East/Africa			
Revenue – Customers	$ 25,280	$ 25,238	$ 23,034
Interarea transfers	2,455	2,530	1,787
Total	$ 27,735	$ 27,768	$ 24,821
Net earnings	1,474	2,271	1,086
Assets at December 31	21,732	24,066	25,816
Asia Pacific			
Revenue – Customers	$ 14,752	$ 13,892	$ 11,365
Interarea transfers	2,781	2,698	1,876
Total	$ 17,533	$ 16,590	$ 13,241
Net earnings	1,466	1,098	567
Assets at December 31	12,152	12,789	12,619
Americas			
Revenue – Customers	$ 6,520	$ 6,021	$ 5,535
Interarea transfers	5,123	5,333	4,257
Total	$ 11,643	$ 11,354	$ 9,792
Net earnings	578	324	498
Assets at December 31	8,123	7,530	7,783
Eliminations			
Revenue	$ (20,556)	$ (21,114)	$ (14,256)
Net earnings	129	(114)	(99)
Assets	(599)	(2,677)	(2,283)
Consolidated			
Revenue	$ 75,947	$ 71,940	$ 64,052
Net earnings	5,429	4,178	3,021
Assets at December 31	81,132	80,292	81,091

Five-Year Comparison of Selected Financial Data

(Dollars in millions except per share amounts)	1996	1995	1994	1993	1992
For the year:					
Revenue	$ 75,947	$ 71,940	$ 64,052	$ 62,716	$ 64,523
Net earnings (loss) before changes in accounting principles	5,429	4,178	3,021	(7,987)	(6,865)
Per share of common stock	10.24	7.23	5.02	(14.02)	(12.03)
Effect of accounting changes*	–	–	–	(114)	1,900
Per share of common stock	–	–	–	(.20)	3.33
Net earnings (loss)	5,429	4,178	3,021	(8,101)	(4,965)
Per share of common stock	10.24	7.23	5.02	(14.22)	(8.70)
Cash dividends paid on common stock	686	572	585	905	2,765
Per share of common stock	1.30	1.00	1.00	1.58	4.84
Investment in plant, rental machines and other property	5,883	4,744	3,078	3,232	4,698
Return on stockholders' equity	24.8%	18.5%	14.3%	–	–
At end of year:					
Total assets	$ 81,132	$ 80,292	$ 81,091	$ 81,113	$ 86,705
Net investment in plant, rental machines and other property	17,407	16,579	16,664	17,521	21,595
Working capital	6,695	9,043	12,112	6,052	2,955
Total debt	22,829	21,629	22,118	27,342	29,320
Stockholders' equity	21,628	22,423	23,413	19,738	27,624

*1993, postemployment benefits; 1992, income taxes.

Selected Quarterly Data

(Dollars in millions except per share and stock prices)

	Revenue	Gross Profit	Net Earnings (Loss)	Per Share Common Stock Earnings (Loss)	Dividends	Stock Prices** High	Stock Prices** Low
1996							
First quarter	$ 16,559	$ 6,769	$ 774	$ 1.41	$ .25	$ 128.88	$ 83.13
Second quarter	18,183	7,191	1,347	2.51	.35	120.88	96.13
Third quarter	18,062	7,258	1,285	2.45	.35	127.88	89.13
Fourth quarter	23,143	9,321	2,023	3.93	.35	166.00	123.13
Total	$ 75,947	$ 30,539	$ 5,429	$ 10.24*	$ 1.30		
1995							
First quarter	$ 15,735	$ 6,664	$ 1,289	$ 2.12	$ .25	$ 85.13	$ 70.25
Second quarter	17,531	7,631	1,716	2.97	.25	99.38	82.25
Third quarter	16,754	6,921	(538)	(.96)	.25	114.63	91.63
Fourth quarter	21,920	9,151	1,711	3.09	.25	102.38	87.75
Total	$ 71,940	$ 30,367	$ 4,178	$ 7.23*	$ 1.00		

*The sum of the quarter's earnings per share does not equal the year-to-date earnings per share due to changes in average share calculations. This is in accordance with prescribed reporting requirements.

**The stock prices reflect the high and low prices for IBM's common stock on the New York Stock Exchange composite tape for the last two years.

IBM Stockholder Services

Stockholders with questions about their accounts should contact:
First Chicago Trust Company
of New York
Mail Suite 4688
P.O. Box 2530
Jersey City, New Jersey
07303-2530
(888) IBM-6700
Stockholders residing outside the United States, Canada and Puerto Rico should call (201) 324-0405.
Stockholders can also reach First Chicago Trust Company via the Internet at:
shares@info.ibm.com

Hearing-impaired stockholders with access to a telecommunications device (TDD) can communicate directly with First Chicago Trust Company of New York by calling (201) 222-4489.

IBM Investor Services

The Investor Services Program brochure outlines a number of services provided for IBM stockholders and potential IBM investors, including the reinvestment of dividends, direct purchase and the deposit of IBM stock certificates for safekeeping. Call (888) 421-8860 for a copy of the brochure.
Investors residing outside the United States, Canada and Puerto Rico should call (212) 220-4169.

Stockholder Communications

Stockholders in the United States and Canada can get quarterly financial results, listen to a summary of Mr. Gerstner's Annual Meeting remarks and hear voting results from the meeting by calling (800) IBM-7800. Callers can also request printed copies of the information via mail or fax. Stockholders residing outside the United States, Canada and Puerto Rico should call (402) 573-9861.

Stockholders with other requests may write to:
IBM Stockholder Relations
IBM Corporation
One Old Orchard Road
Armonk, New York 10504

Annual Meeting

The IBM Annual Meeting of Stockholders will be held on Tuesday, April 29, 1997, at 10 a.m. at the Dallas Convention Center
650 South Griffin St.
Dallas, Texas

IBM Stock

IBM common stock is listed on the New York Stock Exchange, on other exchanges in the United States and around the world.

IBM on the Internet

Topics featured in this Annual Report can be found via the IBM home page on the Internet at http://www.ibm.com. Financial results, news on IBM products, services and other activities can also be found via that address.

Literature for IBM Stockholders

The following literature on IBM is available without charge from
First Chicago Trust Company of New York
Mail Suite 4688
P.O. Box 2530
Jersey City, New Jersey
07303-2530
(201) 324-0405.

The Form 10-K Annual Report and Form 10-Q Quarterly Reports to the SEC provide additional information on IBM's business. The 10-K is issued in April; 10-Q reports are released in May, August and November.

An audiocassette recording of the 1996 Annual Report is available for sight-impaired stockholders.

IBM Credit Corporation's Annual Report is available in April.

"IBM and the Environment" reports on IBM's environmental, safety and energy programs.

"Valuing Diversity: An Ongoing Commitment" reviews IBM's philosophy on workforce diversity, equal opportunity, affirmative action and work/life balance. Programs, both within IBM and in the community, that promote opportunities for women, minorities, people with disabilities, and Vietnam-era and disabled veterans are also discussed.

General Information

For answers to general questions about IBM from within the continental United States, call (800) 426-4968; from outside the continental United States, call (520) 574-4600.

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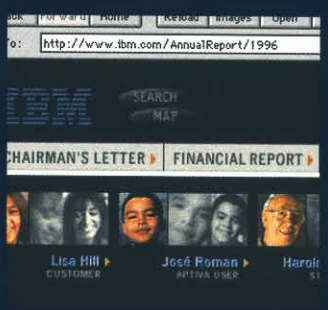

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"I fly." "I deliver." "I cook." "I pretend." "I tinker."
"I explore." "I train." "I communicate." "I rescue.
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