the new blue

Something rather unexpected has happened at IBM.

Our people have worked hard in recent years to reinvent not just the mechanics of their work, but the soul of their company. To be obsessed with customers. First to market. A revitalized engine of innovation, growth and profitability.

They thought they were transforming an enterprise. It turns out their work is part of something much bigger. Information technology is changing every aspect of life. How we work, learn, and govern ourselves. How we think about communication and culture. How we *think*.

IBM is at the center of this global revolution. It's fueling our growth and inspiring our people in ways not seen in a generation. It's happening all over the world, all over IBM. Look inside. It starts here.

Dear fellow investor,

LAST YEAR I TOLD YOU THAT OUR STRATEGIC VISION WAS BEGINNING TO TAKE HOLD, IN THE MARKETPLACE AND INSIDE IBM. I SAID WE PLANNED TO STAY THE COURSE — AND TO INTENSIFY OUR EXECUTION.

My message this year is unchanged. We will continue to implement a strategic plan that our customers, business partners, investors and employees understand and endorse. We expect to continue delivering consistent revenue growth — as we now have for 14 straight quarters. We will continue to improve the execution of our strategies to produce marketplace wins, chiefly by strengthening and leveraging IBM's unique breadth of people, skills and technology — assets many of our competitors are trying furiously to replicate.

IBM's market valuation — the ultimate measure of our performance — grew by $23 billion in 1997. Our stock price surpassed its all-time high and continued to climb, rising 38 percent over the year. Since our major restructuring in 1993, our marketplace worth has increased by more than $73 billion. Last year we split the stock for the first time since 1979.

If you don't read any further in this annual report, know that IBM's comeback is on track and doesn't require a major course correction.

But I hope you will read on. A 40,000-foot view doesn't really tell the story — where growth will come from and why, and how we plan to return IBM to industry leadership.

WHAT DID 1997 TELL US?

FIRST, it demonstrated that IBM remains on solid financial ground. For the third straight year, we reported record revenue — $78.5 billion, up 3 percent. That's 8 percent after you adjust for the effects of currency shifts.

Our earnings rose to $6.1 billion from $5.9 billion in 1996 (excluding a charge related to acquisitions in the first quarter of 1996). Our earnings per common share increased about 12 percent, to a record $6.18, from $5.53 in 1996.

We remain committed to maximizing shareholder value, and to making productive use of our cash. We increased our investment in the exploration and development of future technologies, investing $5.5 billion in 1997 on research and development, up $300 million from 1996. We invested nearly $7 billion during the year on capital expenditures to strengthen existing businesses. We announced plans to invest $700 million to build one of the world's most advanced semiconductor development facilities. We invested $663 million last year in the ongoing reengineering of IBM, resulting in greater manufacturing efficiencies, better customer service and reduced cycle time. We invested $700 million to acquire leadership companies like Unison Software, which strengthens our systems management business, a majority stake in NetObjects, a leader in website design software, and total ownership of Advantis, the U.S. data network services unit of the IBM Global Network.

After all these investments, we still had substantial cash on hand to return to shareholders — directly, via dividends, and indirectly, via our ongoing stock buyback program (another $7.1 billion of IBM shares in 1997). Notwithstanding these investments in the company and shareholder return, IBM finished the year with $7.6 billion in cash.

SECOND, 1997 revealed that there are powerful growth engines underlying our overall numbers. This was evident across most of our major businesses:

- Services revenue increased to $19.3 billion, up 28 percent in constant currency, continuing an exceptionally strong growth story. Seven years ago, with revenues of about $4 billion, we were barely visible in the marketplace. Today, we are the market leader, and IBM Global Services has the highest customer satisfaction rating in the industry. The total value of our services business already booked for 1998 and years to come is more than $42 billion, and we are growing faster than the industry. We continue to hire aggressively to fuel our growth — 15,000 people joined our services business in 1997.

- Software revenue grew 4 percent in constant currency, and its gross profit margin grew by 2 points. These are modest gains, but the key fact to note here is that in distributed middleware — the fastest-growing part of the software industry — we are growing faster than the industry. Five years ago, only one out of ten dollars in IBM software revenue was from distributed software; today, it's nearly four of ten. Lotus Notes "seats" doubled for the third straight year, to 20 million. And Tivoli's systems management products are growing twice as fast as those of the industry. We are also making a strong run at first place in databases, helped by the success of our new DB2 Universal Database.

(Dollars in millions except per share amounts)		1997		1996
For the year:				
Revenue	$	**78,508**	$	75,947
Earnings before income taxes	$	**9,027**	$	8,587
Income taxes	$	**2,934**	$	3,158
Net earnings	$	**6,093**	$	5,429
Per share of common stock	$	**6.18**	$	5.12*
Per share of common stock - assuming dilution	$	**6.01**	$	5.01*
Cash dividends paid on common stock	$	**763**	$	686
Per share of common stock	$	**.775***	$	.65*
Investment in plant, rental machines and other property	$	**6,793**	$	5,883
Average number of common shares outstanding (in millions)		**983**		1,057
At end of year:				
Total assets	$	**81,499**	$	81,132
Net investment in plant, rental machines and other property	$	**18,347**	$	17,407
Working capital	$	**6,911**	$	6,695
Total debt	$	**26,926**	$	22,829
Stockholders' equity	$	**19,816**	$	21,628
Number of employees in IBM/wholly owned subsidiaries		**269,465**		240,615
Number of common stock holders		**623,537**		622,594

*Adjusted to reflect a two-for-one split of the common stock effective May 9, 1997

- Hardware grew 4 percent in constant currency. Again, a closer look reveals important trends. In 1997 we thoroughly reinvigorated our entire server line. Our new System/390 G4 enterprise servers represent the complete conversion of our mainframes to microprocessor technology. Overall, the System/390 line delivered 30 percent growth in shipments of processing capacity. We introduced Web-enabled RS/6000s and AS/400 servers. Our new Netfinity PC server line, which brings our high-end server expertise to bear on smaller-scale needs, has been eagerly accepted by the market. Of particular note is our storage business. Despite having invented magnetic disk storage four decades ago and having pioneered every significant development since then, IBM had fallen seriously behind the competition. Today, our storage business is winning again. Last year, it gained further momentum by introducing a string of leadership products and by growing revenue from hard-disk drives twice as fast as the industry.

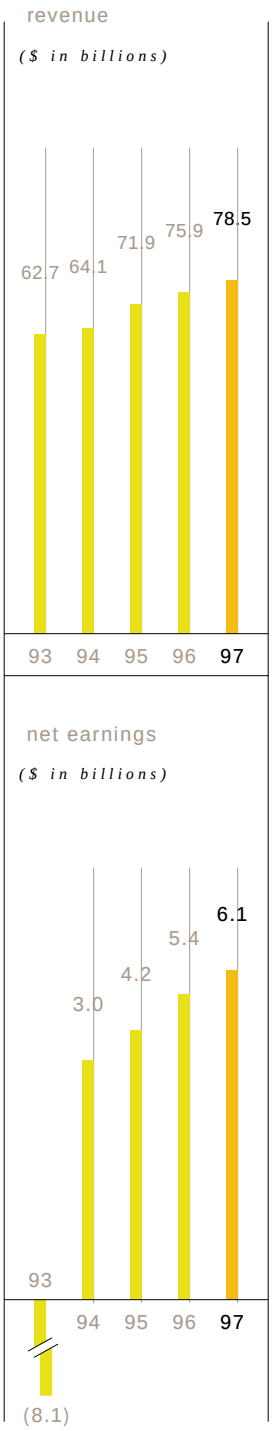
- Our success in disk drives highlights another important story: the growth in sales of IBM technology and components to other companies, many of them our competitors. Five years ago, our OEM revenue was only about $1 billion. In 1997 it was $5.6 billion, growing at double-digit rates, driven mainly by OEM sales of disk drives and semiconductors. We're also generating more than $1 billion annually by licensing IBM patents and other intellectual property to technology companies.

- IBM's commercial PC operations enjoyed a solid year, helping our PC business maintain its

market share and grow revenues by 7 percent in constant currency. We remained the biggest seller of "thin client" network computers. More than 3,000 enterprise customers purchased tens of thousands of IBM Network Stations last year. The award-winning IBM ThinkPad continued as the leader in mobile systems. And we introduced a new line of Microsoft Windows NT-based workstations in 1997, the IBM IntelliStation.

- We continued to expand rapidly in the world's emerging markets — though, like many other global companies, we are being affected by the financial turmoil in parts of Asia. We announced plans to expand our global network of research laboratories by establishing a new one — our eighth — in India. In Hungary we pioneered a "utility" service for small- and medium-size businesses — selling computing power and applications via networks in the same way water and electricity are sold. We plan to roll it out in other markets around the world.

THIRD, we were reminded of the extraordinary resource we have in IBM scientists and technologists — a community of expertise and inventiveness no one can match. For the fifth straight year, IBM led all companies in U.S. patents — discoveries that are building a foundation that will support the company well into the future. IBM people are delivering major technological breakthroughs and getting them to market faster than ever before. In 1997 alone:



- Deep Blue — a specially programmed RS/6000 SP supercomputer — redefined the way humanity understands its relationship to both machines and thinking itself. It also showed the world an IBM energized by tackling "grand" challenges — beginning with taking on the greatest grandmaster in chess history, and now moving on to pharmaceuticals, financial modeling and weather forecasting.

- Our ViaVoice Gold continuous speech recognition product brought an exciting technology to a new level of user-friendliness. It also potentially opened the world of e-mail and the Internet to a quarter of the planet, through Mandarin ViaVoice.

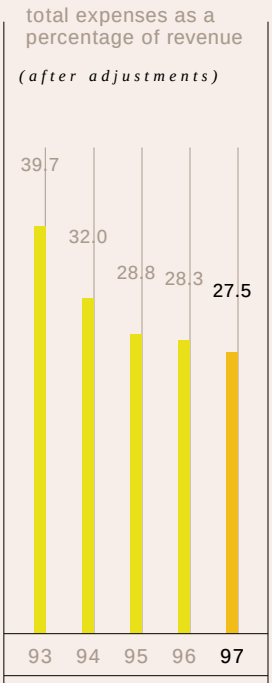
- Lotus's eSuite, introduced last fall, is an entirely new approach in personal productivity applications that takes advantage of network-based computing. Written entirely in Java, eSuite applications, such as word

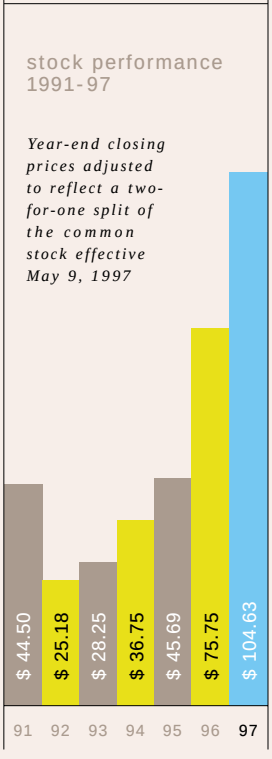
processor and spreadsheet, flow to users' PCs or network computers over both private networks and public networks like the Internet.

- IBM's breakthrough in copper microchips promises a significant increase in the capacity and speed of semiconductors, as well as reductions in cost. IBM has more than 50 issued and pending patents relating to the use of copper in chips, and the first devices will appear this year.

- We quadrupled the capacity of hard-disk drives through IBM's patented giant magnetoresistive (GMR) head technology, and pushed the outer limit of future devices by achieving a new world record in storage density — packing more than 10 billion bits (10 gigabits) per square inch of disk surface.

FOURTH, we can always do better. Our consumer PC business underperformed the market in 1997. And we need to do a better job of strengthening and positioning our family of servers, with particular attention to our AS/400 and RS/6000 lines. We are tackling these problems aggressively. We reorganized our consumer PC business, introduced new Aptiva offerings in the sub-$1,000 category (products that have been selling well), and consolidated AS/400 and RS/6000 manufacturing, marketing and development to reduce cost and improve market effectiveness.





FIFTH, 1997 reminded us that there will always be factors beyond our control, macroeconomic factors that affect our near-term performance. We saw this in the striking negative impact of world currencies and weakness in some Asian markets. These conditions continued into the first quarter of 1998, but at this writing we believe they are short-term effects.

THE FINAL LESSON OF 1997 is how much of our destiny we *do* control. Because we are on the right strategic path, and because the broad changes that are transforming the global economy play to IBM's strengths, things are increasingly going our way.

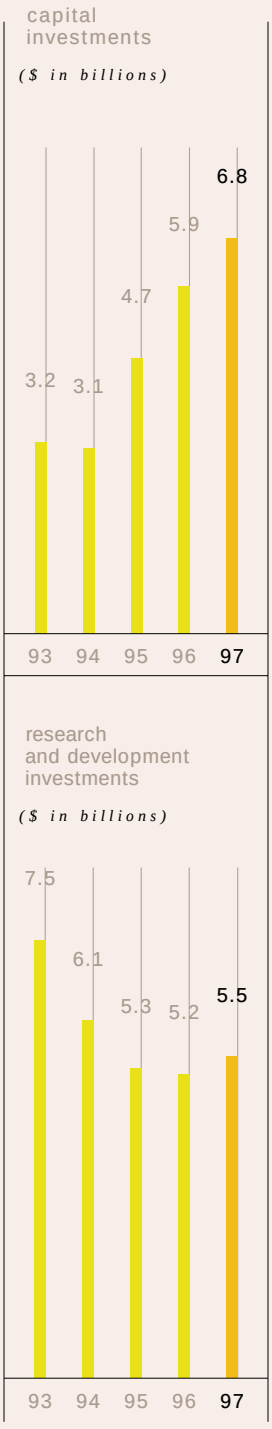
It wasn't always like that. Just five years ago, IBM was on the verge of scattering its businesses to the four corners of the information technology world, to live — or die — within their own industry sectors. We know now what a mistake that would have been.

Our unique value proposition to customers has been — and will continue to be — precisely our ability to offer integrated solutions that draw on resources and strengths across IBM. Today, with the shift to a networked

world, our customers again need integrators. They need secure, reliable, scalable technology — in other words, IBM-style enterprise computing. And they need partners who understand how to apply technology to address basic business issues — our heritage. I believe IBM's comeback is a direct result of our decision to swim against the tide, to stay together.

I think that became clear in 1997 — not just to us, but to the marketplace at large. Last year, *the idea of IBM* began to take hold. Our vision of a networked world began to be accepted, not as a corporate slogan, but as an insightful view of how the world was really changing. Wall Street, customers, business partners and industry consultants welcomed our e-business campaign, which laid out a compelling vision for our customers — compelling because it was real. IBM has led the industry in transforming businesses into e-businesses, completing thousands of e-business customer engagements. And inside the company, we've been working to transform IBM itself into the world's premier e-business.

While I haven't talked much in the past about our work to transform IBM — choosing instead to focus my public comments on customer and industry issues — behind the scenes we've been reengineering IBM from top to bottom, with one goal: to foster a high-performance culture and turn IBM into the world's premier knowledge management company.



We believe very strongly that the age-old levers of competition — labor, capital and land — are being supplemented by knowledge, and that the most successful companies in the future will be those that learn how to exploit knowledge — knowledge about customer behavior, markets, economies, technology — faster and more effectively than their competitors. They will use knowledge to adapt quickly — seizing opportunities and improving products and services, of course, but just as important, renewing the way they define themselves, think and operate.

To support the rapid movement of ideas and knowledge across IBM, we're completing a more than $400 million upgrade of our information technology infrastructure, including the largest single-company rollout ever of groupware — to 240,000 Lotus Notes users. We have created new compensation and rewards systems that foster a high-performance culture based on speed of execution and team-work. Our knowledge management work is also paying off in prosaic areas, such as procurement. Knowing at all times the status of supply and demand of purchased goods has allowed us to leverage our worldwide volumes and negotiate more effectively, saving IBM $4.2 billion since 1995.

To become the world's first truly knowledge-management-based company, you need great technology, but you also need lots of smart people. I've already discussed here some of our world-class technologies. What follow in this report are examples of the wonderful creativity of our nearly 270,000 people.

This team's job, of course, is not finished. We have one more peak to scale: a return to industry leadership. To be part of a true revolution is a rare privilege. For many generations, no such opportunity ever arises. For us, it has. When we started this journey five years ago, we focused on what was required to bring IBM back. We then came to realize that, in doing so, we were joining in the reinvention of the entire information technology industry. It's only within the past couple of years that the full scope of this revolution has become clear.

The rise of a globally connected world is changing everything. It's rewriting the basic assumptions of business, the economy and global society — and the new text reads like an IBM playbook. If IBM didn't exist — if we had disintegrated it five years ago — somebody would have to recreate us to lead this new era. (That's just what some of our competitors are trying to do.)

We have a chance to imagine new ways for people to interact, to govern themselves, to manage their businesses, to enhance their health, to teach their children. And we have the resources to do something about it — to push the technology further and faster than anyone else, and to turn it into real solutions, solutions that matter. Our customers and business partners are looking for someone to lead, and we intend to do it.

The women and men of the new IBM aren't daunted by that prospect. They're fired up by it. And so am I.

As you may know, I've committed to remain IBM's chairman and CEO for at least another five years. I've done so for two reasons.

First, the job I came here to do isn't complete. We've proved we could survive, when many had written us off for dead. We've proved we could grow, when most believed growth would come only to the small and fleet. And I believe we're proving IBM is relevant to the world of the future, when many saw us as an artifact of the past. Now, our task is to lead.

Second, I could not, frankly, think of anything else that would be nearly as much fun. If you love business — and I do — you want to be where the action is, where the marketplace is most dynamic, where the issues are the most urgent, where team creativity is at its most intense. The most important development in the global economy at the dawn of the 21st century is going on right now, and IBM is at its epicenter. This large, resourceful and vitally important company is truly coming into its own. Where else would anyone want to be?

* * * * *

I want to recognize one of our directors, who is retiring this year. Harold Brown has had an extraordinary association with IBM. He was a member of the Board from 1972 to 1977. After serving as U.S. Secretary of Defense, he rejoined the Board in 1981. I would like to thank Dr. Brown for his many years of support and service to our company, and express my personal gratitude for helping me during my transition into IBM.

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

Of course the world is changing.
It never stops.
The technology.
The pace.
The players.
What's far more interesting is
what incites change.
Every revolution,
Every school of philosophy,
Every movement worth joining,
Every defining enterprise
starts the same way.
Not with the grand or distant,
but with something near and personal.
It starts the same way. Every time.

It starts here.

the new world economy

In 1997, IBM unveiled continuous speech recognition for Mandarin — a breakthrough from researchers in the Beijing research laboratory we opened in 1995. Letting Chinese-speaking people interact with a computer in the most natural way imaginable — by talking to it — our ViaVoice software extends the power of information technology to the world's most populous country, without asking its people to shoehorn their language and its 6,700 written characters onto a Western-style keyboard.

As IBM expands in the world's emerging markets — China, Central and Eastern Europe, India, the nations of Southeast Asia — we of course hire locally and make local investments. But more important, we help an economy mature. We transfer skills — through long-term relationships with governments, alliances with universities and joint ventures with local businesses. And we create technologies like ViaVoice that reflect the needs of people and their local culture. It's the difference between being *in* a market, and *of* a market.

Qian Ying Wang research scientist, IBM China Research Lab, Beijing

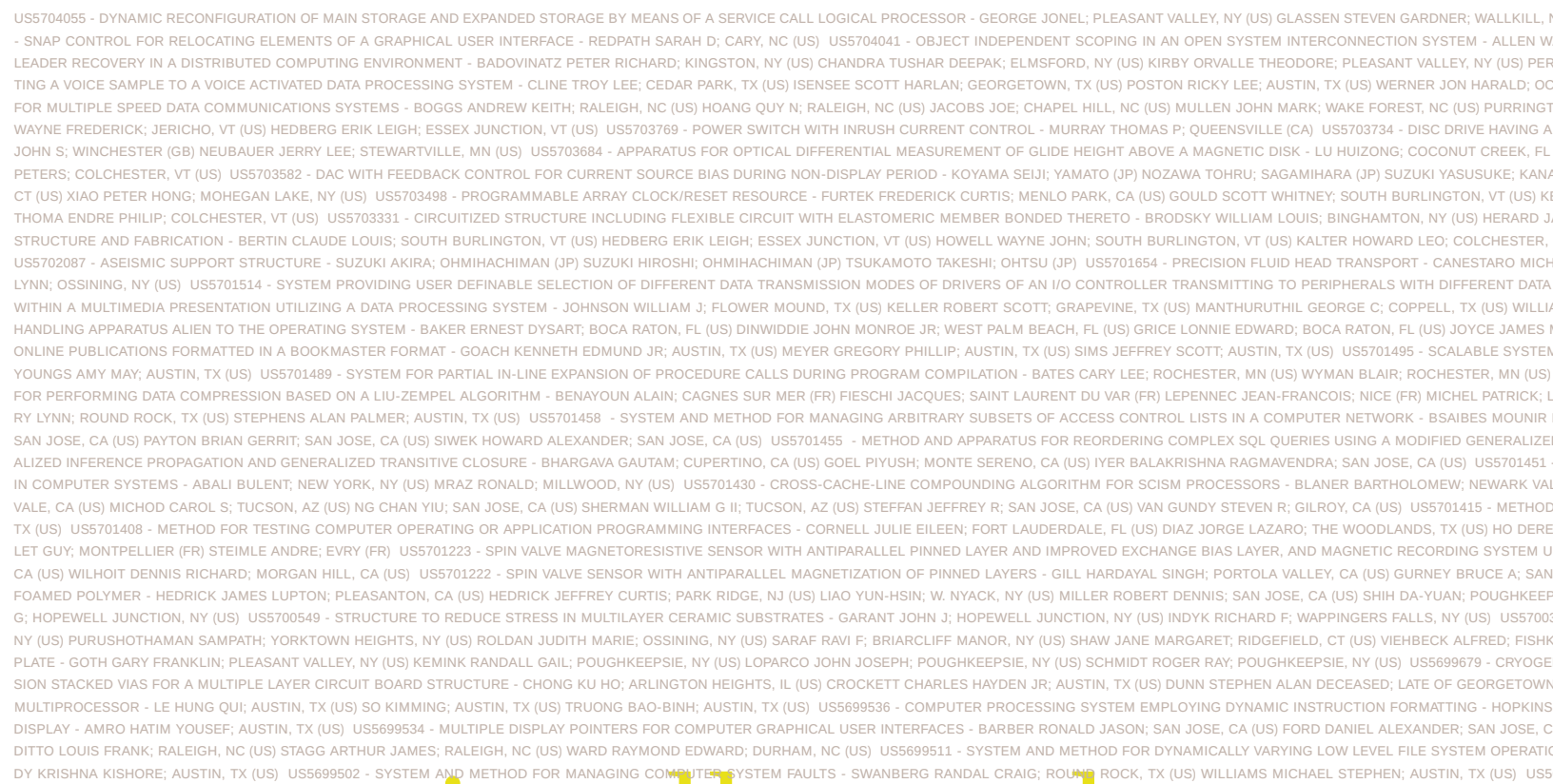
the buzz starts here

As a rule, we don't like to inject jargon into the language of information technology. But in 1997 we indulged ourselves. We coined the phrase "e-business" to talk about the value our customers derive from networked computing, to describe how they are reinventing their business models around networked transactions of every kind — among employees, with suppliers, with trading partners, and of course, with customers.

We've also found that e-business is a powerful, unifying message for IBM itself. As a customer makes its website the front door to the enterprise, the action shifts to powerful servers — the kind of industrial-strength computing systems IBM has built for decades. With millions of potential customers coming through that cyber front door, our customers need heavy-duty transaction and database software — another of our strong suits. To plan their e-business strategy, they need expert assistance up front — the kind of solutions consulting we specialize in. And to implement their strategy fast and cost-effectively, they demand a range of services — like those from IBM Global Services, the world's leading information technology services provider. We completed thousands of e-business engagements last year, and we expect the number of our customers doing e-business will double in 1998.

Left to right:

Top row: Samir Arora, CEO, NetObjects; Keith McCall, Lotus Domino applications, and Doug Wilson, Lotus eSuite development; Jim Pertzborn, AS/400 development; Syd Jones, corporate advertising.
Middle row: Jennifer Kilian, e-business website; Oly Jimenez-Losada, e-business services; Sandesh Bhat and Maria Arbusto, e-business intranet.
Bottom row: Deborah Drakeford, Netfinity servers, and Ed Merenda, RS/6000 network computing integration and consulting; Dave Tryon, System/390 network computing, and Forrest Snowden, secure electronic transactions (SET).



By now, it's become somewhat predictable. The U.S. Patent Office announces the company that received the most new patent awards, and IBM's technical community takes a bow. In 1997, it happened again — for the fifth straight year. These pages contain some of the names of the technologies and the technologists behind some of our patent awards in 1997. (We received 1,724 of them, so we have had to use small print.) But this roster isn't a monument to irrelevant brilliance.

We understand that capitalizing on our intellectual property is as important as creating it, and we do that in several ways. Fully one-third of last year's patented technologies have already been incorporated into IBM products. We also enter into cross-patent agreements that give us access to additional technologies and strengthen our total solutions capability. Finally,

Capitalism starts here

where it makes sense, our experts in intellectual property license our innovations to other communications and computer companies, propagating IBM technologies broadly across this open, networked, universally connected world. That licensing business quietly generates upwards of $1 billion annually. A nice piece of intellectual capital.

JoAnn Kealy Crockatt senior attorney, Intellectual Property Law

overnight success starts here

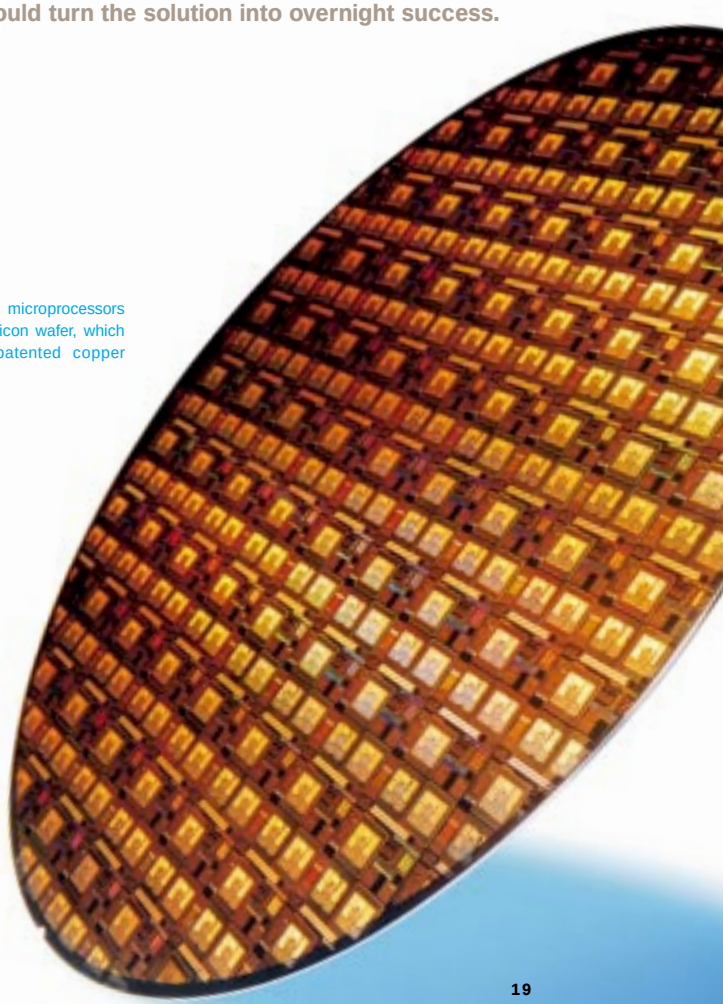
Left to right: Bijan Davari, Cyprian Uzoh, Lisa Su, John Heidenreich members of the copper chip team

PART OF THE FUN IN THE INFORMATION TECHNOLOGY INDUSTRY IS WAITING FOR THE NEXT METEOR — the hot startup that rockets from obscurity behind a new piece of hardware or some hot software. They're fun to watch, and you can sometimes observe their entire life cycle before the seasons change. It takes a bit more patience to track solutions to the industry's biggest challenges — in artificial intelligence, materials science, mathematics, complex algorithms for language recognition. These are challenges only the deepest, most committed, talented and, yes, stubborn teams take on.

For nearly 30 years, the entire semiconductor industry looked for ways to gain the performance advantages of using copper (which conducts electricity 40 percent faster than aluminum) in the tiny, tiny wires inside computer microchips. Last fall, IBM scientists won the race — if a generation-long journey can be called that. Perhaps just as astounding was our schedule to bring copper chips from the lab into production and to the market by this summer.

With this breakthrough, semiconductor devices like microprocessors and memory chips can be made more powerful, less expensive, smaller and more energy efficient.

Only a handful of companies have the staying power to lay siege to challenges like this one. Only one could turn the solution into overnight success.



Hundreds of PowerPC microprocessors are etched into this silicon wafer, which incorporates IBM's patented copper circuitry technology.

world records start here

LIKE MOST STUNNING TECHNOLOGICAL FEATS, OUR SUCCESS IN HARD-DISK DRIVES BEGINS WITH GENIUS; **in this case, scientists and engineers whose special gift is knowing how to pack information into ever-smaller physical spaces. In 1997 they delivered the world's highest-capacity hard drives — compact units about the size of an audiocassette — and surpassed their own world record for hard-disk drive capacity, cramming each square inch of disk space with the equivalent of an 18-story-high stack of double-spaced typed pages.**

As striking as the technology leadership is, there's an even bigger story of marketplace leadership and global teamwork: researchers in California; engineers in Japan and the United States (who integrate the components in lightweight, rugged packaging); and the efficiency of high-volume manufacturing teams around the world, who produce low-cost, high-quality drives that we sell to more than 60 other companies, many of them our competitors.

Today, two in five laptop computers in the world contain an IBM hard-disk drive. That's one reason why this business grew roughly twice as fast as the rest of the disk drive industry last year.

Representatives of IBM's storage business: research, development, manufacturing, operations, OEM marketing, sales and support from San Jose, California, and Fujisawa, Japan

Java didn't start here

THAT'S OK. Occasionally, you've got to be big enough to tip your cap to a competitor, and smart enough to build on something that can reshape the way software is developed and shared.

So we didn't do Java first. But IBM and Lotus are doing plenty of firsts with Java. Lotus's new eSuite "applets" are redefining personal productivity applications like word processors and spreadsheets. With

Enterprise JavaBeans, IBM and Lotus are taking Java into the world of high-volume transaction processing. And more than 200 software developers are working with IBM to create Java frameworks for general ledger, order entry and other business functions as a part of IBM's "San Francisco" project.

Two years ago, IBM had two Java professionals. Today, nearly 2,500, more than any other company. Our people are busy right now, in more than 20 locations in 13 countries, including China, Latvia, Belarus, India, Canada, the United States and the United Kingdom. Because Java represents a revolution. And we've taken a stand.

IBM Java professionals from Austin, Texas, and Hursley, United Kingdom

IT'S ONE THING TO ENVISION AN INFORMATION TECHNOLOGY STRATEGY. **It's another to identify the technology components of that strategy. But without the ability to implement — quickly, cost-effectively, and with minimal complexity — what have you got? Piece parts and a plan.**

Customer demand for help with the hard work of implementation drives the fastest-growing part of the information technology industry, and not coincidentally, it's our fastest-growing business. It describes a way of working with customers that's an enduring strength of IBM. In a word, service. Everything from computer installation and testing to the work of command centers like this one, where we monitor performance across scores of customer networks and head off problems before anyone knows about them.

IBM Global Services is now a $19 billion franchise — one that's grown in double digits every quarter for five straight years. In 1997 alone, we hired 15,000 people for this business. And as we enjoy this explosive growth, we also take pride in the fact that our customers rate the quality of our service the best in the industry.

the finish line starts

here

Charles Beauman operations analyst,
IBM Global Services Command Center, Boulder, Colorado

the end of the computer

starts here

COMPUTERS USED TO LOOK PRETTY CLUNKY — **nondescript boxes, lots of wires, plenty of beige. They used to look like, well... computers. No more. From the acclaimed Aptiva home PC, to the geometric grace of the ThinkPad — already displayed in New York's Museum of Modern Art — IBM designers create products that are as aesthetically pleasing — and comfortable to live with — as they are powerful. And in collaboration with IBM researchers, they're drafting the concept designs that could be the icons of tomorrow.**

Bob Steinbugler product designer

(far left)

ThinkPad companion. With detachable stereo speakers this lightweight, portable CD-ROM drive supports multimedia computing and plays stereo audio discs.

(left)

Personal electronic newspapers. This concept network device allows you to receive customized news, e-mail and other content from the Net loaded into lightweight tablets — one for each person in your household. Update content and recharge batteries by placing the tablets back in the docking station.

(right)

Portable Digital Video. From our design lab in Japan comes a concept for a portable entertainment center based on Digital Video Disk (DVD) technology. Two stereo speakers swing away to reveal an LCD screen, and the two top "antennae" are removable microphones, for those impromptu karaoke sessions.

(right below)

Two-in-one. This prototype integrates a network computer with a flat panel display — a full-function desktop system that relies on the Net for applications and processing power.

There's more going on here than black paint and rounded edges. Microchips are becoming so inexpensive they can be embedded in virtually everything — so common, some people call them "jelly beans." We'll cook with this "embedded intelligence." We'll wear it, drive it (and drive over it), talk to it, sleep on it. All manner of consumer items will join the web of interconnected computing devices — but soon, no one will sit down at "the computer" anymore. Won't that be wonderful?

the conversation starts

here here here here here

There is the language of information technology: **Java, parallelism, areal densities, polymorphism in object-oriented programming. And there is the language of business: return on investment, supply chain management, customer care. A company that wants to hold its own in any important conversation about business and information technology strategy has to speak both.**

The IBM people who have these conversations with our largest customers are members of what we call Industry Solution Units. Each one of the 11 industries we serve is represented by one of the client executives on these pages. They're among 17,000 IBM experts responsible for our business with 20,000 customers, representing about 70 percent of our 1997 revenue. At their fingertips are the resources of the world's greatest information technology research and development organization.

Our client and research teams have developed more than 250 industry-specific solutions — many of them built as "first of a kind" projects — working directly with our customers.

It's not easy amassing a cadre of business experts. Nor can just anyone build world-class R&D capability. To start the conversation, you need the former. To complete that conversation, you need both.

IBM industry specialists *(left to right)*:

Robert Barthelmes Education; Paul Grys Manufacturing; Françoise LeGoues Utilities & Energy; Jeffry Ullman Travel & Transportation; Nallu Reddy Telecommunications & Media; Robert Durot Process & Petroleum; John Wilson Wholesale/Distribution; James Pintar Insurance; Gail Gulinson Healthcare; Jim Martin Government; Nelson Eng Banking, Finance & Securities; pictured in Manhattan, New York


here
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everything starts here

SUSAN CRAYNE IS AN IBM RESEARCH SCIENTIST WITH A SINGULAR PASSION FOR THE FUTURE. It starts small. At home. With the little 4-year-old wonder you see here — Sara Crayne-Dedrick.

While Susan's passion starts with something very personal and private, it encompasses the entire world of children. Susan and more than a dozen fellow IBM researchers develop technologies as part of an IBM grant program called Reinventing Education. The $35 million initiative is dedicated to helping children reach world-class academic standards through innovative technology solutions.

IBM's work in education is one emblem of a powerful intangible that attracts good people to our company — a sense of social responsibility, the desire to work for a company with the resources and the will to make the world a better place.

In a region of South Africa labeled an "educational disaster area" in 1996 by Deputy President Thabo Mbeki, IBM Reinventing Education grants helped equip schools and train teachers on how technology can help them develop innovative curricula. So far, 237 teachers have trained there, improving educational opportunities for some 6,300 students. Nine hundred IBM PCs are in use in the schools — and after hours they're available for adult education and to small business owners. We've launched similar Reinventing Education initiatives in Brazil and will start others like it in Ireland, India and Vietnam.

In 1997, IBM gave more than $100 million to programs for people in need, including corporate contributions and donations from the IBM International Foundation. Individual employees gave another $30 million in matching grants and donations to nonprofit organizations and educational institutions in the communities where we work and raise our families. Each year IBM provides several million dollars' worth of new technology to more than 1,600 U.S. nonprofit health and human services organizations through the United Way's network of agencies. We also gave of ourselves. IBM employees volunteered nearly 4 million hours of service.

IBM grants are allowing millions of people to enjoy the treasures of the State Hermitage Museum in St. Petersburg and the Vatican Library, where priceless but perishable collections are being preserved through the power of information technology. In Peru, a partnership with the Pontifical Catholic University developed a computer-aided reconstruction system to restore ancient Moche figures on the ceiling of an aging temple.

We're a company committed to a culture of inclusion, a workforce as diverse as the cultures, perspectives and human characteristics in the more than 160 countries where we do business. Our longstanding commitment to workforce diversity was recognized recently in a ceremony at the U.S. White House, when IBM received the first annual Ron Brown Award for Corporate Leadership.

Of course, IBM exists to deliver solid financial results, and healthy returns to our investors. But it's not all we do, or all we are. In a world too frequently beset by intolerance, fear, hunger and illiteracy, some of us are in a position to help. We count ourselves among the fortunate — not only able to help, but having the responsibility and the desire to help.

left: Sara Crayne-Dedrick daughter of IBM researcher Susan Crayne

97 starts here

January 9

IBM launches a free U.S. Patent Search website (www.ibm.com/patents) that provides access to more than 2 million patents issued by the U.S. Patent and Trademark Office from 1974 to present.

March 18

IBM introduces IntelliStation, a line of Microsoft Windows NT-based workstations for commercial users. The new family complements IBM's RS/6000 line of UNIX workstations and servers.

March 19

IBM announces its intent to purchase a majority interest in NetObjects, the Silicon Valley-based company that developed the award-winning NetObjects Fusion software for designing and building websites.

April 29

IBM's Board of Directors approves a quarterly dividend increase of 14 percent and the repurchase of $3.5 billion in shares.

May 8

IBM announces plans to become sole proprietor of Advantis — the U.S. data network services arm of the IBM Global Network, one of the world's largest data networks — by buying Sears' 30 percent equity interest for $450 million.

May 9

IBM's common stock splits, entitling each shareholder to receive one additional share for each share held.

May 13

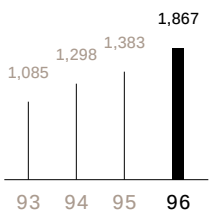
IBM's stock price reaches 177 1/8 (pre-split), passing the previous all-time intraday high of 176 1/8 on August 20, 1987.

IBM's stock price closes at $76.62 (split-adjusted) the first business day of 1997.

jan13

For the fourth consecutive year, IBM surpasses its own record for U.S. patents. In 1996, IBM was issued 1,867 patents from the U.S. Patent and Trademark Office — 326 more than the closest company.

IBM U.S. Patents



mar10

IBM announces Magic 3D Coloring Book, the first in a series of award-winning Crayola interactive multimedia products that inspire creativity and learning among young children.

may11

In a six-game match that captures the imagination of the world, a chess-playing IBM computer known as Deep Blue defeats chess grand-master Garry Kasparov — the first time a reigning world champion loses a match to a computer opponent in tournament play. Deep Blue is an IBM RS/6000 SP super-computer capable of calculating 200,000,000 chess positions per second. Its watershed win touches off debate, commentary and serious thinking about the relationship between people and machines, and about the very nature of thought.

May 19

The Space Shuttle carries 11 IBM ThinkPads into orbit. Combined, the ThinkPads can process more than half a billion instructions per second.

June 16

Three IBM scientists — Robert Dennard, Mark Dean and Dennis Moeller — are inducted into the National Inventors Hall of Fame, joining the ranks of Thomas Edison, Henry Ford, Louis Pasteur and IBM Nobel laureates Heinrich Rohrer and Gerd Binnig. To date, only 137 individuals have been so honored.

June 24

IBM receives the Golden Ladder Award from *We* magazine for being the "No.1 Employer in America for People with Disabilities."

July 22

IBM announces a $25 million investment to establish a research center — its eighth in the world — in Delhi, India. The center will focus initially on weather forecasting, e-business and distance learning, and will foster joint research projects with India's leading universities.

August 14

A survey by the National Society of Black Engineers finds IBM the employer most preferred.

August 18

IBM introduces the AS/400e — a new series of AS/400 servers optimized to help customers take advantage of business opportunities on the Internet. The AS/400e can run Java and Microsoft Windows NT applications, provide Internet security, and support thousands of Lotus Domino users while running other applications.

September 4

IBM introduces ViaVoice continuous speech recognition technology for Mandarin Chinese. In developing the product, researchers identified and classified thousands of vocal tones and homonyms, created an algorithm that deconstructs syllables into parts, and developed a new language model to transform spoken words into the right combination drawn from 6,700 Chinese characters.

june9

IBM completes one of the most important product transitions in the company's history with the debut of a new generation of System/390 servers, all powered by advanced microprocessors. The microprocessor "engines" help make the S/390 Parallel Enterprise Server - Generation 4 more powerful and less costly to produce and maintain than previous models, which used bipolar processor technology.

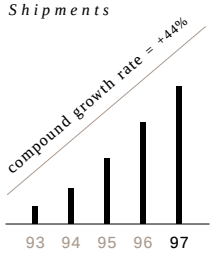
july4

NASA's *Pathfinder*, equipped with IBM RS/6000 technology for its onboard flight computer, lands on Mars. The flight computer is responsible for more than 100 pyro (explosive) events, including deploying the parachutes, inflating the airbags, and firing the retro rockets that allow *Pathfinder* to land safely on Mars.

july25

IBM, Telstra and Lend Lease Corporation form an information technology and communications alliance, signing Australia's largest information technology outsourcing deal and establishing a new network services company called Advantra. As part of the agreement, IBM Global Services Australia will take responsibility for Telstra's data center operations, creating the largest data processing center in the Southern Hemisphere.

Annual Worldwide S/390 Capacity Shipments



September 10

The U.S. Environmental Protection Agency recognizes IBM for outstanding contributions in protecting the earth's ozone layer. Since 1993, IBM has completely eliminated the annual use of more than 12 million pounds of CFCs and 3 million pounds of methyl chloroform from its products and processes.

September 15

IBM's Tivoli Systems subsidiary announces plans to acquire Unison Software, Inc., a leading developer of workload management software for distributed computing environments.

September 22

IBM scientists announce a breakthrough semiconductor manufacturing process that uses copper instead of aluminum to link transistors in chips, the culmination of 30 years of experimentation and inquiry. With copper, which conducts electricity 40 percent more efficiently than aluminum, semiconductor devices like microprocessors and memory chips can be more powerful, smaller and more energy efficient.

September 26

IBM begins shipments of DB2 Universal Database, the industry's first fully scalable, Web-ready database management system. Called universal because it can store and query alphanumeric data — as well as text documents, images, audio, video and other complex objects — it can perform a wide range of tasks from decision support to business transactions. It can also run the same software across desktops, workgroups and enterprises.

September 30

IBM's Edmark educational software subsidiary ships Let's Go Read! An Island Adventure, the first in a new series to help children build reading skills.

September 30

Lotus Domino becomes available for System/390 mainframe servers, providing the industry's leading groupware solution on the industry's most powerful and secure server.

October 7

IBM launches worldwide e-business marketing campaign — covering television, print and direct marketing. "e-business" describes for customers IBM's view of the value and benefits of a networked world.

October 13

IBM's Tokyo Research Laboratory unveils software that reads aloud information displayed on the computer screen. The software allows the visually impaired to access and use the Internet.

October 13

IBM expands its Business Computing Utility service offering to Prague. First established in Budapest, this unique e-business service gives small- and medium-sized businesses access to business management applications running on IBM servers at IBM data centers, 24 hours a day, seven days a week.

sep15

IBM unveils the ScrollPoint mouse — the latest ease-of-use innovation for PC users. It supports one-touch, 360-degree scrolling for easy Internet surfing and document navigation.

sep18

IBM dedicates its new, state-of-the-art corporate headquarters in Armonk, New York. Although smaller than the previous headquarters, the new 280,000 square-foot facility has an open office design and many more meeting areas for team and customer interaction. The building is equipped with a high-speed wire and wireless communication network, and a technology gallery that features IBM products and innovations throughout the company's history.

sep22

IBM introduces Netfinity, a new line of Intel-processor-based servers supporting the Microsoft Windows NT computing environment. Netfinity servers range from entry-level models to high-capacity symmetric multiprocessing machines, and all come with integrated IBM service and support.

October 23

IBM provides $10 million in new Reinventing Education grants to 12 U.S. school districts and state education departments, bringing the total to $35 million since the program was established in 1994. Each grant recipient will work closely with IBM to provide better instructional tools in math, science and reading, increase parental involvement and improve the flow of information among home, school and teachers with the help of technology.

November 17

IBM announces plans to invest $700 million to build one of the world's most advanced microchip development facilities at IBM's site in East Fishkill, New York. The facility will be among the first to produce chips on 12-inch silicon wafers, and will use IBM's unique copper manufacturing process and advanced X-ray lithography technology.

November 24

IBM ships Network Station Series 1000, the industry's first network computer to run Java applications, including Lotus' eSuite.

December 19

IBM's Tivoli Systems subsidiary announces plans to acquire Software Artistry, Inc., a leading provider of consolidated service desk and customer relationship management software.

December 22

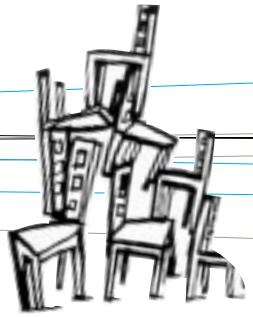
Daiwa Bank and IBM Japan agree to establish a joint venture that will offer information technology services to financial institutions. It will be the largest such outsourcing deal in Japan, and one of the largest in the worldwide financial industry.

IBM's stock price closes at $104.63 on the last business day of 1997.

December 30

IBM Research sets a new world record for disk drive storage density — 10 gigabits per square inch, equivalent to 1,450 average-length novels.

98startshere



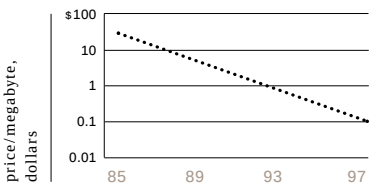
nov3

With the introduction of eSuite, Lotus becomes the first company to offer a complete set of business productivity software written in Java for the network computing environment. Included in eSuite are e-mail, calendar, address book, word processing, spreadsheet, presentation graphics and project scheduling applications. Unlike traditional productivity software, the bulk of eSuite's software code resides and executes on servers in a network, instead of on an individual PC.

nov10

IBM announces the world's highest-capacity desktop PC disk drive. The 16.8-gigabyte drive incorporates breakthrough technology called giant magnetoresistive (GMR) heads. No bigger than the head of a pin, the GMR head is the world's most sensitive sensor for reading and writing computer data on magnetic disks.

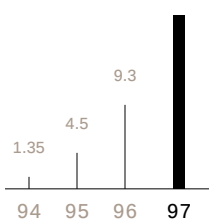
Magnetic Hard-Disk Drive Industry Price per Megabyte Evolution



dec31

IBM ships 4 million Notes seats in the fourth quarter of 1997 — the largest quarter ever of unit volumes for Notes. Total installed base reaches 20 million, up from 2.2 million when Lotus joined IBM in 1995.

Worldwide Lotus Notes Seats
(IN MILLIONS)



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.

It never stops here.

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.

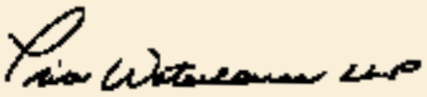
Chairman of the Board
and Chief Executive Officer

Lawrence R. Ricciardi

Senior Vice President, General Counsel
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 50 through 77, present fairly, in all material respects, the financial position of International Business Machines Corporation and its subsidiaries at December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, 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
1177 Avenue of the Americas
New York, NY 10036
January 19, 1998

Overview

IBM's financial results in 1997 increasingly reflect the successful implementation of the company's strategic priorities: revenue growth, stable net income margins and leveraged growth in earnings per share.

The company reported revenue of $78.5 billion—a record for the third consecutive year; while net earnings of $6.1 billion yielded a record $6.18 earnings per share of common stock. Strategic spending continued in 1997 as the company funded investments of approximately $20 billion in its high-growth and advanced technology businesses, research and development, and repurchases of its common stock.

The growth in revenue reflects the continued shift toward the company's high-growth businesses. Revenue from both services and storage products grew strongly year over year. While shipments of System/390 products were higher by 30 percent when measured in computing power, revenue was down slightly as a result of continued price reductions and the effects of currencies. Overall, the weight of the adverse currency movements lowered year-to-year revenue growth from approximately 8 percent to the "as reported" 3 percent.

Challenges

While excellent progress was made in 1997, there are a number of challenges facing the company in 1998. The continued adverse effects of a strong dollar on our non-U.S. results, weakness in some Asian markets and the continued price pressures in the information technology marketplace all contribute to this challenge. The company is prepared to meet its objectives—and to grow revenue—in this difficult environment. The breadth of the company's geographic presence, its portfolio of products and services, and its ability to work with customers of all sizes to help integrate information technology into their business strategies will provide the basis for success in the coming year.

Forward-looking and Cautionary Statements

Certain statements contained in this Annual Report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, as discussed more fully elsewhere in this Annual Report and in the company's filings with the Securities and Exchange Commission, including the company's Form 8-K filed on July 21, 1997, and the company's 1997 Form 10-K to be filed on or about March 23, 1998.

Results of Operations

(Dollars in millions except per share amounts)

	1997	1996	1995
Revenue	$ 78,508	$ 75,947	$ 71,940
Cost	47,899	45,408	41,573
Gross profit	30,609	30,539	30,367
Gross profit margin	39.0%	40.2%	42.2%
Total expense	21,582	21,952	22,554
Net earnings before income taxes	$ 9,027	$ 8,587	$ 7,813
Net earnings	$ 6,093	$ 5,429	$ 4,178
Net earnings per share of common stock	$ 6.18	$ 5.12	$ 3.61
Net earnings per share of common stock–assuming dilution	$ 6.01	$ 5.01	$ 3.53

Revenue in 1997 grew 3.4 percent as reported and 8.3 percent when currency impacts are removed. This increase was primarily driven by the high-growth areas of the company's product portfolio: services, hard disk drive (HDD) storage products and distributed software offerings including those from Tivoli Systems, Inc. (Tivoli).

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

	1997	1996	1995
Hardware sales	46.1%	47.8%	49.5%
Services	24.6	20.9	17.7
Software	16.4	17.2	17.6
Maintenance	8.1	9.2	10.3
Rentals and financing	4.8	4.9	4.9
Total	100.0%	100.0%	100.0%

The overall gross profit margin at 39.0 percent decreased 1.2 points from 1996, following a 2.0 point decrease in 1996 over 1995. The declines were primarily the result of the company's continued shift to the higher growth sources of revenue, most notably, services in 1997 and services and personal computers in 1996. These businesses have lower gross profit margins than the company's high-end hardware offerings (System/390 and AS/400), which declined as a percent of total revenue.

Net earnings per share of common stock were $6.18, $5.12 and $3.61 in 1997, 1996 and 1995, respectively.

The following information, which is provided for informational purposes only, excludes the effects of a $435 million non-tax deductible charge for purchased in-process research and development in connection with the Tivoli and Object Technology International, Inc. acquisitions in March 1996. The 1995 results exclude the effects of the third quarter charge of $1,840 million for purchased in-process research and development in connection with the Lotus Development Company (Lotus) acquisition.

(Dollars in millions except per share amounts)

	1997	1996	1995
Adjusted net earnings	$ 6,093	$ 5,864	$ 6,018
Adjusted net earnings per share of common stock	$ 6.18	$ 5.53	$ 5.23
Adjusted net earnings per share of common stock–assuming dilution	$ 6.01	$ 5.41	$ 5.10

Hardware Sales

Information on revenue by classes of similar products or services is included in note Y, "Segment Information," on page 75. The product trends addressed in this discussion and in that disclosure are indicative, in all material respects, of hardware sales activity.

(Dollars in millions)

	1997	1996	1995
Revenue	$ 36,229	$ 36,316	$ 35,600
Cost	23,538	23,396	21,862
Gross profit	$ 12,691	$ 12,920	$ 13,738
Gross profit margin	35.0%	35.6%	38.6%

Revenue from hardware sales was essentially flat (up about 4 percent in constant currency) from 1996, following an increase of 2.0 percent in 1996 from 1995. Gross profit dollars from hardware sales decreased 1.8 percent from 1996, following a decrease of 6.0 percent in 1996 from 1995.

Client revenue was flat versus 1996, following an increase of 9.8 percent in 1996 over 1995. Although revenue was flat in 1997, commercial personal computer revenue grew, as did general-purpose monitors. These increases were offset by lower revenue associated with consumer personal computers and RS/6000 products. The 1996 increase over 1995 was driven by higher revenue from personal computers, especially consumer products, partially offset by lower revenue from RS/6000.

Revenue from servers decreased 4.5 percent from 1996, following a decrease of 1.4 percent in 1996 versus 1995. The 1997 decrease was primarily driven by lower revenue from System/390, AS/400 and RS/6000 servers. While System/390 revenue declined, total delivery of mainframe computing power increased 30 percent as measured in MIPS (millions of instructions per second) versus last year. AS/400 and RS/6000 revenue was impacted by a major product transition during the year, as new models of these products were announced late in the third quarter of 1997. These decreases were partially offset by higher revenue from personal computer servers and large-scale systems (SP) servers. The decrease in 1996 from 1995 was driven by lower revenue from System/390 servers, partially offset by higher revenue from AS/400, RS/6000 and personal computer servers.

Storage products revenue decreased 1.9 percent versus 1996, following a decline of 15.9 percent in 1996 from 1995. The declines were driven by lower revenue from high-end storage products, due to continuing price competition, partially offset by revenue growth from tape products.

Original Equipment Manufacturer (OEM) hardware revenue increased 22.9 percent over 1996, following a 1.3 percent increase in 1996 versus 1995. The 1997 increase resulted from strong growth in HDD storage products and custom logic products, partially offset by continuing lower DRAM revenue, due to industry-wide pricing pressures.

The decrease in the 1997 hardware sales gross profit dollars was driven by the continued shift in the company's mix of revenue to lower gross profit products, such as personal computers and OEM semiconductors, partially offset by higher margins for System/390 servers and storage products. The overall hardware sales margin continues to be adversely impacted by pricing pressures across all products.

Services

(Dollars in millions)

	1997	1996	1995
Revenue	$ 19,302	$ 15,873	$ 12,714
Cost	15,281	12,647	10,042
Gross profit	$ 4,021	$ 3,226	$ 2,672
Gross profit margin	20.8%	20.3%	21.0%

Services revenue increased 21.6 percent in 1997 (up about 28 percent in constant currency) from 1996 and 24.8 percent in 1996 over 1995. The increases were driven by continued strong growth in professional services, which includes managed operation of systems, as well as systems integration design and development. Network services, which includes managed operation of networks, and product support services continued to experience good growth in revenue year over year. In 1997, the company signed service contracts worth $24 billion. The company continued to meet this growing demand for its services business by hiring over 15,000 employees in both 1997 and 1996, while maintaining a consistent gross profit margin.

Software

(Dollars in millions)

	1997	1996	1995
Revenue	$ 12,844	$ 13,052	$ 12,657
Cost	3,784	4,082	4,428
Gross profit	$ 9,060	$ 8,970	$ 8,229
Gross profit margin	70.5%	68.7%	65.0%

Software revenue decreased 1.6 percent in 1997 (up about 4 percent in constant currency) from 1996, following an increase of 3.1 percent in 1996 over 1995. The revenue decrease in 1997 was a result of lower host-based computer software revenue primarily associated with System/390 products. This decrease was offset by revenue growth for systems management software from Tivoli. While down for the year, software revenue performance strengthened over the course of the year with fourth quarter 1997 revenue increasing 1.4 percent versus the fourth quarter of 1996. The increase in 1996 revenue was driven by distributed software offerings from Lotus and software products from Tivoli, partially offset by lower host-based computer software revenue from System/390 and AS/400.

Software gross profit dollars increased 1.0 percent in 1997 from 1996, following an increase of 9.0 percent in 1996 from 1995. The improvement in gross profit dollars was the result of more software development spending being expensed in the period incurred and less being capitalized in relation to prior historical levels, which in turn yielded less amortization of previously deferred costs. These lower amortization costs were partially offset by higher vendor royalty costs.

Maintenance

(Dollars in millions)

	1997	1996	1995
Revenue	$ 6,402	$ 6,981	$ 7,409
Cost	3,394	3,659	3,651
Gross profit	$ 3,008	$ 3,322	$ 3,758
Gross profit margin	47.0%	47.6%	50.7%

Maintenance revenue decreased 8.3 percent in 1997 (down about 3 percent in constant currency) from 1996, following a decrease of 5.8 percent in 1996 versus 1995. Gross profit dollars decreased 9.5 percent, following a decrease of 11.6 percent in 1996 from 1995. Revenue and gross profit dollars continue to be affected by price reductions on maintenance offerings.

Rentals and Financing

(Dollars in millions)

	1997	1996	1995
Revenue	$ 3,731	$ 3,725	$ 3,560
Cost	1,902	1,624	1,590
Gross profit	$ 1,829	$ 2,101	$ 1,970
Gross profit margin	49.0%	56.4%	55.4%

Rentals and financing revenue was essentially flat (up about 4 percent in constant currency) in 1997 versus 1996, following an increase of 4.6 percent in 1996 from 1995. Although revenue was essentially flat versus 1996, operating lease activity grew, but was offset by lower dealer financing. Gross profit dollars decreased 12.9 percent from 1996, following an increase of 6.6 percent in 1996 from 1995. The decrease was primarily a result of a trend towards financing a greater volume of low-end products and faster growth in the more competitive U.S. market. The increase in 1996 over 1995 was primarily a result of higher margins on operating leases and lower interest rates. The financing results are discussed in more detail in note Q, "Global Financing," on pages 65 and 66.

Operating Expenses
(Dollars in millions)

	1997	1996	1995
Selling, general and administrative	$16,634	$16,854	$16,766
Percentage of revenue	21.2%	22.2%	23.3%
Research, development and engineering	$ 4,877	$ 4,654	$ 4,170
Percentage of revenue	6.2%	6.1%	5.8%
Purchased in-process research and development	$ –	$ 435	$ 1,840

Selling, general and administrative (SG&A) expense declined 1.3 percent in 1997 versus 1996 and remained essentially flat in 1996 compared to 1995. The company continued its focus on reducing fixed infrastructure costs, while increasing its investments in advertising, business partner programs and emerging markets. These actions yielded a 1.0 percentage point improvement in the expense-to-revenue ratio in 1997 and a 1.1 percentage point improvement in 1996.

The company continues to focus on productivity, expense controls and prioritization of spending in order to achieve a more competitive expense-to-revenue level.

Research, development and engineering expense increased 4.8 percent in 1997 from 1996, following an increase of 11.6 percent in 1996 from 1995. The increases reflect the company's continued investments in high-growth opportunities like Java, network computing and e-business, as well as the impact of additional expenses associated with new acquisitions. Also, ongoing activities of Lotus and Tivoli are included in 1996 and 1997 results, as compared to 1995, which only included Lotus activity between July and December 1995.

The benefits of the company's ongoing research and development have resulted in the company being granted 1,724 patents in 1997, placing it number one in the U.S. for the fifth consecutive year. The application of these technological advances has enabled the company to transform this research and development into several significant new product breakthroughs that will be found in products beginning in 1998. Examples of these efforts are the use of copper in place of aluminum in the making of integrated circuits and the manufacturing of HDDs using giant magnetoresistive head technology that delivers a maximum areal density of about 2.6 billion bits per square inch.

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

On a constant currency basis, SG&A expense would have increased approximately 2.7 percent in 1997 versus 1996, and research, development and engineering expense would have increased approximately 5.9 percent.

Provision for Income Taxes

The provision for income taxes resulted in an effective tax rate of 33 percent for 1997, as compared to the 1996 effective tax rate of 37 percent and a 1995 effective tax rate of 47 percent. Adjusting for purchased in-process research and development which had no corresponding tax effect, the 1996 and 1995 effective tax rates would have been 35 percent and 38 percent, respectively. The reduction in the 1997 tax rate reflects the company's continued expansion into markets with lower effective tax rates. The reduction in the 1996 tax rate was also 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, 1997, the company had revenue of $23.7 billion, a 2.5 percent increase over the same period of 1996. Net earnings in the fourth quarter were $2,093 million ($2.16 per common share), compared with net earnings of $2,023 million ($1.97 per common share) in the fourth quarter of 1996.

Fourth-quarter revenue from the United States was $9.5 billion, an increase of 8.9 percent from the same period of 1996. Asia Pacific revenue was essentially flat at $4.4 billion, while revenue from the company's Europe, Middle East and Africa units declined 4.4 percent to $7.7 billion. Revenue in Latin America was $1.2 billion, an increase of 4.4 percent and revenue from Canada increased 14.2 percent to $.9 billion.

Currency had an approximately 6 percentage point negative impact on the company's revenue results in the fourth quarter. At constant currency in the fourth quarter of 1997, Asia Pacific revenue would have increased about 10 percent, European revenue would have grown approximately 5 percent and revenue from Canada would have increased about 19 percent.

Total hardware sales declined 1.3 percent year over year to $11.5 billion. RS/6000, storage and semiconductor revenue increased, while overall personal computer, AS/400 and System/390 revenue declined. On a constant currency basis, hardware sales increased in all key hardware lines, except for System/390 and consumer personal computers.

Services revenue totaled $5.9 billion, a 17.5 percent increase compared to the year-earlier period. Approximately $8.5 billion in new services contracts was signed in the quarter. Services margins were essentially flat year over year at 22.5 percent.

Overall software revenue was $3.8 billion, an increase of 1.4 percent compared with the fourth quarter of 1996. Maintenance revenue declined 9.2 percent to $1.6 billion in the fourth quarter when compared with the year-earlier period, and rentals and financing fell 3.5 percent to $1.0 billion.

The company's overall gross profit margin in the fourth quarter was 40.1 percent, compared to 40.3 percent in the year-earlier period.

Total fourth-quarter 1997 expenses increased 1.1 percent year over year. The expense-to-revenue ratio in the fourth quarter of 1997 was 27.4 percent compared to 27.8 percent in the year-earlier period.

The company's tax rate was 30.5 percent in the fourth quarter, compared to 29.9 percent in the fourth quarter of 1996.

The company spent approximately $2 billion on share repurchases in the fourth quarter. The average number of shares outstanding in the fourth quarter of 1997 was 964.8 million, compared to 1,026.8 million in the year-earlier period.

Financial Condition

During 1997, the company continued to make significant investments to fund future growth and increase shareholder value, expending $6.8 billion for plant, rental machines and other property, $5.5 billion for research, development and engineering, and $7.1 billion for the repurchase of the company's common shares. The company had $7.6 billion in cash, cash equivalents and marketable securities on hand at December 31, 1997.

The company has access to global funding sources. During 1997, 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. More information about company debt is provided in note G, "Debt," on page 58.

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 February 1997, and extended to February 2002. As of December 31, 1997, $9.2 billion was unused and available.

At year-end 1997, the company had an outstanding balance of $.9 billion of assets under management from the securitization of loans, leases and trade receivables, compared to the year-end 1996 level of $1.1 billion. The company has access to additional funds through securitization, as discussed in note K, "Sale and Securitization of Receivables," on page 61.

The rating agencies continued their review of the company's financial condition. 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 as A, commercial paper as A-1, and preferred stock as 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."

Fitch Investors Service rates the company and its rated subsidiaries' senior long-term debt as AA-, commercial paper as F-1+, and preferred stock as A+.

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 52, are summarized in the following table:

(Dollars in millions)

	1997	1996	1995
Net cash provided from (used in):			
Operating activities	$ 8,865	$ 10,275	$ 10,708
Investing activities	(6,155)	(5,723)	(5,052)
Financing activities	(3,090)	(3,952)	(6,384)
Effect of exchange rate changes on cash and cash equivalents	(201)	(172)	65
Net change in cash and cash equivalents	$ (581)	$ 428	$ (663)

Working Capital

(Dollars in millions)

At December 31:	1997	1996
Current assets	$ 40,418	$ 40,695
Current liabilities	33,507	34,000
Working capital	$ 6,911	$ 6,695
Current ratio	1.21:1	1.20:1

Current assets decreased slightly due primarily to aggressive inventory management. The company's overall net inventories declined $.7 billion driven substantially by inventory management process improvements, particularly in personal computers. At December 31, 1997, the company's inventories stood at $5.1 billion, their lowest level since year-end 1983.

Current liabilities were lower primarily due to a decrease in taxes payable and liabilities for prior restructuring actions.

Investments

The company's investments for plant, rental machines and other property were $6.8 billion for 1997, an increase of $.9 billion from 1996. The increase reflects continued investment in the company's rapidly growing services business, principally in the management of customers' information technology, and manufacturing capacity for hard disk drives and microelectronics.

In addition to software development expenses included in research, development and engineering, the company capitalized $.3 billion of software costs during 1997 and 1996. Amortization of capitalized software costs amounted to $1.0 billion for 1997, a decrease of $.4 billion from 1996.

Investments and sundry assets were $21.9 billion at the end of 1997, an increase of $.3 billion from 1996, and were primarily the result of increases in prepaid pension assets and noncurrent sales type leases, offset by decreases in other investments and sundry assets. See note F, "Investments and Sundry Assets," on page 57 for additional information.

Debt and Equity

(Dollars in millions)

	1997	1996
"Core" debt	$ 3,102	$ 2,202
Global financing debt	23,824	20,627
Total debt	$ 26,926	$ 22,829
Stockholders' equity	$ 19,816	$ 21,628
Debt/capitalization	57.6%	51.4%
"Core" debt/capitalization	16.1%	10.7%
Global financing debt/equity	6.5:1	6.3:1

Total debt increased $4.1 billion from year-end 1996, driven by an increase of $3.2 billion in debt to support the growth in global financing assets and $.9 billion in "core" debt. The company's balance sheet is leveraged with a "core" debt to capitalization of 16.1 percent and global financing debt to equity at 6.5 to 1.

Stockholders' equity declined $1.8 billion to $19.8 billion at December 31, 1997. The company's ongoing stock repurchasing program (see note U, "Stock Repurchases," on page 70) and the creation of an Employee Benefits Trust (see note V, "Employee Benefits Trust," on page 71) offset the $6.1 billion of net earnings for the year. The translation effect of the stronger dollar on the company's non-U.S. net assets contributed $1.6 billion to the year-to-year decline.

Currency Rate Fluctuations

Since approximately 81 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. Most worldwide currencies weakened versus the U.S. dollar in 1997, 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 5 percent and 3 percent, respectively, in 1997 and 1996, compared to a favorable impact in 1995 of 4 percent.

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 limits 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 limit specific currency risks related to global financing transactions and the repatriation of dividends and royalties. Further discussion on currency and hedging appears in note J, "Financial Instruments," on pages 59 through 61.

Market Risk

In the normal course of business, the financial position of the company is routinely subjected to a variety of risks. In addition to the market risk associated with interest and currency rate movements on outstanding debt and non-U.S. dollar denominated assets and liabilities, other examples of risk include collectibility of accounts receivable and recoverability of residual values on leased assets.

The company regularly assesses these risks and has established policies and business practices to protect against the adverse effects of these and other potential exposures. As a result, the company does not anticipate any material losses in these areas.

The company's debt in support of the global financing business (see note Q, "Global Financing," on pages 65 and 66) and the geographic breadth of the company's operations contain an element of market risk from changes in interest and currency rates. The company manages this risk, in part, through the use of a variety of financial instruments including derivatives, as explained in note J, "Financial Instruments," on pages 59 through 61.

For purposes of specific risk analysis, the company uses sensitivity analysis to determine the impacts that market risk exposures may have on the fair values of the company's debt and financial instruments.

The financial instruments included in the sensitivity analysis consist of all of the company's cash and cash equivalents, marketable securities, long-term non-lease receivables, investments, long-term and short-term debt and all derivative financial instruments. Interest rate swaps, interest rate options, foreign currency swaps, forward contracts and foreign currency option contracts constitute the company's portfolio of derivative financial instruments.

To perform sensitivity analysis, the company assesses the risk of loss in fair values from the impact of hypothetical changes in interest rates and foreign currency exchange rates on market sensitive instruments. The market values for interest and foreign currency exchange risk are computed based on the present value of future cash flows as impacted by the changes in the rates attributable to the market risk being measured. The discount rates used for the present value computations were selected based on market interest and foreign currency exchange rates in effect at December 31, 1997. The market values that result from these computations are compared with the market values of these financial instruments at December 31, 1997. The differences in this comparison are the hypothetical gains or losses associated with each type of risk.

The results of the sensitivity analysis at December 31, 1997, are as follows:

Interest Rate Risk:

A 10 percent decrease in the levels of interest rates with all other variables held constant would result in a decrease in the fair value of the company's financial instruments by $369 million. A 10 percent increase in the levels of interest rates with all other variables held constant would result in an increase in the fair value of the company's financial instruments by $341 million.

Foreign Currency Exchange Rate Risk:

A 10 percent movement in the levels of foreign currency exchange rates against the U.S. dollar with all other variables held constant would result in a decrease in the fair value of the company's financial instruments by $809 million or an increase in the fair value of the company's financial instruments by $981 million.

Financing Risks

Global financing is an integral part of the company's total worldwide offerings. Financial results of global financing can be found in note Q, "Global Financing," on pages 65 and 66. Inherent in global financing are certain risks, including 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 1997, 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, 1995, 1996 and 1997. The following table excludes approximately $49 million of estimated residual value associated with non-information technology equipment.

(Dollars in millions)	Total			Run Out of 1997 Residual Value Balance			
	1995	1996	1997	1998	1999	2000	2001 and beyond
Sales-type leases	$ 470	$ 471	$ 563	$ 120	$ 205	$ 205	$ 33
Operating leases	295	480	701	247	266	166	22
Total residual value	$ 765	$ 951	$ 1,264	$ 367	$ 471	$ 371	$ 55

Acquisitions

On April 16, 1997, IBM and NetObjects, Inc. announced that IBM had purchased a majority interest in NetObjects, a leading provider of website development tools for designers and intranet developers. In September 1997, the company acquired the 30 percent equity interest held by Sears in Advantis, the U.S. network services arm of the IBM Global Network. Advantis is now 100 percent owned by IBM. In December 1997, the company acquired Eastman Kodak's share of Technology Service Solutions (TSS), which was formed in 1994 by IBM and Eastman Kodak. TSS is now a wholly owned subsidiary of IBM, offering comprehensive services solutions to its customers. In addition, the company acquired Unison Software, Inc., a leading developer of workload management software, and announced plans to acquire Software Artistry, Inc., a leading provider of both consolidated service desk and customer relationship management solutions for distributed enterprise environments.

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 represents 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. in 1996 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.

Employees

				Percentage Changes	
	1997	1996	1995	1997-96	1996-95
IBM/wholly owned subsidiaries	269,465	240,615	225,347	12.0	6.8
Less than wholly owned subsidiaries	20,751	28,033	26,868	(26.0)	4.3
Complementary	43,000	37,000	38,000	16.2	(2.6)

As of December 31, 1997, employees of IBM and its wholly owned subsidiaries increased 28,850 from 1996, mainly from hiring in high-growth areas of the business—services, storage, Tivoli and Lotus, as well as from continued expansion in emerging geographic markets and acquisition of business entities, such as Unison Software. In 1997, Advantis, with approximately 5,000 employees, and Technology Service Solutions, with approximately 5,100 employees, previously less than wholly owned subsidiaries, were acquired from Sears and Eastman Kodak, respectively.

The decline in employees in less than wholly owned subsidiaries reflects the acquisition of the minority interests in Advantis and TSS, offset by growth in the company's rapidly expanding global services business, as well as in emerging geographic markets, such as China.

The company's complementary work force is an approximation of 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.

Year 2000

What is commonly known as the "Year 2000 issue" arises because many computer hardware and software systems use only two digits to represent the year. As a result, these systems and programs may not calculate dates beyond 1999, which may cause errors in information or systems failures.

With respect to its internal systems, the company is taking appropriate steps to remediate the Year 2000 issues and does not expect the costs of these efforts to be material. In addition, in the ordinary course of its product development efforts, the company has designed its current hardware and software offerings to be Year 2000 ready. (However, the Year 2000 readiness of the company's customers and the hardware and software offerings from the company's suppliers, subcontractors and business partners may vary.) The company is also aware of the potential for claims against it and other companies for damages from products and services that were not Year 2000 ready. The company believes that any such claims against it will be without merit. While the company does not believe that the Year 2000 matters discussed above will have a material impact on its business, financial condition or results of operations, it is uncertain whether or to what extent the company may be affected by such matters.

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	1997	1996	1995
Revenue:				
Hardware sales		$ 36,229	$ 36,316	$ 35,600
Services		19,302	15,873	12,714
Software		12,844	13,052	12,657
Maintenance		6,402	6,981	7,409
Rentals and financing	Q	3,731	3,725	3,560
Total revenue		78,508	75,947	71,940
Cost:				
Hardware sales		23,538	23,396	21,862
Services		15,281	12,647	10,042
Software		3,784	4,082	4,428
Maintenance		3,394	3,659	3,651
Rentals and financing		1,902	1,624	1,590
Total cost		47,899	45,408	41,573
Gross profit		30,609	30,539	30,367
Operating expenses:				
Selling, general and administrative	O	16,634	16,854	16,766
Research, development and engineering	P	4,877	4,654	4,170
Purchased in-process research and development	P	–	435	1,840
Total operating expenses		21,511	21,943	22,776
Operating income		9,098	8,596	7,591
Other income, principally interest		657	707	947
Interest expense	H	728	716	725
Earnings before income taxes		9,027	8,587	7,813
Provision for income taxes	N	2,934	3,158	3,635
Net earnings		6,093	5,429	4,178
Preferred stock dividends and transaction costs		20	20	62
Net earnings applicable to common shareholders		$ 6,073	$ 5,409	$ 4,116
Net earnings per share of common stock	C & R	$ 6.18	$ 5.12*	$ 3.61*
Net earnings per share of common stock – assuming dilution	C & R	$ 6.01	$ 5.01*	$ 3.53*
Average number of common shares outstanding:				
1997 – 983,286,361; 1996 – 1,056,704,188*; 1995 – 1,138,768,058*				

*Adjusted to reflect a two-for-one stock split on May 9, 1997.

The notes on pages 54 through 77 of the 1997 IBM Annual Report are an integral part of this statement.

consolidated statement of financial position

International Business Machines Corporation
and Subsidiary Companies

(Dollars in millions)

At December 31:	Notes	1997	1996
Assets			
Current assets:			
Cash and cash equivalents		$ 7,106	$ 7,687
Marketable securities	J	447	450
Notes and accounts receivable – trade, net of allowances		16,850	16,515
Sales-type leases receivable		5,720	5,721
Other accounts receivable		1,256	931
Inventories	D	5,139	5,870
Prepaid expenses and other current assets		3,900	3,521
Total current assets		40,418	40,695
Plant, rental machines and other property	E	42,133	41,893
Less: Accumulated depreciation		23,786	24,486
Plant, rental machines and other property – net		18,347	17,407
Software, less accumulated amortization (1997, $12,610; 1996, $12,199)		819	1,435
Investments and sundry assets	F	21,915	21,595
Total assets		$ 81,499	$ 81,132
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	N	$ 2,381	$ 3,029
Short-term debt	G & J	13,230	12,957
Accounts payable		5,215	4,767
Compensation and benefits		3,043	2,950
Deferred income		3,445	3,640
Other accrued expenses and liabilities		6,193	6,657
Total current liabilities		33,507	34,000
Long-term debt	G & J	13,696	9,872
Other liabilities	L	12,993	14,005
Deferred income taxes	N	1,487	1,627
Total liabilities		61,683	59,504
Contingencies	M		
Stockholders' equity:			
Preferred stock, par value $.01 per share – shares authorized: 150,000,000 shares issued: 1997 – 2,597,261; 1996 – 2,610,711	U	252	253
Common stock, par value $.50* per share – shares authorized: 1,875,000,000* shares issued: 1997 – 969,015,351; 1996 – 1,018,141,084*	C & U	8,601	7,752
Retained earnings		11,010	11,189
Translation adjustments		791	2,401
Treasury stock, at cost (shares: 1997 – 923,955; 1996 – 2,179,066*)		(86)	(135)
Employee benefits trust, at cost (10,000,000 shares)	V	(860)	–
Net unrealized gain on marketable securities		108	168
Total stockholders' equity		19,816	21,628
Total liabilities and stockholders' equity		$ 81,499	$ 81,132

*Adjusted to reflect a two-for-one stock split on May 9, 1997.

The notes on pages 54 through 77 of the 1997 IBM Annual Report are an integral part of this statement.

(Dollars in millions)

For the year ended December 31:	1997	1996	1995
Cash flow from operating activities:			
Net earnings	$ 6,093	$ 5,429	$ 4,178
Adjustments to reconcile net earnings to cash provided from operating activities:			
Depreciation	4,018	3,676	3,955
Amortization of software	983	1,336	1,647
Effect of restructuring charges	(445)	(1,491)	(2,119)
Purchased in-process research and development	–	435	1,840
Deferred income taxes	358	11	1,392
Gain on disposition of fixed and other assets	(273)	(300)	(339)
Other changes that (used) provided cash:			
Receivables	(3,727)	(650)	(530)
Inventories	432	196	107
Other assets	(1,087)	(980)	(1,100)
Accounts payable	699	319	659
Other liabilities	1,814	2,294	1,018
Net cash provided from operating activities	8,865	10,275	10,708
Cash flow from investing activities:			
Payments for plant, rental machines and other property	(6,793)	(5,883)	(4,744)
Proceeds from disposition of plant, rental machines and other property	1,130	1,314	1,561
Acquisitions of Tivoli Systems, Inc. and Lotus Development Corporation – net, 1996 and 1995, respectively	–	(716)	(2,880)
Investment in software	(314)	(295)	(823)
Purchases of marketable securities and other investments	(1,617)	(1,613)	(1,315)
Proceeds from marketable securities and other investments	1,439	1,470	3,149
Net cash used in investing activities	(6,155)	(5,723)	(5,052)
Cash flow from financing activities:			
Proceeds from new debt	9,142	7,670	6,636
Short-term borrowings less than 90 days – net	(668)	(919)	2,557
Payments to settle debt	(4,530)	(4,992)	(9,460)
Preferred stock transactions – net	(1)	–	(870)
Common stock transactions – net	(6,250)	(5,005)	(4,656)
Cash dividends paid	(783)	(706)	(591)
Net cash used in financing activities	(3,090)	(3,952)	(6,384)
Effect of exchange rate changes on cash and cash equivalents	(201)	(172)	65
Net change in cash and cash equivalents	(581)	428	(663)
Cash and cash equivalents at January 1	7,687	7,259	7,922
Cash and cash equivalents at December 31	$ 7,106	$ 7,687	$ 7,259
Supplemental data:			
Cash paid during the year for:			
Income taxes	$ 2,472	$ 2,229	$ 1,453
Interest	$ 1,475	$ 1,563	$ 1,720

The notes on pages 54 through 77 of the 1997 IBM Annual Report are an integral part of this statement.

(Dollars in millions)	Preferred Stock	Common Stock	Retained Earnings	Translation Adjustments	Treasury Stock	Employee Benefits Trust	Net Unrealized Gain on Marketable Securities	Total
1995								
Stockholders' equity, January 1, 1995	**$ 1,081**	**$ 7,342**	**$ 12,352**	**$ 2,672**	**$ (34)**	**$ –**	**$ –**	**$ 23,413**
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 (101,812,600* shares)		**(655)**	**(4,209)**					**(4,864)**
Preferred stock purchased and retired (8,534,289 shares)	**(828)**		**(42)**					**(870)**
Common stock issued under employee plans (8,543,896* shares)		**279**						**279**
Purchases (9,324,094* shares) and sales (9,413,928* shares) of treasury stock under employee plans – net			**(57)**		**(7)**			**(64)**
Conversion of debentures (13,306,242* shares)		**471**						**471**
Tax effect – stock transactions		**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 (97,951,400* shares)		**(710)**	**(5,046)**					**(5,756)**
Common stock issued under employee plans (19,694,458* shares)		**811**	**(13)**					**798**
Purchases (8,914,332* shares) and sales (7,584,432* shares) of treasury stock under employee plans – net			**(105)**		**(94)**			**(199)**
Tax effect – stock transactions		**163**						**163**
Other				**(635)**			**111**	**(524)**
Stockholders' equity, December 31, 1996	**253**	**7,752**	**11,189**	**2,401**	**(135)**	**–**	**168**	**21,628**
1997								
Net earnings			**6,093**					**6,093**
Cash dividends declared – common stock			**(763)**					**(763)**
Cash dividends declared – preferred stock			**(20)**					**(20)**
Common stock purchased and retired (68,777,336 shares)		**(565)**	**(5,455)**					**(6,020)**
Preferred stock purchased and retired (13,450 shares)	**(1)**							**(1)**
Common stock issued under employee plans (19,651,603 shares)		**985**	**(2)**					**983**
Purchases (3,850,643 shares) and sales (5,105,754 shares) of treasury stock under employee plans – net			**(32)**		**49**			**17**
Employee benefits trust (10,000,000 shares)						**(860)**		**(860)**
Tax effect – stock transactions		**429**						**429**
Other				**(1,610)**			**(60)**	**(1,670)**
Stockholders' equity, December 31, 1997	**$ 252**	**$ 8,601**	**$ 11,010**	**$ 791**	**$ (86)**	**$ (860)**	**$ 108**	**$ 19,816**

*Adjusted to reflect a two-for-one stock split on May 9, 1997.

The notes on pages 54 through 77 of the 1997 IBM Annual Report 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 controlled subsidiary companies, which are generally majority owned. 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 a 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 income tax purposes. In accordance with Statement of Financial Accounting Standards (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 nonmonetary 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 uses a variety of derivative financial instruments for the purpose of currency exchange rate and interest rate risk management. Refer to note J, "Financial Instruments," on pages 59 through 61 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 that are based on market conditions and risks existing at each balance sheet date. Quoted market prices or dealer quotes for the same or similar instruments are 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, are 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, generally not exceeding five years.

Common Stock

Common stock refers to the $.50 par value capital stock as designated in the company's Certificate of Incorporation.

B Accounting Changes

The company implemented new accounting standards in 1997, 1996 and 1995. None of these standards had a material effect on the financial position or results of operations of the company.

In December 1997, the company implemented SFAS 128, "Earnings Per Share" (EPS). This standard prescribes the methods for calculating basic and diluted EPS and requires dual presentation of these amounts on the face of the earnings statement. All EPS amounts are calculated in accordance with SFAS 128; no restatement of EPS, for either basic or diluted, was required for amounts reported previously in the company's filings with the U.S. Securities and Exchange Commission.

Effective January 1, 1997, the company implemented 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. The company was generally in compliance with this standard prior to adoption.

In 1996, the company adopted the American Institute of Certified Public Accountants Statement of Position (SOP) 96-1, "Environmental Remediation Liabilities." This SOP provides guidance on the recognition, measurement, display and disclosure of environmental remediation liabilities. See note L, "Other Liabilities and Environmental," on page 61 for further information. The company was generally in compliance with this standard prior to adoption.

In 1996, the company implemented the disclosure-only provisions of SFAS 123, "Accounting for Stock-Based Compensation." See note T, "Stock-Based Compensation Plans," on pages 68 through 70 for further information.

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 to be held and used or intended for disposal. 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. See note O, "Selling and Advertising," on page 64 for additional disclosure on advertising expenses. The company was generally in conformance with this SOP prior to adoption.

In 1998, the company will implement two accounting standards issued by the Financial Accounting Standards Board in June of 1997. SFAS 130, "Reporting Comprehensive Income," and SFAS 131, "Disclosures About Segments of an Enterprise and Related Information," will have no effect on the company's financial position or results of operations as they require only changes in or additions to current disclosures.

During 1997, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued SOP 97-2, "Software Revenue Recognition." This SOP provides guidance on revenue recognition on software transactions and is effective for transactions entered into in fiscal years beginning after December 15, 1997. The company is taking steps to meet the requirements of the SOP and expects that it will not have a material impact on the financial position or results of operations of the company.

C Common Stock Split

On April 29, 1997, the stockholders of the company approved amendments to the Certificate of Incorporation to increase the number of authorized shares of common stock from 750 million to 1,875 million, which was required to effect a two-for-one stock split approved by the company's Board of Directors on January 28, 1997. In addition, the amendments served to reduce the par value of the common stock from $1.25 to $.50 per share. Stockholders of record at the close of business on May 9, 1997, received one additional share for each share held. All share and per share data prior to the second quarter of 1997 presented in the Consolidated Financial Statements and footnotes of this annual report reflect the two-for-one stock split.

D Inventories

(Dollars in millions)

At December 31:	1997	1996
Finished goods	$ 1,090	$ 1,413
Work in process	4,026	4,377
Raw materials	23	80
Total	$ 5,139	$ 5,870

E Plant, Rental Machines and Other Property

(Dollars in millions)

At December 31:	1997	1996
Land and land improvements	$ 1,117	$ 1,208
Buildings	11,208	12,073
Plant, laboratory and office equipment	25,015	24,824
	37,340	38,105
Less: Accumulated depreciation	21,680	22,935
	15,660	15,170
Rental machines	4,793	3,788
Less: Accumulated depreciation	2,106	1,551
	2,687	2,237
Total	$ 18,347	$ 17,407

F Investments and Sundry Assets

(Dollars in millions)

At December 31:	1997	1996
Net investment in sales-type leases*	$ 13,733	$ 13,345
Less: Current portion – net	5,720	5,721
	8,013	7,624
Deferred taxes	3,163	3,246
Prepaid pension cost	3,828	3,324
Customer loan receivables – not yet due	2,741	2,622
Installment payment receivables	977	830
Alliance investments:		
Cost method	236	320
Equity method	484	564
Goodwill, less accumulated amortization (1997, $1,717; 1996, $1,300)	950	1,067
Marketable securities – non-current	295	381
Other investments and sundry assets	1,228	1,617
Total	$ 21,915	$ 21,595

*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 $563 million and $471 million at December 31, 1997 and 1996, respectively, and is reflected net of unearned income at these dates of approximately $1,600 million and $2,000 million, respectively. Scheduled maturities of minimum lease payments outstanding at December 31, 1997, expressed as a percentage of the total, are approximately as follows: 1998, 45 percent; 1999, 32 percent; 2000, 16 percent; 2001, 5 percent; and 2002 and beyond, 2 percent.

G Debt

Short-term debt

(Dollars in millions)

At December 31:	1997	1996
Commercial paper	**$ 4,583**	**$ 6,069**
Short-term loans	**5,699**	**3,966**
Long-term debt: Current maturities	**2,948**	**2,922**
Total	**$ 13,230**	**$ 12,957**

The weighted-average interest rates for commercial paper at December 31, 1997 and 1996, were approximately 5.8 percent and 5.6 percent, respectively. The weighted-average interest rates for short-term loans at December 31, 1997 and 1996, were approximately 5.5 percent and 5.7 percent, respectively.

Long-term debt

(Dollars in millions)

At December 31:	Maturities	1997	1996
U.S. Dollars:			
Debentures:			
6.22%	**2027**	**$ 500**	**$ –**
7.0%	**2025**	**600**	**600**
7.0%	**2045**	**150**	**150**
7.125%	**2096**	**850**	**850**
7.5%	**2013**	**550**	**550**
8.375%	**2019**	**750**	**750**
Notes: 6.8% average	**1998-2007**	**2,674**	**3,199**
Medium-term note program: 6.0% average	**1998-2009**	**4,472**	**1,851**
Other: 6.3% average	**1998-2012**	**1,319**	**330**
		11,865	**8,280**
Other currencies (average interest rate at December 31, 1997, in parentheses):			
Japanese yen (3.1%)	**1998-2014**	**3,944**	**4,028**
Canadian dollars (5.7%)	**1998-2003**	**407**	**5**
French francs (8.0%)	**1998-2002**	**13**	**282**
German deutschmarks (4.9%)	**1998-2000**	**111**	**25**
Other (8.7%)	**1998-2017**	**335**	**207**
		16,675	**12,827**
Less: Net unamortized discount		**31**	**33**
		16,644	**12,794**
Less: Current maturities		**2,948**	**2,922**
Total		**$ 13,696**	**$ 9,872**

Annual maturities in millions of dollars on long-term debt outstanding at December 31, 1997, are as follows: 1998, $2,948; 1999, $2,766; 2000, $4,213; 2001, $1,021; 2002, $1,338; 2003 and beyond, $4,389.

H Interest on Debt

Interest paid and accrued on borrowings of the company and its subsidiaries amounted to $1,596 million in 1997, $1,565 million in 1996 and $1,600 million in 1995. Of these amounts, $32 million in 1997, $31 million in 1996 and $23 million in 1995 were capitalized. The remainder was charged to the cost of rentals and financing, or interest expense. The increase in interest expense is primarily due to higher levels of debt, partially offset by lower average interest rates in 1997 versus 1996. The decrease in interest expense in 1996 versus 1995 was primarily a result of lower average interest rates. The average interest rate for total debt was 6.4 percent, 7.0 percent and 7.2 percent in 1997, 1996 and 1995, respectively. These rates reflect the results of currency and interest rate swaps applied to the debt described in note G, "Debt," on page 58.

I 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, 1997, were $13.1 billion, compared to $13.9 billion at December 31, 1996. Interest rates on borrowings vary from country to country depending on local market conditions.

J 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, and 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

(Dollars in millions)	Carrying Value	
At December 31:	1997	1996
Current marketable securities:		
U.S. government securities	$ 93	$ 108
Time deposits and other bank obligations	181	283
Non-U.S. government securities and other fixed-term obligations	173	59
Total	$ 447	$ 450
Marketable securities - non-current:*		
U.S. government securities	$ 54	$ 99
Time deposits and other bank obligations	183	127
Non-U.S. government securities and other fixed-term obligations	58	155
Total	$ 295	$ 381
Other investments:*		
Alliance investments on cost method	$ 236	$ 320

* Included within Investments and sundry assets on the Consolidated Statement of Financial Position (See note F on page 57).

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 $861 million and $787 million at December 31, 1997 and 1996, respectively. Additionally, the company is contingently liable for commitments of various ventures to which it is a party and certain other contracts. These commitments, which in the aggregate were approximately $600 million and $400 million at December 31, 1997 and 1996, 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 at December 31, 1997 and 1996.

Derivative Financial Instruments

The company has used derivative instruments as an element of its risk management strategy for many years. Although derivatives entail a risk of nonperformance 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.

The following table summarizes the notional value, carrying value and fair value of the company's derivative financial instruments on- and off-balance sheet. The notional value at December 31 provides an indication of the extent of the company's involvement in such instruments at that time, but does not represent exposure to market risk.

	At December 31, 1997			At December 31, 1996		
(Dollars in millions)	Notional Value	Carrying Value	Fair Value*	Notional Value	Carrying Value	Fair Value*
Interest rate and currency contracts	**$ 24,774**	**$ 29**	**$ 84**	**$ 18,700**	**$ (70)**	**$ (117)**
Option contracts	**14,211**	**41**	**193**	**10,100**	**92**	**81**
Total	**$ 38,985**	**$ 70**	**$ 277**	**$ 28,800**	**$ 22**	**$ (36)**

Bracketed amounts are liabilities.

*The estimated fair value of derivatives both on- and off-balance sheet at December 31, 1997 and 1996, consists of assets of $561 million and $258 million and liabilities of $304 million and $294 million, respectively.

The majority of the company's derivative transactions relates to the matching of liabilities to assets associated with its global financing business. The company issues debt, using the most efficient capital markets and products, which may result in a currency or interest rate mismatch with the underlying lease. Interest rate swaps or currency swaps are then used to match the interest rates and currencies of its debt to the related global financing receivables. These swap contracts are principally one to five years in duration. Interest and currency rate differentials accruing under interest rate and currency swap contracts related to the global financing business are recognized over the life of the contracts in interest expense.

The company uses internal regional centers to manage the cash of its subsidiaries. These regional centers principally use 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. The effects of these contracts are recognized over the life of the contract in interest income.

When the terms of the underlying instrument are modified, or if it ceases to exist, all changes in fair value of the swap contract are recognized in income each period until it matures.

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, 1997 and 1996, 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 also enters into derivative transactions to moderate the impact that an appreciation of the dollar relative to other currencies would have on the translation of foreign earnings. These transactions do not qualify as hedges for accounting purposes, and their foreign exchange gains and losses are recorded in earnings as they occur.

K Sale and Securitization of Receivables

At year-end 1997, the company had a net balance of $.9 billion in assets under management from the securitization of loans, leases and trade receivables, compared to $1.1 billion at year-end 1996. The company received total cash proceeds of approximately $3.0 billion and $4.0 billion in 1997 and 1996, 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.

L Other Liabilities and Environmental

Other liabilities consists principally of accruals for nonpension postretirement benefits for U.S. employees ($6.8 billion) and indemnity and retirement plan reserves for non-U.S. employees ($1.3 billion). More detailed discussion of these liabilities appears in note X, "Nonpension Postretirement Benefits," on pages 73 and 74, and note W, "Retirement Plans," on pages 71 through 73. In addition, noncurrent liabilities associated with prior infrastructure reduction actions amounted to $1.8 billion at December 31, 1997.

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 costs 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 $243 million and $244 million at December 31, 1997 and 1996, 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.

M 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 monetary 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. Plaintiffs have filed an appeal which is pending. 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.

N Taxes

(Dollars in millions)

For the year ended December 31:	1997	1996	1995
Earnings before income taxes:			
U.S. operations	$ 3,193	$ 3,025	$ 2,149
Non-U.S. operations	5,834	5,562	5,664
	$ 9,027	$ 8,587	$ 7,813
The provision for income taxes by geographic operations is as follows:			
U.S. operations	$ 974	$ 1,137	$ 1,538
Non-U.S. operations	1,960	2,021	2,097
Total provision for income taxes	$ 2,934	$ 3,158	$ 3,635
The components of the provision for income taxes by taxing jurisdiction are as follows:			
U.S. federal:			
Current	$ 163	$ 727	$ 85
Deferred	349	83	1,075
	512	810	1,160
U.S. state and local:			
Current	83	158	65
Deferred	(87)	(353)	–
	(4)	(195)	65
Non-U.S.:			
Current	2,330	2,262	2,093
Deferred	96	281	317
	2,426	2,543	2,410
Total provision for income taxes	2,934	3,158	3,635
Provision for social security, real estate, personal property and other taxes	2,774	2,584	2,566
Total provision for taxes	$ 5,708	$ 5,742	$ 6,201

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:	1997	1996
Employee benefits	**$ 3,707**	**$ 3,554**
Capitalized research and development	**1,196**	**1,478**
Restructuring charges	**1,163**	**1,323**
Alternative minimum tax credits	**1,092**	**1,016**
Asset impairments	**1,027**	**1,304**
Deferred income	**893**	**993**
General business credits	**492**	**452**
Equity alliances	**378**	**340**
Intracompany sales and services	**235**	**194**
State and local tax loss carryforwards	**203**	**166**
Foreign tax loss carryforwards	**202**	**368**
Depreciation	**132**	**123**
Other	**2,507**	**2,411**
Gross deferred tax assets	**13,227**	**13,722**
Less: Valuation allowance	**2,163**	**2,239**
Net deferred tax assets	**$ 11,064**	**$ 11,483**

Deferred Tax Liabilities

(Dollars in millions)

At December 31:	1997	1996
Sales-type leases	**$ 3,147**	**$ 3,126**
Retirement benefits	**2,147**	**1,967**
Depreciation	**1,556**	**1,702**
Software costs deferred	**420**	**648**
Other	**1,413**	**1,465**
Gross deferred tax liabilities	**$ 8,683**	**$ 8,908**

The estimated reversal periods for the largest deductible temporary differences are: employee benefits –1 to 30 years; capitalized research and development –1 to 6 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 that may expire before the company can utilize them.

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:	1997	1996	1995
Statutory rate	35%	35%	35%
Foreign tax differential	(3)	2	2
State and local	1	1	1
U.S. valuation allowance	–	(6)	(2)
Other	–	3	2
Effective rate before purchased in-process research and development	33	35	38
Purchased in-process research and development	–	2	9
Effective rate	33%	37%	47%

For tax return purposes, the company has available tax credit carryforwards of approximately $2,035 million, of which $1,092 million have an indefinite carryforward period, $431 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 $405 million. Most of these carryforwards are available for 15 years or have an indefinite carryforward period.

Undistributed earnings of non-U.S. subsidiaries included in consolidated retained earnings amounted to $12,511 million at December 31, 1997, $12,111 million at December 31, 1996, and $12,565 million at December 31, 1995. 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.

O Selling and Advertising

Selling and advertising expense is charged against income as incurred. Advertising expense, which includes media, agency and promotional expenses, amounted to $1,708 million, $1,569 million and $1,315 million in 1997, 1996 and 1995, respectively.

P Research, Development and Engineering

Research, development and engineering expense amounted to $4,877 million in 1997, $4,654 million in 1996 and $4,170 million in 1995. Expenditures for product-related engineering included in these amounts were $570 million, $720 million and $783 million in 1997, 1996 and 1995, respectively.

Expenditures of $4,307 million in 1997, $3,934 million in 1996 and $3,387 million in 1995 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 $2,016 million, $1,726 million and $1,157 million in 1997, 1996 and 1995, respectively.

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

Q Global Financing

The primary focus of IBM's worldwide global financing offerings is to support customers in their acquisition 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 global financing in comparison to the company's consolidated results with global financing results reflected on an equity basis. This involves presenting within a single line item the investment and related return from global financing as reflected in the company's consolidated financial statements. For the statement of financial position, global financing's assets net of related liabilities and after elimination of applicable intracompany transactions, are shown separately as a single line item, Investment in global financing. Eliminations primarily pertain to internal markups to fair value of equipment held on operating leases. With respect to the statement of earnings, net earnings for global financing before applicable taxes, and after elimination of related intracompany transactions are included in the description, Other income. The provision for income taxes for global 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 global 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

(Dollars in millions)	Global Financing		IBM with Global Financing on an Equity Basis	
At December 31:	1997	1996	1997	1996
Assets:				
Cash and cash equivalents	$ 998	$ 1,433	$ 6,108	$ 6,254
Notes and accounts receivable	–	–	9,551	10,063
Net investment in capital leases	13,831	13,430	–	–
Working capital financing receivables	4,928	4,030	–	–
Loans receivable	6,951	6,428	–	–
Inventories	111	98	5,044	5,788
Plant, rental machines and other property, net of accumulated depreciation	5,168	3,988	15,790	15,229
Other assets	3,457	2,386	13,364	15,010
Investment in global financing	–	–	5,142	5,613
Total assets	$ 35,444	$ 31,793	$ 54,999	$ 57,957
Liabilities and stockholders' equity:				
Taxes, accrued expenses and other liabilities	$ 7,969	$ 7,915	$ 32,081	$ 34,127
Debt	23,824	20,627	3,102	2,202
Total liabilities	31,793	28,542	35,183	36,329
Stockholders' equity/invested capital	3,651	3,251	19,816	21,628
Total liabilities and stockholders' equity	$ 35,444	$ 31,793	$ 54,999	$ 57,957

Statement of Earnings

(Dollars in millions)	Global Financing			IBM with Global Financing on an Equity Basis		
For the year ended December 31:	1997	1996	1995	1997	1996	1995
Finance and other income:						
Finance income	$ 1,833	$ 2,048	$ 2,110	$ –	$ –	$ –
Rental income – net	603	509	415	527	590	469
Sales and services	788	809	1,001	74,421	71,798	67,588
Other income	339	320	367	1,119	1,381	1,473
Total finance and other income	3,563	3,686	3,893	76,067	73,769	69,530
Interest and other costs and expenses	2,432	2,426	2,782	67,040	65,182	61,717
Net earnings before income taxes	1,131	1,260	1,111	9,027	8,587	7,813
Provision for income taxes	429	531	428	2,934	3,158	3,635
Net earnings	$ 702	$ 729	$ 683	$ 6,093	$ 5,429	$ 4,178

Global financing earnings yielded a return on average invested capital of 20.3 percent in 1997, compared to 22.7 percent in 1996. 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.

Statement of Cash Flows

(Dollars in millions)	Global Financing			IBM with Global Financing on an Equity Basis		
For the year ended December 31:	1997	1996	1995	1997	1996	1995
Net cash provided from operating activities	$ 3,919	$ 5,314	$ 3,712	$ 10,910	$ 8,217	$ 9,250
Net cash used in investing activities	(8,435)	(5,544)	(3,968)	(3,684)	(3,435)	(3,338)
Net cash provided from (used in) financing activities	4,102	872	(198)	(7,192)	(4,824)	(6,186)
Effect of exchange rate changes on cash and cash equivalents	(21)	(17)	(42)	(180)	(155)	107
Net change in cash and cash equivalents	(435)	625	(496)	(146)	(197)	(167)
Cash and cash equivalents at January 1	1,433	808	1,304	6,254	6,451	6,618
Cash and cash equivalents at December 31	$ 998	$ 1,433	$ 808	$ 6,108	$ 6,254	$ 6,451

R Net Earnings Per Share of Common Stock

The following table sets forth the computation of basic and diluted earnings per share.

For the year ended December 31:	1997	1996	1995	1994	1993
Number of shares on which basic earnings per share is calculated:					
Average outstanding during year	**983,286,361**	**1,056,704,188**	**1,138,768,058**	**1,169,917,398**	**1,146,478,480**
Add – Incremental shares under stock compensation plans	**27,648,581**	**23,004,716**	**18,446,278**	**8,616,538**	**–**
– Incremental shares related to 5.75% convertible bonds (average)	**–**	**–**	**10,582,196**	**15,430,782**	**–**
Number of shares on which diluted earnings per share is calculated	**1,010,934,942**	**1,079,708,904**	**1,167,796,532**	**1,193,964,718**	**1,146,478,480**
Net earnings (loss) applicable to common shareholders (millions)	**$ 6,073**	**$ 5,409**	**$ 4,116**	**$ 2,937**	**$ (8,148)**
Net earnings effect of interest on 5.75% convertible bonds (millions)	**–**	**–**	**1**	**19**	**–**
Net earnings (loss) on which diluted earnings per share is calculated (millions)	**$ 6,073**	**$ 5,409**	**$ 4,117**	**$ 2,956**	**$ (8,148)**
Basic earnings (loss) per share	**$ 6.18**	**$ 5.12**	**$ 3.61**	**$ 2.51**	**$ (7.11)**
Diluted earnings (loss) per share	**$ 6.01**	**$ 5.01**	**$ 3.53**	**$ 2.48**	**$ (7.11)**

Stock options to purchase 165,833 shares in 1997, 784,141 shares in 1996, 10,304,286 shares in 1995 and 14,531,336 shares in 1994 were outstanding, but were not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares, and therefore, the effect would be antidilutive. In 1993, the incremental shares under stock plans (58,971,448 shares) and the effect of the convertible bonds (15,430,800 shares) were not considered for the diluted earnings per share calculation due to their antidilutive effect. As such, the amounts reported for basic and diluted earnings per share are the same.

S Rental Expense and Lease Commitments

Rental expense, including amounts charged to inventories and fixed assets and excluding amounts previously reserved, was $1,280 million in 1997, $1,210 million in 1996 and $1,145 million in 1995. The table below depicts gross minimum rental commitments under noncancelable leases, amounts related to vacant space that the company had previously reserved and sublease income commitments. These amounts generally reflect activities related to office space.

(Dollars in millions)	1998	1999	2000	2001	2002	Beyond 2002
Gross rental commitments	$ 1,431	$ 1,235	$ 1,101	$ 936	$ 752	$ 1,787
Vacant space	262	206	194	149	111	255
Sublease income commitments	127	115	107	79	57	106

T Stock-Based Compensation Plans

The company applies Accounting Principles Board (APB) Opinion 25 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 1997 Long-Term Performance Plan, which was approved by stockholders in April 1997, and its predecessor plan, the 1994 Long-Term Performance Plan ("the Plans"). The Plans are administered by the Executive Compensation and Management Resources Committee of the Board of Directors. The committee determines the type and terms of the awards to be granted, including vesting provisions.

Awards may include stock options, stock appreciation rights (SARs), restricted stock, cash or stock awards, or any combination thereof. The number of shares that may be issued under the IBM 1997 Long-Term Performance Plan for awards is 50.3 million, which was 5 percent of the outstanding common stock on February 10, 1997. There were 46.4 million unused shares available for granting under the IBM 1997 Long-Term Performance Plan and approximately 9.0 million shares available for granting under the 1994 Long-Term Performance Plan at December 31, 1997.

Awards under the Plans resulted in compensation expense of $214.1 million, $203.9 million and $106.3 million that were included in net earnings before income taxes in 1997, 1996 and 1995, respectively. Such awards include those that settle in cash, such as SARs, and restricted stock grants.

Stock Option Grants

Stock options granted under the Plans allow the purchase of IBM's common stock at 100 percent of the market price on the date of grant and generally expire 10 years from the date of grant. The following table summarizes option activity of the Plans during 1997, 1996 and 1995:

	1997		1996		1995	
	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	$ 44	61,435,322	$ 39	68,565,806	$ 34	68,126,634
Options granted	71	21,471,228	63	15,359,058	39	12,937,404
Options exercised	42	(19,630,005)	36	(19,302,622)	26	(7,391,578)
Options terminated	56	(1,548,184)	61	(3,186,920)	52	(5,106,654)
Balance at December 31	$ 54	61,728,361	$ 44	61,435,322	$ 39	68,565,806
Exercisable at December 31	$ 38	26,619,548	$ 41	30,603,845	$ 46	38,352,820

The shares under option at December 31, 1997, were in the following exercise price ranges:

	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
$21 – 50	25,762,003	$ 32	6	20,646,476	$ 31
$51 – 69	16,880,188	62	7	5,959,624	61
$70 and over	19,086,170	76	9	13,448	74
	61,728,361			26,619,548	

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 1997, 1996 and 1995, employees purchased 4,676,980; 6,461,856 and 8,958,680 shares, all of which were treasury shares, for which $354 million, $324 million and $344 million were paid to IBM, respectively.

There were approximately 35.5 million, 40.2 million and 46.6 million reserved unissued shares available for purchase under the ESPP, as previously approved by stockholders, at December 31, 1997, 1996 and 1995, 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. SFAS 123 requires 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)

	1997		1996		1995	
	As reported	Pro forma	As reported	Pro forma	As reported	Pro forma
Net earnings applicable to common shareholders	$ 6,073	$ 5,866	$ 5,409	$ 5,267	$ 4,116	$ 4,020
Net earnings per share of common stock	$ 6.18	$ 5.97	$ 5.12	$ 4.98	$ 3.61	$ 3.53
Net earnings per share of common stock - assuming dilution	$ 6.01	$ 5.82	$ 5.01	$ 4.89	$ 3.53	$ 3.45

The above pro forma amounts, for purposes of SFAS 123, reflect the portion of the estimated fair value of awards earned in 1997, 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 1997, 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:

	1997	1996	1995
Term (years)*	5/6	5/6	5/6
Volatility**	23.0%	22.0%	21.0%
Risk-free interest rate (zero coupon U.S. Treasury note)	6.2%	6.0%	7.0%
Dividend yield	1.0%	1.2%	2.0%
Weighted average fair value	$ 25	$ 20	$ 12

* 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.

U Stock Repurchases

The Board of Directors has authorized the company to repurchase IBM common stock. The company repurchased 81,505,200 common shares at a cost of $7,128 million and 98,930,400 common shares at a cost of $5,810 million in 1997 and 1996, respectively. The repurchases resulted in a reduction of $34,338,668 and $61,831,500 in the stated capital (par value) associated with common stock in 1997 and 1996, respectively. In 1997, 10 million repurchased shares were used to establish the Employee Benefits Trust, while 2,727,864 and 979,000 in 1997 and 1996, respectively, were used to fund new acquisitions. The rest of the repurchased shares were retired and restored to the status of authorized but unissued shares. At December 31, 1997, approximately $2.7 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 its outstanding Series A 7½ percent preferred stock. The company repurchased 13,450 shares at a cost of $1.4 million during 1997, which resulted in a $134.50 ($.01 par value per share) reduction in the stated capital 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.

V Employee Benefits Trust

Effective November 1, 1997, the company created an employee benefits trust to which the company contributed 10 million shares of treasury stock. The company is authorized to instruct the trustee to sell shares from time to time and to use proceeds from such sales, and any dividends paid on such contributed stock, toward the partial satisfaction of the company's future obligations under certain of its compensation and benefits plans, including its retiree medical plans. The shares held in trust are not considered outstanding for earnings per share purposes until they are committed to be released, and the shares will be voted by the trustee in accordance with its fiduciary duties. As of December 31, 1997, no shares have been committed to be released.

W Retirement Plans

The company and its subsidiaries have defined benefit and defined contribution retirement plans covering substantially all regular employees, and a supplemental retirement plan that covers certain executives. The aggregate (benefit) cost of these plans for 1997, 1996 and 1995 was $(50) million, $120 million and $377 million, respectively.

The cost of the defined benefit plans for 1997, 1996 and 1995 was as follows:

Net Periodic Pension Cost

	U.S. Plan			Non-U.S. Plans		
(Dollars in millions)	1997	1996	1995	1997	1996	1995
Service cost	$ 397	$ 412	$ 315	$ 360	$ 378	$ 386
Interest cost on the projected benefit obligation	2,215	2,125	2,098	1,173	1,292	1,325
Return on plan assets:						
Actual	(6,193)	(4,849)	(5,500)	(3,461)	(2,543)	(1,848)
Deferred	3,286	2,148	2,958	2,021	1,075	403
Net amortizations	(125)	(121)	(123)	16	28	12
Settlement (gains)/curtailment losses	–	–	–	(68)	(102)	128
Net periodic pension cost (benefit)	$ (420)	$ (285)	$ (252)	$ 41	$ 128	$ 406
Total net periodic pension cost for all non-U.S. plans				$ 50	$ 148	$ 417
Expected long-term rate of return on plan assets	9.5%	9.25%	9.25%	6.0-9.5%	6.5-10.0%	6.25-10.0%
Cost of defined contribution plans	$ 236	$ 209	$ 176	$ 64	$ 29	$ 21

Net periodic pension cost is determined using the Projected Unit Credit actuarial method. Settlement gains in 1997 and 1996 reflect principally the transfer of assets to defined contribution plans upon election by the employees in certain countries. Curtailment losses in 1995 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.

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

Funded Status

(Dollars in millions)	U.S. Plan 1997	U.S. Plan 1996	Non-U.S. Plans 1997	Non-U.S. Plans 1996
Actuarial present value of benefit obligations:				
Vested benefit obligation	**$ (29,155)**	**$ (26,355)**	**$ (16,388)**	**$ (17,380)**
Accumulated benefit obligation	**$ (30,466)**	**$ (27,698)**	**$ (17,187)**	**$ (18,273)**
Projected benefit obligation	**$ (33,161)**	**$ (29,729)**	**$ (18,709)**	**$ (19,739)**
Plan assets at fair value	**38,475**	**34,281**	**21,601**	**20,808**
Projected benefit obligation less than plan assets	**5,314**	**4,552**	**2,892**	**1,069**
Unrecognized net gain	**(1,901)**	**(1,421)**	**(2,822)**	**(1,539)**
Unrecognized prior service cost	**190**	**193**	**194**	**248**
Unrecognized net asset established at January 1, 1986	**(911)**	**(1,052)**	**(87)**	**(110)**
Prepaid pension cost (pension liability) recognized in the Consolidated Statement of Financial Position	**$ 2,692**	**$ 2,272**	**$ 177**	**$ (332)**
Assumptions:				
Discount rate	**7.0%**	**7.75%**	**4.5-7.5%**	**4.5-8.5%**
Long-term rate of compensation increase	**5.0%**	**5.0%**	**2.6-6.1%**	**2.3-6.5%**

The U.S. plan's projected benefit obligation increased in 1997 by $3,432 million, primarily as a result of a change in the discount rate assumption, as required under SFAS 87, "Employers' Accounting for Pensions," which increased the projected benefit obligation by approximately $2,723 million. The non-U.S. plans' projected benefit obligation decreased $1,030 million, primarily due to the effects of exchange rates. The fair value of the plan assets for the U.S. and non-U.S. plans increased $4,194 million and $793 million, respectively, year to year as a result of the strong performance of the plan assets.

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 that 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, which 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, 1997 and 1996, was 108,415 and 101,293, 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.

In 1994, the company introduced a non-qualified U.S. Supplemental Executive Retirement Plan (SERP) effective January 1, 1995, which is being 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, 1997 and 1996, the projected benefit obligation was $128 million and $93 million, respectively. The net unrecognized costs of the SERP were $72 million and $57 million, and the amounts included in the Consolidated Statement of Financial Position were pension liabilities of $56 million and $36 million at December 31, 1997 and 1996, respectively. The cost of the SERP, which is included in the Consolidated Statement of Earnings, was $20 million, $19 million and $15 million for 1997, 1996 and 1995, respectively.

X 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.

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

(Dollars in millions)	1997	1996	1995
Service cost	$ 32	$ 43	$ 40
Interest cost on the accumulated postretirement benefit obligation	455	478	520
Actual return on plan assets	(15)	(68)	(198)
Net amortizations and deferrals	(119)	(87)	(7)
Net periodic postretirement benefit cost	$ 353	$ 366	$ 355
Expected long-term rate of return on plan assets	5.0%	9.25%	9.25%

During 1997, the expected long-term rate of return on plan assets was reduced to 5 percent as a result of the shift in the asset portfolio. 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.

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

Funded Status

(Dollars in millions)

	1997	1996
Accumulated postretirement benefit obligation:		
Retirees	**$ (5,327)**	**$ (5,454)**
Fully eligible active plan participants	**(518)**	**(512)**
Other active plan participants	**(539)**	**(487)**
Total	**(6,384)**	**(6,453)**
Plan assets at fair value	**120**	**559**
Accumulated postretirement benefit obligation in excess of plan assets	**(6,264)**	**(5,894)**
Unrecognized net loss	**578**	**378**
Unrecognized prior service cost	**(1,073)**	**(902)**
Accrued postretirement benefit cost recognized in the Consolidated Statement of Financial Position	**$ (6,759)**	**$ (6,418)**
Assumed discount rate	**7.0%**	**7.75%**

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 1997, the accumulated postretirement benefit obligation increased by $387 million from the change, as required by SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," in the assumed discount rate. This increase was partially offset by certain plan amendments, which reduced the accumulated postretirement benefit obligation by $300 million.

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, 1997, by approximately $51 million; the 1997 annual costs would not be materially affected.

The plan assets include various domestic short-term fixed income securities. Once plan assets have been depleted, the company intends to fund costs as they are incurred. The accounting for the plan is based on the written plan.

Y 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 below shows revenue by classes of similar products or services. Financial information by geographic area is summarized in note Z, "Geographic Areas," on pages 76 and 77.

For purposes of classifying similar information technology products, general-purpose computer systems that operate on a large class of applications are classified as 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. Clients include personal computer and RS/6000 products, general-purpose display-based terminals and monitors, and consumer and financial systems. Servers include the System/390, AS/400, RS/6000 and personal computer server products. Storage consists of externally attached direct access storage devices and tape storage devices. Other peripherals consists of advanced function printers and telecommunication devices. OEM hardware consists primarily of revenue from the sale of HDD storage files and 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 full range of solutions in Network Services, which includes managed network operations and services; Professional Services, consisting of systems management or outsourcing, systems integration design and development, education and consulting; and Product Support Services, which consists of availability services for operation support and business recovery systems. 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

(Dollars in millions)	Consolidated			U.S. Only		
	1997	1996*	1995*	1997	1996*	1995*
Information technology:						
Clients**	$ 13,915	$ 13,925	$ 12,677	$ 5,804	$ 5,519	$ 4,881
Servers**	11,868	12,421	12,597	4,535	4,365	4,464
Peripherals:						
Storage**	2,725	2,779	3,306	1,131	1,036	1,121
Other peripherals**	2,126	2,304	2,085	781	860	764
OEM hardware	5,590	4,550	4,490	3,848	3,092	2,824
Services	19,302	15,873	12,714	7,980	6,129	4,606
Software	12,844	13,052	12,657	4,569	4,377	4,117
Maintenance	6,402	6,981	7,409	2,461	2,525	2,618
Financing and other	3,736	4,062	4,005	1,554	1,492	1,394
Total	$ 78,508	$ 75,947	$ 71,940	$ 32,663	$ 29,395	$ 26,789

*Reclassified to conform to 1997 presentation.
**Hardware only, includes applicable rental revenue, excludes functions not embedded, software and maintenance.

Z Geographic Areas

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 81 percent of the company's non-U.S. revenue. The remaining 19 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 1997, 1996 and 1995.

Interarea transfers consist principally of completed machines, subassemblies and parts, and software. Machines and 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)

	1997	1996	1995
United States			
Revenue – Customers	$ 32,663	$ 29,395	$ 26,789
Interarea transfers	9,426	10,197	10,553
Total	$ 42,089	$ 39,592	$ 37,342
Net earnings	2,354	1,782	599
Assets at December 31	41,633	39,724	38,584
Europe/Middle East/Africa			
Revenue – Customers	$ 23,919	$ 25,280	$ 25,238
Interarea transfers	2,513	2,455	2,530
Total	$ 26,432	$ 27,735	$ 27,768
Net earnings	1,343	1,474	2,271
Assets at December 31	21,006	21,732	24,066
Asia Pacific			
Revenue – Customers	$ 15,246	$ 14,752	$ 13,892
Interarea transfers	3,475	2,781	2,698
Total	$ 18,721	$ 17,533	$ 16,590
Net earnings	1,788	1,466	1,098
Assets at December 31	11,984	12,152	12,789
Americas			
Revenue – Customers	$ 6,680	$ 6,520	$ 6,021
Interarea transfers	4,407	5,123	5,333
Total	$ 11,087	$ 11,643	$ 11,354
Net earnings	586	578	324
Assets at December 31	7,628	8,123	7,530
Eliminations			
Revenue	$ (19,821)	$ (20,556)	$ (21,114)
Net earnings	22	129	(114)
Assets	(752)	(599)	(2,677)
Consolidated			
Revenue	$ 78,508	$ 75,947	$ 71,940
Net earnings	6,093	5,429	4,178
Assets at December 31	81,499	81,132	80,292

Five-Year Comparison of Selected Financial Data

(Dollars in millions except per share amounts)

For the year:	1997	1996	1995	1994	1993
Revenue	$ 78,508	$ 75,947	$ 71,940	$ 64,052	$ 62,716
Net earnings (loss) before changes in accounting principles	6,093	5,429	4,178	3,021	(7,987)
Per share of common stock	6.18	5.12	3.61	2.51	(7.01)
Effect of accounting changes*	–	–	–	–	(114)
Per share of common stock	–	–	–	–	(.10)
Net earnings (loss)	6,093	5,429	4,178	3,021	(8,101)
Per share of common stock	6.18	5.12	3.61	2.51	(7.11)
Per share of common stock – assuming dilution	6.01	5.01	3.53	2.48	(7.11)
Cash dividends paid on common stock	763	686	572	585	905
Per share of common stock	.775	.65	.50	.50	.79
Investment in plant, rental machines and other property	6,793	5,883	4,744	3,078	3,232
Return on stockholders' equity	29.7%	24.8%	18.5%	14.3%	–
At end of year:					
Total assets	$ 81,499	$ 81,132	$ 80,292	$ 81,091	$ 81,113
Net investment in plant, rental machines and other property	18,347	17,407	16,579	16,664	17,521
Working capital	6,911	6,695	9,043	12,112	6,052
Total debt	26,926	22,829	21,629	22,118	27,342
Stockholders' equity	19,816	21,628	22,423	23,413	19,738

*1993, postemployment benefits.

Selected Quarterly Data

(Dollars in millions except per share amounts and stock prices)

	Revenue	Gross Profit	Net Earnings	Per Share Common Stock Earnings	Per Share Common Stock Earnings Assuming Dilution	Per Share Common Stock Dividends	Stock Prices** High	Stock Prices** Low
1997								
First quarter	$ 17,308	$ 6,592	$ 1,195	$ 1.18	$ 1.16	$ .175	$ 85.06	$ 65.00
Second quarter	18,872	7,401	1,446	1.46	1.43	.200	93.75	63.56
Third quarter	18,605	7,098	1,359	1.38	1.35	.200	109.44	90.13
Fourth quarter	23,723	9,518	2,093	2.16	2.11	.200	113.50	88.63
Total	$ 78,508	$ 30,609	$ 6,093	$ 6.18	$ 6.01*	$ .775		
1996								
First quarter	$ 16,559	$ 6,769	$ 774	$ .71	$ .69	$ .125	$ 64.44	$ 41.56
Second quarter	18,183	7,191	1,347	1.26	1.24	.175	60.44	48.06
Third quarter	18,062	7,258	1,285	1.23	1.20	.175	63.94	44.56
Fourth quarter	23,143	9,321	2,023	1.97	1.93	.175	83.00	61.56
Total	$ 75,947	$ 30,539	$ 5,429	$ 5.12*	$ 5.01*	$ .650		

*The sum of the quarters' 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
Investors 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@ibm.net
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.
Investors with other requests may write to:
IBM Stockholder Relations
IBM Corporation
New Orchard Road
Armonk, New York 10504

Annual Meeting

The IBM Annual Meeting of Stockholders will be held on Tuesday, April 28, 1998, at 10 a.m. (CST) at the Arie Crown Theatre, Lakeside Center, Chicago, Illinois.

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 1997 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) 426-3333; from outside the continental United States, call (520) 574-4600.

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And if financial information is a mystery to you, visit the Guide to Understanding Financials – www.ibm.com/FinancialGuide – a resource that explains basic financial terms and statements.

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