

.COM

We're not changing our name. Just everything else.
And we're not the only ones.

Millions of enterprises aren't waiting for a revolution.
And they aren't just watching one either.
The revolution has arrived.

With stunning speed, it has swept all of us into a new
kind of economy and a new kind of society.
A world of new mindsets and new ambitions, to be sure.
But also a world where time-honored assets – customer
relationships, smart people, deft strategy – still matter.
This is the world of e-business.

It is a world where everyone looks both new and familiar.
Where any company and every company is a dot-com.
e-business is here. We're never going back.



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

Dear fellow investor,

At this point last year, the only thing we knew for certain was that the coming year would be unlike any other. We faced some big unknowns – economic crises in Asia and Latin America, the Euro conversion and, of course, Y2K. Underlying it all, making the uncertainties even more uncertain, was the tectonic plate shift of e-business.

As it played out, 1999 was, indeed, a roller coaster for IBM. The first half saw remarkable growth for our company, but in the second half, Y2K hit us hard. Many of our biggest customers locked down their systems and their spending, and because IBM's customer base contains so many of the world's leading businesses, government agencies and financial institutions – the very enterprises most at risk from Y2K – our sales suffered accordingly.

Even so, when you average out the highs and lows, 1999 was a good year for IBM. For the fifth straight year, we reported record revenue – \$87.5 billion, up 7 percent over 1998. Our earnings rose to \$7.7 billion, a 22-percent increase, resulting in another new record in earnings per diluted common share. Customer satisfaction achieved its highest level in a decade.

After making substantial investments – \$5.8 billion on research and development, \$6 billion on capital expenditures and \$1.5 billion on acquisitions that strengthened our business portfolio – we had enough cash to buy back \$7.3 billion of common shares and to increase our dividend to shareholders. Our market value, probably the most important measure of progress to investors, grew \$24 billion in 1999, and has increased by nearly \$170 billion in the past seven years.

Those are all good numbers, but not good enough. After building some real momentum over the previous two years, IBMers found the last two quarters of 1999

frustrating in the extreme. Some outside the company say it was a wake-up call. I say it was a starting gun, because now, the real race begins.

The dot-coms, it seems, are taking over. You can't chart future strategy, execute a transaction, invest money, even read a paper or magazine or watch TV without, somewhere in the process, bumping into dot-coms and, behind them, the whole world of e-business.

Some find all this energizing, some annoying, but everyone's paying attention. It's the first question I get from any IBM customer in almost any part of the world: "What must I do to survive and win in this new world?" In fact, at the moment, it's just about the *only* question I get.

The fact is, 1999 was the year e-business and the global Internet economy came of age. It was a tidal wave, sweeping everything before it, driving new levels of megamerger activity, carrying thousands of entirely new businesses to unprecedented levels of wealth (much of it probably unsustainable), submerging almost as many others, and rearranging the landscape of commerce.

One conservative estimate is that the e-business opportunity will approach \$600 billion by 2003, and it could well be even larger than that. While the overall information technology (I/T) industry grows at around 11 percent, the e-business portion is growing much faster – at around 22 percent.

All that adds up to a tremendous opportunity for IBM. I'm not talking here about the pent-up demand that will be released as Y2K lockdowns are unlocked. I'm talking about the fact that customers are investing heavily in new e-business applications and solutions. We expect 2000 to be a good year for our company. However, we aren't taking anything for granted. We know how open the field

is and how huge the stakes are. It's tough to be fast, focused and surefooted in a period of explosive change. But that's what we have to do.

As the race begins, these are our top three goals:

[1] **Accelerate our growth.** A hyperdynamic marketplace such as we see today values *trajectory* – that is, the potential for growth – more than current market position. That's good for IBM, because we're entering a period of explosive demand for everything we have – hardware, software, services, component technology, expertise – the whole portfolio. There's no question the opportunity is there, but thus far we haven't captured our rightful share across all segments.

However, when we set our targets high – to grow not with the market, but faster – we've proved that we can deliver. In 1999, for example, our revenue for database products on UNIX and Windows NT was up 56 percent, more than three times the industry growth rate; our custom-logic chip business growth exceeded 70 percent year over year, as we focused on the communications industry; and shipments of our Netfinity line of Intel-based servers increased more than 30 percent. Shark, our new enterprise storage subsystem, was ordered by half of the Fortune Global 100 within the first 100 days of its introduction. In the first three months of the RS/6000 S80 e-business server, we sold as many as Sun shipped of its competitive offering in its first one and a half years. And e-business services, the most exciting growth opportunity since we started our services business, reached more than \$3 billion in

1999 revenue, a 60 percent increase.

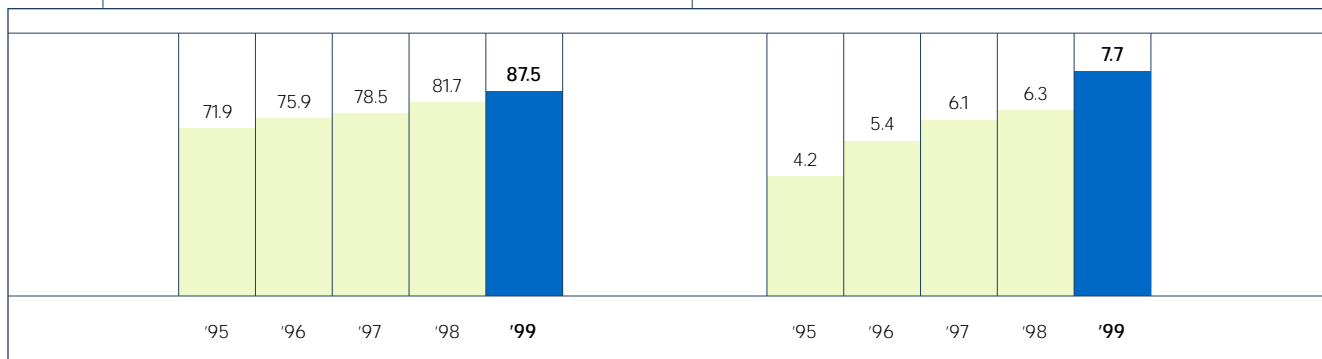
We will continue to shift our portfolio toward the highest-growth e-business opportunities. In this regard, we passed an important milestone last year. Our three major growth engines – services, software and component (OEM) technology – now provide more than half (in fact, nearly 60 percent) of IBM's revenue. Conversely, we are exiting businesses where we can't achieve our growth objectives, or where partnership is the preferred strategy. That's why we formed a networking solutions alliance with Cisco Systems last year. And it's why we scaled back our enterprise application software efforts in 1999, instead partnering with leading software developers like Siebel Systems, i2 Technologies, SAP and Telcordia Technologies.

We are stepping up our work with the NetGen and dot-com companies and aggressively pursuing opportunities in online trading hubs, application service providers and the whole area of pervasive computing. One standout opportunity is in wireless devices, particularly in Europe and Asia, where the number of data-enabled cell phones is expected to surpass the number of PCs in just a few years. We recently signed a deal with Vodafone AirTouch to design, build and manage an Internet portal that will allow businesses and individuals to access content and services over the Internet using a variety of wireless devices.

We're targeting the emerging "white spaces" of the networked world, such as storage, which is being transformed through the emergence of Net-driven storage area networks (SANs); and the

revenue – \$ in billions

net income – \$ in billions



game-changing open-source operating system Linux, which we're moving aggressively to support across our entire product line. And we will continue to build on IBM's e-commerce lead, increasing sales and distribution through ibm.com. In 1998, e-commerce generated \$3.3 billion in sales; in 1999, that rose to \$14.8 billion. We expect to double that this year.

Finally, as the Net shifts computing workload, applications and data from PCs to large server systems, more and more computing solutions will be delivered as a service, over the Web. We've already got a significant Web hosting business, from complex sites for customers like Macy's and the Olympics, to small businesses. And our acquisition of Whistle Communications last June strengthened our ability to offer network computing services to smaller customers.

[2] *In all things, innovate.* By innovation I don't just mean technology – though of course I mean that, too. With our seventh straight year of patent leadership and another record total (2,756 U.S. patents in 1999), IBM's position as the world's premier commercial center of technology innovation is unchallenged. We will continue to invest in that. We will also continue to speed those innovations – such as copper chips and record-setting hard disk drives – into products (our own, and those of our customers). And we'll continue taking on "grand challenges" that bring technology breakthroughs to bear on previously intractable problems. For example, in December 1999,

IBM Research announced a \$100 million push to build a supercomputer named "Blue Gene" – 500 times more powerful than today's fastest computers – that initially will be used to model the mysterious folding of human proteins.

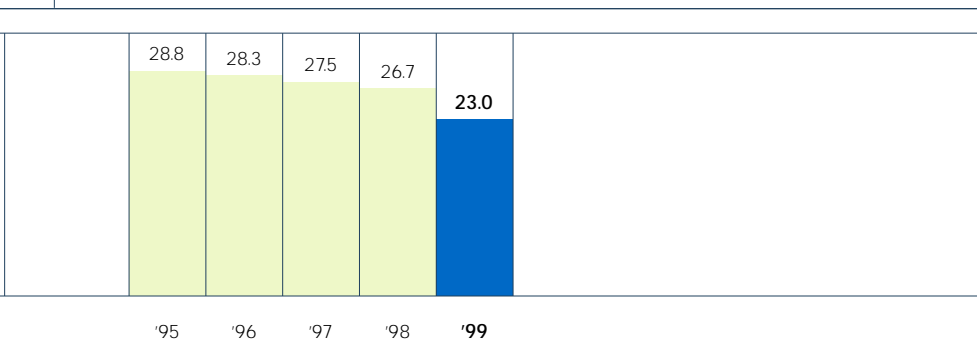
But innovation at IBM has never been about technology alone, or for its own sake. Especially now, when the competitive environment demands that we create radically new ways in which we go to market, attract new employees and structure relationships with customers and partners.

For instance, we have stepped up our efforts to reach out to Internet startups – through novel incubator programs and more than \$700 million in planned startup financing and venture capital investments. We form relationships with dot-coms while they're still in the incubator, so we can help them make technology decisions before they launch. Just as important, we get to see beyond the current technology horizon, understand the trends and deploy that learning directly in IBM. (And, by the way, we've already seen a tidy return on our investments.)

We're also innovating in how we build relationships with such important communities as software developers (via our developerWorks Web site, a resource for the Web's 10 million-plus developers worldwide) and future employees (witness last summer's "Extreme Blue" internship program, which gave some of the world's brightest computer science students a chance to work on real, cutting-edge IBM projects).

Finally, we continue to drive innovation in

total expenses as a percentage of revenue



transforming IBM into a leading e-business – and not just in e-commerce sales, which I mentioned earlier. In providing e-care for customers, we handled 42 million self-service transactions in 1999, avoiding some \$750 million in support costs. We delivered 25 percent of our internal training via distributed learning, which has not only saved us more than \$200 million, but made it far easier and faster for our people to educate themselves. Through e-procurement, we bought about \$13 billion in goods and services over the Web, saving at least \$270 million. And our intranet, which we believe is the largest and most heavily trafficked in the world, has emerged as a vital business platform and knowledge-sharing medium for IBMers. It is quickly becoming IBM’s digital nervous system.

[3] Shape the new face of IBM. What will “IBM” mean to customers, potential customers and employees, and the public at large in the years ahead? Our brand used to be touched and our company experienced primarily through our products. But going forward, a smaller percentage of our customers will buy an item with “IBM” stamped on it. Instead, when they experience the benefits of our innovative technology, much of it will be inside other companies’ branded products, or at work behind the scenes in the computing infrastructure of the Net.

Even more important, they’ll experience IBM in the person of another human being. Sometime within the next five years, more than half of our

revenues and workforce will come from services. This will mean that, very soon, revered IBM brand attributes like quality, reliability and innovation will primarily be descriptors of IBM people – their knowledge, ideas and behavior – just as today they describe IBM ThinkPads, servers and software.

We are very proud of what we accomplished through the 1990s in reanimating the IBM brand. Going forward, as the nature of our business changes, we will create new ways to make “IBM” relevant, compelling and exciting to people. And since so much of the IBM experience will be shaped by our people, I believe one of the most important tasks will be building the training, development, reward and knowledge management systems that support the IBM workforce. In other words, the strategic connection between our culture and our brand will be even more important – and more visible.

What’s Next? Last year I told you about three trends that were shaping the immediate future of information technology:

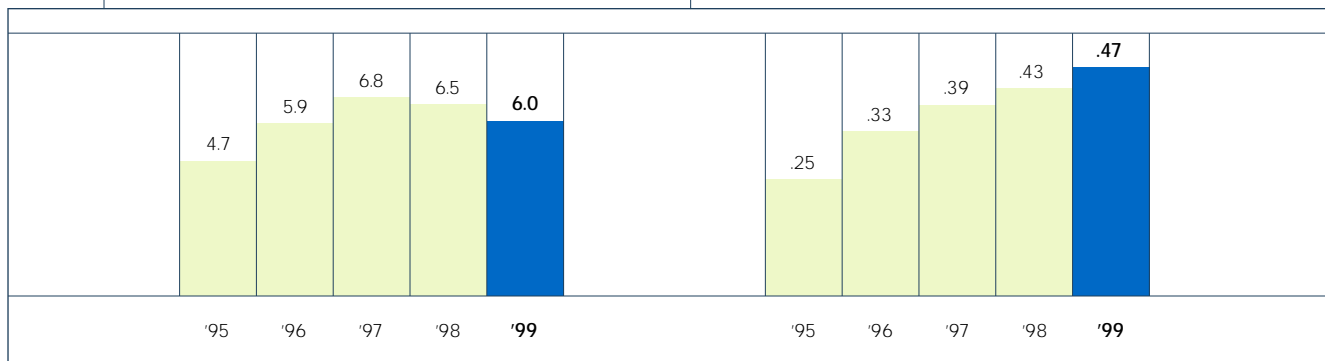
- > the Internet was creating not just new businesses, but new business models;
- > competitive advantage in the I/T industry was moving from creating technology to helping customers use it; and
- > with the rise of the networked world, the PC era was over.

There was some clucking about my PC era statement by the usual suspects, but amid the ups and downs of 1999, all three trends were confirmed and underscored in the marketplace.

ADJUSTED TO REFLECT A TWO-FOR-ONE SPLIT OF THE COMMON STOCK EFFECTIVE MAY 10, 1999

capital investments — \$ in billions

dividends — \$ per share



financial highlights

International Business Machines Corporation
and Subsidiary Companies

(Dollars in millions except per share amounts)	1999	1998
FOR THE YEAR:		
Revenue	\$ 87,548	\$ 81,667
Income before income taxes	\$ 11,757	\$ 9,040
Income taxes	\$ 4,045	\$ 2,712
Net income	\$ 7,712	\$ 6,328
Earnings per share of common stock—assuming dilution	\$ 4.12	\$ 3.29*
Earnings per share of common stock—basic	\$ 4.25	\$ 3.38*
Cash dividends paid on common stock	\$ 859	\$ 814
Per share of common stock	\$.47	\$.43*
Investment in plant, rental machines and other property	\$ 5,959	\$ 6,520
Average number of common shares outstanding (in millions)		
Assuming dilution	1,871	1,920*
Basic	1,809	1,869*
AT YEAR END:		
Total assets	\$ 87,495	\$ 86,100
Net investment in plant, rental machines and other property	\$ 17,590	\$ 19,631
Working capital	\$ 3,577	\$ 5,533
Total debt	\$ 28,354	\$ 29,413
Stockholders' equity	\$ 20,511	\$ 19,433
Number of employees in IBM/wholly owned subsidiaries	307,401	291,067
Number of common stock holders	646,702	616,800

*Adjusted to reflect a two-for-one split of the common stock effective May 10, 1999

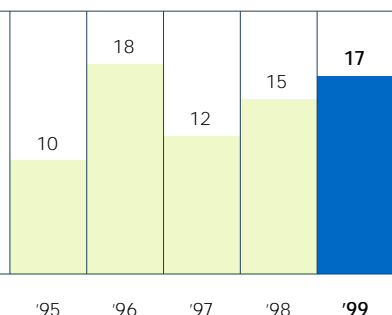
This year I'd like to mention three other important developments (actually, they are more like new realities) that are now taking hold:

> Up to now, the primary impact of e-business has been on individual companies. Now the Internet is reinventing entire markets – you might say, the very *idea* of a market. A few years ago, search engines took off because people needed help finding information on the Web. Then, as e-commerce

exploded, search engines morphed into portals, which helped people find not just information but also products and services.

Last year we began seeing entirely new business life-forms – companies that function not like traditional companies, because they don't make or sell anything themselves, but very much like markets. They help buyers find and qualify sellers. We call these "e-marketplaces" and "e-exchanges," and we already see them facilitating business-to-business

number of acquisitions



transactions in chemicals, steel, pharmaceuticals, industrial goods of all kinds, capital, even labor.

As they grow, e-marketplaces hold the potential fundamentally to change the dynamics of every industry, as they venture out into the global, borderless marketplace of the Internet, with millions of buyers looking for millions of sellers, and vice versa. IBM is already working with pioneers in this area, like SciQuest.com, e-Chemicals and PartMiner.

> **Market control is no longer a sensible or an achievable business goal.** I don't think this is fully understood by Wall Street. In the world we're now leaving – defined by the era of proprietary technology and computing architectures – customers were dependent on the providers of key pieces of technology. New iterations, new features came out when the provider decided they would.

The Internet changes all that. Customers, not technology providers, are in the driver's seat. No longer is it possible to operate a successful information technology company from the lab out; an e-business economy requires that we organize ourselves from the customer in. (And this applies not just to labs, but to garages. If what you want to do is get some cool new technology into the marketplace and then cash out, that's one thing. But if you want to build an enterprise that lasts, you've got to address some real customer need.)

Breakthrough technology is just as crucial as it ever was – but it doesn't confer control. For our industry, that changes everything. No technology company can any longer dream of coming up with

the magic bullet that will establish it as "the next IBM" or "the next Microsoft" – that is, sole owner of a key platform. I believe the wild market valuations of many dot-coms reflect the persistence of "Next Big Thing" thinking – the idea that one or more of these companies will lock up some controlling position. We're not managing IBM – or investing its resources – in the expectation of or hope for that kind of control. Instead, we're building an enterprise that will thrive in a more complex, interdependent and open world.

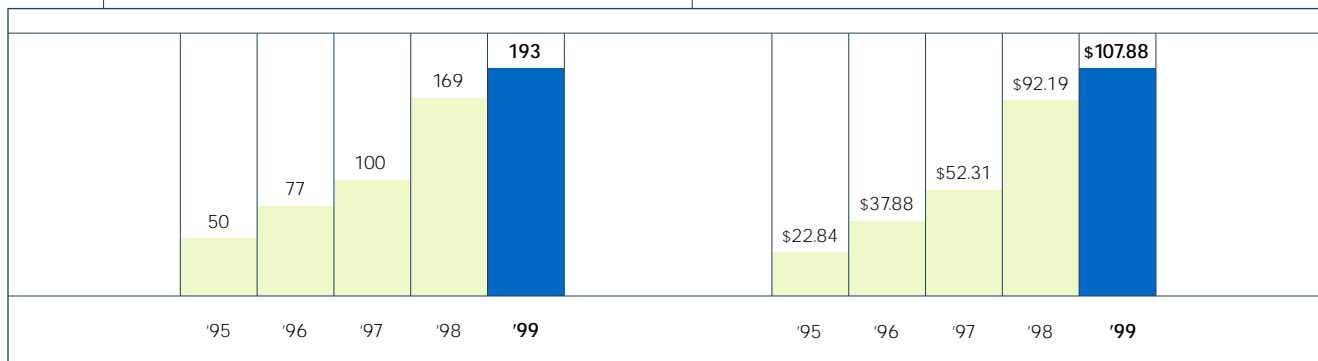
> **The intersection of societal issues and the Internet will force our industry to grow up – fast – and assume a new level of public responsibility.** It is disturbing to see many of the new members of our industry – and even some of the "old" ones – act as if the rest of society had no call on them. Yet modern history shows that when a new technology really matters, when it changes society in fundamental ways, the industry that pioneered it – be it telecommunications, energy, transportation or broadcasting – has always been called upon to take responsibility for those changes, for their impact on people and on the planet. If the industry doesn't, people do something about it – as they should – often through government intervention.

We are now at one of those inflection points. The Internet is driving everything our industry creates into every factory, store and office – and also into every home, classroom and voting booth. Crucial issues such as privacy, equal access, data security, national security, protection of children and

YEAR-END CLOSING PRICES ADJUSTED TO REFLECT A TWO-FOR-ONE SPLIT OF THE COMMON STOCK EFFECTIVE MAY 10, 1999

IBM market value – \$ in billions

stock performance



education are all profoundly affected by this onrush. In most cases, our technology is at once a threat and an important part of the solution.

The implications are clear. Our industry has a very limited opportunity to step up to these imperatives and demonstrate responsible leadership. Just as we are entitled to ask our public institutions to adjust to a world that runs at Web speed, so the information industries themselves must learn to define their ambitions with the broadest constituency – and longest time frame – in mind. The business of e-business is not the IPO; it's the future. At IBM, that's how we're shaping our business decisions and our actions in the ever-more-essential arena of Internet-driven public policy.

* * *

There has never been a headier time to run a business – or a more challenging one. For all its fluctuations, though, I find myself more optimistic than I have been in my seven years at IBM – and that optimism has been deepened by three lessons of 1999.

First, the global economy has proven a lot more resilient than many of the doomsayers predicted. A networked world, it turns out, cushions rather than amplifies local downturns.

Second, technology and technology professionals came through the challenge of Y2K with flying colors (including tens of thousands of IBMers who exemplified our company at its very best in the way they helped our customers and our

own company through this challenge). A year ago, a severe backlash against technology in the wake of Y2K seemed likely. Going forward, people will probably feel confident in I/T's ability to survive even the severest of threats.

But the biggest reason for my feeling of optimism about IBM's prospects is the change in IBM itself. In identifying and defining e-business, we have created a huge, entirely new kind of market for our goods, services and expertise – and we are stepping up to an entirely new set of challenges. We are reshaping our own company into a fundamentally different enterprise, what *Business Week* magazine recently called "The Biggest Dot.Com of Them All."

I don't make predictions. Even with 1999's uncertainties largely behind us, our industry, our economy, the developments in technology and the shape of the emerging global culture remain far too dynamic to predict outcomes. But I am certain of one thing that 2000 holds in store for IBM. This year we will attack our remarkable opportunities with a new level of aggressiveness.

Watch this space.



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

e-business is here.

e-business innovation center
atlanta georgia

To help customers take their franchises to the Net in a way that's smart, cool and consistent with their existing brands, IBM's growing global network of nine e-business Innovation Centers is staffed with experts in areas like interactive design, Web use analysis, portal personalization and data mining technologies for proactive selling.

A photograph of two women sitting on a rocky ledge, looking out over a vast mountain range. The woman on the left is wearing a red and black jacket and a patterned headband. The woman on the right is wearing a yellow and black jacket and a patterned headband. The background shows a clear blue sky and distant mountain peaks.

jagged edge mountain gear

www.jagged-edge.com
telluride colorado

Started by twins Paula and Margaret Quenemoen, this outerwear manufacturer and retailer turned to IBM's Small Business WebConnections service to get the same e-business edge as bigger competitors. The service provides a single, easy-to-install Internet connection – utilizing the toaster-sized Interjet from IBM's Whistle Communications – as well as registration of a dot-com name, business-class e-mail, firewall security and around-the-clock technical support. And it's all available as an inexpensive monthly service – so a major capital investment won't push *them* over the edge.



eToys
www.etoys.com
santa monica california

With no physical stores (but very big warehouses), eToys has become the Internet's largest seller of children's products. To make sure it can handle the traffic – even during those heavenly but scary holiday spikes – eToys uses NUMA (non-uniform memory access) servers pioneered by Sequent Computer Systems, which IBM acquired in July. Sequent's specialty is linking lots of Intel processors to operate as a single UNIX system.





post-PC design

raleigh north carolina

IBM's Industrial Design team is thinking "out of the box" – literally – to dream up and design new "Net appliances" for the post-PC age. As computing power moves to the network and touches our lives in myriad new ways, the venerable personal computer is morphing into a variety of specialized, ergonomic and inconspicuous "edge of network" computing devices. IBM's recent creations include concepts (shown clockwise, bottom-left to right) for an electronic newspaper (download, roll up and read anywhere); a PC in a hardhat with a built-in display and wireless Internet connection; and another you can strap over your shoulder.



ibm consulting group

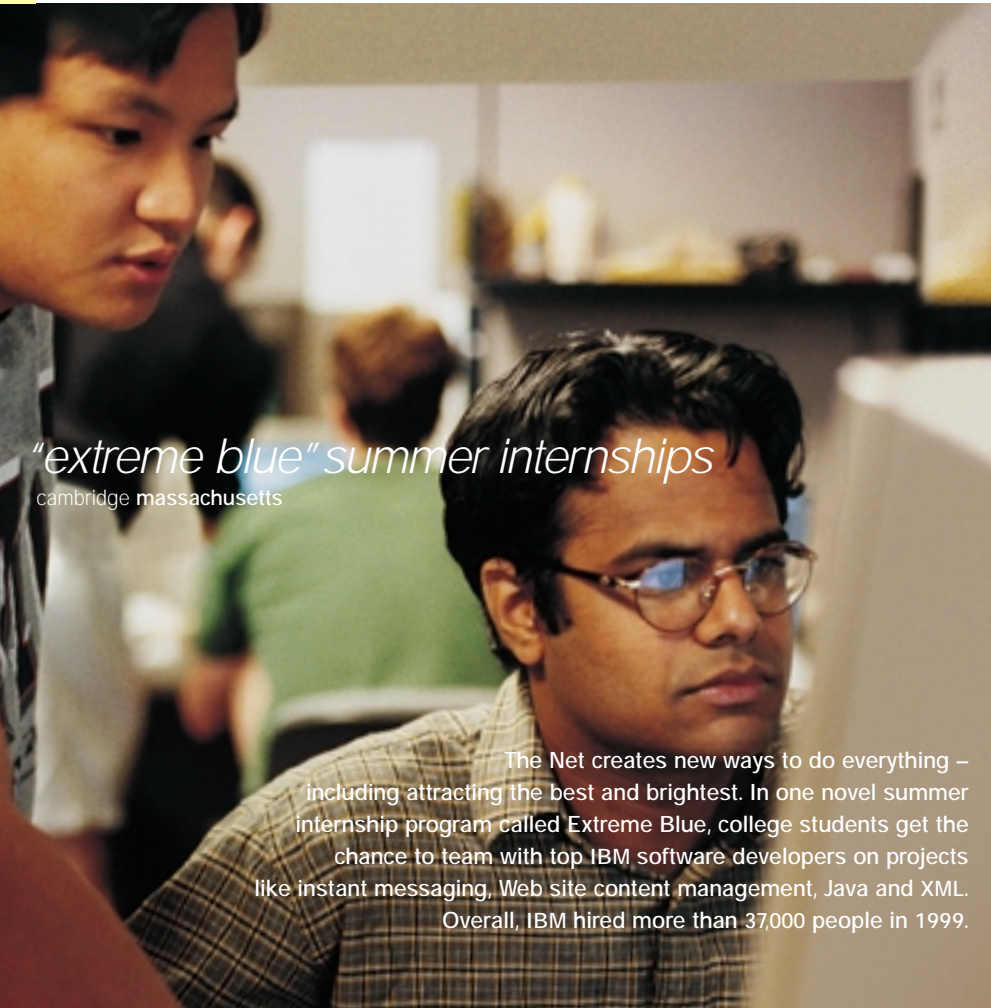
chicago illinois

Sometimes, the rush to the networked world takes on a "ready, fire, aim" quality. But if you're betting the ranch (or even a part of it) on a move to the Net, success requires a plan – and the expertise to implement it with speed and precision. With more than 65,000 consulting and systems integration practitioners, IBM is the world's number-one provider of e-business transformation services.



This January, 4,000 of IBM's 90,000 Business Partners – which now include Web integrators, software developers, Internet service providers, and application service providers, as well as retailers, distributors and remarketers – converged on San Diego to plan ways to grow the \$28 billion in IBM revenue they generated in 1999.





"extreme blue" summer internships

cambridge massachusetts

The Net creates new ways to do everything – including attracting the best and brightest. In one novel summer internship program called Extreme Blue, college students get the chance to team with top IBM software developers on projects like instant messaging, Web site content management, Java and XML.

Overall, IBM hired more than 37,000 people in 1999.



ibm.com call center

greenock scotland

Call centers – and the Net – make it easy for any customer to have a direct relationship with IBM. Recently, IBM's call centers – like this 60,000-square-foot facility, one of 24 worldwide – were integrated with Web-based sales and support. In 1999, IBM sold nearly \$15 billion over the Internet and handled 42 million Web-based self-service transactions.

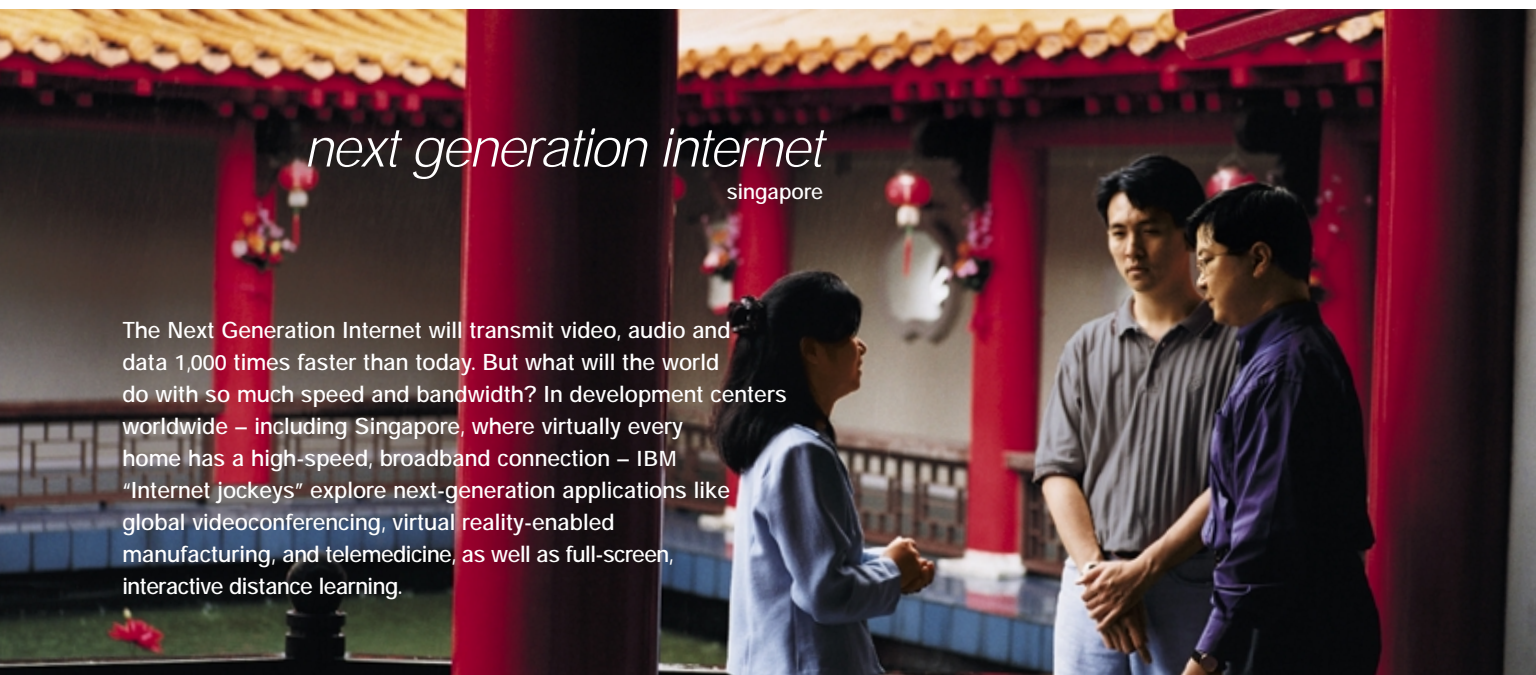




netfinity manufacturing

greenock scotland

Every important e-business application resides on some computer server, somewhere. This IBM manufacturing site turned out nearly half of the hundreds of thousands of Netfinity servers shipped to customers in 1999. Netfinity's ability to bring mainframe-style reliability to the red-hot market for servers based on Intel processors is one reason it increased its market share last year.



next generation internet

singapore

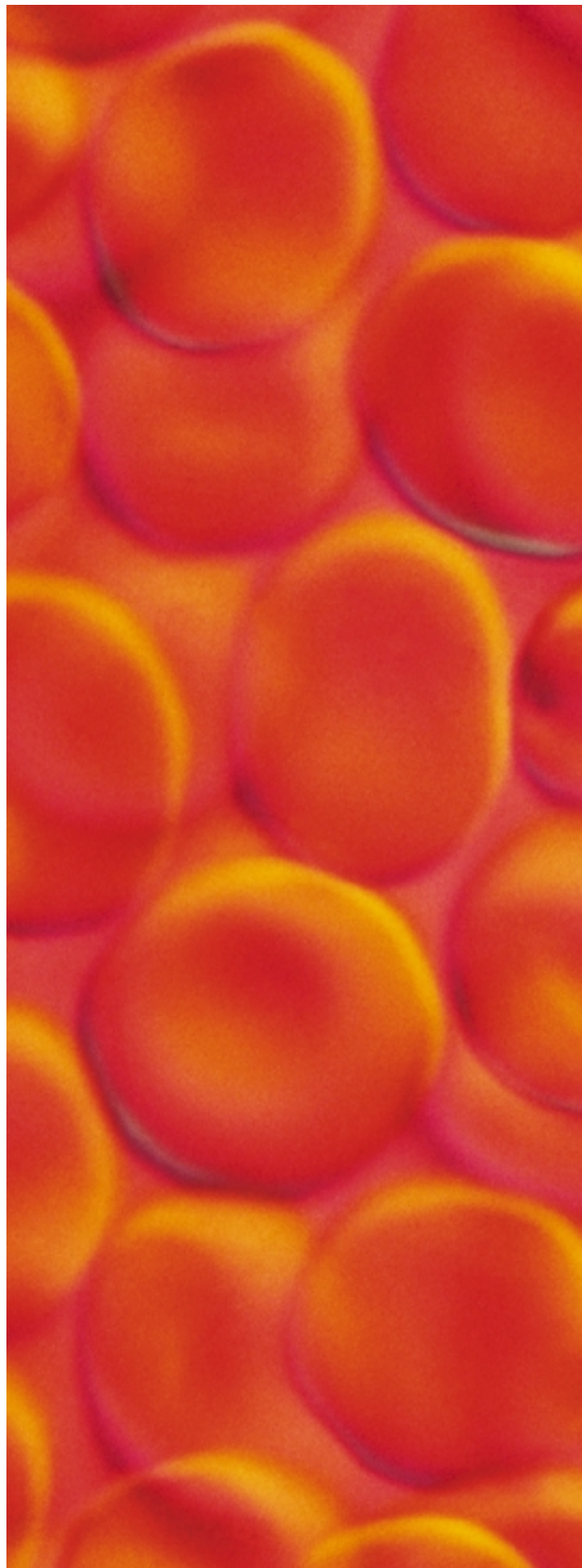
The Next Generation Internet will transmit video, audio and data 1,000 times faster than today. But what will the world do with so much speed and bandwidth? In development centers worldwide – including Singapore, where virtually every home has a high-speed, broadband connection – IBM “Internet jockeys” explore next-generation applications like global videoconferencing, virtual reality-enabled manufacturing, and telemedicine, as well as full-screen, interactive distance learning.

project blue gene

thomas j. watson research center
yorktown heights new york

How do subtle changes in the way proteins form turn otherwise normal red blood cells into cells that cause the condition known as sickle cell anemia? In December, IBM announced a \$100 million multiyear initiative to build a supercomputer powerful enough to explore such questions by simulating the “folding” of proteins into their complex, final shapes. Dubbed “Blue Gene” by IBM researchers, the computer may help unlock hidden causes of cancer, Alzheimer’s disease, cardiovascular problems, stroke or arthritis. Armed with that kind of information, scientists can then begin the search for new diagnoses and treatments needed for cures.

When completed, Blue Gene will be able to calculate at one “petaflop” (a quadrillion operations per second) – some 500 times more powerful than today’s fastest supercomputers. To achieve that kind of performance in five years (a full 10 years ahead of the information technology industry’s current rate of performance improvement), IBM is developing a new architecture that will be, appropriately, “self-healing” – so the system can overcome failures during the more than one year of computation needed to simulate the folding of just one protein.



A man in a dark suit and glasses is standing on an escalator, looking at a mobile phone in his hand. The background shows a large, modern building with a high, vaulted ceiling and a glass railing. The lighting is bright, suggesting an indoor or well-lit outdoor space.

banesto bank
madrid spain

Banesto's customers literally carry a full-service bank in their pockets. The first Spanish bank to provide secure electronic payments over the Web is now one of the first banks anywhere to enable Internet banking using the Wireless Application Protocol – the de facto global standard for Internet communications on wireless devices like cell phones.





international space station

220 miles straight up

There's an intranet in outer space, and it's controlled by IBM ThinkPads. Already on board the International Space Station, ThinkPads run everything from e-mail to tracking and rendezvous applications. Shown here is a component of the station, a connecting module, awaiting deployment from the Space Shuttle *Endeavour's* bay. IBM has been computing in space since *Explorer 1* in 1958 – participating in the Mercury, Gemini and Apollo missions, and the *Pathfinder* landing on Mars.

acorn
smart housing project
oakland california

Learning to read just got a little bit easier for 9-year-old Frank Martin, thanks to IBM's participation in an award-winning program designed to address issues like youth literacy and adult job training. Acorn's 293 families each get an IBM Network Station "thin client" computer and high-speed links to the Internet. And because challenges like these can't be addressed with information technology alone, IBM is also supplying educational consulting and customized courseware.



information security practice

amsterdam the netherlands

Nanette (top left window), Han (center) and Daniel (top right) are on the wanted list. Our customers pay them and their teams of industry specialists and "ethical hackers" to exploit business vulnerabilities and attack computer systems in order to stress-test company defenses and evaluate risks.

As security moves to the top of customers' agendas, with growing requirements to protect against theft, industrial espionage and fraud, IBM's information security practice is doubling its revenue annually.



Power4 chip testing

yorktown heights new york

IBM's top-of-the-line RS/6000 and AS/400 servers will sport a powerful – and identical – new brain in 2001. The Power4 will be IBM's first commercially available "gigaprocessor" – a chip with an internal clock speed of a billion cycles per second. It will feature improved bandwidth, as well as IBM invented technologies like copper interconnect and silicon-on-insulator.





e-business consulting
rio de janeiro brazil

With Internet use in Latin America growing faster than anywhere else in the world, Glauciene Bentes and the e-business consulting team in Brazil don't lack for opportunity. They have partnered with 24 companies that, using IBM technology, have developed some of the most innovative e-business sites in the country – from a virtual supermarket based in Minas Gerais to Boa Compra, a mega-boutique hosting 200 online shops.

Kevin Wilson
Director of Technology
YourLives.com

Christine Herron
Founder, Chairman and CEO
Mercury2, Inc.

internet startup incubator

palo alto california

In the lonely Web years before billion-dollar IPOs, most NetGen startups needed an angel. So why not a well-heeled angel in blue? IBM is partnering with Internet service provider Conxion to provide up to \$1 million in technology and services to selected Internet startups. The price? Nada. At the end of six months, the startups can buy or lease the equipment or walk away altogether.

Mark Cahsens
CEO
ebuddies.com

Shane McRann Bigelow
President and Chief Revolutionary
E-Pair.com

Christian Buckley
CEO
QOSES

David Allen
Business Development
ebuddies.com



network processor

burlington vermont

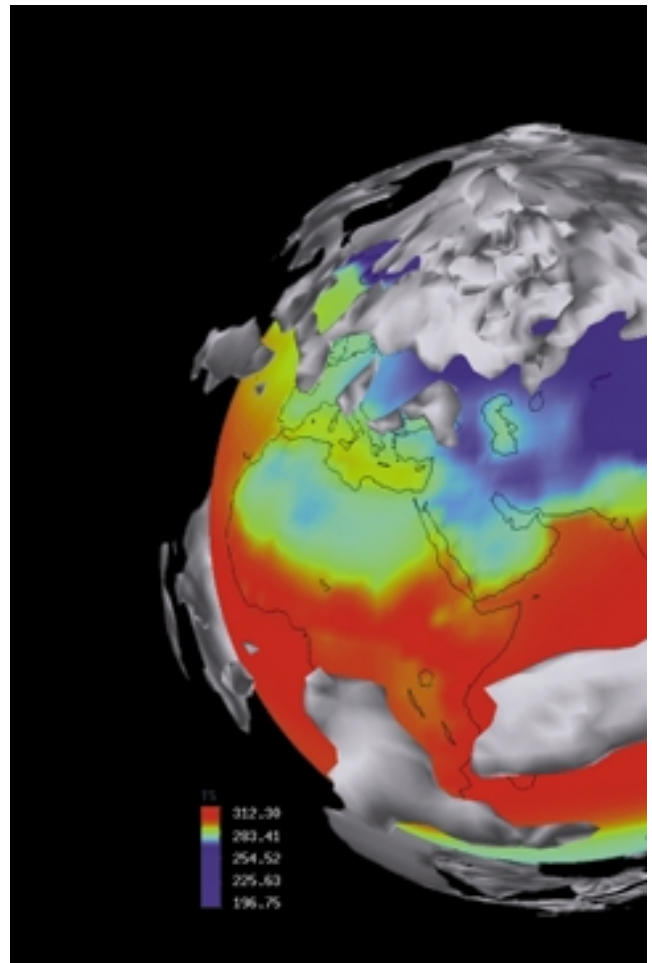
Meet the post-PC processor – faster, more adaptable and more upgradable. Specialized chips like these are needed in advanced communications equipment to manage applications like streaming audio and video at speeds far beyond the reach of traditional microprocessors. Here, chips etched on 8-inch wafers await final “dicing,” or cutting into hundreds of thumbnail-size processors.

*national center
for atmospheric research*

boulder colorado

As industrial pollutants continue to alter global chemistry in barely understood ways, predicting long-term climate changes could be key to preserving life on our planet. At the U.S.

National Center for Atmospheric Research, scientists are improving our odds with an IBM RS/6000 SP supercomputer that can calculate the interactions of thousands of variables (like ocean temperature, precipitation and ozone depletion) over extended periods of time. In this simulation, white areas of cloud cover float over warmer surface temperatures shown in red and yellow, and cooler areas in blue-green.



planetRx.com

anywhere

Since December, customers with handheld computers have been able to go to PlanetRx.com to order over-the-counter medications and other health and beauty products. IBM provides RS/6000 SP and Netfinity servers, DB2 Universal Database and WebSphere software, as well as the technology that translates information from Web format to one used on handheld computers, such as this IBM WorkPad.





det norske veritas

bergen norway

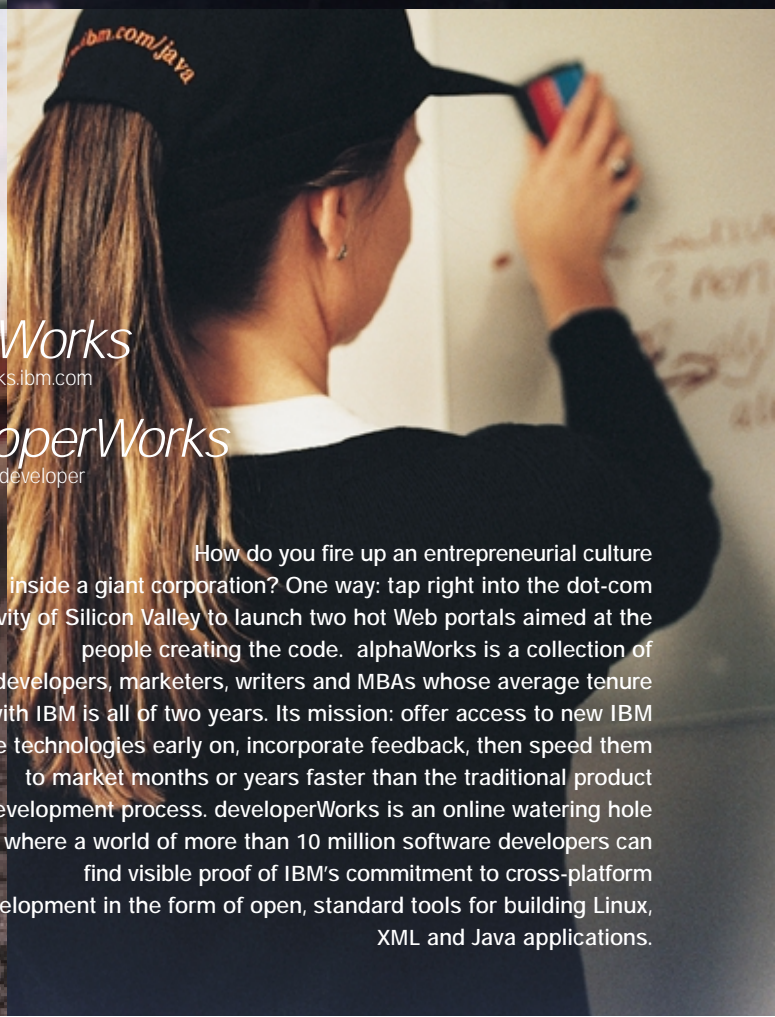
Why would anyone *wear* a computer? If you're an inspector for this Norwegian company that monitors the safety of large ships, it's because you need to access computer drawings, verbally enter evaluations and submit digital reports – even while your hands are busy wearing gloves or toting a wrench. This IBM prototype of a wearable PC features a tiny, headset-mounted display, IBM's Microdrive storage device, and ViaVoice speech recognition software – all in a belt-mounted package that weighs less than a pound.





alphaWorks
www.alphaWorks.ibm.com

developerWorks
www.ibm.com/developer
silicon valley



How do you fire up an entrepreneurial culture inside a giant corporation? One way: tap right into the dot-com creativity of Silicon Valley to launch two hot Web portals aimed at the people creating the code. *alphaWorks* is a collection of developers, marketers, writers and MBAs whose average tenure with IBM is all of two years. Its mission: offer access to new IBM software technologies early on, incorporate feedback, then speed them to market months or years faster than the traditional product development process. *developerWorks* is an online watering hole where a world of more than 10 million software developers can find visible proof of IBM's commitment to cross-platform development in the form of open, standard tools for building Linux, XML and Java applications.



e-business testing center

gaithersburg maryland

Enough fiber-optic cabling to stretch from Washington, D.C., to Los Angeles and back again; more than 10 billion instructions per second of processor capability; more than 40 terabytes of disk storage. It takes that kind of computing muscle to model customers' technology infrastructures, then stress-test them to see if they can handle day-to-day operations (or even the possibility of runaway success). That's why more than 500 customers have come to this IBM Testing Center – the largest such test bed in the world – to put their systems through the paces.





ford motor company
accelerated solution center
dearborn michigan

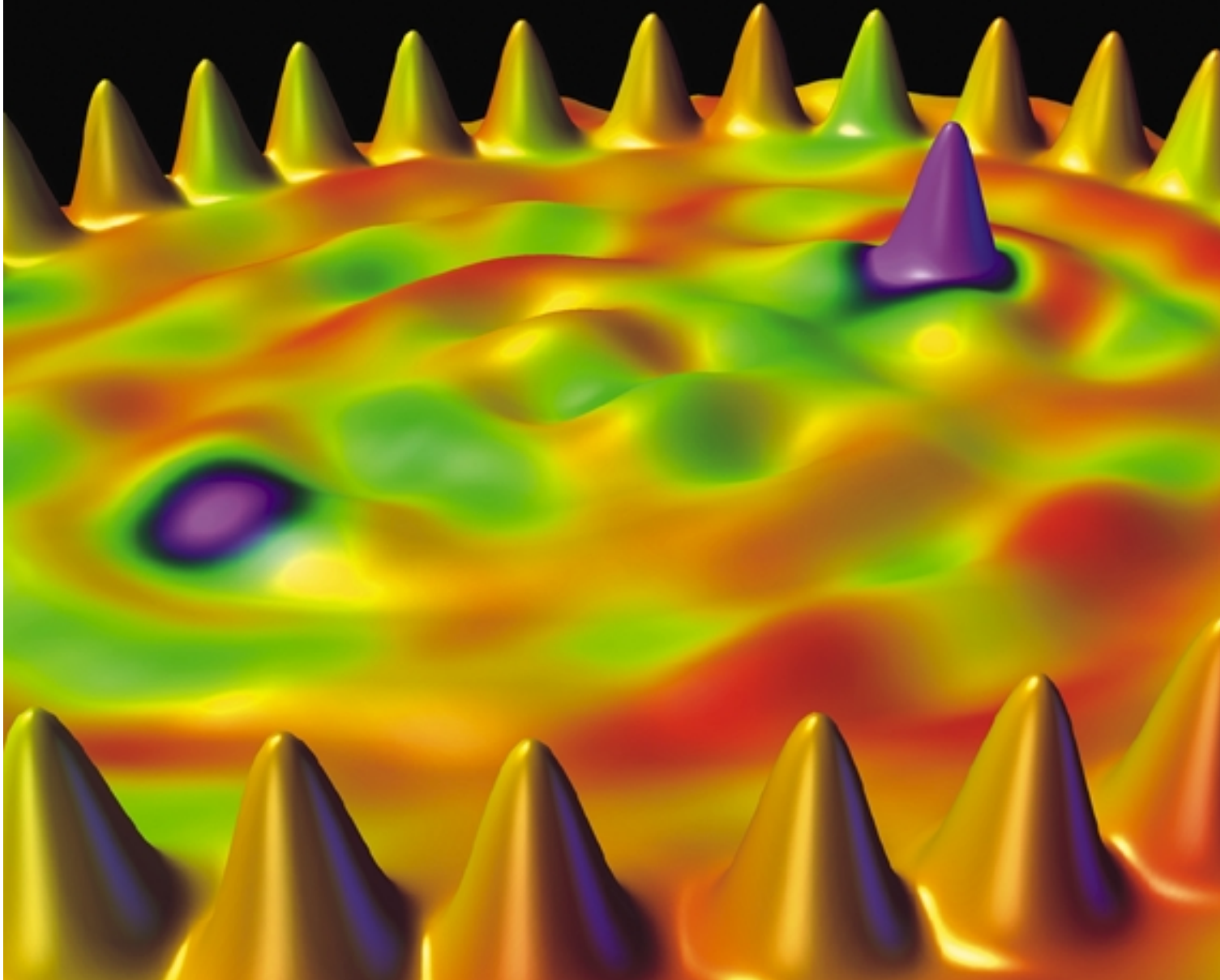
Ford's Accelerated Solution Center is a novel experiment that welds IBM and Ford programmers into tightly integrated teams to speed the development of e-business applications. Ford contributes automotive expertise and IBM brings its e-business knowledge. Part of a \$300 million services agreement, the approach has slashed Ford's software development time in half and cut costs by 30 percent.

quantum mirage

almaden research center
san jose california

It looks like a freeze-frame of a technicolor raindrop, taken milliseconds after impact — but it could someday lead to extraordinarily small computing devices a few nanometers (billionths of a meter) across. In February, three scientists at IBM's Almaden Research Center discovered a fundamental new way of communicating information on an atomic scale using a "quantum mirage." This scientific achievement, which projects information about one atom to a spot where no such atom exists, may make data transfer in nanoscale electronic circuits possible, enabling ever smaller, but more powerful, computers.

To demonstrate the effect, the research team used a Scanning Tunneling Microscope (a Nobel-prize winning IBM invention) to create a "quantum corral," the ring of yellow atoms partially visible here. When a cobalt atom (the tall magenta peak on the right) is placed at one focus of the ellipse, a smaller mirage appears at the other focus (the lower left magenta spot).



e-business is here. We're never going back.

the abc's of @

Having unleashed the e-business revolution, we at IBM take seriously our responsibility to help people understand it all. Here's a brief guide to help you sort through the vocabulary, history and unique culture of all things "e."

the "lingo"

B2B (adj.)

As in "Business-to-Business," the biggest and most lucrative e-business marketplace – pegged by industry consultant Gartner Group at nearly \$4 trillion by 2003, compared to estimates of \$380 billion for B2C (Business-to-Consumer).

clicks-and-mortar (adj.)

Also "clicks-and-bricks." A heretofore traditional (bricks-and-mortar) enterprise that "gets" the value of e-business and integrates its online and offline operations, creating benefits for each. For example, a customer who buys something from your online store might have the option of returning it either by visiting the physical storefront or by requesting a prepaid shipping label from the Web site.

e-line (n.)

You're said to be "above the e-line" if you operate on the Net. You're below it if you actually have physical stores, manufacturing facilities, distribution centers, etc. Since most enterprises are somewhere in between, we prefer the notion of an *e-zone*. Interestingly, travel through the zone is two-way – witness AOL's planned merger with Time Warner (a dot-com moving down through the zone to add physical operations and assets).

incubator (n.)

A startup nest – that is, a business or project that provides financing, technology, office space and marketing muscle to fledgling e-businesses, sometimes in exchange for equity in the new company. IBM's involvement in incubator programs, such as our joint venture with Silicon Valley Bank and Internet service provider Conxion, helps these NetGen companies get to market, and gives us an excellent early-detection system to spot technology trends and market directions.

infomediary (n.)

A service – usually a Web site – that brings together the latest information and prices from a variety of suppliers, and delivers them online to buyers. Quickly evolves into an "e-marketplace" (see "A Brief History of e"). For example, the infomediary SciQuest (www.sciquest.com) created an e-marketplace where researchers in the life sciences industry comparison shop for lab products with just a mouse click before placing an order. (Not to be confused with the less-appealing "infodromedary," an e-commerce site that may go for days without being updated.)

NetGen (adj.)

Short for "Network Generation." Applies to companies born during the explosive growth of the Internet and the Web. Easily recognized – until lately (see "clicks-and-mortar") – by names emblazoned with the insignias of the networked world – the ubiquitous "dot" and the mysterious "com."



a brief history of e [*then* -> *now*]

profit (n., v.)

The market valuations of many dot-coms notwithstanding, still a valid measure of business success.

stickiness (n.; from sticky, adj.)

In the Web world, sticky is good. A sticky site is one that attracts and keeps users. To make a site stickier, its creators may add personalization elements, online communities and discussion areas, user feedback, and extensive links.

vortal (n.)

Vertical portal. It provides all the features of a "portal" (a Web site for a general audience, with its own content and links to other sites – like Yahoo!), but for a specific audience, such as expectant parents, fly fishers, or steelmakers and their customers. Software developers, for example, go to sites like IBM's developerWorks (www.ibm.com/developer) to find resources, code and tools, and to swap ideas within a like-minded community.

wallet (n.)

A small software program that resides on your computer or a server, allowing you to e-shop till you drop. The wallet usually consists of encryption software that can hold your already-submitted payment information (such as credit card or online account), a digital certificate to identify and protect you, and even the address where you'd like your purchase sent. Wallets speed the process and eliminate buyer frustration, thereby increasing sales.

client/server -> Internet

In the mists of time (less than a decade ago), the information technology industry made a big promise. It was called client/server – and it described seamless connections and communication among all kinds of disparate computing platforms. It didn't happen. The promise of "any client to any server" proved to be far more costly and difficult to implement than anyone expected. Then, along came the Internet and its open communications protocols. Almost before we noticed, the long-awaited promise of any-to-any connectivity materialized – not just among computers, but also among the people and the enterprises that use them.

big iron -> strong iron

How big are mainframes these days? Smaller than you might think, and far more powerful than just a few years ago. Recast in the Net world as enterprise servers, they are about the size of a refrigerator, but nearly 30 times more powerful – as measured in MIPS (millions of instructions per second) – than just five years ago. And enterprises turning into e-businesses are finding more value for these powerful servers than ever before, using them both to host existing systems and applications, and to integrate those with their new online offerings for customers, suppliers and employees.

hard drives -> microdrives

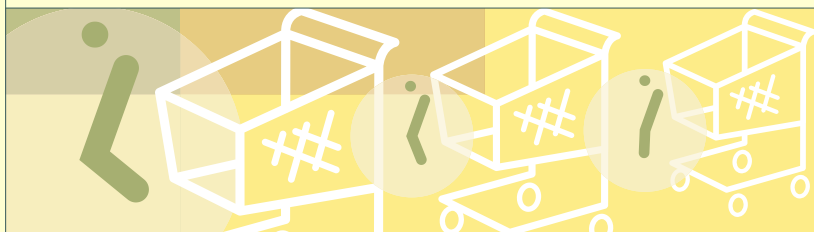
IBM makes, and sells, a lot of hard disk drives, many to our competitors in the PC market. (We're flattered that they want to pay us for better hardware.) We've also been shipping our tiny-but-powerful 340-megabyte Microdrive to such customers as Kodak, Samsung, Hitachi and other leaders in the consumer electronics field. Just a little over an inch square, the Microdrive can hold 1,000 digital compressed photos, six hours of CD-quality music, or the equivalent of 300 novels.

trading hours -> friction-free markets

The closing bell says it's time for people to go home. But their money wants to hang out and play some more. Pure demand, unhindered by distance or time differences, can set prices on the Web while we sleep, and sellers don't need to wait for a phone call or a fax to hear from the market. Online brokerages and computerized exchanges already do big business in after-hours trading, and other marketplaces – for parts, supplies, services, you name it – are starting to follow suit.

e-businesses -> e-marketplaces

Today, the company. Tomorrow, the industry. Once a business e-enables its operations, it can find itself in new terrain, where all its competitors and customers are also operating as e-businesses. At that point, "buy, sell, trade online" doesn't apply just to stocks and bonds, but to every transaction in which an enterprise engages. Airlines and hotels are already auctioning off unsold seats and rooms via Web sites; universities are accepting online bids for tuition to fulfill their enrollment targets. And consolidators and infomediaries are bringing all parties together, with up-to-the-minute bids, prices and availability information. Markets become more liquid and efficient, and obstacles like time and geography become so... 20th century.



1999: *the highlights*

our portfolio

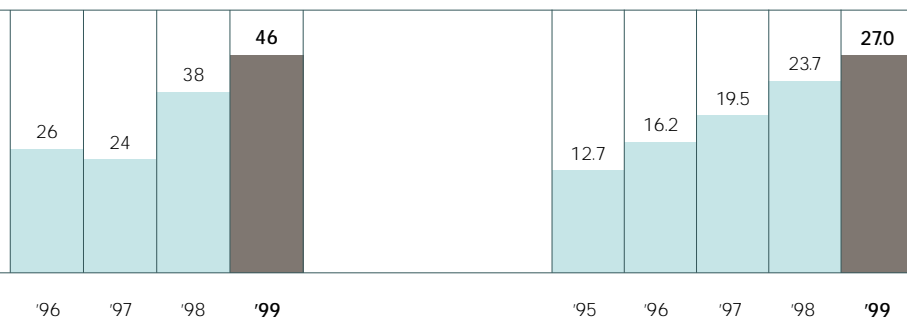
services

In 1999, IBM extended its lead as the world's largest provider of I/T services. Revenue grew 11 percent; customers committed to more than \$38 billion in new contracts, and the backlog of engagements (work we'll do and be paid for this year and into the future) grew 18 percent to more than \$60 billion.

And in the most explosive segment of the marketplace – **e-business services** – revenue increased 60 percent, to more than \$3 billion. Factor in all the other services revenue that can be attributed to e-business – from consulting, business intelligence and strategic outsourcing – and our e-business services revenue easily doubles.

number of signed strategic outsourcing contracts valued at more than \$100 million

services revenue – [excluding maintenance, \$ in billions



enterprise and personal systems

Customers ordered record server processing capacity in 1999. We also took some major steps toward building for the future, introducing new high-performance servers and acquiring two companies with strategic technologies. Sequent Computer Systems strengthens the high end of our Web server line, while Whistle Communications' elegant "thin server" technology is a key feature of our e-business offering for smaller enterprises. Among the other high points:

- > Added **hundreds of ISV applications** to our platforms.
- > Made the industry's most sweeping commitment to **drive the Linux operating system** across all our server lines.
- > **Increased share of the 500 most powerful supercomputers** in the world by 36 percent, establishing IBM as the leader in high-performance computing in 1999.
- > Replaced Compaq in 1999 as the #2 mobile PC vendor in the world. **ThinkPad unit volumes grew 50 percent faster** than the industry.

- > Most important, we came on strong in **three strategic segments**:

UNIX : RS/6000 S80

Debuted in September as the world's fastest e-business UNIX server. Customers purchased as many S80s in its first three months as Sun shipped of its competitive product in its first 18 months.

High-end storage : Shark

Shipped more than 1,000 units within the first 100 days of its introduction, and penetrated half of the Fortune Global 100.

Intel-based servers : Netfinity

Increased shipments by more than 30 percent and gained market share.

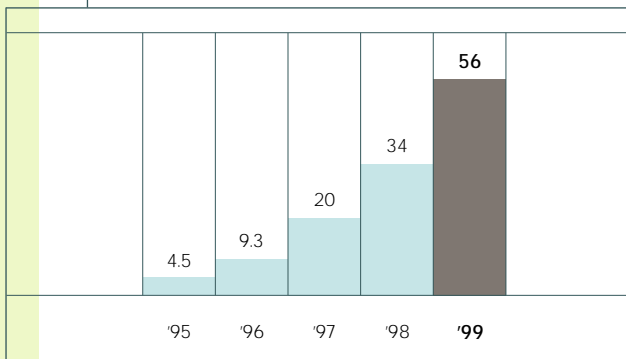
software

IBM middleware, a key component in building current and next-generation e-business solutions, grew in double digits and faster than the industry. Our strategic e-business middleware products on UNIX, Windows NT and other fast-growing platforms grew significantly:

	revenue growth rate ('98/'99)	industry growth rate
Tivoli Systems Management:	34%	20%
Business Integration Software (MQ Series):	96%	53%
Database Products:	56%	16%
Web Application Servers:	59%	25%

- > **40 percent of the top 100 retailers** in the world use IBM's WebSphere Commerce Suite to drive their e-tail sites.
- > IBM has an unmatched collection of professionals devoted to advancing open Internet standards and applications – more than **500 XML**, **600 Linux**, and **4,000 Java professionals** worldwide.

Lotus Notes seats – [in millions

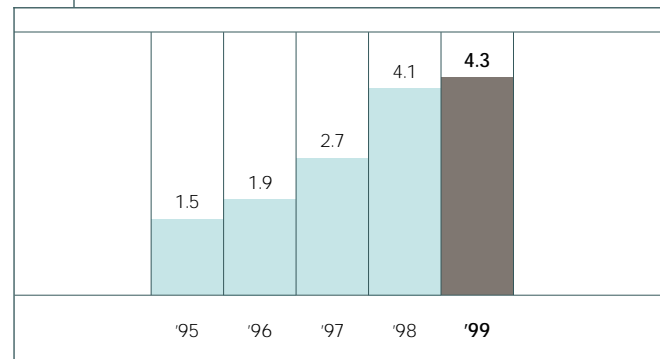


oem

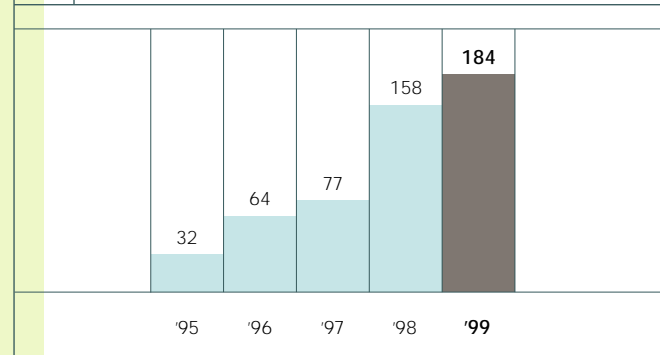
Overall, OEM hardware revenues – from sales of components and finished products to other high-tech companies – increased 15 percent to \$7.8 billion last year. That does not include the vast majority of revenues from five major OEM contracts signed in 1999, which are forecast to deliver \$30 billion over five to seven years.

- > Shipped more than **2 million copper chips** since their introduction in 1998.
- > Led the industry with more than **40 percent of the mobile hard disk drive (HDD) market**. Introduced the industry's highest-capacity mobile HDD at 25 gigabytes.

OEM storage revenue – [\$ in billions



number of custom microchip designs for customers



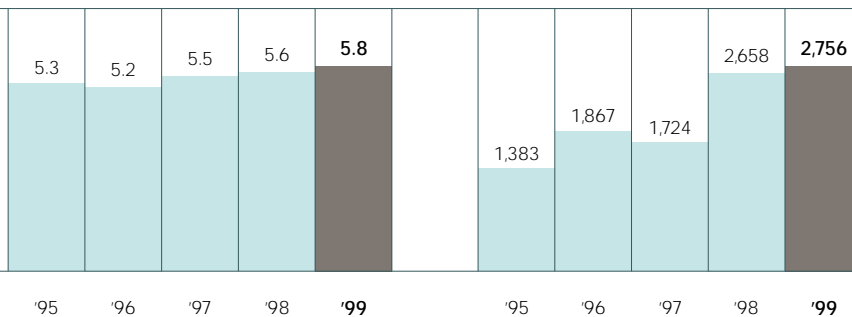
research and development

At our core, we are a technology company. In 1999, the industry's greatest foundry of technical innovation achieved breakthroughs ranging from **new world records in magnetic storage densities to the creation of transistors made of organic materials**. These transistors could lead to products like flat-panel computer displays that you can fold and put in your pocket.

For the seventh consecutive year, IBM's technical community led the world in U.S. patent awards, with 2,756 – 900 more than the second-place finisher. Our intellectual property portfolio earns IBM more than \$1 billion in licensing royalties, in addition to securing our technical leadership now and for years to come. In fact, **one-third of the technologies we patented in 1999 are already in the marketplace**.

research and development investments – [\$ in billions

total number of patents



pervasive computing

Pervasive computing is the inevitable extension of the networked world. It describes a mosaic of computing that extends beyond traditional computers and PCs to include an array of small computing devices like handheld computers and intelligent cell phones, as well as lots of everyday things – from household appliances to clothes and machine tools – all containing a little embedded computing and networking capability.

In 1998, pervasive computing was largely a strategic vision. In 1999, that vision became reality. **Last year, IBM signed nearly 250 pervasive computing-related contracts, with more than 100 customers**, for revenue in excess of a quarter of a billion dollars. We are helping **Vodafone AirTouch** – to build and run a global Internet portal that will allow its customers to use a variety of wireless devices to access content and services over the Net. For **Swissair** we are developing an application that

will allow passengers to check in from their mobile phones.

Of these engagements, **more than 60 percent were signed in the last four months** of the year, demonstrating that our customers are now starting to make investments in extending their e-businesses to the universe of new computing devices – like cell phones and palmtop organizers – which already outsell personal computers three to one.

our transformation

Last year, we made important progress toward our goal of transforming IBM into a premier e-business. Sales of products and services over *ibm.com* averaged \$40 million a day for the full year, and \$50 million a day in the fourth quarter.

IBM e-procurement web purchases – \$ in billions | e-commerce revenues – \$ in billions



e-care for customers

QUESTIONS AND PROBLEMS RESOLVED VIA *IBM.COM*

1998: 14 million
1999: 42 million

COST AVOIDANCE

1998: \$ 300 million
1999: \$ 750 million

supply chain management

On-time delivery improved by up to **95 percent**, and the time from order entry to delivery for some products has been reduced to two days.

distributed learning

More than **25 percent** of internal training was delivered via distributed learning to nearly **135,000 employees**, producing cost avoidance and productivity gains of more than \$200 million.

e-care for business partners

Partners generated more than half of all IBM e-commerce revenues. More than **14,000 partners** used *ibm.com* to access product and marketing information.

21st century alliances

To ensure that we will participate in the explosive growth of e-business services – projected to represent nearly 60 percent of the total e-business opportunity by 2003 – we're striking alliances with hundreds of Internet service providers, application service providers, independent software developers and professional services firms such as Web integrators.

More than 850 Web integrators – like USWeb/CKS, Razorfish, US Interactive, Rare Medium and Viant – signed on with us in 1999. Among independent software providers, we established much stronger relationships with SAP, Siebel Systems and i2 Technologies for enterprise resource planning, customer relationship management, and supply chain management solutions.



U.S. President Bill Clinton and IBM Chairman Lou Gerstner
National Education Summit
IBM Executive Education Center
Palisades, New York September 1999

“The time for analysis and evaluation has passed”

With those eight words in his address at the 1999 National Education Summit, IBM Chairman and CEO Lou Gerstner crystallized why there is no going back on the issue of world-class standards as the catalyst for reform in America’s public schools.

The 1999 Summit was the second national conference in three years on the issue of raising academic performance and student achievement in K-12 public education in America. Both were held at IBM’s Executive Conference Center in Palisades, New York, and both were co-chaired by Gerstner.

Driving high-quality public education is just one manifestation of IBM’s long-standing commitment to the communities that sustain our operations and our families. Through a \$40 million grant program called Reinventing Education, we apply advanced information technologies and the expertise of some of our top technologists to improve learning. In recent years, the program has expanded to include schools in seven other countries, including a 1999 grant in the United Kingdom.

While education is our most visible philanthropic endeavor, we’re far from single-minded about our responsibilities as a good corporate citizen. In the U.S. portion of the largest-ever survey on the role of business in society, consumers identified IBM as the company that best exemplifies effective corporate citizenship.

In 1999, IBM dedicated more than \$116 million to programs that assist people in need. Individual IBM employees added another \$25 million through matching grants and donations to nonprofit organizations and educational institutions. And they gave

even more – volunteering more than 4 million hours of their own time to local causes.

We are a company with a commitment to a culture of inclusion, one that draws on the talents of a workforce as broad and diverse as the markets we serve in more than 160 countries worldwide. In 1999, the number of minority executives in the United States increased by 31 percent. Women executives across IBM increased by 27 percent, and in March of this year the company was recognized by highly regarded Catalyst, Inc. for its leadership in advancing the careers of women throughout our workforce.

Hosting the 1999 National Education Summit is completely consistent with the commitment to community leadership. Nobody – at least none of the realists – believes the transition from low standards to high standards will be easy, or that it will be made without painful consequences in the short term, as schools step up and end practices like social promotion.

Yet when the Summit adjourned, governors from across the United States – along with business leaders, educators and representatives of both major teachers’ unions – had done two things: reaffirmed their commitment to high academic standards as the starting point for reform; and committed to execute a specific set of priorities – with deadlines – to move schools toward the goal of dramatically improved student achievement.

“We can’t cut and run when some students can’t meet the standards. We have to redouble our efforts and provide the help they need,” Gerstner said. “We have to have some faith in our children and our teachers. They’ll deliver. It’s up to us to give them the chance.”

company mission

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.



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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,

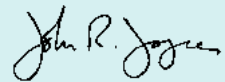
translated into numerous languages, are distributed to employees throughout the world, and reemphasized through internal programs to assure that they are understood and followed.

PricewaterhouseCoopers 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.



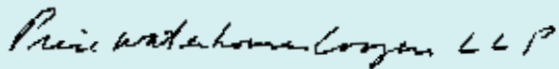
Louis V. Gerstner, Jr.
Chairman of the Board and
Chief Executive Officer



John R. Joyce
Senior Vice President and
Chief Financial Officer

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

In our opinion, the accompanying consolidated financial statements, appearing on pages 64 through 93, present fairly, in all material respects, the financial position of International Business Machines Corporation and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. 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 auditing standards generally accepted in the United States, 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.



PricewaterhouseCoopers LLP
New York, New York
January 19, 2000

Overview of 1999

IBM's financial performance reflects two very different halves of 1999. The company's performance in the first half was strong. The second half was hit hard by Y2K-related issues, as many of its large customers locked down their systems and technology purchases heading into the Y2K transition. Despite the difficult second half, the overall year was a good one for the company. Revenue, net income and earnings per share were at record levels. The company also had good results on a full-year basis in the strategic growth areas of services, software and original equipment manufacturer (OEM) technology.

The company reported revenue of \$87.5 billion and net income of \$7.7 billion which yielded \$4.12 per diluted common share. The results include an after-tax benefit of \$750 million, or \$.40 per diluted common share, for a gain from the sale of the company's Global Network to AT&T, charges for actions intended to improve the long-term competitiveness of the company, a change in personal computer depreciable lives and charges for acquired in-process research and development related to acquisitions.

The company ended 1999 with cash and cash equivalents and marketable securities of \$5.8 billion, after funding investments of approximately \$20 billion in capital expenditures, research and development, strategic acquisitions and repurchases of common stock. The company's debt ratios were well below 1998 levels. The non-global financing debt-to-capital ratio was 9 percent, and the Global Financing business leverage was 5.5 to 1.

Challenges

The company believes that it has passed the most critical stage of Y2K. However, because it expects the lockdowns to be lifted at different times by different customers during the early part of 2000, the company will feel the lingering effects of Y2K.

Consistent with the fundamental strategy that it put in place several years ago, the company is well positioned to help its customers build integrated e-business solutions. Services, software and OEM technology that are required for this demanding e-business environment will drive the growth in IBM's revenue and earnings.

In addition, the company is aggressively pursuing expanding markets. By increasing sales and distribution through ibm.com, the company will continue to build itself into a leading e-business company.

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 be materially different, 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 1999 Form 10-K to be filed on or about March 13, 2000.

Results of Operations

(Dollars in millions except per share amounts)	1999	1998	1997
Revenue	\$ 87,548	\$ 81,667	\$ 78,508
Cost	55,619	50,795	47,899
Gross profit	31,929	30,872	30,609
Gross profit margin	36.4%	37.8%	39.0%
Total expense	20,172	21,832	21,582
Income before income taxes	\$ 11,757	\$ 9,040	\$ 9,027
Net income	\$ 7,712	\$ 6,328	\$ 6,093
Earnings per share of common stock— assuming dilution	\$ 4.12	\$ 3.29	\$ 3.00
Earnings per share of common stock—basic	\$ 4.25	\$ 3.38	\$ 3.09

Revenue in 1999 grew 7.2 percent. Growth in Global Services, personal computers, microelectronics and middleware software products drove the increase, partially offset by lower server revenue.

management discussion

International Business Machines Corporation
and Subsidiary Companies

The following table identifies the company's percentage of revenue by category:

	1999	1998	1997
Hardware	42.3%	43.4%	46.7%
Global Services	36.7	35.4	32.1
Software	14.5	14.5	14.2
Global Financing	3.6	3.5	3.6
Enterprise Investments/Other	2.9	3.2	3.4
Total	100.0%	100.0%	100.0%

The overall gross profit margin of 36.4 percent decreased 1.4 points from 1998, following a 1.2 point decrease in 1998 versus 1997. The company's continued shift in revenue to Global Services primarily drove the decline. Global Services has a lower gross profit margin than the company's server products (S/390, AS/400, RS/6000 and NUMA-Q), which are a declining percentage of total revenue.

Revenue for 1999 from the company's end-user businesses totaled \$38.8 billion from the Americas, an increase of 5.2 percent (7 percent increase in constant currency) from 1998. Revenue from Europe/Middle East/Africa was \$25.7 billion, up 1.8 percent (6 percent increase in constant currency). Asia Pacific revenue increased 19.4 percent (8 percent increase in constant currency) to \$15.2 billion. OEM revenue was \$7.8 billion, a 15.3 percent increase (14 percent increase in constant currency) compared with 1998.

Information about the company's operating segments can be found in note Y, "Segment Information," on pages 89 through 93. This note provides additional information, including a description of the products and services of each segment, as well as financial data pertaining to each segment.

The following discussion is based on the Consolidated Financial Statements on pages 64 through 68, which reflect, in all material respects, the company's segment results on an external basis.

Hardware

(Dollars in millions)	1999	1998	1997
Revenue	\$ 37,041	\$ 35,419	\$ 36,630
Cost	27,071	24,214	23,473
Gross profit	\$ 9,970	\$ 11,205	\$ 13,157
Gross profit margin	26.9%	31.6%	35.9%

Hardware revenue increased 4.6 percent from 1998, following a decline of 3.3 percent in 1998 versus 1997. Hardware gross profit dollars declined 11.0 percent from 1998, following a decrease of 14.8 percent in 1998 from 1997.

Technology revenue increased 5.9 percent when compared with 1998, following an increase of 7.3 percent in 1998 versus 1997. Strong growth in OEM technology, primarily custom logic and high-performance static random access memory (SRAM) revenue drove the increase in 1999 revenue. A slower growth rate in hard disk drive (HDD) storage revenue in 1999 versus 1998 reflected pricing pressures and a revenue mix away from high-end products. Lower revenues from storage tape and direct access storage device (DASD) products, as well as lower networking hardware revenue, partially offset those increases. The networking hardware decreases resulted, in part, from the sale of routing and switching intellectual property (IP) to Cisco Systems, Inc.

The company took actions in 1999 in the microelectronics and storage areas that are aimed directly at strengthening the Technology Group over the long term. Those actions are intended to shift the focus of the Technology Group to higher margin businesses and more efficient operations. (See note R, "1999 Actions," on pages 81 and 82 for additional information.)

Strong growth in HDD storage products, storage tape products and growth in custom logic products drove the revenue increase in 1998 versus 1997. Lower revenue from dynamic random access memory (DRAMs) and DASD sales partially offset this revenue growth.

Personal Systems revenue grew 19.7 percent in 1999 from 1998, following a 10.9 percent decline in 1998 versus 1997. Despite continued pricing pressures, personal computer revenue improved in 1999. Supply shortages of flat-panel displays in the second half of 1999 constrained sales of ThinkPads, although overall ThinkPad revenue was good. Netfinity servers demonstrated strong revenue growth, compared with 1998 levels. The company continues to focus on expanding its direct channel customers; improving its indirect channel efficiency; increasing its attention on fast-growing, small- and medium-size businesses; and realizing more opportunity in businesses that are tied to the personal computer, including services, software and financing.

Server revenue declined 17.9 percent in 1999 from 1998, following a decrease of 5.9 percent in 1998 versus 1997. S/390 revenue declined in 1999 as customers completed the task of making Y2K ready the mainframe computers that they use in data centers to run mission critical, highly integrated enterprise-wide applications with large transaction volumes. Once the systems were Y2K tested and ready, customers were not inclined to enhance them because of concerns about affecting their Y2K readiness. AS/400 revenue declined due to a slow-down in sales related to Enterprise Resource Planning (ERP) solutions because of Y2K concerns. RS/6000 revenue declined for SP-2 and entry models, partially offset by the enterprise servers which had strong revenue growth in 1999.

Lower revenue from S/390, AS/400 and RS/6000 drove the 5.9 percent decrease in revenue in 1998 versus 1997. While S/390 revenue declined, total delivery of computing power increased more than 60 percent as measured in MIPS (millions of instructions per second) versus 1997. Product transitions late in 1998 affected the revenue for AS/400 and RS/6000 in 1998 versus 1997.

In January 2000, the Server Group reorganized to become the Enterprise Systems Group and adopted a market-centric alignment to help customers connect and integrate S/390, AS/400, RS/6000, NUMA-Q and Netfinity servers to support a wider variety of applications. The reorganized group will focus on cross-server customer requirements for Web servers, enterprise servers, mid-market servers, and for storage sub-systems across all computing environments.

During the year, the company signed major technology contracts with Dell Computer Corporation (for the purchase of personal computer parts from the company over seven years), Acer Incorporated (technology purchase contract over seven years), EMC Corporation (five-year strategic technology and business alliance), Cisco Systems, Inc. (technology purchase over five years) and Nintendo Company, Ltd. (multi-year contract to purchase technology). The total of these contracts could be in excess of \$15 billion.

Hardware gross profit dollars decreased 11.0 percent in 1999 from 1998, following a 14.8 percent decrease in 1998 versus 1997. In 1999, the shift in the company's revenue away from servers, pricing pressures associated with HDDs and memory

chip prices drove the declines in gross profit dollars from 1998. A lower model mix in the mobile HDDs (in which some customers are meeting their capacity needs with new mid-range products, rather than with the more profitable high-end mobile products) also had a negative effect on gross profit dollars. The decline in gross profit dollars in 1998 was primarily driven by lower margins associated with significant price reductions in Personal Systems products.

Hardware gross profit margin decreases in 1999 versus 1998 and 1998 versus 1997 continued to be driven by the shift in the company's revenue away from servers to lower gross profit products, such as personal computers, OEM chip technology and HDDs, as well as price pressures.

Global Services

(Dollars in millions)	1999	1998	1997
Revenue	\$ 32,172	\$ 28,916	\$ 25,166
Cost	23,304	21,125	18,464
Gross profit	\$ 8,868	\$ 7,791	\$ 6,702
Gross profit margin	27.6%	26.9%	26.6%

Global Services revenue increased 11.3 percent in 1999 from 1998 and 14.9 percent in 1998 over 1997. Revenue growth in 1999 without the effect of the sale of the company's Global Network to AT&T would have been 13 percent. (See note D, "Acquisitions/Divestitures," on pages 72 and 73 for additional information about this sale.)

While maintenance revenues declined 1 percent, reflecting continued price pressures as customers transitioned to new technologies, services revenue excluding maintenance and the effect of the sale of the Global Network grew 17 percent. Strategic Outsourcing Services was a major contributor to this performance. Strategic Outsourcing Services creates business value through long-term strategic partnerships with customers by taking on responsibility for their processes and systems. Business Innovation Services (formerly Systems Integration and Consulting) and Integrated Technology Services (formerly Product Support Services) performance was strong through the first nine months of 1999 but slowed in the fourth quarter due to the effect of Y2K-related customer lockdowns and a slow-down in Y2K services.

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Toward the end of the third quarter of 1999, the company started to see a decline in demand for Y2K services and expects the effect of Y2K to linger into 2000 as the need for those services disappears. The company sees growing demand for new services offerings especially in Business Innovation Services, which provides business/industry consulting and end-to-end e-business implementation of offerings like Supply Chain Management, Customer Relationship Management, Enterprise Resource Planning and Business Intelligence. Integrated Technology Services offers customers a single IT partner to manage multi-vendor IT systems complexity in today's e-business environment, including traditional offerings like Product Support Services, Business Recovery Services, Site and Connectivity Services and Systems Management and Networking Services.

e-business spans many of the Global Services offerings and contributed significantly to 1999 performance. e-business services offerings include: e-business strategy and planning; e-commerce services for Web selling, e-payments, e-procurement, security and privacy; e-business enablement services; distributed learning; and hosted business applications such as network-delivered applications, Web hosting and Web infrastructure outsourcing. The company's total discrete e-business services revenue grew 60 percent to over \$3 billion in 1999. Revenue from Web hosting and e-business infrastructure services doubled over 1998 and revenue from supply chain and e-procurement services tripled.

In 1999, the company signed contracts totaling over \$38 billion, including 46 deals in excess of \$100 million with four of those deals in excess of \$1 billion. These deals contributed to a services backlog at December 31, 1999, in excess of \$60 billion compared with \$51 billion at December 31, 1998. In addition to these contracts, the company signed two extensive strategic alliances with Dell Computer Corporation and Cisco Systems, Inc. The company continued to meet the demand for its services by hiring more than 17,000 employees in 1999 and 18,000 employees in 1998.

Gross profit dollars and gross profit margins improved in 1999 over 1998. Significant productivity improvements more than offset competitive pressures and the negative effect of the changing mix of services and maintenance within the Global Services portfolio.

Software

(Dollars in millions)	1999	1998	1997
Revenue	\$ 12,662	\$ 11,863	\$ 11,164
Cost	2,240	2,260	2,785
Gross profit	\$ 10,422	\$ 9,603	\$ 8,379
Gross profit margin	82.3%	80.9%	75.1%

Software revenue increased 6.7 percent in 1999 from 1998, following an increase of 6.3 percent from 1997. The company's middleware products (which comprise, for both IBM and non-IBM platforms, data management, transaction processing, Tivoli systems management and Lotus Notes messaging and collaboration) had revenue growth of 12 percent in 1999 and 9 percent in 1998. The company continues to focus on helping customers use its software to transform their businesses into e-businesses, particularly in collaboration with the company's Global Services and channel partners.

The company's middleware products continued their momentum due to the company's ability to integrate; the growing participation on non-IBM platforms and the expanding market coverage as more partnerships were formed with Independent Software Vendors, Web integrators and service providers; and a dedicated sales force of 6,600 people.

Operating systems software revenue declined 4 percent in 1999 and increased 3 percent in 1998 when compared with previous periods. The decline in 1999 was driven by lower revenue in AS/400. The 1998 increase was driven by higher AS/400 operating systems revenue versus 1997.

Software gross profit dollars increased 8.5 percent in 1999 from 1998, following an increase of 14.6 percent in 1998 from 1997. Increased revenue and lower levels of amortization costs associated with previously deferred software development spending drove the improvement, partially offset by higher vendor royalty payments due primarily to increased volumes.

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Global Financing

(Dollars in millions)	1999	1998	1997
Revenue	\$ 3,137	\$ 2,877	\$ 2,806
Cost	1,446	1,494	1,448
Gross profit	\$ 1,691	\$ 1,383	\$ 1,358
Gross profit margin	53.9%	48.1%	48.4%

Global Financing revenue increased 9.0 percent in 1999 from 1998, following an increase of 2.5 percent in 1998 versus 1997. Growth in working capital financing, along with continued growth in financing of software and services, drove the revenue increase in 1999. Financing originations increased to approximately \$43 billion, with year-to-year growth in working capital financing, along with software and services financing. The revenue increase in 1998 over 1997 was due to improved sales of used equipment and growth in software and services financing, offset by a decline in working capital financing.

Gross profit dollars increased 22.3 percent in 1999 versus 1998, following an increase of 1.8 percent in 1998 over 1997. The increase in 1999 reflects Global Financing's ongoing strategy to increase its use of the company's Global Treasury Centers rather than external banks as a funding source and lower costs of borrowing. The increase in gross profit dollars in 1998 versus 1997 was primarily due to increased revenue and a higher gross profit margin in the U.S. markets.

Enterprise Investments/Other

(Dollars in millions)	1999	1998	1997
Revenue	\$ 2,536	\$ 2,592	\$ 2,742
Cost	1,558	1,702	1,729
Gross profit	\$ 978	\$ 890	\$ 1,013
Gross profit margin	38.6%	34.3%	36.9%

Enterprise Investments/Other revenue decreased 2.2 percent from 1998, following a decrease of 5.5 percent in 1998 from 1997. The decrease was driven by lower revenue from discontinued product lines, such as automated teller machines (ATMs), partially offset by growth in point-of-sale terminals and computer-aided three-dimensional interactive application (CATIA) software. The decrease in 1998 versus 1997 was primarily a result of lower software revenue, partially offset by higher revenue from point-of-sale terminals.

The gross profit dollars from Enterprise Investments/Other increased 9.9 percent in 1999 versus 1998, following a decrease of 12.1 percent in 1998 versus 1997. The increase in 1999 gross profit dollars and gross profit margin was primarily driven by an improving gross profit margin for point-of-sale terminals and software. The decline in 1998 gross profit dollars and gross profit margin was primarily driven by the lower software revenue versus 1997.

Operating Expenses

(Dollars in millions)	1999	1998	1997
Selling, general and administrative	\$ 14,729	\$ 16,662	\$ 16,634
Percentage of revenue	16.8%	20.4%	21.2%
Research, development and engineering	\$ 5,273	\$ 5,046	\$ 4,877
Percentage of revenue	6.0%	6.2%	6.2%

Selling, general and administrative (SG&A) expense declined 11.6 percent in 1999 versus 1998 and was essentially flat in 1998 with 1997. The decrease in 1999 reflects the net pre-tax benefit associated with the sale of the Global Network and the actions taken by the company in 1999 to improve its competitiveness and to strengthen further the company's overall business portfolio. (See note D, "Acquisitions/Divestitures," on pages 72 and 73, and note R, "1999 Actions," on pages 81 and 82 for further information.)

The company continues to manage aggressively its infrastructure expense and its overall portfolio to allow for investment in growth areas of the business. Key ongoing investments include software marketing, major marketing campaigns, and new offerings for small and medium business opportunities, as well as the e-business campaign. These types of expenditures are consistent with the company's ongoing objective of growing revenue while improving the expense-to-revenue ratio over time.

Research, development and engineering expense increased 4.5 percent in 1999 from 1998, following an increase of 3.5 percent in 1998 from 1997. The increase in 1999 reflects additional expenses associated with the acquisition of Sequent Computer Systems, Inc., Mylex Corporation and DASCUM, Inc. Those acquisitions are intended to improve the company's long-term

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competitiveness in the server, storage and Web-security markets, respectively. (See note D, "Acquisitions/Divestitures," on pages 72 and 73 for further detail about the in-process research and development charge.) In addition, the increases in both 1999 and 1998 reflect the company's continued investments in high-growth opportunities like e-business, Tivoli systems management and Lotus products, as well as the effect of ongoing research, development and engineering expense associated with new acquisitions.

As a result of its ongoing research and development efforts, the company received 2,756 patents in 1999, placing it number one in patents granted in the U.S. for the seventh consecutive year. The application of these technological advances transforms the company's research and development into new products. Examples of these efforts range from new e-business solutions to innovative manufacturing techniques. A patent for performing computer-based online commerce using an intelligent agent will play a major role in future e-business. This patent enables customers to use intelligent software agents to negotiate for services from multiple providers. The intelligent agents take into account both the availability of the requested service, such as airline seats, and the providers' business policies, such as those on cancellations. The agents commit to services with the most flexible policies first, giving the user the greatest possible protection. With respect to manufacturing technologies, the silicon-on-insulator (SOI) chip technology can reduce power consumption and improve chip performance. A new patent in 1999 defines processing improvements that increase the efficiency and reduce the cost of manufacturing SOI chips. This technology will be crucial in the industry's development of a new class of "pervasive computing" devices, handheld and embedded products such as smart phones, and Internet appliances that business professionals and consumers will rely on for easy access to e-business data and services.

See note Y, "Segment Information," on pages 89 through 93 for additional information about the pre-tax income of each segment, as well as the methodologies employed by the company to allocate shared expenses to the segments.

Provision for Income Taxes

The provision for income taxes resulted in an effective tax rate of 34.4 percent for 1999, compared with the 1998 effective tax rate of 30.0 percent and a 1997 effective tax rate of 32.5 percent. The 4.4 point increase from the 1998 rate is the result of the company's sale of its Global Network business to AT&T and various other actions implemented during 1999. (See note D, "Acquisitions/Divestitures," on pages 72 and 73 and note R, "1999 Actions," on pages 81 and 82 for further detail regarding the tax impacts of these items.) The reduction in the 1998 tax rate versus 1997 reflects the company's continued expansion into markets with lower effective tax rates.

The company accounts for income taxes under Statement of Financial Accounting Standards (SFAS) No. 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.

Fourth Quarter

For the quarter ended December 31, 1999, the company had revenue of \$24.2 billion, a decrease of 3.8 percent from the same period in 1998. Net income in the fourth quarter was \$2.1 billion (\$1.12 per diluted common share), compared with net income of \$2.3 billion (\$1.24 per diluted common share) in the fourth quarter of 1998.

Revenue for the fourth quarter of 1999 from the company's end-user businesses totaled \$10.4 billion from the Americas, a decrease of 3.7 percent (2 percent decrease in constant currency) compared with the same period last year. Revenue from Europe/Middle East/Africa was \$7.2 billion, down 15.0 percent (6 percent decrease in constant currency). Asia Pacific revenue grew 12.3 percent (2 percent increase in constant currency) to \$4.4 billion. OEM revenue across all geographies was \$2.2 billion, a 12.5 percent increase (12 percent in constant currency) compared with the fourth quarter of 1998.

Hardware revenue declined 10.7 percent (10 percent in constant currency) to \$10.2 billion from the 1998 fourth quarter. Y2K-related declines in customer demand were a significant factor behind fourth-quarter revenue decreases in S/390, AS/400, RS/6000 and personal computers. However, within the company's server family, Netfinity PC revenues increased significantly, as did revenues from RS/6000 mid-range servers, including the advanced RS/6000 Model S80. Microelectronics revenues increased substantially, principally due to growth in custom logic shipments. Shipments of the company's new "Shark" disk storage product were strong in the quarter, although overall storage revenues declined largely as a result of ongoing price pressures in HDDs. The overall hardware gross profit margin declined to 26.6 percent from 34.2 percent.

Global Services revenue grew 2.0 percent (4 percent in constant currency) versus the fourth quarter of 1998. Strategic Outsourcing showed good growth versus the fourth quarter of 1998. Networking Services declined year to year due to the sale of the Global Network to AT&T during 1999, while revenue from the other categories of services was flat or declined as a result of the Y2K-related slowdown. The company's services unit signed more than \$10 billion in services contracts in the quarter. Revenue from maintenance offerings was essentially flat when compared with the fourth quarter of 1998.

Software revenue totaled \$3.6 billion, up 1.7 percent (6 percent in constant currency) over the prior year's final quarter. Middleware—which is critical for e-business—grew 8 percent (13 percent at constant currency), with record fourth quarter shipments of Lotus Notes and Domino groupware products and strong performance in database, transaction processing, and Tivoli system management software. The software gross profit margin improved 1.1 points year over year to 83.4 percent.

Global Financing revenue increased 19.3 percent (22 percent in constant currency) versus the same period of 1998, and Enterprise Investments/Other declined 13.3 percent (10 percent in constant currency) compared with 1998's fourth quarter. The revenue decline in Enterprise Investments/Other resulted from the company's strategy to withdraw from certain businesses, such as ATMs.

The company's overall gross profit margin in the fourth quarter was 36.7 percent, compared with 39.0 percent in the year-earlier period. The decrease was primarily due to a drop in the hardware margin of 7.6 points from the fourth quarter 1998 across

S/390 and AS/400 servers, storage and personal computer products. This decrease was partially offset by improved margins for services and software in the fourth quarter of 1999 versus the same period in 1998.

Total fourth-quarter 1999 expense declined 9.3 percent when compared with the fourth quarter of 1998. The decline reflects lower revenue-related expenses due to the slowdown that is included in the fourth quarter results. The quarter also reflected expenses associated with infrastructure reductions in areas such as Sales and Distribution, Personal Systems and Server Group, which offset a gain associated with the sale to Cisco Systems, Inc. of certain IBM intellectual property. The expense-to-revenue ratio in the fourth quarter of 1999 was 24.4 percent, compared with 25.9 percent in the year-earlier period.

The company's tax rate was 30.0 percent in the fourth quarter, compared with 28.9 percent in the fourth quarter of 1998.

The company spent approximately \$2.1 billion on common share repurchases in the fourth quarter. The average number of shares outstanding in the fourth quarter of 1999 was 1,793.0 million, compared with 1,839.5 million in the year-earlier period. The average number of shares outstanding for purposes of calculating diluted earnings per share was 1,847.8 million in the fourth quarter of 1999 versus 1,894.3 million in the fourth quarter of 1998.

Financial Condition

During 1999, the company continued to make significant investments to fund future growth and increase shareholder value, spending \$5,806 million for research, development and engineering; \$4,346 million for plant and other property, including machines used in strategic outsourcing contracts; \$1,613 million for machines on operating leases with customers; \$1,542 million for strategic acquisitions; and \$7,280 million for the repurchase of the company's common shares. The company had \$5,831 million in cash and cash equivalents and marketable securities at December 31, 1999.

The company has access to global funding sources. During 1999, the company issued debt in a variety of geographies to a diverse set of investors, including significant funding in the United States, Japan and Europe. The funding has a wide range of maturities from short-term commercial paper to long-term debt. More information about company debt is provided in note J, "Debt," on page 74.

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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, 1999, \$8,562 million was unused and available.

The company managed assets of \$273 million and \$864 million at December 31, 1999 and 1998, respectively, from the securitization of loans, leases and trade receivables. For additional information, see note I, "Sale and Securitization of Receivables," on page 74.

The major rating agencies have continued their review of the company's financial condition. None of the agencies announced a change in rating in 1999. Standard and Poor's rates the company and its rated subsidiaries' senior long-term debt as A+, the commercial paper as A-1 and IBM's 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 reflected in the Consolidated Statement of Cash Flows on page 68, are summarized in the following table:

(Dollars in millions)	1999	1998	1997
Net cash provided from			
(used in):			
Operating activities	\$ 10,111	\$ 9,273	\$ 8,865
Investing activities	(1,669)	(6,131)	(6,155)
Financing activities	(8,625)	(4,993)	(3,090)
Effect of exchange rate changes on cash and cash equivalents	(149)	120	(201)
Net change in cash and cash equivalents	\$ (332)	\$ (1,731)	\$ (581)

Working Capital

(Dollars in millions)

At December 31:	1999	1998
Current assets	\$ 43,155	\$ 42,360
Current liabilities	39,578	36,827
Working capital	\$ 3,577	\$ 5,533
Current ratio	1.09:1	1.15:1

Current assets increased \$795 million, driven primarily by increases of \$837 million in accounts receivable, \$227 million in prepaid expenses and other current assets and \$63 million in cash and cash equivalents and marketable securities, offset by a decrease of \$332 million in inventories. The increase in accounts receivable is due to strong global financing activity in the software and services businesses across all geographies. The increase in prepaid expenses and other current assets is due to increases in deferred tax assets from year-end 1998. The increase in cash and cash equivalents and marketable securities resulted primarily from cash generated from operations and the net proceeds from the sale of the company's Global Network, offset by stock repurchases, capital expenditures and strategic acquisitions.

The company ended 1999 with inventories of \$4,868 million, the lowest level since 1983, due to continued focus on inventory management process improvements, notably in Personal Systems. These improvements increased the company's inventory turnover to 5.9 in 1999 from 5.3 in 1998.

Current liabilities increased \$2,751 million from year-end 1998 with increases of \$1,667 million in taxes payable, \$325 million in short-term debt and \$759 million in other current liabilities. The increase in other current liabilities resulted from increases in accounts payable (\$148 million), compensation and benefits (\$310 million), and deferred income (\$414 million), and a \$113 million decrease in other accrued expenses and liabilities. The increase in taxes payable primarily reflects improvements in the company's results associated with the sale of the company's Global Network to AT&T. Short-term debt increased to support the growth of global financing assets. The increase in other current liabilities was primarily related to deferred income, mainly advanced billings for software.

Investments

The company's investments for plant, rental machines and other property were \$5,959 million for 1999, a decrease of \$561 million from 1998. The company continues to invest significantly in its rapidly growing services business, primarily in the management of customers' information technology, and in manufacturing capacity for HDDs and microelectronics.

In addition to software development expenses included in research, development and engineering, the company capitalized \$464 million of software costs during 1999, an increase of \$214 million from the 1998 period. The increase resulted primarily from the adoption by the company as of January 1, 1999, of the American Institute of Certified Public Accountants Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The SOP requires the capitalization of internal use computer software if certain criteria are met. The company amortizes the capitalized costs over two years. Amortization of capitalized software costs (both internal use and licensed programs) was \$426 million in 1999, a decline of \$91 million from 1998.

Investments and sundry assets were \$26,087 million at the end of 1999, an increase of \$2,577 million from 1998, primarily the result of increases in prepaid pension assets, customer loan receivables-not yet due, and alliance investments, which include investments in high-growth-potential technology companies. See note G, "Investments and Sundry Assets," on page 73 for additional information.

Debt and Equity

(Dollars in millions)	1999	1998
Non-global financing debt	\$ 1,555	\$ 1,659
Global financing debt	26,799	27,754
Total debt	\$ 28,354	\$ 29,413
Stockholders' equity	\$ 20,511	\$ 19,433
Debt/capitalization	58.0%	60.2%
EBITDA/Interest expense	9x	8x
Non-global financing:		
Debt/capitalization	9.0%	9.9%
EBITDA/Interest expense	19x	15x
Global financing debt/equity	5.5:1	6.5:1

Because a financing business has a different capital structure than a technology business, the company's debt and key financial ratios are calculated on both a global financing and non-global financing basis.

Total debt decreased \$1,059 million from year-end 1998 as debt supporting the growth of global financing assets decreased \$955 million and non-global financing debt decreased \$104 million.

Stockholders' equity increased \$1,078 million to \$20,511 million at December 31, 1999, primarily due to the increase in retained earnings and accumulated gains and losses not affecting retained earnings, partially offset by the company's ongoing stock repurchase program. (See note N, "Stockholders' Equity Activity," on pages 78 and 79.)

The ratio of non-global financing earnings before interest and taxes plus depreciation and amortization (EBITDA) to non-global financing interest expense, adjusted for future gross minimum rental commitments, was 19x and 15x in 1999 and 1998, respectively. EBITDA is a useful indicator of the company's ability to service its debt.

Currency Rate Fluctuations

Changes in the relative values of non-U.S. currencies to the U.S. dollar affect the company's results. At December 31, 1999, currency changes resulted in assets and liabilities denominated in local currencies being translated into fewer dollars than at year-end 1998. The currency rate changes had minimal effect on 1999 revenue growth, but had an unfavorable effect on 1998 and 1997 revenue growth of approximately 2 percent and 5 percent, respectively.

In high-inflation environments, translation adjustments are reflected in period income, as required by SFAS No. 52, "Foreign Currency Translation." Generally, the company limits currency risk in these countries by linking prices and contracts to U.S. dollars, financing operations locally and entering into 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 of currency and hedging appears in note L, "Financial Instruments," on pages 75 through 77.

Market Risk

In the normal course of business, the financial position of the company routinely is subject to a variety of risks. In addition to the market risk associated with interest rate and currency 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 all of 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 from these risks.

The company's debt in support of the global financing business 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 L, "Financial Instruments," on pages 75 through 77.

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

The financial instruments that are included in the sensitivity analysis comprise 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. The company's portfolio of derivative financial instruments includes interest rate swaps, interest rate options, foreign currency swaps, forward contracts and foreign currency option contracts.

To perform sensitivity analysis, the company assesses the risk of loss in fair values from the effect 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 affected by the changes in rates that are attributable to the market risk that is being measured.

The company selected the discount rates that it used for the present value computations based on market interest and foreign currency exchange rates in effect at December 31, 1999 and 1998. The differences in this comparison are the hypothetical gains or losses associated with each type of risk.

Information provided by the sensitivity analysis does not necessarily represent the actual changes in fair value that the company would incur under normal market conditions because, due to practical limitations, all variables other than the specific market risk factor are held constant. In addition, the results of the model are constrained by the fact that certain items are specifically excluded from the analysis, while the financial instruments that relate to the financing or hedging of those items are included by definition. Excluded items include leased assets, forecasted foreign currency cash flows, and the company's net investment in foreign operations. As a consequence, the reported changes in the values of some financial instruments that affect the results of the sensitivity analysis are not matched with the offsetting changes in the values of the items that those instruments are designed to finance or hedge.

The results of the sensitivity analysis at December 31, 1999, and December 31, 1998, are as follows:

Interest Rate Risk: As of December 31, 1999, 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 of \$164 million as compared with a decrease of \$322 million as of December 31, 1998. 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 of \$145 million as compared with an increase of \$282 million as of December 31, 1998. Changes in the relative sensitivity of the fair value of the company's financial instrument portfolio for these theoretical changes in the level of interest rates primarily are driven by changes in the company's debt maturity and interest rate profile and amount. In 1999 versus 1998, the reported decline in interest rate sensitivity primarily is due to the effect of increased activity in receive fixed/pay floating interest rate swaps.

Foreign Currency Exchange Rate Risk: As of December 31, 1999, a 10 percent decrease or increase 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 of \$1,319 million or an increase in the fair value of the company's financial instruments of \$1,340 million, respectively, compared with a decrease of \$597 million or an increase of \$855 million, respectively, as of December 31, 1998. The change in the relative sensitivity of the fair market value of the company's financial instrument portfolio to the level of foreign currency exchange rates primarily is driven by an increase in the overall level of net foreign investment hedging activity as well as by an increase in the use of foreign currency forwards in lieu of foreign currency options to hedge the company's various foreign currency exposures in accordance with the company's established risk management practices. As the effect of offsetting changes in the fair market value of the company's net foreign investments are not included in the sensitivity model, the results of the analysis do not indicate an increase in the company's actual exposure to foreign currency exchange rate risk.

Financing Risks

Global financing is an integral part of the company's total worldwide offerings. 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. Remarketing efforts consistently have 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 the remaining net book value of machines on operating leases at the end of the lease terms as of December 31, 1997, 1998 and 1999. The following table excludes approximately \$34 million of estimated residual value associated with non-information technology equipment.

(Dollars in millions)	Total			Run Out of 1999 Balance			
	1997	1998	1999	2000	2001	2002	2003 and beyond
Sales-type leases	\$ 563	\$ 685	\$ 737	\$ 209	\$ 301	\$ 198	\$ 29
Operating leases	701	731	609	319	197	87	6
Total residual value	\$ 1,264	\$ 1,416	\$ 1,346	\$ 528	\$ 498	\$ 285	\$ 35

management discussion

International Business Machines Corporation
and Subsidiary Companies

Employees and Related Workforce

	1999	1998	1997	Percentage Changes	
				1999-98	1998-97
IBM/wholly owned subsidiaries	307,401	291,067	269,465	5.6	8.0
Less than wholly owned subsidiaries	17,176	21,704	20,751	(20.9)	4.6
Complementary	29,800	36,900	43,000	(19.2)	(14.2)

IBM employees, including wholly owned subsidiaries, increased by more than 16,000 in 1999. The growth areas of the company, Global Services and the Software Group, continue to drive the increase; Global Services hired approximately 17,000 in 1999. Acquisitions also contributed to the increase. The company also continues to reduce its infrastructure and to withdraw from certain businesses, thereby offsetting some of the growth. For example, during 1999, IBM sold its Global Network to AT&T, resulting in the loss of about 5,300 employees.

The decrease in employees in the less than wholly owned subsidiaries over the last year reflects a number of entities that were converted to a wholly owned status, such as Global Services in India and MiCRUS in the U.S., or divested during the year. Partially offsetting the decrease was continued growth in Global Services, notably in Australia, and in a number of subsidiaries in China.

The company's complementary workforce 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

The issues raised by the transition to the Year 2000 presented a pervasive and unprecedented global challenge to IBM, its customers, partners, suppliers and employees, as well as to governments, communities and individuals. The company believes that the overall uneventful arrival of the Year 2000 is testimony to the hard work and investment of organizations and individuals around the world.

With respect to the company's own operations, it prepared more than one million critical items for the transition, including PCs and servers, application software, and manufacturing tools and instruments. In addition, 2,500 suppliers, 750 business partners and 200 subsidiaries were assessed for risk mitigation planning purposes. The company estimates that it will have spent approximately \$500 million over a multi-year period in these efforts, including conversion, testing and contingency planning.

Over the past five years, the company undertook numerous initiatives to help customers prepare for the Year 2000 including contacting customers around the world to help promote awareness of Year 2000 issues; developing a range of service offerings and tools to help customers assess, develop and execute plans to make their systems Year 2000 ready; and making the company's own current hardware and software offerings Year 2000 ready. To illustrate the extent of the company's efforts, more than one million customers used the company's technical support Year 2000 Web site; and the company's Global Services organization processed more than one billion lines of customer code. Further, the company found that a large number of its enterprise customers locked down their information technology systems and postponed technology purchases heading into the Year 2000 transition, which adversely affected the company's business performance during the second half of 1999. See the Results of Operations and Financial Condition sections within the Management Discussion for further information.

In the near term, the company recognizes the need to maintain its vigilance in the event Y2K issues do arise. Further, some commentators believe that a significant amount of litigation will arise from Year 2000 issues. The company continues to believe that it has good defenses to any such potential claims brought against it.

The Year 2000 statements set forth above are designated as "Year 2000 Readiness Disclosures" pursuant to the Year 2000 Information and Readiness Disclosure Act (P.L. 105-271).

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	1999	1998	1997
Revenue:				
Hardware		\$ 37,041	\$ 35,419	\$ 36,630
Global Services		32,172	28,916	25,166
Software		12,662	11,863	11,164
Global Financing		3,137	2,877	2,806
Enterprise Investments/Other		2,536	2,592	2,742
Total revenue		87,548	81,667	78,508
Cost:				
Hardware		27,071	24,214	23,473
Global Services		23,304	21,125	18,464
Software		2,240	2,260	2,785
Global Financing		1,446	1,494	1,448
Enterprise Investments/Other		1,558	1,702	1,729
Total cost		55,619	50,795	47,899
Gross profit		31,929	30,872	30,609
Operating expenses:				
Selling, general and administrative	Q	14,729	16,662	16,634
Research, development and engineering	S	5,273	5,046	4,877
Total operating expenses		20,002	21,708	21,511
Operating income		11,927	9,164	9,098
Other income, principally interest		557	589	657
Interest expense	K	727	713	728
Income before income taxes		11,757	9,040	9,027
Provision for income taxes	P	4,045	2,712	2,934
Net income		7,712	6,328	6,093
Preferred stock dividends		20	20	20
Net income applicable to common stockholders		\$ 7,692	\$ 6,308	\$ 6,073
Earnings per share of common stock:				
Assuming dilution	T	\$ 4.12	\$ 3.29*	\$ 3.00*
Basic	T	\$ 4.25	\$ 3.38*	\$ 3.09*

Average number of common shares outstanding:

Assuming dilution: 1999–1,871,073,912; 1998–1,920,130,470*; 1997–2,021,869,884*

Basic: 1999–1,808,538,346; 1998–1,869,005,570*; 1997–1,966,572,722*

* Adjusted to reflect a two-for-one stock split effective May 10, 1999.

The accompanying notes on pages 69 through 93 are an integral part of the financial statements.

International Business Machines Corporation
and Subsidiary Companies

(Dollars in millions except per share amounts)

At December 31:	Notes	1999	1998
Assets			
Current assets:			
Cash and cash equivalents		\$ 5,043	\$ 5,375
Marketable securities	L	788	393
Notes and accounts receivable—trade, net of allowances		20,039	18,958
Sales-type leases receivable		6,220	6,510
Other accounts receivable		1,359	1,313
Inventories	E	4,868	5,200
Prepaid expenses and other current assets		4,838	4,611
Total current assets		43,155	42,360
Plant, rental machines and other property	F	39,616	44,870
Less: Accumulated depreciation		22,026	25,239
Plant, rental machines and other property—net		17,590	19,631
Software		663	599
Investments and sundry assets	G	26,087	23,510
Total assets		\$ 87,495	\$ 86,100
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	P	\$ 4,792	\$ 3,125
Short-term debt	J & L	14,230	13,905
Accounts payable		6,400	6,252
Compensation and benefits		3,840	3,530
Deferred income		4,529	4,115
Other accrued expenses and liabilities		5,787	5,900
Total current liabilities		39,578	36,827
Long-term debt	J & L	14,124	15,508
Other liabilities	M	11,928	12,818
Deferred income taxes	P	1,354	1,514
Total liabilities		66,984	66,667
Contingencies	O		
Stockholders' equity:			
Preferred stock, par value \$.01 per share	N	247	247
Shares authorized: 150,000,000			
Shares issued and outstanding (1999 and 1998—2,546,011)			
Common stock, par value \$.20* per share	C	11,762	10,121
Shares authorized: 4,687,500,000*			
Shares issued (1999—1,876,665,245; 1998—1,853,738,104*)			
Retained earnings		16,878	10,141
Treasury stock, at cost (shares: 1999—72,449,015; 1998—1,924,293*)		(7,375)	(133)
Employee benefits trust (shares: 1999—20,000,000; 1998—20,000,000*)		(2,162)	(1,854)
Accumulated gains and losses not affecting retained earnings		1,161	911
Total stockholders' equity		20,511	19,433
Total liabilities and stockholders' equity		\$ 87,495	\$ 86,100

* Adjusted to reflect a two-for-one stock split effective May 10, 1999.

The accompanying notes on pages 69 through 93 are an integral part of the financial statements.

consolidated statement of stockholders' equity

International Business Machines Corporation
and Subsidiary Companies

(Dollars in millions)	Preferred Stock	Common Stock	Retained Earnings	Treasury Stock	Employee Benefits Trust	Accumulated Gains and Losses Not Affecting Retained Earnings	Total
1997*							
Stockholders' equity, January 1, 1997	\$ 253	\$ 7,752	\$ 11,189	\$ (135)	\$ —	\$ 2,569	\$ 21,628
Net income plus gains and losses not affecting retained earnings:							
Net income			6,093				<u>\$ 6,093</u>
Gains and losses not affecting retained earnings (net of tax):							
Foreign currency translation adjustments (net of tax expense of \$24)						(1,610)	(1,610)
Net unrealized losses on marketable securities (net of tax benefit of \$37)						(60)	<u>(60)</u>
Total gains and losses not affecting retained earnings							<u>(1,670)</u>
Subtotal: Net income plus gains and losses not affecting retained earnings							<u>\$ 4,423</u>
Cash dividends declared—common stock			(763)				(763)
Cash dividends declared—preferred stock			(20)				(20)
Common stock purchased and retired (137,554,672** shares)		(565)	(5,455)				(6,020)
Preferred stock purchased and retired (13,450 shares)	(1)						(1)
Common stock issued under employee plans (39,303,206** shares)		985	(2)				983
Purchases (8,254,336** shares) and sales (10,764,558** shares) of treasury stock under employee plans—net			(32)	49			17
Employee benefits trust (20,000,000** shares)					(860)		(860)
Tax effect—stock transactions		429					429
Stockholders' equity, December 31, 1997	\$ 252	\$ 8,601	\$ 11,010	\$ (86)	\$ (860)	\$ 899	\$ 19,816
1998*							
Net income plus gains and losses not affecting retained earnings:							
Net income			6,328				<u>\$ 6,328</u>
Gains and losses not affecting retained earnings (net of tax):							
Foreign currency translation adjustments (net of tax benefit of \$45)						69	69
Net unrealized losses on marketable securities (net of tax benefit of \$36)						(57)	<u>(57)</u>
Total gains and losses not affecting retained earnings							<u>12</u>
Subtotal: Net income plus gains and losses not affecting retained earnings							<u>\$ 6,340</u>
Cash dividends declared—common stock			(814)				(814)
Cash dividends declared—preferred stock			(20)				(20)
Common stock purchased and retired (113,993,636** shares)		(556)	(6,291)				(6,847)
Preferred stock purchased and retired (51,250 shares)	(5)						(5)
Common stock issued under employee plans (29,701,038** shares)		709	(1)				708
Purchases (9,100,678** shares) and sales (9,024,296** shares) of treasury stock under employee plans—net			(71)	(47)			(118)
Fair value adjustment of employee benefits trust		1,002			(994)		8
Tax effect—stock transactions		365					365
Stockholders' equity, December 31, 1998	\$ 247	\$ 10,121	\$ 10,141	\$ (133)	\$ (1,854)	\$ 911	\$ 19,433

consolidated statement of stockholders' equity

International Business Machines Corporation
and Subsidiary Companies

(Dollars in millions)	Preferred Stock	Common Stock	Retained Earnings	Treasury Stock	Employee Benefits Trust	Accumulated Gains and Losses Not Affecting Retained Earnings	Total
1999							
Stockholders' equity, December 31, 1998	\$ 247	\$ 10,121	\$ 10,141	\$ (133)	\$ (1,854)	\$ 911	\$ 19,433
Net income plus gains and losses not affecting retained earnings:							
Net income			7,712				\$ 7,712
Gains and losses not affecting retained earnings (net of tax):							
Foreign currency translation adjustments (net of tax expense of \$180)						(546)	(546)
Net unrealized gains on marketable securities (net of tax expense of \$456)						796	796
Total gains and losses not affecting retained earnings							250
Subtotal: Net income plus gains and losses not affecting retained earnings							\$ 7,962
Cash dividends declared—common stock			(859)				(859)
Cash dividends declared—preferred stock			(20)				(20)
Treasury shares purchased, not retired (70,711,971 shares)				(7,192)			(7,192)
Common stock issued under employee plans (22,927,141 shares)		741	(1)				740
Purchases (6,418,975 shares) and sales (6,606,223 shares) of treasury stock under employee plans—net			(95)	(50)			(145)
Fair value adjustment of employee benefits trust		318			(308)		10
Increase due to shares issued by subsidiary		37					37
Tax effect—stock transactions		545					545
Stockholders' equity, December 31, 1999	\$ 247	\$ 11,762	\$ 16,878	\$ (7,375)	\$ (2,162)	\$ 1,161	\$ 20,511

* Reclassified to conform with 1999 presentation.

**Adjusted to reflect a two-for-one stock split effective May 10, 1999.

The accompanying notes on pages 69 through 93 are an integral part of the financial statements.

consolidated statement of cash flows

International Business Machines Corporation
and Subsidiary Companies

(Dollars in millions)

At December 31:	1999	1998*	1997*
Cash flow from operating activities:			
Net income	\$ 7,712	\$ 6,328	\$ 6,093
Adjustments to reconcile net income to cash provided from operating activities:			
Depreciation	6,159	4,475	4,018
Amortization of software	426	517	983
Deferred income taxes	(713)	(606)	358
Gain on disposition of fixed and other assets	(4,791)	(261)	(273)
Other changes that (used) provided cash:			
Receivables	(1,677)	(2,736)	(3,727)
Inventories	301	73	432
Other assets	(130)	219	(378)
Accounts payable	(3)	362	699
Other liabilities	2,827	902	660
Net cash provided from operating activities	10,111	9,273	8,865
Cash flow from investing activities:			
Payments for plant, rental machines and other property	(5,959)	(6,520)	(6,793)
Proceeds from disposition of plant, rental machines and other property	1,207	905	1,130
Investment in software	(464)	(250)	(314)
Purchases of marketable securities and other investments	(3,949)	(4,211)	(1,617)
Proceeds from marketable securities and other investments	2,616	3,945	1,439
Proceeds from sale of the Global Network	4,880	—	—
Net cash used in investing activities	(1,669)	(6,131)	(6,155)
Cash flow from financing activities:			
Proceeds from new debt	6,133	7,567	9,142
Short-term borrowings less than 90 days—net	276	499	(668)
Payments to settle debt	(7,510)	(5,942)	(4,530)
Preferred stock transactions—net	—	(5)	(1)
Common stock transactions—net	(6,645)	(6,278)	(6,250)
Cash dividends paid	(879)	(834)	(783)
Net cash used in financing activities	(8,625)	(4,993)	(3,090)
Effect of exchange rate changes on cash and cash equivalents	(149)	120	(201)
Net change in cash and cash equivalents	(332)	(1,731)	(581)
Cash and cash equivalents at January 1	5,375	7,106	7,687
Cash and cash equivalents at December 31	\$ 5,043	\$ 5,375	\$ 7,106
Supplemental data:			
Cash paid during the year for:			
Income taxes	\$ 1,904	\$ 1,929	\$ 2,472
Interest	\$ 1,574	\$ 1,605	\$ 1,475

* Reclassified to conform with 1999 presentation.

The accompanying notes on pages 69 through 93 are an integral part of the financial statements.

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 in general are 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 that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on management's best knowledge of current events and actions that the company may undertake in the future, actual results may be different from the estimates.

Revenue

The company recognizes revenue when it is realized or realizable and earned. The company reduces revenue for estimated customer returns, allowances and anticipated price actions. The following are the specific revenue recognition policies for each major category of revenue.

HARDWARE

Revenue from hardware sales or sales-type leases is recognized when the product is shipped. Revenue from rentals and operating leases is recognized monthly as the fees accrue.

SERVICES

Revenue from time and material service contracts is recognized as the services are provided. Revenue from fixed price long-term service contracts is recognized over the contract term based on the percentage of services that are provided during the period compared with the total estimated services to be provided over the entire contract. Losses on fixed price contracts are recognized during the period in which the loss first becomes apparent. Revenue from maintenance is recognized over the contractual period or as the services are performed. Revenue in excess of billings on service contracts is recorded as unbilled receivables and is included in trade accounts receivable. Billings in excess of revenue that is recognized on service contracts are recorded as deferred income until the above revenue recognition criteria are met.

SOFTWARE

Revenue from one-time charge licensed software is recognized at the inception of the license term, provided the company has vendor-specific objective evidence of the fair value of each element of the software offering and the software has been delivered. Revenue is deferred if vendor-specific objective evidence does not exist for each contract element, or if there are uncertainties about the timing of delivery of specific contract elements. The revenue that is deferred for any contract element is recognized when all of the revenue recognition criteria have been met for that element. Revenue from monthly software licenses is recognized as license fees accrue.

FINANCING

Revenue from financing is recognized at level rates of return over the term of the lease or receivable.

Income Taxes

Income tax expense is based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences between assets and liabilities that are recognized for financial reporting purposes and the amounts that are recognized for income tax purposes. In accordance with Statement of Financial Accounting Standards (SFAS) No. 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 recorded in Accumulated gains and losses not affecting retained earnings within stockholders' equity.

Inventories and plant, rental machines and other non-monetary assets and liabilities of non-U.S. subsidiaries and branches that operate in U.S. dollars, or whose economic environment is highly inflationary, are translated at approximate exchange rates prevailing when the company acquired the assets or liabilities. All other assets and liabilities are translated at year-end exchange rates. Cost of sales and depreciation are translated at historical exchange rates. All other income and expense items are translated at the average rates of exchange prevailing during the year. Gains and losses that result from translation are included in net income.

Financial Instruments

In the normal course of business, the company uses a variety of derivative financial instruments to manage currency exchange rate and interest rate risk. To qualify for hedge accounting, the company requires that the derivative instruments that are used for risk management purposes effectively reduce the risk exposure that they are designed to hedge. For instruments that are associated with the hedge of an anticipated transaction, hedge effectiveness criteria also require that it be probable that the underlying transaction will occur. Instruments that meet these hedging criteria are formally designated as hedges at the inception of the contract. When the terms of an underlying hedged item or transaction are modified, or when the underlying hedged item ceases to exist, all changes in the fair value of the risk management instrument are recognized in income each period until the instrument matures. Those risk management instruments that do not meet the hedging criteria are accounted for at fair value, and changes in fair value are recognized immediately in net income. Refer to note L, "Financial Instruments," on pages 75 through 77 for descriptions of the major classes of derivative financial instruments used by the company, including the specific methods that the company uses to account for them.

In determining the fair value of its derivative and non-derivative financial instruments, the company uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. For the majority of financial instruments including most derivatives, long-term investments and long-term debt, standard market conventions and techniques such as estimated discounted value of future cash flows, option pricing models, replacement cost and termination cost are used to determine fair value. Quoted market prices or dealer quotes for the same or similar instruments are used for the remaining financial instruments.

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.

Marketable Securities

Marketable securities included in current assets represent securities with a maturity of less than one year. The company's policy is to invest in primarily high-grade marketable securities. The company's marketable securities are considered available for sale and are reported at fair value with changes in unrealized gains and losses, net of applicable taxes, recorded in Accumulated gains and losses not affecting retained earnings within stockholders' equity. Realized gains and losses are calculated based on the specific identification method.

Inventories

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

Depreciation

Plant, rental machines (computer equipment that is used internally, subject to an operating lease or as part of strategic outsourcing contracts) and other property are carried at cost and depreciated over their estimated useful lives using the straight-line method.

The estimated useful lives of depreciable properties generally are as follows: buildings, 50 years; building equipment, 20 years; land improvements, 20 years; plant, laboratory and office equipment, 2 to 15 years; and computer equipment, 1.5 to 5 years.

Software

Costs that are related to the conceptual formulation and design of licensed programs are expensed as research and development. Also, for licensed programs, the company capitalizes costs to produce the finished product that are incurred after technological feasibility is established. 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 three years. The company performs periodic reviews to ensure that unamortized program costs remain recoverable from future revenue. The company charges costs to support or service licensed programs against income as they are incurred.

The company capitalizes certain costs that are incurred to purchase or to create and implement internal use computer software, which include software coding, installation, testing and data conversion. Capitalized costs are amortized on a straight-line basis over two years.

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 that result from amendments to the plans are amortized over the average remaining service period of the employees expected to receive benefits. Unrecognized net gains and losses that exceed ten percent of the greater of the projected benefit obligation or the market-related value of plan assets are amortized to service cost over the average remaining service life of employees expected to receive benefits. See note W, "Retirement Plans," on pages 86 through 88 and note X, "Nonpension Postretirement Benefits," on pages 88 and 89 for further discussion.

Goodwill

Goodwill is charged to net income on a straight-line basis over the periods estimated to benefit, generally not to exceed five years. The company performs reviews to evaluate the recoverability of goodwill and takes into account events or circumstances that warrant revised estimates of useful lives or that indicate that an impairment exists.

Common Stock

Common stock refers to the \$.20 par value capital stock as designated in the company's Certificate of Incorporation.

Earnings Per Share of Common Stock

Earnings per share of common stock—basic is computed by dividing Net income applicable to common stockholders by the weighted-average number of common shares outstanding for the period. Earnings per share of common stock—assuming dilution reflects the maximum potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock and would then share in the net income of the company. See note T, "Earnings Per Share of Common Stock," on page 83 for further discussion.

B Accounting Changes**Standards Implemented**

The company implemented new accounting standards in 1999, 1998 and 1997. None of these standards had a material effect on the financial position or results of operations of the company.

Effective January 1, 1999, the company adopted American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The SOP requires a company to capitalize certain costs that are incurred to purchase or to create and implement internal use computer software. See note A, "Significant Accounting Policies" on pages 69 through 71 for a description of the company's policies for internal use software.

Effective December 31, 1998, the company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which establishes standards for reporting operating segments and disclosures about products and services, geographic areas and major customers. See note Y, "Segment Information," on pages 89 through 93 for the company's segment information.

Effective December 31, 1998, the company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," which establishes standardized disclosures for defined benefit pension and postretirement benefit plans. See note W, "Retirement Plans," on pages 86 through 88 and note X, "Nonpension Postretirement Benefits," on pages 88 and 89 for the disclosures.

Effective January 1, 1998, the company adopted SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and displaying in a full set of general-purpose financial statements the gains and losses not affecting retained earnings. The disclosures required by SFAS No. 130 are presented in the Accumulated gains and losses not affecting retained earnings section in the Consolidated Statement of Stockholders' Equity on pages 66 and 67 and in note N, "Stockholders' Equity Activity," on pages 78 and 79.

Effective January 1, 1998, the company adopted the AICPA SOP 97-2, "Software Revenue Recognition." This SOP provides guidance on revenue recognition for software transactions. See note A, "Significant Accounting Policies" on pages 69 through 71 for a description of the company's policy for software revenue recognition.

Effective December 31, 1997, the company implemented SFAS No. 128, "Earnings Per Share" (EPS). This statement prescribes the methods for calculating basic and diluted EPS and requires dual presentation of these amounts on the face of the Consolidated Statement of Earnings.

Effective January 1, 1997, the company implemented SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This statement provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities.

New Standards to be Implemented

In June 1999, the Financial Accounting Standards Board issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133." This statement defers the effective date of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," to fiscal years beginning after June 15, 2000, although early adoption is encouraged. SFAS No. 133 establishes accounting and reporting standards for derivative instruments. It requires a company to recognize all derivatives as

either assets or liabilities in the statement of financial position and to measure those instruments at fair value. Additionally, the fair value adjustments will affect either stockholders' equity or net income depending on whether the derivative instrument qualifies as a hedge for accounting purposes and, if so, the nature of the hedging activity. The company will adopt this standard as of January 1, 2001. Management does not expect the adoption to have a material effect on the company's results of operations; however, the effect on the company's financial position depends on the fair values of the company's derivatives and related financial instruments at the date of adoption.

C Common Stock Split

On January 26, 1999, the company's Board of Directors approved a two-for-one stock split effective May 10, 1999. On April 27, 1999, the stockholders of the company approved amendments to the Certificate of Incorporation to increase the number of authorized shares of common stock from 1,875 million to 4,687.5 million, which was required to effect that stock split. In addition, the amendment reduced the par value of the common shares from \$.50 to \$.20 per share. Common stockholders of record at the close of business on May 10, 1999, received one additional share for each share held. All share and per share data presented in the Consolidated Financial Statements and notes of this Annual Report reflect the two-for-one stock split.

D Acquisitions/Divestitures

Acquisitions

In 1999, the company completed 17 acquisitions at a cost of approximately \$1.5 billion. Three of the major acquisitions for the year are detailed in the following discussion.

On September 24, 1999, the company acquired all of the outstanding capital stock of Sequent Computer Systems, Inc. (Sequent) for approximately \$828 million. Sequent was an acknowledged leader in systems based on NUMA (non-uniform memory access) architecture.

On September 29, 1999, the company acquired all of the outstanding stock of Mylex Corporation (Mylex) for approximately \$259 million. Mylex was a leading developer of technology for moving, storing, protecting and managing data in desktop and networked environments.

On September 27, 1999, the company acquired DASCOC, Inc. (DASCOC), an industry leader in Web-based and enterprise-security technology, for approximately \$115 million.

The company accounted for each acquisition as a purchase transaction. The effects of these acquisitions on the company's Consolidated Financial Statements were not material. Hence, the company has not provided pro forma financial statements as if the companies had combined at the beginning of the current period or the immediately preceding period.

The company engaged a nationally recognized independent appraisal firm to express an opinion on the fair value of the net assets that the company acquired to serve as a basis for the following allocation of the purchase price.

(Dollars in millions)	Sequent	Mylex	DASCOC
Purchase price	\$ 828	\$ 259	\$ 115
Tangible net assets (liabilities)	382	67	(17)
Identifiable intangible assets	187	35	13
Current technology	87	26	19
Goodwill	183	145	92
In-process research and development	85	7	19
Deferred tax liabilities related to identifiable intangible assets	(96)	(21)	(11)

The tangible net assets comprise primarily cash, accounts receivable, land, buildings and leasehold improvements. The identifiable intangible assets comprise primarily patents, trademarks, customer lists, assembled workforce, employee agreements and leasehold interests. The identifiable intangible assets and goodwill will be amortized on a straight-line basis over a five-year period.

In connection with the acquisitions of Sequent, Mylex and DASCOC, the company recorded a pre-tax charge for research, development and engineering of \$111 million (\$111 million after tax, or \$.06 per diluted common share) for acquired in-process research and development (IPR&D). At the date of each acquisition, the IPR&D projects had not yet reached technological feasibility and had no alternative future uses. The value of the IPR&D reflects the relative value and contribution of the acquired research and development to the company's existing research or product lines.

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In January 1998, the company acquired Software Artistry, Inc., a leading provider of both consolidated service desk and customer relationship management solutions for distributed enterprise environments. In March 1998, the company acquired CommQuest Technologies, Inc., a company that designs and markets advanced semiconductors for wireless communications applications such as cellular phones and satellite communications. In connection with these acquisitions, the company recorded a pre-tax charge for IPR&D of \$111 million (\$111 million after tax, or \$.06 per diluted common share).

On April 16, 1997, the company purchased a majority interest in NetObjects, a leading provider of Web site development tools for designers and intranet developers. In 1999, as a result of NetObject's initial public offering, the company's interest declined to less than 50 percent. In September 1997, the company acquired the 30 percent equity interest held by Sears in Advantis, the U.S. network services arm of the company's Global Network. Advantis was then owned 100 percent by the company. Advantis became part of the company's Global Network, which the company sold to AT&T in 1999. In December 1997, the company acquired Eastman Kodak's share of Technology Service Solutions, which was formed in 1994 by the company and Eastman Kodak. In December 1997, the company acquired Unison Software, Inc., a leading developer of workload management software. In connection with these acquisitions the company recorded a pre-tax charge for IPR&D of \$111 million (\$111 million after tax, or \$.05 per diluted common share).

Divestitures

In December 1998, the company announced that it would sell its Global Network business to AT&T. During 1999, the company completed the sale to AT&T for \$4,991 million. More than 5,300 IBM employees joined AT&T as a result of these sales of operations in 71 countries.

The company recognized a pre-tax gain of \$4,057 million (\$2,495 million after tax, or \$1.33 per diluted common share). The net gain reflects dispositions of Plant, rental machines and other property of \$410 million, other assets of \$182 million and contractual obligations of \$342 million.

E Inventories

(Dollars in millions)

At December 31:	1999	1998
Finished goods	\$ 1,162	\$ 1,088
Work in process and raw materials	3,706	4,112
Total	\$ 4,868	\$ 5,200

F Plant, Rental Machines and Other Property

(Dollars in millions)

At December 31:	1999	1998
Land and land improvements	\$ 1,026	\$ 1,091
Buildings	10,395	11,088
Plant, laboratory and office equipment	22,503	27,025
	33,924	39,204
Less: Accumulated depreciation	19,268	22,463
	14,656	16,741
Rental machines	5,692	5,666
Less: Accumulated depreciation	2,758	2,776
	2,934	2,890
Total	\$ 17,590	\$ 19,631

G Investments and Sundry Assets

(Dollars in millions)

At December 31:	1999	1998
Net investment in sales-type leases*	\$ 14,201	\$ 14,384
Less: Current portion—net	6,220	6,510
	7,981	7,874
Deferred taxes	2,654	2,921
Prepaid pension assets	5,636	4,836
Customer loan receivables— not yet due	4,219	3,499
Installment payment receivables	848	1,087
Alliance investments:		
Equity method	595	420
Other—available for sale	1,439	138
Goodwill, less accumulated amortization (1999, \$2,646; 1998, \$2,111)	1,045	945
Marketable securities—non-current	113	281
Other investments and sundry assets	1,557	1,509
Total	\$ 26,087	\$ 23,510

* 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 \$737 million and \$685 million at December 31, 1999 and 1998, respectively, and is reflected net of unearned income at those dates of approximately \$1,600 million for both years. Scheduled maturities of minimum lease payments outstanding at December 31, 1999, expressed as a percentage of the total, are approximately as follows: 2000, 49 percent; 2001, 32 percent; 2002, 14 percent; 2003, 4 percent; and 2004 and beyond, 1 percent.

H Lines of Credit

The company maintains a \$10.0 billion global credit facility. The company's other committed and uncommitted lines of credit were \$5.5 billion and \$5.2 billion at December 31, 1999 and 1998, respectively. Interest rates and other terms of borrowing under these lines of credit vary from country to country depending on local market conditions at the time of the borrowing.

(Dollars in billions)		
At December 31:	1999	1998
Unused Lines		
From the global credit facility	\$ 8.6	\$ 8.8
From other committed and uncommitted lines	4.5	4.3
Total unused lines of credit	\$ 13.1	\$ 13.1

I Sale and Securitization of Receivables

The company manages assets of \$273 million and \$864 million from the securitization of loans, leases and trade receivables, at year-end 1999 and 1998, respectively. The company received cash proceeds of \$1,311 million and \$2,425 million in 1999 and 1998, respectively, from the sale and securitization of these receivables and assets. No significant gain or loss resulted from these transactions. The company expects recourse amounts associated with the aforementioned sale and securitization activities to be minimal, and has adequate reserves to cover potential losses.

J Debt**Short-term debt**

(Dollars in millions)		
At December 31:	1999	1998
Commercial paper	\$ 5,074	\$ 4,885
Short-term loans	3,351	6,370
Long-term debt: Current maturities	5,805	2,650
Total	\$ 14,230	\$ 13,905

The weighted-average interest rates for commercial paper at December 31, 1999 and 1998, were 5.9 percent and 5.7 percent, respectively. The weighted-average interest rates for short-term loans at December 31, 1999 and 1998, were 4.0 percent and 5.3 percent, respectively.

Long-term debt

(Dollars in millions)			
At December 31:	Maturities	1999	1998
U.S. Dollars:			
Debentures:			
6.22%	2027	\$ 500	\$ 500
6.5%	2028	700	700
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: 6.3% average	2000-2014	4,191	2,695
Medium-term note			
program: 5.8% average	2000-2014	6,230	4,885
Other: 6.5% average	2000-2012	1,227	1,514
		15,748	13,194
Other currencies			
(average interest rate at December 31, 1999, in parentheses):			
Japanese yen (3.0%)	2000-2014	3,141	3,866
Canadian dollars (5.7%)	2000-2005	707	672
German marks (4.9%)	2002	103	120
Swiss francs (2.5%)	2001	78	91
U.K. pounds (7.0%)	2000-2003	33	25
Other (13.6%)	2000-2014	159	221
		19,969	18,189
Less: Net unamortized discount			
		40	31
		19,929	18,158
Less: Current maturities			
		5,805	2,650
Total		\$ 14,124	\$ 15,508

Annual maturities in millions of dollars on long-term debt outstanding at December 31, 1999, are as follows: 2000, \$5,805; 2001, \$2,915; 2002, \$2,659; 2003, \$1,234; 2004, \$489; 2005 and beyond, \$6,867.

K Interest on Debt

Interest paid and accrued on borrowings of the company and its subsidiaries was \$1,475 million in 1999, \$1,585 million in 1998 and \$1,596 million in 1997. Of these amounts, the company capitalized \$23 million in 1999, \$28 million in 1998 and \$32 million in 1997. Of the remainder, the company charged to the cost of financing \$725 million in 1999, \$844 million in 1998 and \$836 million in 1997, and to interest expense \$727 million in 1999, \$713 million in 1998 and \$728 million in 1997. The decrease in total interest in 1999 versus 1998 was due primarily to lower average interest rates, partially offset by an increase in average debt outstanding during 1999. The decrease in 1998 versus 1997 was due primarily to lower average interest rates, partially offset by higher outstanding average debt. The average effective interest rate for total debt was 5.1 percent, 5.7 percent and 6.4 percent in 1999, 1998 and 1997, respectively. These rates include the results of currency and interest rate swaps applied to the debt described in note J, "Debt," on page 74.

L Financial Instruments

The company maintains on- and off-balance sheet portfolios of financial instruments.

Financial Instruments On-Balance Sheet (excluding derivatives)

Financial assets with carrying values that approximate fair value include cash and cash equivalents, marketable securities, notes and other accounts receivable and other investments. Financial liabilities with carrying values that approximate 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, all of which are considered available for sale.

MARKETABLE SECURITIES*

(Dollars in millions)	Fair Value	
	1999	1998
At December 31:		
Current marketable securities:		
U.S. government securities	\$ 15	\$ 15
Time deposits and other bank obligations	746	335
Non-U.S. government securities and other fixed-term obligations	27	43
Total	\$ 788	\$ 393
Marketable securities—non-current:**		
Time deposits and other bank obligations	\$ 105	\$ 271
Non-U.S. government securities and other fixed-term obligations	8	10
Total	\$ 113	\$ 281
Alliance investments**	\$ 1,439	\$ 138

* Gross unrealized gains (before taxes) on marketable securities were \$1,310 million and \$87 million at December 31, 1999 and 1998, respectively. Gross unrealized losses (before taxes) on marketable securities were \$7 million and \$8 million at December 31, 1999 and 1998, respectively.

** Included within Investments and sundry assets on the Consolidated Statement of Financial Position. (See note G on page 73.)

Financial Instruments Off-Balance Sheet (excluding derivatives)

IBM has guaranteed certain loans and financial commitments of its affiliates. The approximate amount of these financial guarantees was \$1.2 billion at December 31, 1999 and 1998.

The company's dealers had unused lines of credit available from IBM for working capital financing of approximately \$4.5 billion and \$3.6 billion at December 31, 1999 and 1998, respectively.

The company enters into contracts that effectively provide the company with committed future borrowings in select foreign currencies. The aggregate notional value of these contracts was \$6.4 billion and \$3.0 billion as of December 31, 1999 and 1998, respectively. The terms of these contracts generally are less than eighteen months. Foreign exchange gains and losses associated with these contracts are recorded in net income as they are realized. These amounts have not been and are not expected to be material to the company's financial results.

Derivative Financial Instruments

The company uses derivative financial instruments as an element of its risk management strategy. The company manages the risk

of nonperformance by counterparties 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 these instruments at that time, but does not represent exposure to credit, interest rate or foreign exchange rate market risks.

(Dollars in millions)	At December 31, 1999			At December 31, 1998		
	Notional Value	Carrying Value	Fair Value	Notional Value	Carrying Value	Fair Value
Interest rate and currency contracts	\$ 29,830	\$ (257)	\$ (491)	\$ 31,484	\$ (485)	\$ (427)
Option contracts	1,705	59	54	9,021	67	45
Total	\$ 31,535	\$ (198)	\$ (437)*	\$ 40,505	\$ (418)	\$ (382)*

Amounts in parentheses are liabilities.

* The estimated fair value of derivatives both on- and off-balance sheet at December 31, 1999 and 1998, comprises assets of \$616 million and \$486 million and liabilities of \$1,053 million and \$868 million, respectively.

A significant portion of the company's derivative transactions relates to matching the interest and foreign currency rate profiles of funding liabilities with the interest and foreign currency rate profiles of global financing and other market risk sensitive assets. 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 assets. The company uses interest rate swaps or currency swaps to match the interest rate and currency profiles of its debt to the related assets. The terms of these swap contracts generally are less than five years. Net interest settlements and currency rate differentials that accrue under interest rate and currency swap contracts, respectively, are recognized in interest expense over the life of the contracts.

The company uses its Global Treasury Centers to manage the cash of its subsidiaries. These treasury 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 generally are less than one year. The interest rate differential in these contracts is recognized in interest expense over the life of the contracts.

The company also uses currency swaps and other foreign currency contracts to hedge the foreign currency exposures of certain of the company's net investments in foreign subsidiaries. The currency effects of these hedges are reflected in the Accumulated gains and losses not affecting retained earnings section of stockholders' equity thereby offsetting a portion of the translation of the net foreign assets.

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

For purchased options that hedge qualifying anticipated transactions, gains and losses are deferred and recognized in net income in the same period that the underlying transaction occurs, expires or otherwise is terminated. At December 31, 1999 and 1998, there were no material deferred gains or losses. The premiums associated with entering into these option contracts generally are amortized over the life of the options and are not material to the company's results. Unamortized premiums are recorded in prepaid assets. Gains and losses on purchased options that hedge anticipated transactions that do not qualify for hedge accounting, and on written options, are recorded in earnings as they occur and are not material to the company's results.

M Other Liabilities and Environmental Remediation

Other liabilities principally comprises accruals for nonpension postretirement benefits for U.S. employees (\$6,392 million) and nonpension postretirement benefits, indemnity and retirement plan reserves for non-U.S. employees (\$1,028 million). More detailed discussion of these liabilities appears in note X, "Nonpension Postretirement Benefits," on pages 88 and 89, and note W, "Retirement Plans," on pages 86 through 88.

Also included in other liabilities are non-current liabilities associated with infrastructure reduction and restructuring actions taken through 1993. Other liabilities includes \$659 million for postemployment preretirement accruals and \$503 million (net of sublease receipts) for accruals for leased space that the company vacated.

The company employs extensive internal environmental protection programs that primarily are preventive in nature. The cost of these ongoing programs is recorded as incurred.

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 when it becomes probable that the company will incur clean-up costs and those costs can reasonably be estimated. In addition, estimated environmental costs that are associated with post-closure activities (for example, the removal and restoration of chemical storage facilities and monitoring) are accrued when the decision is made to close a facility. The total amounts accrued, which do not reflect actual or anticipated insurance recoveries, were \$240 million and \$238 million at December 31, 1999 and 1998, respectively.

The amounts accrued do not cover sites that are in the preliminary stages of investigation; that is, for which neither the company's percentage of responsibility nor the extent of cleanup required has been identified. Estimated environmental costs are not expected to materially affect the financial position or results of the company's operations in future periods. However, estimates of future costs are subject to change due to protracted cleanup periods and changing environmental remediation regulations.

N Stockholders' Equity Activity**Stock Repurchases**

From time to time, the Board of Directors authorizes the company to repurchase IBM common stock. The company repurchased 71,618,800 common shares at a cost of \$7.3 billion and 114,768,200 common shares at a cost of \$6.9 billion in 1999 and 1998, respectively. In 1999, the company did not retire the shares it repurchased. The 1998 repurchases resulted in a reduction of \$28,498,409 in the stated capital (par value) associated with common stock. In 1998, the company retired the repurchased shares and restored them to the status of authorized but unissued shares. In 1999 and 1998, the company issued 906,829 and 774,564 shares, respectively, as a result of exercises of employee stock options. At December 31, 1999, approximately \$2.5 billion of Board authorization for repurchases remained. The company plans to purchase shares on the open market from time to time, depending on market conditions.

In 1995, the Board of Directors authorized the company to purchase all of its outstanding Series A 7-1/2 percent preferred stock. The company did not repurchase any shares in 1999. During 1998, the company repurchased 51,250 shares at a cost of \$5.5 million. This resulted in a \$512.50 (\$.01 par value per share) reduction in the stated capital associated with preferred stock as of December 31, 1998. The company retired the

repurchased shares and restored them to the status of authorized but unissued shares. The company plans to purchase the remaining outstanding shares on the open market and in private transactions from time to time, depending on market conditions. There were 2,546,011 shares outstanding at December 31, 1999 and 1998.

Employee Benefits Trust

Effective November 1, 1997, the company created an employee benefits trust to which it contributed 20 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 those sales, and any dividends paid on the contributed stock, toward the partial satisfaction of the company's future obligations under certain of its compensation and benefits plans. The shares held in trust are not considered outstanding for purposes of calculating earnings per share until they are committed to be released. The trustee will vote the shares in accordance with its fiduciary duties. As of December 31, 1999 and 1998, the company had not committed any shares to be released.

At December 31, 1998, the company adjusted its valuation of the employee benefits trust to fair value. This adjustment affected only line items within stockholders' equity; it did not affect total stockholders' equity or net income.

Accumulated Gains and Losses Not Affecting Retained Earnings

(Dollars in millions)	Foreign Currency Items*	Net Unrealized Gains (Losses) on Marketable Securities*	Total Gains and Losses Not Affecting Retained Earnings*
Beginning balance, January 1, 1997	\$ 2,401	\$ 168	\$ 2,569
Change for period	(1,610)	(60)	(1,670)
Ending balance, December 31, 1997	791	108	899
Change for period	69	(57)	12
Ending balance, December 31, 1998	860	51	911
Change for period	(546)	796	250
Ending balance, December 31, 1999	\$ 314	\$ 847	\$ 1,161

* Net of tax.

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NET CHANGE IN UNREALIZED GAINS (LOSSES) ON
MARKETABLE SECURITIES (NET OF TAX)

(Dollars in millions)

For the year ended December 31:	1999	1998*
Net unrealized gains arising during the period	\$ 943	\$ 44
Less net gains included in net income for the period	147	101
Net increase in net unrealized gains on marketable securities	\$ 796	\$ (57)

* Restated to present amounts net of tax.

O Contingencies

The company is subject to a variety of claims and suits that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property, product liability and environmental matters. The company does not believe that any current action will have a material effect on the company's business, financial condition or results of operations.

P Taxes

(Dollars in millions)

For the year ended December 31:	1999	1998	1997
Income before income taxes:			
U.S. operations	\$ 5,892	\$ 2,960	\$ 3,193
Non-U.S. operations	5,865	6,080	5,834
	\$ 11,757	\$ 9,040	\$ 9,027

The provision for income taxes by geographic operations is as follows:

U.S. operations	\$ 2,005	\$ 991	\$ 974
Non-U.S. operations	2,040	1,721	1,960
Total provision for income taxes	\$ 4,045	\$ 2,712	\$ 2,934

The components of the provision for income taxes by taxing jurisdiction are as follows:

(Dollars in millions)

For the year ended December 31:	1999	1998	1997
U.S. federal:			
Current	\$ 1,759	\$ 1,117	\$ 163
Deferred	(427)	(475)	349
	1,332	642	512
U.S. state and local:			
Current	272	139	83
Deferred	7	(260)	(87)
	279	(121)	(4)
Non-U.S.:			
Current	2,727	2,062	2,330
Deferred	(293)	129	96
	2,434	2,191	2,426
Total provision for income taxes	4,045	2,712	2,934
Provision for social security, real estate, personal property and other taxes	2,831	2,859	2,774
Total provision for taxes	\$ 6,876	\$ 5,571	\$ 5,708

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

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

DEFERRED TAX ASSETS

(Dollars in millions)

At December 31:	1999	1998
Employee benefits	\$ 3,737	\$ 3,909
Alternative minimum tax credits	1,244	1,169
Bad debt, inventory and warranty reserves	1,093	1,249
Infrastructure reduction charges	918	863
Capitalized research and development	880	913
Deferred income	870	686
General business credits	605	555
Foreign tax loss carryforwards	406	304
Equity alliances	377	387
Depreciation	326	201
State and local tax loss carryforwards	227	212
Intracompany sales and services	153	182
Other	2,763	2,614
Gross deferred tax assets	13,599	13,244
Less: Valuation allowance	647	488
Net deferred tax assets	\$ 12,952	\$ 12,756

DEFERRED TAX LIABILITIES

(Dollars in millions)

At December 31:	1999	1998
Retirement benefits	\$ 3,092	\$ 2,775
Sales-type leases	2,914	3,433
Depreciation	1,237	1,505
Software costs deferred	250	287
Other	2,058	1,841
Gross deferred tax liabilities	\$ 9,551	\$ 9,841

The valuation allowance at December 31, 1999, principally applies to certain state and local and foreign tax loss carryforwards that, in the opinion of management, are more likely than not to expire before the company can use 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:	1999	1998	1997
Statutory rate	35%	35%	35%
Foreign tax differential	(2)	(6)	(3)
State and local	1	1	1
Valuation allowance related items	—	(1)	—
Other	—	1	—
Effective rate	34%	30%	33%

For tax return purposes, the company has available tax credit carryforwards of approximately \$1,919 million, of which \$1,244 million have an indefinite carryforward period, \$199 million expire in 2004 and the remainder thereafter. The company also has state and local and foreign tax loss carryforwards, the tax effect of which is \$633 million. Most of these carryforwards are available for 10 years or have an indefinite carryforward period.

Undistributed earnings of non-U.S. subsidiaries included in consolidated retained earnings were \$14,900 million at December 31, 1999, \$13,165 million at December 31, 1998, and \$12,511 million at December 31, 1997. 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.

Q Selling and Advertising

Selling and advertising expense is charged against income as incurred. Advertising expense, which includes media, agency and promotional expenses, was \$1,758 million, \$1,681 million and \$1,708 million in 1999, 1998 and 1997, respectively.

R 1999 Actions**Technology Group Actions**

During 1999, the company implemented actions that were designed to better align the operations and cost structure of IBM's Technology Group with that group's strategic direction in view of the competitive environment, overcapacity in the industry and resulting pricing pressures. The actions affect the Microelectronics Division (MD), the Storage Systems Division (SSD) and the Networking Hardware Division (NHD) of the company's Technology Group. The company expects these actions to be substantially completed by the first half of 2000.

In total, the Technology Group actions resulted in a charge of \$1,690 million (\$1,366 million after tax, or \$.73 per diluted common share) as described below and in the table on page 82.

The actions within MD addressed a prolonged, industry-wide downturn in memory chip prices that affected the results of the company's semiconductor business. They are intended to enable the company to (1) reconfigure the assets and capabilities of the division to allow more focus on the faster-growth, higher-margin custom logic portion of the MD business and (2) enhance its ability to more cost effectively manage a partnership agreement that was formed to produce complementary metal oxide semiconductor (CMOS) based logic components.

The company will reduce its internal dynamic random access memory (DRAM) capacity by converting its manufacturing facility in Essonnes, France, from DRAM to custom logic over an 18-month period. The company is effecting that conversion through a joint venture with Infineon Technologies, a subsidiary of Siemens AG. Also related to DRAM, the company executed contracts with various banks and other financing institutions to sell and lease back test equipment.

The company also participates in a 50/50 joint venture (Dominion Semiconductor Company) with Toshiba Corporation to produce DRAM memory components. The company entered into an agreement whereby Toshiba will assume the company's interest in Dominion effective December 31, 2000. The company will participate in the capacity output of Dominion at a significantly reduced rate in the interim period.

The company held a majority interest in a joint venture (MiCRUS) with Cirrus Logic Inc. (the partner) to produce CMOS-based logic components for IBM and its partner based on contractual capacity agreements. The partner indicated that it would not require the output capacity that is provided for in the partnership agreement. The company determined that the most cost-effective manner in which to address the partner's desire to exit the partnership agreement was to acquire the minority interest held by that partner.

The company also announced aggressive steps intended to improve its competitive position in the markets that SSD serves by merging server hard disk drive (HDD) product lines and realigning operations. The company is integrating all server HDDs into a single low-cost design platform that uses common development and manufacturing processes. The company continues to transfer manufacturing assembly and test operations to Hungary and Mexico and expects to complete these actions by mid 2000.

The actions within NHD relate to a global alliance with Cisco Systems, Inc. As a result of the announcement of the alliance, demand for the router and switch products from both existing and new customers deteriorated.

The following table identifies the significant components of the pre-tax charge related to the 1999 actions as well as the after-tax charges and the effect on earnings per share assuming dilution; the investments and other asset write-downs in 1999; and the liability as of December 31, 1999:

(Dollars in millions except per share amounts)	Total Pre-Tax Charges*	After-Tax Charges	Effect on Earnings per Share— Assuming Dilution	Investments and Other Asset Write-Downs	Liability Created in 1999	Liability as of Dec. 31, 1999
Technology Group						
MD Actions:						
DRAM						
Equipment ⁽¹⁾	\$ 662	\$ 603	\$.32	\$ 662	\$ —	\$ —
Employee Terminations ⁽²⁾	167	167	.09	—	167	149
Dominion Investment ⁽³⁾	171	104	.05	171	—	—
MiCRUS Investment ⁽⁴⁾	152	92	.05	—	152	152
SSD Actions:						
Equipment ⁽⁵⁾	337	277	.15	337	—	—
Employee Terminations ⁽⁶⁾	23	14	.01	—	23	7
NHD Action:						
Inventory Write-downs and Contract Cancellations ⁽⁷⁾	178	109	.06	178	—	—
Total 1999 Actions	\$ 1,690	\$ 1,366	\$.73	\$ 1,348	\$ 342	\$ 308

* With the exception of NHD inventory write-downs, all charges were recorded in Selling, general and administrative expense. NHD inventory write-downs were recorded in Hardware cost.

- (1) Represents (a) the difference between net book value and fair value of assets that were contributed to a joint venture, (b) the book value of assets that were idled as a result of the MD actions and that were scrapped and (c) the difference between the net book value and the appraised fair value of test equipment subject to sale-leaseback agreements.
- (2) Workforce reductions that affect approximately 790 employees (455 direct manufacturing and 335 indirect manufacturing) in France. The workforce reductions are expected to be substantially completed by the end of the first quarter of 2000.
- (3) Write-off of investment in joint venture at the signing of the agreement with Toshiba Corporation.
- (4) Acquisition of minority interest in MiCRUS and charges for equipment leasehold cancellation liabilities and lease rental payments for idle equipment.
- (5) Represents (a) the book value of assets that were idled as a result of the SSD actions and scrapped, (b) write-downs to fair value of equipment under contract for sale and delivery by December 31, 1999, and March 31, 2000, and (c) the difference between the net book value and the appraised fair value of equipment subject to sale-leaseback agreements.
- (6) Workforce reductions that affect approximately 900 employees (780 direct manufacturing and 120 indirect manufacturing) in the United States. There are 210 terminations remaining in the first half of 2000.
- (7) Write-down to net realizable value of inventory of router and switch products (\$144 million) and contract cancellation fees (\$34 million) related to deterioration in demand for router and switch products.

Change in Estimate

As a result of a change in estimate of the useful life of personal computers (PCs) from five years to three years, the company recognized a charge in the second quarter of 1999 of \$404 million (\$241 million after tax, \$.13 per diluted common share). In the second quarter, the company wrote off the net book value of PCs that were 3 years or older and, therefore, had no remaining useful life. The remaining book value of the assets will be depreciated over the remaining new useful life. The net effect on future operations is expected to be minimal as the increased depreciation due to the shorter life will be offset by the lower depreciable base attributable to the write-off of PCs older than three years.

S Research, Development and Engineering

Research, development and engineering expense was \$5,273 million in 1999, \$5,046 million in 1998 and \$4,877 million in 1997. Expenses for product-related engineering included in these amounts were \$698 million, \$580 million and \$570 million in 1999, 1998 and 1997, respectively.

The company had expenses of \$4,575 million in 1999, \$4,466 million in 1998 and \$4,307 million in 1997 for 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 expenses were \$2,036 million, \$2,086 million and \$2,016 million in 1999, 1998 and 1997, respectively. Included in the expense each year are charges for acquired in-process research and development. See note D, "Acquisitions/Divestitures" on pages 72 and 73 for further information about that expense.

T Earnings Per Share of Common Stock

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

For the year ended December 31:	1999	1998	1997
Number of shares on which basic earnings per share is calculated:			
Weighted-average shares outstanding during year	1,808,538,346	1,869,005,570	1,966,572,722
Add—Incremental shares under stock compensation plans	59,344,849	51,124,900	55,297,162
Add—Incremental shares associated with contingently issuable shares	3,190,717	—	—
Number of shares on which diluted earnings per share is calculated	1,871,073,912	1,920,130,470	2,021,869,884
Net income applicable to common stockholders (millions)	\$ 7,692	\$ 6,308	\$ 6,073
Add—net income applicable to contingently issuable shares (millions)	11	—	—
Net income on which diluted earnings per share is calculated (millions)	\$ 7,703	\$ 6,308	\$ 6,073
Earnings per share of common stock:			
Assuming dilution	\$ 4.12	\$ 3.29	\$ 3.00
Basic	\$ 4.25	\$ 3.38	\$ 3.09

Stock options to purchase 27,355,056 common shares in 1999, 4,124,730 shares in 1998 and 331,666 shares in 1997 were outstanding, but were not included in the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the common shares and, therefore, the effect would have been antidilutive. In addition, 5,131,038 restricted stock units in 1998 relating to the company's Long Term Performance Plan were not included in the computation of diluted earnings per share as their effect would have been antidilutive. Net income applicable to common stockholders excludes preferred stock dividends of \$20 million for 1999, 1998 and 1997.

U Rental Expense and Lease Commitments

Rental expense, including amounts charged to inventories and fixed assets and excluding amounts previously reserved, was \$1,397 million in 1999, \$1,431 million in 1998 and \$1,280 million in 1997. The table below depicts (a) gross minimum rental commitments under noncancelable leases, including amounts related to vacant space associated with infrastructure reduction and restructuring actions taken through 1993 (previously reserved), and (b) offsetting sublease income commitments. These amounts generally reflect activities related to office space and manufacturing equipment.

(Dollars in millions)	2000	2001	2002	2003	2004	Beyond 2004
Gross rental commitments	\$ 1,314	\$ 1,143	\$ 982	\$ 769	\$ 469	\$ 1,213
Vacant space	219	168	122	75	41	130
Sublease income commitments	124	91	71	48	34	62

V Stock-Based Compensation Plans

The company applies Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for its stock-based compensation plans. A description of the terms of the company's stock-based compensation plans follows:

Long-Term Performance Plan

Incentive awards are provided to officers and other key employees under the terms of the IBM 1999 Long-Term Performance Plan, which was approved by stockholders in April 1999, the IBM 1997 Long-Term Performance Plan, which was approved by stockholders in April 1997, and its predecessor plan, the IBM 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, restricted stock, cash or stock awards, or any combination thereof. The number of shares that may be issued under the IBM 1999 Long-Term Performance Plan is 118.7 million, which

was 6.5 percent of the company's outstanding common stock on February 10, 1999. No shares were issued under this Plan during 1999. There were 33.7 million and 68.8 million unused shares available to be granted under the IBM 1997 Long-Term Performance Plan as of December 31, 1999 and 1998, respectively. As of December 31, 1999, there were no unused shares under the IBM 1994 Long-Term Performance Plan. There were 4.1 million shares available to be granted under that Plan as of December 31, 1998.

With the exception of stock options, these awards (which are expressed in terms of shares) are adjusted to fair value at the end of each period and the change in value is included in net income. Awards under the Plans resulted in compensation expense of \$267.3 million, \$322.4 million and \$214.1 million in 1999, 1998 and 1997, respectively.

STOCK OPTION GRANTS

Stock options are granted to employees at an exercise price equal to the fair market value of the company's stock at the date of grant. Generally, options vest 25 percent per year, are fully vested four years from the grant date and have a term of 10 years. The following tables summarize option activity under the Plans during 1999, 1998 and 1997:

	1999		1998		1997	
	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	\$ 36	131,443,850	\$ 27	123,456,722	\$ 22	122,870,644
Options granted	115	42,786,845	53	41,175,350	36	42,942,456
Options exercised	28	(23,160,228)	22	(29,633,476)	21	(39,260,010)
Options canceled/expired	61	(4,933,944)	36	(3,554,746)	28	(3,096,368)
Balance at December 31	\$ 60	146,136,523	\$ 36	131,443,850	\$ 27	123,456,722
Exercisable at December 31	\$ 29	51,599,735	\$ 22	46,191,636	\$ 19	53,239,096

The shares under option at December 31, 1999, were in the following exercise price ranges:

Exercise Price Range	Options Outstanding			Options Currently Exercisable	
	No. of Options	Wtd. Avg. Exercise Price	Wtd. Avg. Remaining Contractual Life (in years)	No. of Options	Wtd. Avg. Exercise Price
\$ 10 – 40	64,827,422	\$ 28	6	42,694,829	\$ 24
\$ 41 – 70	37,007,973	52	8	8,234,965	52
\$ 71 – 100	17,135,848	87	9	664,991	76
\$ 101 and over	27,165,280	127	10	4,950	126
	146,136,523	\$ 60		51,599,735	\$ 29

International Business Machines Corporation
and Subsidiary Companies**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 the applicable pay period. The stockholders approved the current plan in 1995. Approximately 57.3 million, 63.0 million and 71.0 million reserved unissued shares were available for purchase under the ESPP at December 31, 1999, 1998 and 1997, respectively.

During 1999, 1998 and 1997, employees purchased 5.7 million, 8.0 million and 9.4 million shares, respectively, all of which were

treasury shares, and paid to IBM \$514 million, \$415 million and \$354 million, respectively, for these shares.

Pro Forma Disclosure

In accordance with APB Opinion No. 25, the company does not recognize expense for stock options granted under the Plans or for employee stock purchases under the ESPP. SFAS No. 123, "Accounting for Stock-Based Compensation," requires a company to determine the fair market value of all awards of stock-based compensation using an option-pricing model and to disclose pro forma net income and earnings per share as if the resulting stock-based compensation amounts were recorded in the Consolidated Statement of Earnings. The table below presents these pro forma disclosures.

(Dollars in millions except per share amounts)	1999		1998		1997	
	As reported	Pro forma	As reported	Pro forma	As reported	Pro forma
Net income applicable to common shareholders	\$ 7,692	\$ 7,044	\$ 6,308	\$ 5,985	\$ 6,073	\$ 5,866
Earnings per share of common stock—assuming dilution	\$ 4.12	\$ 3.78	\$ 3.29	\$ 3.12	\$ 3.00	\$ 2.91
Earnings per share of common stock—basic	\$ 4.25	\$ 3.89	\$ 3.38	\$ 3.20	\$ 3.09	\$ 2.98

The pro forma amounts that are disclosed in accordance with SFAS 123 reflect the portion of the estimated fair value of awards that was earned in 1999, 1998 and 1997.

The company used the Black-Scholes model to value the stock options that it granted in 1999, 1998 and 1997. The assumptions that the company used to estimate the fair value of the options and the weighted-average estimated fair value of an option on the date of grant are as follows:

	1999	1998	1997
Term (years)*	5/6	5/6	5/6
Volatility**	27.3%	26.4%	23.0%
Risk-free interest rate (zero coupon U.S. treasury note)	6.6%	5.1%	6.2%
Dividend yield	0.4%	0.8%	1.0%
Weighted-average fair value per option	\$ 46	\$ 18	\$ 13

* Option term is 5 years for tax incentive options and 6 years for non-tax incentive options.

** To determine volatility, the company measured the daily price changes of the stock over the last 5- and 6-year periods for tax incentive options and non-tax incentive options, respectively.

W Retirement Plans

The company and its subsidiaries have defined benefit and defined contribution retirement plans that cover substantially all regular employees, and a supplemental retirement plan that covers certain executives.

The changes in the benefit obligations and plan assets of the U.S. and material non-U.S. defined benefit plans for 1999 and 1998 were as follows:

(Dollars in millions)	U.S. Plan		Non-U.S. Plans	
	1999	1998	1999	1998
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 36,561	\$ 33,161	\$ 22,048	\$ 18,846
Service cost	566	532	475	399
Interest cost	2,404	2,261	1,282	1,213
Plan participants' contributions	—	—	29	29
Acquisitions/divestitures, net	68	22	(47)	—
Amendments	75	—	—	2
Actuarial (gains) losses	(2,766)	2,729	522	1,331
Benefits paid from trust	(2,474)	(2,144)	(737)	(683)
Direct benefit payments	—	—	(257)	(254)
Foreign exchange impact	—	—	(1,552)	1,155
Plan curtailments/settlements/termination benefits	—	—	7	10
Benefit obligation at end of year	34,434	36,561	21,770	22,048
Change in plan assets:				
Fair value of plan assets at beginning of year	41,593	38,475	25,294	21,841
Actual return on plan assets	6,397	5,240	5,184	2,400
Employer contribution	—	—	143	452
Acquisitions/divestitures, net	68	22	(36)	—
Plan participants' contributions	—	—	29	29
Benefits paid from trust	(2,474)	(2,144)	(737)	(683)
Foreign exchange impact	—	—	(1,995)	1,283
Settlements	—	—	(39)	(28)
Fair value of plan assets at end of year	45,584	41,593	27,843	25,294
Fair value of plan assets in excess of benefit obligation	11,150	5,032	6,073	3,246
Unrecognized net actuarial gains	(7,003)	(1,289)	(4,597)	(2,342)
Unrecognized prior service costs	269	174	140	181
Unrecognized net transition asset	(632)	(771)	(72)	(78)
Adjustment to recognize minimum liability	—	—	(84)	(87)
Net prepaid pension asset recognized in the Consolidated Statement of Financial Position	\$ 3,784	\$ 3,146	\$ 1,460	\$ 920

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 participants.

Effective July 1, 1999, IBM converted to a new formula, the Personal Pension Account (PPA), for determining pension benefits for most of its employees. Under the PPA, retirement benefits are credited to each employee's cash balance account monthly based on a percentage of the employee's pensionable compensation. Employees who were retirement eligible or within five years of retirement eligibility with at least one year of service, or who were at least forty years of age with at least ten years of service as of June 30, 1999, could elect to participate in the PPA or to have their service and earnings credit accrue under the preexisting benefit formula. Benefits become vested on the completion of five years of service under either formula.

The number of individuals who were receiving benefits at December 31, 1999 and 1998, was 124,175 and 116,685, respectively.

Non-U.S. Plans

Most subsidiaries and branches outside the U.S. have retirement plans that cover substantially all regular employees, under

which the company deposits funds under various fiduciary-type arrangements, purchases annuities under group contracts or provides reserves. Retirement benefits are based on years of service and the employee's compensation, generally during a fixed number of years immediately before retirement. The ranges of assumptions that are used for the non-U.S. plans reflect the different economic environments within various countries.

U.S. Supplemental Executive Retention Plan

The company also has a non-qualified U.S. Supplemental Executive Retention Plan (SERP). The SERP, which is unfunded, provides defined pension benefits outside the IBM Retirement Plan to eligible executives based on average earnings, years of service and age at retirement. Effective July 1, 1999, the company adopted the Supplemental Executive Retention Plan (which replaces the previous Supplemental Executive Retirement Plan). Some participants of the pre-existing SERP still will be eligible for benefits under that plan, but will not be eligible for the new plan. At December 31, 1999 and 1998, the projected benefit obligation was \$149 million and \$178 million, respectively, and the amounts included in the Consolidated Statement of Financial Position were pension liabilities of \$109 million and \$81 million, respectively.

WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31:

	U.S. Plan			Non-U.S. Plans		
	1999	1998	1997	1999	1998	1997
Discount rate	7.75%	6.5%	7.0%	4.5–7.3%	4.5–7.5%	4.5–7.5%
Expected return on plan assets	9.5%	9.5%	9.5%	6.0–10.5%	6.5–10.0%	6.0–9.5%
Rate of compensation increase	6.0%	5.0%	5.0%	2.6–6.1%	2.7–6.1%	2.6–6.1%

COST OF THE DEFINED BENEFIT PLANS:

(Dollars in millions)	U.S. Plan			Non-U.S. Plans		
	1999	1998	1997	1999	1998	1997
Service cost	\$ 566	\$ 532	\$ 397	\$ 475	\$ 399	\$ 366
Interest cost	2,404	2,261	2,215	1,282	1,213	1,182
Expected return on plan assets	(3,463)	(3,123)	(2,907)	(1,937)	(1,739)	(1,457)
Net amortization of unrecognized net actuarial gains, net transition asset and prior service costs	(145)	(124)	(125)	42	21	15
Settlement (gains)/losses	—	—	—	(23)	10	(63)
Net periodic pension (benefit) cost—U.S. Plan and material non-U.S. Plans	\$ (638)	\$ (454)	\$ (420)	\$ (161)	\$ (96)	\$ 43
Total net periodic pension (benefit) cost for all non-U.S. Plans				\$ (124)	\$ (42)	\$ 50
Cost of defined contribution plans	\$ 275	\$ 258	\$ 236	\$ 131	\$ 90	\$ 64
Cost of complementary defined benefits	\$ 38	\$ 34	\$ 33			
Cost of U.S. Supplemental Executive Retention Plan	\$ 30	\$ 25	\$ 20			

Net periodic pension cost is determined using the Projected Unit Credit actuarial method.

The effects on the company's results of operations and financial position from most changes in the estimates and assumptions used to compute pension and prepaid pension assets or pension liability is mitigated by the delayed recognition provisions of SFAS No. 87, "Employers' Accounting for Pensions." The effects of settlement gains, curtailment losses and early terminations are recognized immediately. The 1.25 percent increase in the discount rate in 1999 resulted in an actuarial gain of \$5,003 million for the U.S. plan. The 0.5 percent decrease in the discount rate in 1998 resulted in an actuarial loss of \$2,144 million for the U.S. plan.

It is the company's practice to fund amounts for pensions sufficient to meet the minimum requirements set forth in applicable employee benefits laws and local tax laws. From time to time, the company contributes additional amounts as it deems appropriate. 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 real estate.

At December 31, 1999, the material non-U.S. defined benefit plans in which the plan assets exceeded the benefit obligation had obligations of \$21,168 million and assets of \$27,400 million. The material non-U.S. defined benefit plans in which the benefit obligation exceeded the fair value of plan assets had obligations of \$602 million and assets of \$443 million.

At December 31, 1998, the material non-U.S. defined benefit plans in which the plan assets exceeded the benefit obligation had obligations of \$18,217 million and assets of \$21,736 million. The material non-U.S. defined benefit plans in which the benefit obligation exceeded the fair value of plan assets had obligations of \$3,831 million and assets of \$3,558 million.

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. Effective July 1, 1999, IBM established a "Future Health Account (FHA) Plan" for employees who are more than five years away from retirement eligibility. Employees who are eligible to retire within five years retained the benefits under the company's preexisting retiree health benefits plan. Under either the FHA or the preexisting plan, there is a maximum cost to the company for retiree health care. For employees who retired before January 1, 1992, that maximum will become effective in the year 2001. For all other employees, the maximum is effective on retirement.

The changes in the benefit obligation and plan assets of the U.S. plans for 1999 and 1998 are as follows:

<i>(Dollars in millions)</i>	1999	1998
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 6,457	\$ 6,384
Service cost	48	42
Interest cost	424	427
Amendments	(127)	(26)
Actuarial gains	(445)	(146)
Actuarial losses	371	272
Benefits paid from trust	(325)	(486)
Direct benefit payments	(225)	(10)
Benefit obligation at end of year	6,178	6,457
Change in plan assets:		
Fair value of plan assets at beginning of year	123	120
Actual (loss)/gain on plan assets	(18)	10
Employer contributions	325	479
Benefits paid, net of employee contributions	(325)	(486)
Fair value of plan assets at end of year	105	123
Benefit obligation in excess of plan assets	(6,073)	(6,334)
Unrecognized net actuarial losses	631	700
Unrecognized prior service costs	(948)	(965)
Accrued postretirement benefit liability recognized in the Consolidated Statement of Financial Position	\$ (6,390)	\$ (6,599)

The benefit obligation was determined by applying 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 include a projected healthcare cost trend rate of 6 percent.

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

(Dollars in millions)	1999	1998	1997
Service cost	\$ 48	\$ 42	\$ 32
Interest cost	424	427	455
Expected return on plan assets	(6)	(5)	(15)
Net amortization of unrecognized net actuarial losses and prior service costs	(124)	(133)	(119)
Net periodic postretirement benefit cost	\$ 342	\$ 331	\$ 353

WEIGHTED-AVERAGE ASSUMPTIONS AS OF DECEMBER 31:

Discount rate	7.75%	6.5%	7.0%
Expected return on plan assets	5.0%	5.0%	5.0%

The plan assets primarily comprise short-term fixed income investments.

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

A one-percentage-point change in the assumed healthcare cost trend rate would have the following effects as of December 31, 1999:

(Dollars in millions)	One-Percentage-Point Increase	One-Percentage-Point Decrease
Effect on total service and interest cost	\$ 7	\$ (9)
Effect on postretirement benefit obligation	\$ 95	\$ (120)

Y Segment Information

IBM uses advanced information technology to provide customer solutions. The company operates primarily in a single industry using several segments that create value by offering a variety of solutions that include, either singularly or in some combination, technologies, systems, products, services, software and financing.

Organizationally, the company's major operations comprise three hardware product segments—Technology, Personal Systems and Server; a Global Services segment; a Software segment; a Global Financing segment and an Enterprise Investment segment. The segments are determined based on several factors, including customer base, homogeneity of products, technology and delivery channels.

The Technology segment produces peripheral equipment for use in general-purpose computer systems, including storage and networking devices, advanced function printers and display devices. In addition, the segment provides components such as semiconductors and HDDs for use in the company's products and for sale to original equipment manufacturers (OEM). Major business units include Storage Systems, Microelectronics, Printer Systems and Networking Hardware.

The Personal Systems segment produces general-purpose computer systems, including some system and consumer software, that operate applications for use by one user at a time (personal computer clients) or as servers, and display devices. Major brands include the Aptiva home PCs, IntelliStation workstations, Netfinity servers, PC 300 commercial desktop and ThinkPad mobile systems. These products are sold directly by the company and through reseller and retail channels.

The Server segment produces powerful multi-purpose computer systems that operate many open-network-based applications and are used simultaneously by multiple users. They perform high-volume transaction processing and serve data to personal systems and other end-user devices. The servers are the engines behind the bulk of electronic business transactions, including e-commerce. Brands include S/390, AS/400, RS/6000 and NUMA-Q. The segment's products are sold directly by the company and through business partner relationships.

The Global Services segment is the world's largest and most versatile information technology services provider, supporting computer hardware and software products and providing professional services to help customers of all sizes realize the full value of information technology. The segment provides value through three primary lines of business: Strategic Outsourcing Services; Business Innovation Services; and Integrated Technology Services. Strategic Outsourcing Services create business value through long-term strategic partnerships with customers by taking on responsibility for their processes and systems. Business Innovation Services (formerly Systems Integration and Consulting) provide business/industry consulting and end-to-end e-business implementation of offerings like Supply Chain Management, Customer Relationship Management, Enterprise Resource Planning and Business Intelligence.

Integrated Technology Services offer customers a single IT partner to manage multi-vendor IT systems' complexity in today's e-business environment including traditional offerings like Product Support, Business Recovery Services, Site and Connectivity Services, and Systems Management and Networking Services. Learning Services supports the three primary lines of business and help customers design, develop and deploy curricula to educate their employees. The Global Services segment is uniquely suited to integrate the full range of the company's and key industry participants' capabilities, including hardware, software, services and research.

The Software segment delivers operating systems for the company's servers and e-business enabling software (middleware) for IBM and non-IBM platforms. The company has reorganized its e-business offerings to align with key customer opportunity areas—transformation and integration, leveraging information, organizational effectiveness and managing technology. In addition to its own development, product and marketing effort, the segment supports more than 35,000 Independent Software Vendors to ensure that the company's software and hardware offerings are included in those partners' solutions.

The Global Financing segment is the world's largest provider of financing services for information technology (IT). The segment provides lease and loan financing that enables the company's customers to acquire complete IT and e-business solutions—hardware, software and services—provided by the company and its business partners. Special focus is placed on the financing needs of small and medium businesses, and the emerging financing needs of NetGen companies. Global Financing, as a reliable source of capital for the distribution channel, also provides the company's business partners with customized commercial financing for inventory, accounts receivable, term loans and acquisitions, helping them manage their cash flow, invest in infrastructure and grow their business.

The Enterprise Investments segment provides industry specific information technology solutions, supporting the hardware, software and services segments of the company. The segment develops unique products designed to meet specific marketplace requirements and to complement the company's overall portfolio of products.

Segment revenue and pre-tax income include transactions between the segments that are intended to reflect an arm's-length transfer at the best price available for comparable external customers. Specifically, semiconductors and disk drives are

sourced internally from the Technology segment for use in the manufacture of the Server segment and Personal Systems segment products. Technology, hardware and software that are used by the Global Services segment in outsourcing engagements are sourced internally from the Technology, Server, Personal Systems and Software segments. For the internal use of information technology services, the Global Services segment recovers cost as well as a reasonable fee reflecting the arm's-length value of providing the services. The Global Services segment enters into arm's-length leases at prices equivalent to market rates with the Global Financing segment to facilitate the acquisition of equipment used in outsourcing engagements. All internal transaction prices are reviewed and reset annually if appropriate.

The company extensively uses shared-staff concepts to realize economies of scale and efficient use of resources. Thus, a significant amount of expense is shared by all of the company's segments. This expense represents sales coverage, marketing and support functions such as Accounting, Treasury, Procurement, Legal, Human Resources, and Billing and Collections. Where practical, shared expenses are allocated based on measurable drivers of expense; e.g., Human Resources costs are allocated on headcount while account coverage expenses are allocated on a revenue mix that reflects the company's sales commission plan. When a clear and measurable driver cannot be identified, shared expenses are allocated on a financial basis that is consistent with the company's management system; e.g., image advertising is allocated based on the gross profit of the segments. The unallocated corporate expenses arising from certain acquisitions, indirect infrastructure reductions, certain intellectual property income and currency exchange gains and losses are recorded in net income but are not allocated to the segments.

The following tables reflect the results of the segments consistent with the company's management system. These results are not necessarily a depiction that is in conformity with generally accepted accounting principles; e.g., employee retirement plan costs are developed using actuarial assumptions on a country-by-country basis and allocated to the segments on headcount. A different result could be arrived at for any segment using actuarial assumptions that are unique to the segment. Performance measurement is based on income before income taxes (pre-tax income). These results are used, in part, by management, both in evaluating the performance of, and in allocating resources to, each of the segments.

notes to consolidated financial statements

International Business Machines Corporation
and Subsidiary Companies

MANAGEMENT SYSTEM SEGMENT VIEW

(Dollars in millions)	Hardware			Global Services	Software	Global Financing	Enterprise Investments	Total Segments
	Technology	Personal Systems	Server					
1999:								
External revenue	\$ 12,597	\$ 15,290	\$ 8,718	\$ 32,172	\$ 12,662	\$ 3,219	\$ 2,499	\$ 87,157
Internal revenue	3,800	45	326	2,636	767	835	19	8,428
Total revenue	\$ 16,397	\$ 15,335	\$ 9,044	\$ 34,808	\$ 13,429	\$ 4,054	\$ 2,518	\$ 95,585
Pre-tax income	\$ 764	\$ (557)	\$ 1,590	\$ 4,528	\$ 2,830	\$ 1,286	\$ (324)	\$ 10,117
Revenue year-to-year change	(0.4)%	19.8%	(18.3)%	9.9%	6.5%	7.5%	(0.2)%	5.1%
Pre-tax income year-to-year change	(20.0)%	43.9%	(44.1)%	20.5%	9.4%	10.4%	47.4%	4.3%
Pre-tax income margin	4.7%	(3.6)%	17.6%	13.0%	21.1%	31.7%	(12.9)%	10.6%
1998:								
External revenue	\$ 11,890	\$ 12,776	\$ 10,624	\$ 28,916	\$ 11,863	\$ 2,979	\$ 2,468	\$ 81,516
Internal revenue	4,578	29	445	2,747	749	792	56	9,396
Total revenue	\$ 16,468	\$ 12,805	\$ 11,069	\$ 31,663	\$ 12,612	\$ 3,771	\$ 2,524	\$ 90,912
Pre-tax income	\$ 955	\$ (992)	\$ 2,842	\$ 3,757	\$ 2,588	\$ 1,165	\$ (616)	\$ 9,699
Revenue year-to-year change	(4.4)%	(10.8)%	(6.0)%	13.5%	6.6%	5.8%	0.6%	2.0%
Pre-tax income year-to-year change	(47.1)%	(516.1)%	(1.9)%	30.0%	27.2%	3.0%	32.3%	0.1%
Pre-tax income margin	5.8%	(7.7)%	25.7%	11.9%	20.5%	30.9%	(24.4)%	10.7%
1997:								
External revenue	\$ 11,083	\$ 14,337	\$ 11,286	\$ 25,166	\$ 11,164	\$ 2,935	\$ 2,438	\$ 78,409
Internal revenue	6,147	20	491	2,737	671	628	70	10,764
Total revenue	\$ 17,230	\$ 14,357	\$ 11,777	\$ 27,903	\$ 11,835	\$ 3,563	\$ 2,508	\$ 89,173
Pre-tax income	\$ 1,806	\$ (161)	\$ 2,896	\$ 2,890	\$ 2,034	\$ 1,131	\$ (910)	\$ 9,686
Revenue year-to-year change	0.3%	3.3%	(6.9)%	12.6%	(1.5)%	(3.3)%	5.0%	3.0%
Pre-tax income year-to-year change	17.7%	(312.8)%	(12.1)%	14.3%	(17.5)%	(10.2)%	(17.4)%	(5.7)%
Pre-tax income margin	10.5%	(1.1)%	24.6%	10.4%	17.2%	31.7%	(36.3)%	10.9%

Reconciliations to IBM as Reported

(Dollars in millions)	1999	1998	1997	(Dollars in millions)	1999	1998	1997
REVENUE:				PRE-TAX INCOME:			
Total reportable segments	\$ 95,585	\$ 90,912	\$ 89,173	Total reportable segments	\$ 10,117	\$ 9,699	\$ 9,686
Other revenues	391	151	99	Elimination of internal transactions	(145)	(162)	(377)
Elimination of internal revenue	(8,428)	(9,396)	(10,764)	Sale of Global Network	4,057	—	—
Total IBM Consolidated	\$ 87,548	\$ 81,667	\$ 78,508	1999 actions	(2,205)	—	—
				Unallocated corporate expenses	(67)	(497)	(282)
				Total IBM Consolidated	\$ 11,757	\$ 9,040	\$ 9,027

Immaterial Items**INVESTMENT IN EQUITY ALLIANCES AND EQUITY****ALLIANCES GAINS/LOSSES**

The investments in equity alliances and the resulting gains and losses from these investments that are attributable to the segments do not have a significant effect on the financial results of the segments.

Segment Assets and Other Items

The assets of the hardware segments primarily are inventory and plant, property and equipment. The software segment assets mainly are plant, property and equipment, and investment in deferred software development. The Global Services segment assets primarily are maintenance inventory and plant, property and equipment associated with its strategic outsourcing business.

To accomplish the efficient use of the company's space and equipment, it usually is necessary for several segments to share plant, property and equipment assets. Where assets are shared, landlord ownership of the assets is assigned to one segment and is not allocated to each user segment. This is

consistent with the company's management system and is reflected accordingly in the schedule below. In those cases, there will not be a precise correlation between segment pre-tax income and segment assets.

Similarly, the depreciation amounts reported by each segment are based on the assigned landlord ownership and may not be consistent with the amounts that are included in the segments' pre-tax income. The amounts that are included in pre-tax income reflect occupancy charges from the landlord segment and are not specifically identified by the management reporting system.

Capital expenditures that are reported by each segment also are in line with the landlord ownership basis of asset assignment.

The Global Financing segment amounts below for interest income and interest expense reflect the interest income and interest expense associated with the financing business as well as the investment in cash and marketable securities. The remaining amounts of interest income and interest expense are not discretely identified to the other segments, but are included as part of an indirect expense allocation.

MANAGEMENT SYSTEM SEGMENT VIEW

(Dollars in millions)	Hardware			Global Services	Software	Global Financing	Enterprise Investments	Total Segments
	Technology	Personal Systems	Server					
1999:								
Assets	\$ 10,409	\$ 1,372	\$ 2,846	\$ 2,060	\$ 2,527	\$ 39,686	\$ 408	\$ 59,308
Depreciation/amortization	2,142	127	191	367	576	2,976	15	6,394
Capital expenditures/ investment in software	1,834	172	312	249	656	3,217	12	6,452
Interest income	—	—	—	—	—	2,961	—	2,961
Interest expense	—	—	—	—	—	1,232	—	1,232
1998:								
Assets	\$ 11,251	\$ 1,464	\$ 2,106	\$ 2,236	\$ 2,577	\$ 40,109	\$ 363	\$ 60,106
Depreciation/amortization	1,207	121	178	322	681	2,768	15	5,292
Capital expenditures/ investment in software	2,044	156	288	358	424	3,438	19	6,727
Interest income	—	—	—	—	—	2,725	—	2,725
Interest expense	—	—	—	—	—	1,252	—	1,252
1997:								
Assets	\$ 10,060	\$ 1,629	\$ 2,191	\$ 1,914	\$ 2,642	\$ 35,444	\$ 362	\$ 54,242
Depreciation/amortization	1,092	112	167	315	1,132	2,170	10	4,998
Capital expenditures/ investment in software	2,028	195	235	361	515	3,615	16	6,965
Interest income	—	—	—	—	—	2,639	—	2,639
Interest expense	—	—	—	—	—	1,175	—	1,175

notes to consolidated financial statements

International Business Machines Corporation
and Subsidiary Companies

Reconciliations to IBM as Reported

(Dollars in millions)	1999	1998	1997
ASSETS:			
Total reportable segments	\$ 59,308	\$ 60,106	\$ 54,242
Elimination of internal transactions	(5,776)	(7,519)	(6,287)
Unallocated amounts:			
Cash and marketable securities	4,563	4,295	6,062
Notes and accounts receivable	7,004	7,715	7,441
Deferred tax assets	5,428	5,376	4,746
Plant, other property and equipment	6,146	7,706	7,564
Pension assets	5,636	4,836	3,828
Other	5,186	3,585	3,903
Total IBM Consolidated	\$ 87,495	\$ 86,100	\$ 81,499

Revenue by Classes of Similar Products or Services

For the Personal Systems, Server, Software and Global Financing segments, the segment data on page 91 represents the revenue contributions from the products that are contained in the segments and that are basically similar in nature. The table below provides external revenue for similar classes of products within the Technology and Global Services segments. OEM hardware comprises primarily revenue from the sale of HDD storage files and semiconductors. Storage comprises externally attached direct access storage devices and tape storage devices. Other technology comprises advanced function printers and networking devices.

	Consolidated		
(Dollars in millions)	1999	1998	1997
Technology:			
OEM	\$ 7,800	\$ 6,756	\$ 5,560
Storage	2,389	2,439	2,644
Other technology	2,408	2,695	2,879
Global Services:			
Services	27,035	23,730	19,534
Maintenance	5,137	5,186	5,632

Major Customers

No single customer represents 10 percent or more of the company's total revenue.

Geographic Information

(Dollars in millions)	Revenue*			Long-lived Assets**		
	1999	1998	1997	1999	1998	1997
United States	\$ 37,171	\$ 35,303	\$ 32,663	\$ 19,309	\$ 18,450	\$ 17,802
Japan	10,411	8,567	9,765	4,710	4,310	3,635
Other countries	39,966	37,797	36,080	10,259	12,343	11,621
Total	\$ 87,548	\$ 81,667	\$ 78,508	\$ 34,278	\$ 35,103	\$ 33,058

* Revenues are attributed to countries based on location of customer.

** Includes all non-current assets except non-current financial instruments and deferred tax assets.

International Business Machines Corporation
and Subsidiary Companies

Five-Year Comparison of Selected Financial Data

(Dollars in millions except per share amounts)

For the year:	1999	1998	1997	1996	1995
Revenue	\$ 87,548	\$ 81,667	\$ 78,508	\$ 75,947	\$ 71,940
Net income	7,712	6,328	6,093	5,429	4,178
Per share of common stock:					
Assuming dilution	4.12	3.29*	3.00*	2.50*	1.76*
Basic	4.25	3.38*	3.09*	2.56*	1.81*
Cash dividends paid on common stock	859	814	763	686	572
Per share of common stock	.47	.43*	.3875*	.325*	.25*
Investment in plant, rental machines and other property	5,959	6,520	6,793	5,883	4,744
Return on stockholders' equity	39.0%	32.6%	29.7%	24.8%	18.5%
At end of year:					
Total assets	\$ 87,495	\$ 86,100	\$ 81,499	\$ 81,132	\$ 80,292
Net investment in plant, rental machines and other property	17,590	19,631	18,347	17,407	16,579
Working capital	3,577	5,533	6,911	6,695	9,043
Total debt	28,354	29,413	26,926	22,829	21,629
Stockholders' equity	20,511	19,433	19,816	21,628	22,423

* Adjusted to reflect a two-for-one stock split effective May 10, 1999.

Selected Quarterly Data

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

	Revenue	Gross Profit	Net Income	Per Share of Common Stock			Stock Prices**	
				Earnings			High	Low
				Assuming Dilution	Basic	Dividends		
1999								
First quarter	\$ 20,317	\$ 7,258	\$ 1,470	\$.78	\$ 0.80	\$.11*	\$ 99.63*	\$ 80.88*
Second quarter	21,905	8,224	2,391	1.28	1.32	.12	132.00	81.50*
Third quarter	21,144	7,564	1,762	.93	.97	.12	139.19	117.56
Fourth quarter	24,182	8,883	2,089	1.12	1.16	.12	123.25	89.00
Total	\$ 87,548	\$ 31,929	\$ 7,712	\$ 4.12[†]	\$ 4.25	\$.47		
1998								
First quarter	\$ 17,618	\$ 6,450	\$ 1,036	\$.53*	\$.54*	\$.10*	\$ 54.19*	\$ 47.81*
Second quarter	18,823	7,146	1,452	.75*	.77*	.11*	64.66*	51.66*
Third quarter	20,095	7,467	1,494	.78*	.80*	.11*	69.06*	55.38*
Fourth quarter	25,131	9,809	2,346	1.24*	1.27*	.11*	94.97*	58.41*
Total	\$ 81,667	\$ 30,872	\$ 6,328	\$ 3.29*[†]	\$ 3.38*	\$.43*		

* Adjusted to reflect a two-for-one stock split effective May 10, 1999.

[†] Earnings Per Share (EPS) in each quarter is computed using the weighted-average number of shares outstanding during that quarter while EPS for the full year is computed using the weighted-average number of shares outstanding during the year. Thus, the sum of the four quarters' EPS does not equal the full-year EPS.

** 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.

stockholder information

International Business Machines Corporation
and Subsidiary Companies

IBM Stockholder Services

Stockholders with questions about their accounts should contact:
EquiServe, First Chicago Trust Division
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 EquiServe, First Chicago Trust Division, via the Internet at: ibmfct@equiserve.com

Hearing-impaired stockholders with access to a telecommunications device (TDD) can communicate directly with EquiServe, First Chicago Trust Division, by calling (800) 490-1493. Stockholders residing outside the United States, Canada and Puerto Rico should call (201) 222-4489.

IBM on the Internet

Topics featured in this Annual Report can be found via the IBM home page on the Internet (<http://www.ibm.com>). Financial results, news on IBM products, services and other activities can also be found via that address. Stockholders of record can receive online account information and answers to frequently asked questions regarding stockholder accounts via the internet (<http://www.ibm.com/investor>).

Stockholder of record can also consent to receive future IBM Annual Reports and Proxy Statements online through the Internet at this site.

IBM Investor Services Program

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 (201) 324-0405.

Annual Meeting

The IBM Annual Meeting of Stockholders will be held on Tuesday, April 25, 2000, at 10 a.m. (EST) in the Grand Ballroom at the Renaissance Cleveland Hotel in Cleveland, Ohio.

IBM Stock

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

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

Literature for IBM Stockholders

The following literature on IBM is available without charge from EquiServe, First Chicago Trust Division
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.

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 March; 10-Q reports are released in May, August and November.

An audio cassette recording of the 1999 Annual Report will be available for sight-impaired stockholders in June.

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

"IBM Environment and Well-Being: Progress Report" reports on IBM's environmental, safety and energy programs.

"Valuing Diversity: An Ongoing Commitment" communicates to the company's entire community of employees, customers, stockholders, vendors, suppliers, business partners and employment applicants the importance IBM places on the diversity of the company's workplace and marketplace.

General Information

For answers to general questions about IBM from within the continental United States, call (800) IBM-4YOU. From outside the United States, call (770) 863-1234.

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Senior Management

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a quick look back

In January of this year, we sampled expert opinion – including IBM employees, via a survey on our intranet – to compile a list of IBM's most significant contributions to the 20th century. Herewith our top 10 (and three more we couldn't resist).

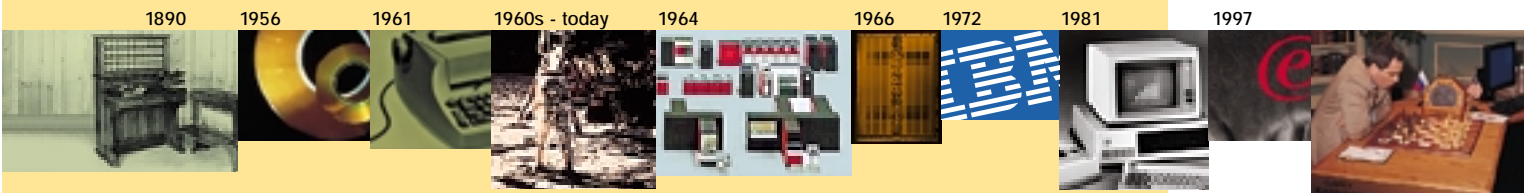
Hollerith Tabulating Machine, 1890 Punch-card tabulating machine first demonstrated the possibilities of large-scale automated computation and came of age with U.S. Social Security accounting in 1937.

Disk Storage, 1956 Beginning with the original RAMAC disk drive, IBM has introduced every significant advance in magnetic disk technology.

Relational Database and SQL (Structured Query Language), 1970 This more flexible, standardized way to store and retrieve data became the foundation for most modern data management systems, including IBM's hugely popular DB2. SQL is an industry standard for database access.

RISC (Reduced Instruction Set Computer) Architecture, 1980 Boosts computer speed by using simplified machine instructions for frequently used functions. It is the basis for most workstations and UNIX-based servers in use today.

Three more for the ages. They didn't make the top 10, but we couldn't exit the 20th century without a bow to:



FORTRAN (FORmula TRANslation Language), 1957 The first modern computer language, and still the basis for all important numerical analysis programs.

Manned Space Exploration, 1960s-today In a long partnership with NASA, IBM developed systems for telemetry monitoring, trajectory calculations, mission command, and fail-safe software for running multiple programs at once.

System/360, 1964 Redefined business computing by introducing the concept of compatibility across a family of systems and peripheral equipment.

Single-cell DRAM (Dynamic Random Access Memory), 1966 The one-transistor memory cell became the mainstay of modern computer memory systems. DRAMs have been called the "crude oil" of the information age.

IBM Personal Computer, 1981 Introduced personal computing to a mass market and helped legitimize the then-novel PC for the business world.

e-business, 1997 IBM coined the term and defined an enormous new industry category to describe the broad implications of the Internet as a medium for real business and institutional transformation.

Selectric Typewriter, 1961 Iconic "golf ball" typing element symbolized stunningly elegant product design and prefigured modern-day word processing.

IBM Logo, 1972 Paul Rand's classic eight-bar design has withstood the test of time. It focused attention on the importance of corporate branding and the central role a company's ubiquitous logo could play in maintaining it.

Deep Blue, 1997 First computer to defeat a reigning chess world champion. The win sparked a fundamental re-examination of the relationship between people and machines.

