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ANNUAL REPORT 1994

IBM


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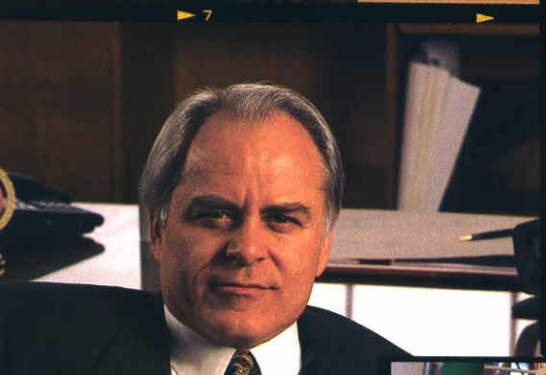
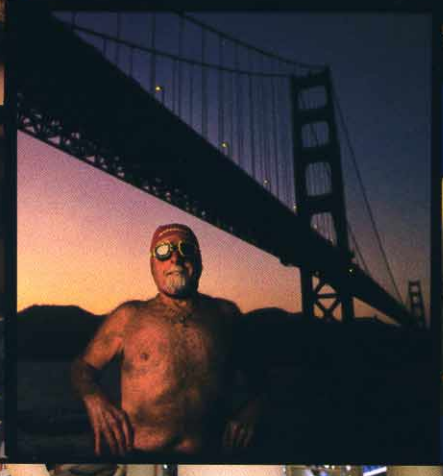




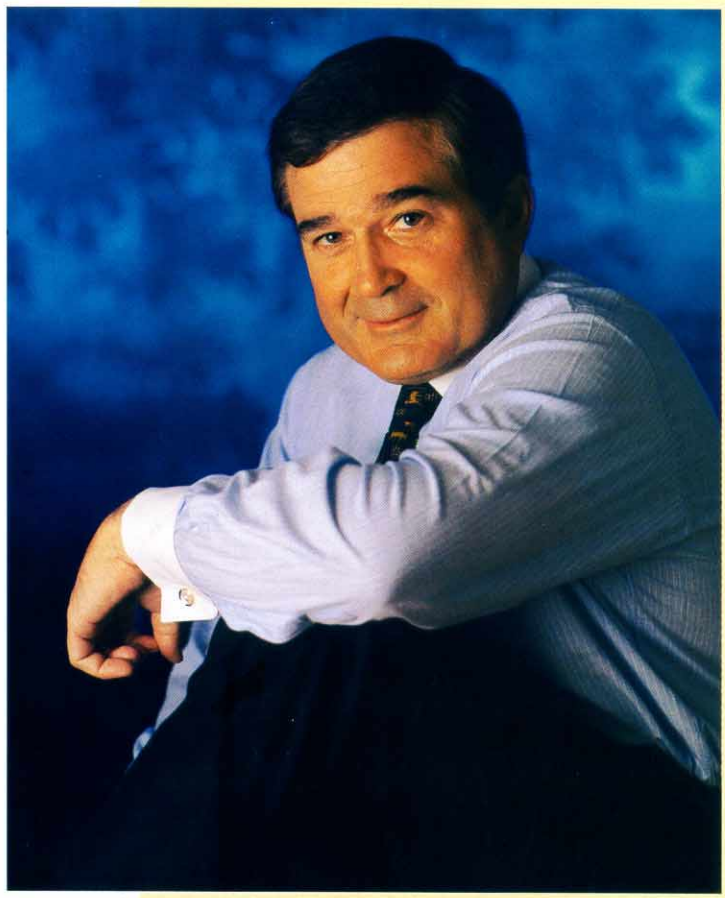
You are facing the future.

It's racing toward us all. A world in which information is advantage. And freedom.
Where time and space are shortened. Where computers operate faster.
Taking up a fraction of the space. Communicating across networks without borders.
You hear it every day.
Cyberspace. Wired. On demand. Seamless access. Productive. Nonstop. Fun.

But what does it all really mean to you?
Does it make your job easier? Does it make your life better?
Can you get there from here?

These questions are important to IBM.
They matter to us because they matter to *you.*

Dear Fellow Investors:



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

LAST YEAR I told you that, as we worked to transform IBM and return it fully to industry leadership, we had four clear priorities:

- to be profitable;
- to become more competitive;
- to increase shareholder value;
- to grow.

We have a lot of work ahead on many fronts – growth, speed to market and re-engineering, to name three. We're not the industry leader yet – at least by my definition. Still, I believe we did make significant progress on our priorities and that 1994 was the year a new IBM began to emerge.

Starting with profitability. Last year was a solid one financially. We earned $3 billion – our first profitable year since 1990 and, compared with 1993, a profit swing of $11 billion.

Last year we also achieved our first year of revenue growth since 1990. Total revenue was $64.1 billion, up 6 percent after the sale of the Federal Systems Co.

We reduced annual expenses by $3.5 billion, or 15 percent. In the past two years, we reduced expenses a total of $6.3 billion, and we are on course to achieve the additional $1.7 billion toward our total goal of $8 billion no later than mid-1996.

We finished 1994 with more than $10 billion in cash. Our cash flow was exceptionally strong, even after paying out $2.8 billion in restructuring costs. Just as important, we reduced our core debt – debt in support of operations – by $3.3 billion, to a total of $2.9 billion.

Our key report card – market value – reflected all

(Dollars in millions except per share amounts)	1994	1993
For the year:		
Revenue	$ 64,052	$ 62,716
Earnings (loss) before income taxes	$ 5,155	$ (8,797)
Income taxes	$ 2,134	$ (810)
Net earnings (loss) before change in accounting principle	$ 3,021	$ (7,987)
Per share of common stock	$ 5.02	$ (14.02)
Effect of change in accounting principle*	$ –	$ (114)
Per share of common stock	$ –	$ (.20)
Net earnings (loss)	$ 3,021	$ (8,101)
Per share of common stock	$ 5.02	$ (14.22)
Cash dividends paid on common stock	$ 585	$ 905
Per share of common stock	$ 1.00	$ 1.58
Investment in plant, rental machines and other property	$ 3,078	$ 3,232
Average number of common shares outstanding (in millions)	585	573
At end of year:		
Total assets	$ 81,091	$ 81,113
Net investment in plant, rental machines and other property	$ 16,664	$ 17,521
Working capital	$ 12,112	$ 6,052
Total debt	$ 22,118	$ 27,342
Stockholders' equity	$ 23,413	$ 19,738
Number of regular, full-time employees	219,839	256,207
Number of stockholders	713,060	741,047

**1993, cumulative effect of Statement of Financial Accounting Standards (SFAS) 112, "Employers' Accounting for Postemployment Benefits."*

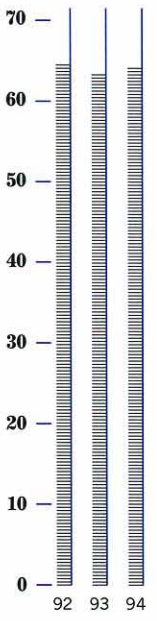
this. In 1994 our market value increased more than $10 billion, an increase of 32 percent.

We had our problems too, most notably the performance of our PC unit. We are aggressively overhauling and refocusing the whole operation. Also, we didn't do well in forecasting demand for products. Demand outstripped supply in mainframes, storage devices and certain PC models.

I think it's fair to say, however, that the question about IBM is no longer one of survival. We've stabilized the company financially and, beyond that, strengthened it. IBM is back, and we're here to stay. The question now is, can IBM grow? I believe it can and that it will, for many reasons, but mostly these two:

First, our industry – information technology (I/T) – is a growth industry. In fact, it's just beginning to rev up. Year by year, even month by month, we make breathtaking advances in computing power, speed, size, stor-

revenue
(in billions)



age capacity and more. According to one estimate, in the U.S. in the early 1990s, more was invested in I/T hardware and software than in industrial, agricultural and mining equipment combined. The cost of microelectronics in some cars has now passed the cost of steel.

I have spent a good bit of time in our IBM labs, and I can tell you that right now, we see no limit to the pace of change for at least the next decade. And IBM will be a pacesetter. Last year we were No. 1 in the number of U.S. patents issued for the second year in a row, and our 1,298 patents last year were the most ever issued to any company in any year.

Information technology will revolutionize every institution in our society – governments, schools, post offices, libraries and, of course, every form of commercial enterprise. I/T will fundamentally alter the way individuals deal with these institutions and with each other.

But it will not happen the way, or as fast as, predicted by the pied pipers of this industry, who are obsessed with and endlessly promote electronic utopias and who are covered breathlessly by some in the media. What is possible is not always desirable – particularly if it costs too much money. Nor do many people ride on highways just for the sheer joy of spending a day in traffic.

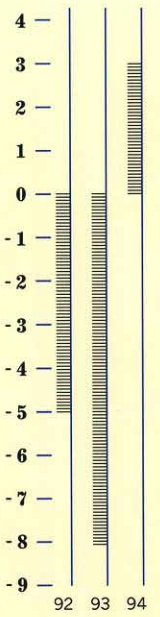
The information revolution will happen, but only when the industry stops worshipping technology for its own sake and starts focusing on *real value* for its customers. We must provide products and services that improve customers' competitive position; that enhance their own customer service; that increase their productivity; that enrich their personal lives. These benefits are what will drive the revolution, not faster and faster silicon or millions of miles of fiber optics.

There's no reason why our products shouldn't be as simple to use as household appliances – and a whole lot simpler than programming a VCR. In the pages that follow, you'll see how we're making technology easier to use, easier to manage and how we're helping customers of all sizes embrace advanced technology and put it to work in the real world. In the years ahead, you will be seeing and hearing more from IBM on these subjects because I am making this – translating technology into value for cus-

IBM strategic imperatives

1} Exploiting our technology.
2} Increasing our share of the client/server computing market.
3} Establishing leadership in the emerging network-centric computing world.
4} Realigning the way we deliver value to customers.
5} Rapidly expanding our position in key emerging geographic markets.
6} Leveraging our size and scale to achieve cost and market advantages.

net earnings
(in billions)



tomers – a company-wide crusade.

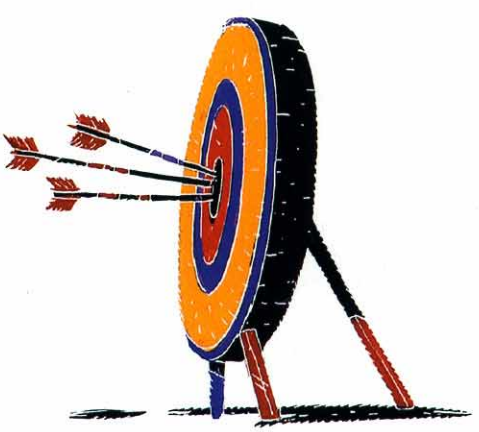
The second reason I am confident IBM can and will grow is because we are focusing on doing the things we have to do in order to grow, and we are making real progress.

Last year, I told you that no company – in any industry – is going to succeed without a set of tough-minded strategies grounded in a clear understanding of what's happening in the marketplace. I said that, after making IBM profitable, setting such strategies is our single-highest priority because they are critical to growth and building shareholder value.

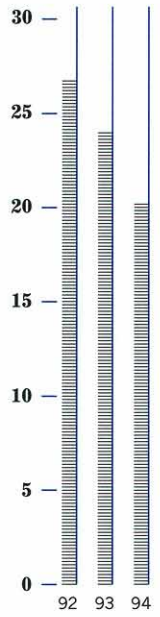
For more than a year now, we have been working on a dozen or so business and technology strategies. We've made a great deal of progress on some, and on others we've just started. I have grouped these strategies into six "strategic imperatives" – our roadmap for IBM's near-term future. Here's a status report on each of them:

Exploit technology: Getting technology out of our labs and into the marketplace, and doing it quickly, is important to success in a fast-changing industry. New products introduced in the past 12 to 18 months accounted for almost half our hardware revenues last year. We rolled out entirely new generations of key IBM product families: a new class of mainframes, AS/400s, storage devices and networking hardware and software. We're exploiting our technology in the industry through technology agreements with companies like Hitachi, Toshiba, Canon and Cyrix. Our patent and technology licensing agreements contributed nearly $640 million in cash last year, up from $345 million in 1993. Sales of IBM technology products to other manufacturers grew to $3.3 billion in 1994, up from $1.3 billion in 1993 and more than five times the 1992 figure.

Establish leadership in network-centric computing: We're moving on many fronts to define this new market and this new model of computing. We created the IBM Global Network, the world's largest data network, with presence in 700 cities in more than 100 countries. Working with telephone and cable TV companies, we're field testing IBM technologies that deliver interactive services to consumers and businesses. We're embracing the Internet and helping customers do the same, providing encryption technology, anti-virus software and "firewall" security products to support heavy-duty commercial transactions while protecting vital data from intruders.



total expenses
(in billions)



Realign the way we deliver value to customers: Responding to what our customers said they wanted from IBM – global solutions – we created a single, worldwide sales and services organization, and organized it by industry and technology specialization. Almost every person in IBM's field force today is aligned by product, service or industry. Our direct marketing activities continue to expand. IBM Direct, our largest U.S. telesales operation, grew almost 750 percent in revenues last year.

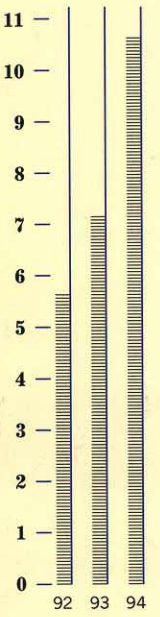
Leverage IBM's size and scale for competitive advantage: We are rapidly moving to common technology "building blocks" across IBM hardware units to take advantage of economies of scale and to give customers greater interoperability across our systems. Every month, new IBM products and services are being introduced with technologies and features contributed from multiple IBM laboratories. We consolidated more than 100 advertising campaigns administered by dozens of agencies, and now have a single voice with one worldwide ad agency. We consolidated work done by 89 data centers and now have 58 – saving nearly $1 billion. By increasing our number of mobile employees and reducing work locations, we've eliminated nearly 20 million square feet of office space worldwide. We're doing common-sense things, too, like consolidating how we purchase goods and services across the company.

Expand market share in client/server computing: We now have 42 Open Systems Centers in 34 countries, where we help customers design and implement client/server applications. Our work with customers in these centers grew more than 50 percent last year, to about the $1 billion revenue mark. We're focusing on ease of use, systems management and software tools that improve the way products from IBM and other vendors work together. Independent observers are noting our progress: IBM's VisualAge tool for creating client/server software was named best application development product of 1994 by both *Datamation* and *PC Week* magazines. And *Datamation* readers picked NetView for AIX as systems management product of the year.

Expand rapidly in key emerging geographic markets: We signed several contracts in China to help build an advanced information infrastructure. We opened seven subsidiaries in Eastern Europe and Northern Asia, and

Last year IBM was No. 1 in the number of U.S. patents issued for the second year in a row, and our 1,298 patents were the most ever issued to any company in any year.

cash and marketable securities
(in billions)



re-established IBM South Africa. We've increased the output of PCs being assembled in China and Russia, opened a PC plant in South Africa, and announced plans to establish a research laboratory in China in mid-1995. We are on track to develop, within the next five years, billion-dollar operations in China, Eastern Europe, South Africa and India.

There's one additional key to growth and to restoring IBM to industry leadership, and it's an important one: our corporate culture – how we view the world, what we focus on, how we work with our customers and among ourselves.

We are doing everything we can to focus everyone here on what's outside IBM – markets, customers, competitors. We're increasing the speed of our decision-making and execution because in an industry changing so rapidly that a product's life cycle is now 9 to 12 months, speed can make the difference between profit and loss. We're completely overhauling our compensation system to make it truly incentive based. And to quicken the process of transformation, we've brought in some new perspectives – more than 60 new executives in 1994 alone.

Even as we make all these changes, I want to emphasize just how much of an asset we have in our people. IBM people are smart. They are tough and durable and resilient. They are proud of this company, proud of their own contributions, and their commitment to success is rock-solid.

We, all of us at IBM, have a lot of work, a lot of change, a lot of rebuilding left to do if we are to complete our transformation. But we are beginning to sense some momentum, and it feels good.

• • •

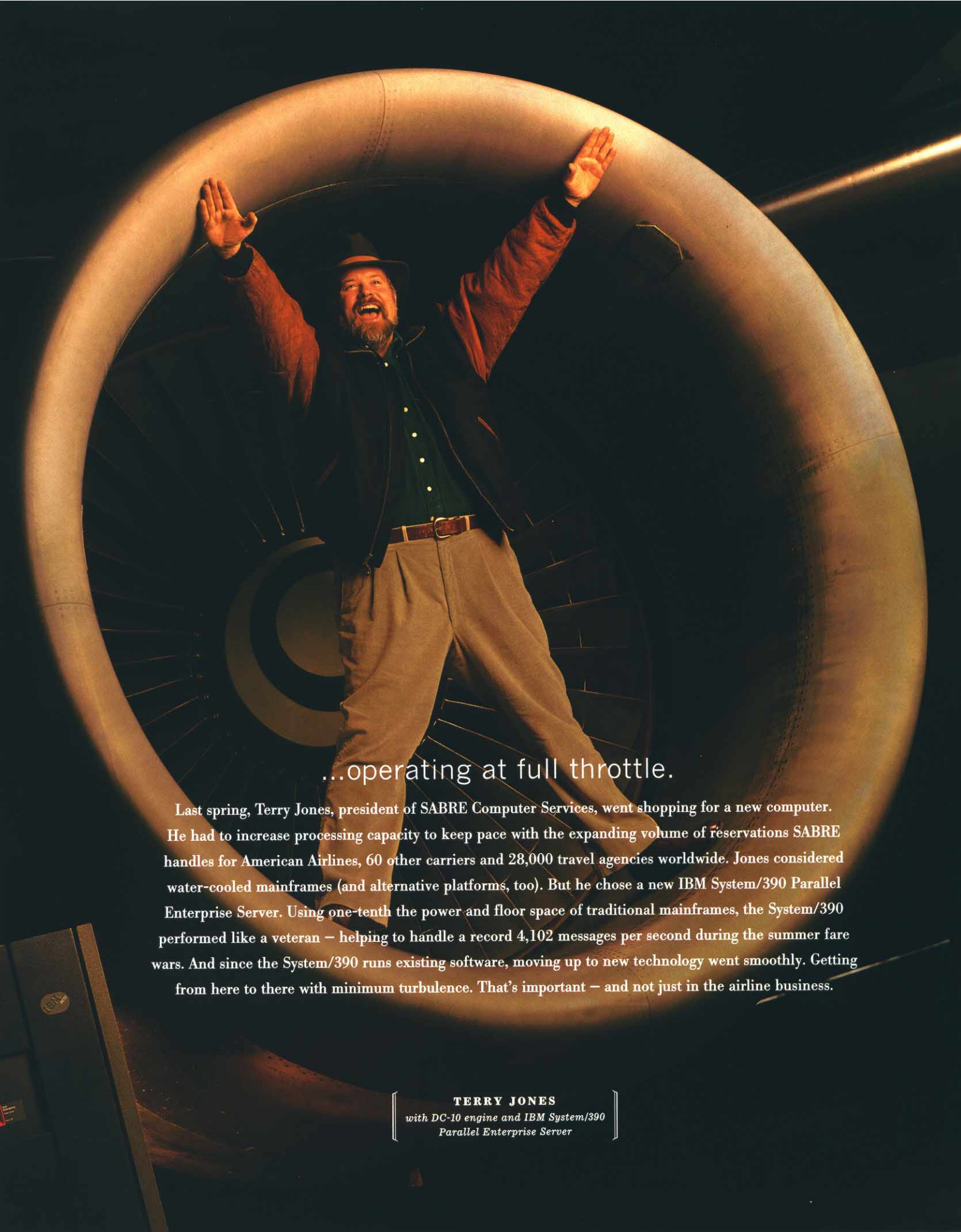
I WOULD LIKE to take a moment to thank someone who performed a very special service to IBM over the past two years.

Paul Rizzo retired as vice chairman of IBM in 1987 after 30 years of service to the company. When things got tough in 1992, the company asked him to come back and help out, and he did so immediately and without complaint. Since then he pitched in whenever and wherever he was needed. At year end, he really retired from IBM, and I want to thank him personally, as well as on behalf of the company, for the important part he played in our transformation.

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

You are an executive on a task force

determined to squeeze profits from your information systems that provide services in the hotly competitive travel and transportation industries. The consultant's report on your desk claims you can cut costs by moving off the "Big Iron" – those glasshouse-enshrined, water-cooled mainframes downstairs. But your operation supports millions of passengers, reservations, flight changes, credit card transactions. Every day. No downtime. No excuses. Can you really roll in new, less expensive technology, achieve your business goals *and* keep your company flying high? In 357 glossy pages, the consultant never answered that one.



...operating at full throttle.

Last spring, Terry Jones, president of SABRE Computer Services, went shopping for a new computer. He had to increase processing capacity to keep pace with the expanding volume of reservations SABRE handles for American Airlines, 60 other carriers and 28,000 travel agencies worldwide. Jones considered water-cooled mainframes (and alternative platforms, too). But he chose a new IBM System/390 Parallel Enterprise Server. Using one-tenth the power and floor space of traditional mainframes, the System/390 performed like a veteran – helping to handle a record 4,102 messages per second during the summer fare wars. And since the System/390 runs existing software, moving up to new technology went smoothly. Getting from here to there with minimum turbulence. That's important – and not just in the airline business.

TERRY JONES
with DC-10 engine and IBM System/390 Parallel Enterprise Server

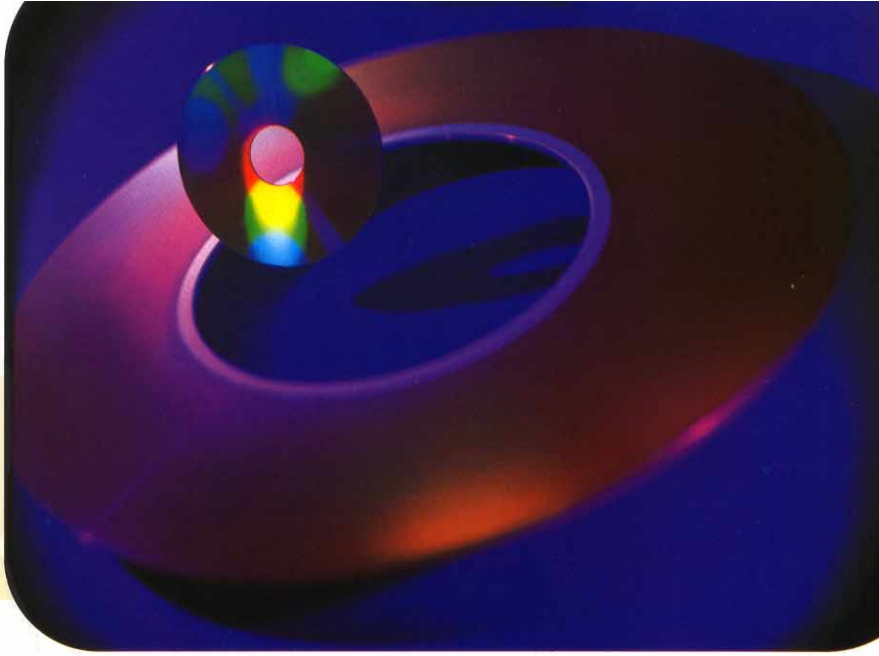
Designing technology to get you from **here** to **there**

When it comes to information technology, few people have the luxury of starting with a clean sheet of paper. That's true whether you manage a mainframe-based global information system or carry a notebook PC in your briefcase. You've made investments in hardware, software and training – investments you can't simply abandon, even when faster, more powerful and less expensive technology comes along.

At IBM, we understand the realities our customers face. So, as we transform virtually our entire product line with advanced technology, we're looking not just at where customers can be, but where they are now. That's why last year was pivotal for IBM. We began delivering to the marketplace entirely new generations – not just upgrades – of IBM's major product families.

Take mainframes, for example. Our new System/390 servers use advanced microprocessors running in parallel, making them smaller, less expensive, more energy efficient and easier to maintain and operate than traditional mainframes. We also made sure these advanced systems can run all existing System/390 software. That's no small consideration to customers who have invested roughly $1 trillion in large-system software.

The time was right: For Mike DeRosier, president of Empire Clock Co. in St. Paul, Minnesota, 1994 was the right time for IBM's new AS/400 Advanced 36 server. The new system is the first AS/400 equipped with IBM's PowerPC microprocessor. Trading up from his vintage System/36 saved DeRosier money and space — while boosting performance five times.



LESS IS MORE: **Even as disk drives get smaller, their storage capacity is growing tremendously. Using 3.5-inch disks and a technology known as RAID 5 (redundant array of independent disks), IBM's new RAMAC systems can hold massive amounts of data — more than 90 billion bytes. RAMAC gives customers greater capacity at lower cost and provides unprecedented data availability.**

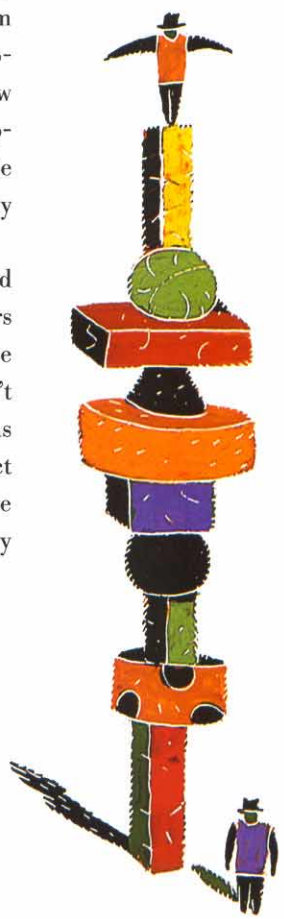
The same thinking went into reshaping our AS/400 Advanced Series. Last year, we began moving the AS/400 to advanced 64-bit RISC processor technology. By year-end, all AS/400 Advanced Systems and AS/400 Advanced Servers will be based on PowerPC chips, the superfast microprocessors now used extensively in IBM's RS/6000 workstation and server family. This transition will improve AS/400 performance by 70 percent each year through 1997. Equally important to customers, these new systems will run their thousands of existing AS/400 applications without requiring a single line of code to be rewritten or recompiled.

Over time, PowerPC technology will be extended even further into our full range of products through the introduction of new PowerPC-based personal computers and POWERparallel supercomputers.

Last year also saw the launch of our RAMAC Array Family, a major advance in information storage technology. RAMAC's RAID 5 architecture distributes information across several small, interconnected disk drives. In the unlikely event that a single disk fails, data is quickly reconstructed from other disks, substantially reducing the risk of customer data loss. RAMAC represents one of IBM's most successful storage product launches ever, with almost 2,000 systems shipped to customers in its first three months of availability.

Innovative hardware has always been an IBM strength. Today, we're also working to reshape the fundamentals of software technology. Rather than programming and debugging code line by line, developers are turning to new, object-oriented programming environments that let them visually assemble complex applications from pretested, reusable software components. For example, with IBM's new VisualAge family of visual development tools, programmers can create new applications quickly, efficiently and at far lower cost.

At IBM, we're excited by advanced technologies that offer our customers exciting new possibilities. But we know that innovation alone isn't enough. That's why we work just as hard on helping customers extract value, productivity and a competitive edge from technology – so that they *can* get from here to there.



BANKING ON OBJECTS: **Object-oriented programming turns pieces of software into reusable components — objects — which programmers can combine to create applications faster. Customers such as Zurich-based Credit Suisse are finding object-based tools like IBM's VisualAge invaluable in developing banking applications in half the development time and cost.**

You are a twelfth-grader in science class

figuring out how to pump up your paper on the Earth's biosphere. Twenty pages of double-spaced dullness. Due Monday. Would be cool to insert a satellite image of the ozone hole. But you've gone to the library five times to find the book you – and your 30 classmates – need. Finally got it on the fifth try. Great. The page you need is torn out. Probably that Eddie Bevan. Again.


...wired to the rest of the world.
Another boring science project? Not when you're wired, like Jenifer Nestman and her friends at Burnaby South High School and the Provincial School for the Deaf in Burnaby, British Columbia. When they were assigned a project on the biosphere, they went online, using IBM's Internet for Kids pilot software to bypass dusty science books and roam the Internet. They talked to students and educators across North America and downloaded the latest maps and atmospheric charts from NASA. "The Internet makes learning a lot easier and more interesting," says Jenifer. "It makes you want to learn."
JENIFER NESTMAN
with keyboard and a few friends

SOME SAY today's Internet is the roadbed for the Information Highway. Maybe so. But we think there won't be just one "I-Way," any more than there's just one mode of transportation today. Instead, we'll likely see a variety of interconnected "networks of networks," both public and private.

We've defined this emerging market opportunity as "network-centric" computing – *computing* because it's fundamentally about moving, managing and presenting digital information. And that's what IBM has been doing for decades. What's generating so much excitement is that these networks will have tremendous bandwidth, so they can transmit new types of digital information – movies, X-rays, animation. And they'll be fast enough to support true interactivity – videoconferencing and interactive games, for example.

We're working hard to establish leadership in this market. We're leveraging our digital heritage to develop the technologies from which these networks will be built, and helping customers design business and consumer applications to exploit these networks.

In Victoria, Australia, IBM is assisting the Royal Children's Hospital in a "distance learning" trial to help ill and injured young people continue their education – and keep up with their classmates – from their hospital beds. We're also field testing interactive services with Hong Kong Telecom in Asia, Le Groupe Videotron in Canada and Cox Cable in the U.S.

Behind the scenes, we're making this new world possible by developing a variety of high-performance network technologies – video servers, storage devices, set-top TV boxes, and database and network management software.

A particularly critical networking technology is Asynchronous Transfer Mode (ATM). ATM is extremely fast, supporting over 2 billion bits per second. It also enables transmission of multimedia information across a single network. Last year, we introduced our first ATM products, part of our Nways family of networking hardware and software.

Building **networks** that work for **you**

THEATER IS THEATER IS...MULTIMEDIA: **Using IBM's Person to Person software for videoconferencing and distance collaboration, Cheryl Faver, artistic director at New York's Gertrude Stein Repertory Theater, can work with artists and designers around the world. From bi-coastal production meetings to global multi-site performances, Faver's theater is pioneering a "World Stage Network," linking arts organizations and schools with real-time collaborative technology.**

ON-RAMP TO THE VATICAN: **Once accessible only to scholars, the Vatican Library holds some of the world's rarest literary works including those of Dante, Ptolemy and Virgil and this 1477 illuminated edition of Homer's *Iliad*. Now, these masperpieces are going online. Supported by high-resolution imaging and networking technology from IBM, they are being made available globally on the Internet and other networks.**

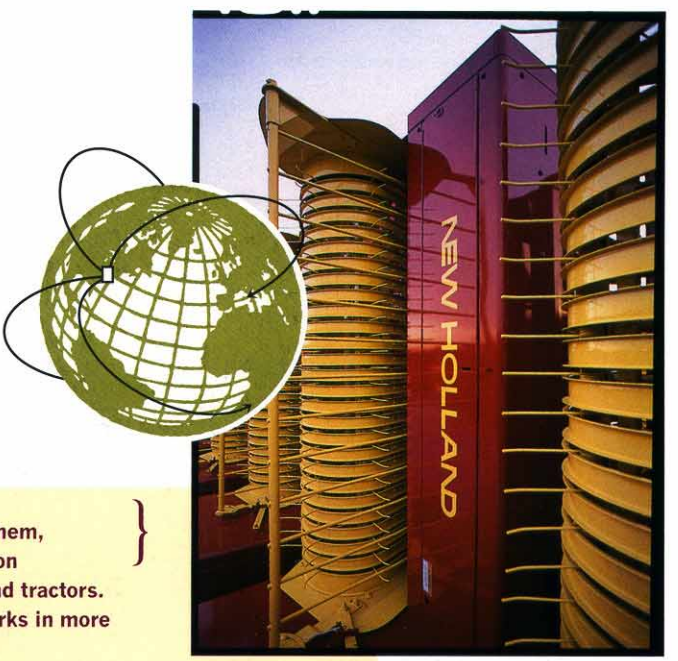
In November, we demonstrated a pilot model of the IBM Media Streamer, a system that stores and delivers huge volumes of video and other multimedia information. Operating in an open systems environment, Media Streamer is designed to transmit many streams of information smoothly from a single copy.

IBM software – from our DB2 relational database to our popular AIX multiuser operating system – is well positioned to exploit complex network capabilities. And our newest software for personal computers, OS/2 Warp, even includes a simple one-click connection to the Internet.

Not all enterprises want to build and maintain their own networks. Some prefer to buy telecommunications services or outsource their entire network. That's why last year we created the IBM Global Network, a high-speed voice and data communications network that already serves 2 million users at some 25,000 businesses and government agencies in more than 100 countries.

We're also providing services to strengthen the use of the Internet to make it ready for complex commercial transactions. In December, we announced a number of these, including a "firewall" offering, which protects a customer's private network from outside intrusion.

Whether you're a student "surfing the Net," a doctor practicing long-distance telemedicine or a historian viewing ancient artwork from thousands of miles away, you're experiencing the power of computer networks. And no one is working harder to bring people and information together through network-centric computing than IBM.



WORLD-CLASS NETWORK: **Using the IBM Global Network to connect them, New Holland North America, Inc., engineers remotely collaborated on electronic blueprints to design their company's newest combines and tractors. The IBM Global Network supports more than 5,500 customer networks in more than 100 countries.**

You are a radiologist working late

searching for a foothold in a man-made mountain of paperwork. Patient X-rays, CAT scans, MRIs. The office staff has left for the day, and you've got another two hours reviewing, revising and signing reports. All routine – or as routine as medicine can be. Until you come across some unexpected images. They suggest something more serious than pneumonia – a tumor? The physician-in-charge will want your analysis first thing tomorrow. Which means you have an appointment with the keyboard tonight – at 20 words a minute.

...putting your voice to good use.

Dr. John Lawson, consultant radiologist and clinical director of radiology at Northern Ireland's Belfast City Hospital Trust, no longer waits hours for typists to prepare his medical reports. With IBM's new VoiceType Dictation System, Dr. Lawson speaks into a microphone and his personal computer types his reports – making them instantly available to other doctors and nurses via the Northern Ireland Radiology System. And since VoiceType reduces doctors' dependence on administrative help, they can spend more time on patient care. "We were one of the first in the world to use this technology, but in several years' time, I predict everybody will be working this way," says Dr. Lawson.

DR. JOHN LAWSON
at work

Creating **intelligent** technology that's **easy** to use

It's happening so fast. A few years back, speech-recognition technology required the power of a mainframe. Today, IBM's VoiceType Dictation System transcribes 70 to 100 words per minute with 97 percent accuracy or better, and boasts a vocabulary of up to 32,000 words. And it runs on a PC.

Speech recognition is what we at IBM call a Human-Centered technology. It's easier than using a keyboard or mouse. It's more natural, more intuitive. More human.

Human-Centered technologies are an important focus area for IBM because in the not-too-distant future nearly everyone will be a technology consumer. But this growth opportunity won't be realized unless we make technology so accessible and easy to use it will be virtually transparent. Which is why we're so excited about computers that listen. And why we're working hard to drive other Human-Centered technologies from our laboratories to the marketplace – technologies like language translation, pen-based computing and handwriting recognition.

We want to give people the flexibility to choose the way they work with their computers. For some, pointing and touching is preferred. Others want the control and familiarity of a pen.

Unearthing clues: **At an anthropological dig near Casablanca, Dr. Jean-Jacques Hublin, left, of the Musée de l'Homme in Paris discovered fossilized skull fragments. With help from IBM research scientists and IBM's Visualization Data Explorer, Hublin and colleague Dr. David Dean electronically created a unique reconstruction of hominids who lived in North Africa 400,000 years ago.**

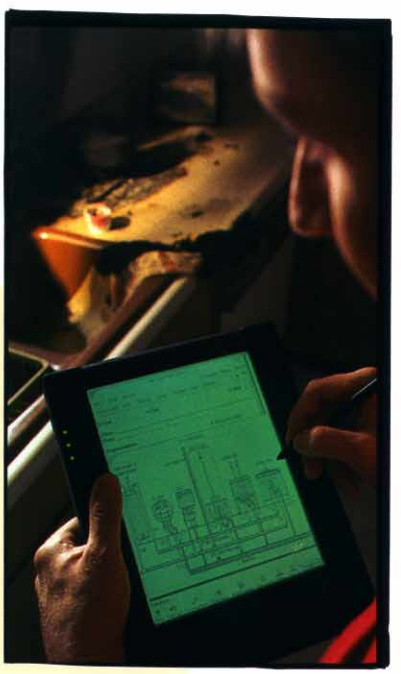
At the Chicago Mercantile Exchange, for example, traders still scribble orders on pads. But in place of pencil and paper, they use electronic pads and IBM's pen technology for OS/2. Orders are transmitted directly from the traders' pads to trading pit. That's faster and more reliable than depending on runners with handfuls of paper, racing around the pit.

Human-Centered technology involves more than bypassing the keyboard. It doesn't do much good to communicate faster with your computer if you can't get the information you need out of it. That's why IBM is putting just as much thought into improving machine intelligence and computer navigational tools. We're creating intelligent agents – highly personalized software programs which hide the complexity of difficult tasks by doing the work for you. You'll be able to send an agent out on a network to search for data or perform chores like buying stock or booking airline reservations.

Last year, IBM announced Parallel Visual Explorer, innovative "data mining" software that graphically analyzes massive databases by dozens of variables, and lets you see relationships and trends that were previously invisible. Parallel Visual Explorer is a powerful tool for any data-intensive field. It's currently being used in AIDS research. It's helping companies spot subtle buying trends and segments in their customer lists. It even showed IBM how to improve the way we make circuit boards.

Ease of use. At IBM, it's more than just another pretty interface.

No compromises: **Users of ultralight notebook computers have long contended with tiny keys crowded together onto a shrunken keyboard. No more. IBM's new ThinkPad 701C sports a patented full-size keyboard that expands as the lid is opened. The 701C also delivers advanced desktop computing features like speakerphone, fax and a 10.4-inch screen — all in a 4.5-pound package.**



Estimates on the spot: **State Farm's fire claims representatives once used ballpoint pen, paper and stacks of huge construction manuals to estimate fire damage from their offices. Now, they use a different kind of pen — and IBM ThinkPad 730T computers — to review building data, calculate and print estimates at the loss site. The 730T reduces processing time for claims from weeks to hours.**

You are an automotive engineer in Russia

crawling across an industrial drafting table on your hands and knees, drawing plans for a new car in the old 1:1 ratio. This one's expected to compete in Eastern European and Chinese markets. Unfortunately, it'll take another year or so before the design gets from blueprint to hand-carved wooden prototype, and another six or seven before all the kinks are worked out and it's fully tested. By then, other manufacturers will have rolled out at least six new and improved models. And you'll still be crawling.

...driving the market.

For Edward Nezhura, an engineer at the Russian automobile maker GAZ, designing a new car is no longer a once-in-a-lifetime affair. GAZ was the first Russian manufacturer to employ an IBM CATIA computer integrated design system – with revolutionary results. The company's lead time has been more than halved. Testing times have been shortened dramatically, and the new models are expected to hold their own against international competitors. With this modern technology, says Nezhura, "more alternatives can be explored."

EDWARD NEZHURA
with 1995 Gazelle and GAZ colleagues

FOR NATIONS racing to develop, the information revolution carries a special urgency. Without fundamental changes in the way they manage and distribute information and support communications, they won't keep up. In many cases, making those sweeping changes means building – or rebuilding – entire information infrastructures from the ground up.

High-growth countries represent tremendous, once-in-a-century market opportunities. Few companies have the size, expertise and resources to take part. IBM is one of them, and we're hard at work.

In the People's Republic of China, IBM's worldwide banking expertise is helping to modernize the payment systems of several major banks. Farmers around the country will soon benefit from an IBM POWERparallel SP2 supercomputer we're installing at the government's weather forecasting agency – the largest SP2 installation in Asia. We're also involved in a range of national infrastructure programs, including a number of "Golden Projects." In one of these, we're building networks to address the information needs of up to 500 cities.

Delivering **the future** all around **the world**

IBM RETURNS: **IBM South Africa was re-established in 1994, and IBM's headquarters for African operations was transferred from Milan to Johannesburg. Among our customers based there: South African Breweries, one of six leading brewers in the world, which turned to IBM to handle its information systems, resulting in an $84 million outsourcing contract.**

AUTOMATING SOCIAL SECURITY: **IBM Argentina won a $360 million outsourcing contract to administer that country's nationwide social security system. Personal data is gathered through automated teller machines and by using intelligent character recognition technology for information submitted on tax forms.**

CHINA'S INFRASTRUCTURE PROJECTS: **IBM last year began work on several national projects in the People's Republic of China. Among them: one of China's "Golden Projects," which will result in a massive digital information system that will one day connect people and businesses in as many as 500 cities. Also in 1994, IBM announced plans to establish its fifth research center, in Beijing.**

IBM's systems are automating India's tax system. Through improved efficiency in collections, the government expects greater funds to be made available for the country's health and education programs.

We're also growing rapidly in Central and Eastern Europe. Since 1991, IBM has opened subsidiaries in a half-dozen formerly Communist nations – Poland, the Czech Republic, Slovenia, Slovakia, Bulgaria and Russia. Just outside Moscow, the Kvant factory in Russia's "Silicon Valley" has produced more than 30,000 PCs for the Russian market. IBM employs over 1,000 people in the local area, and several hundred others work for IBM alliance companies and business partners.

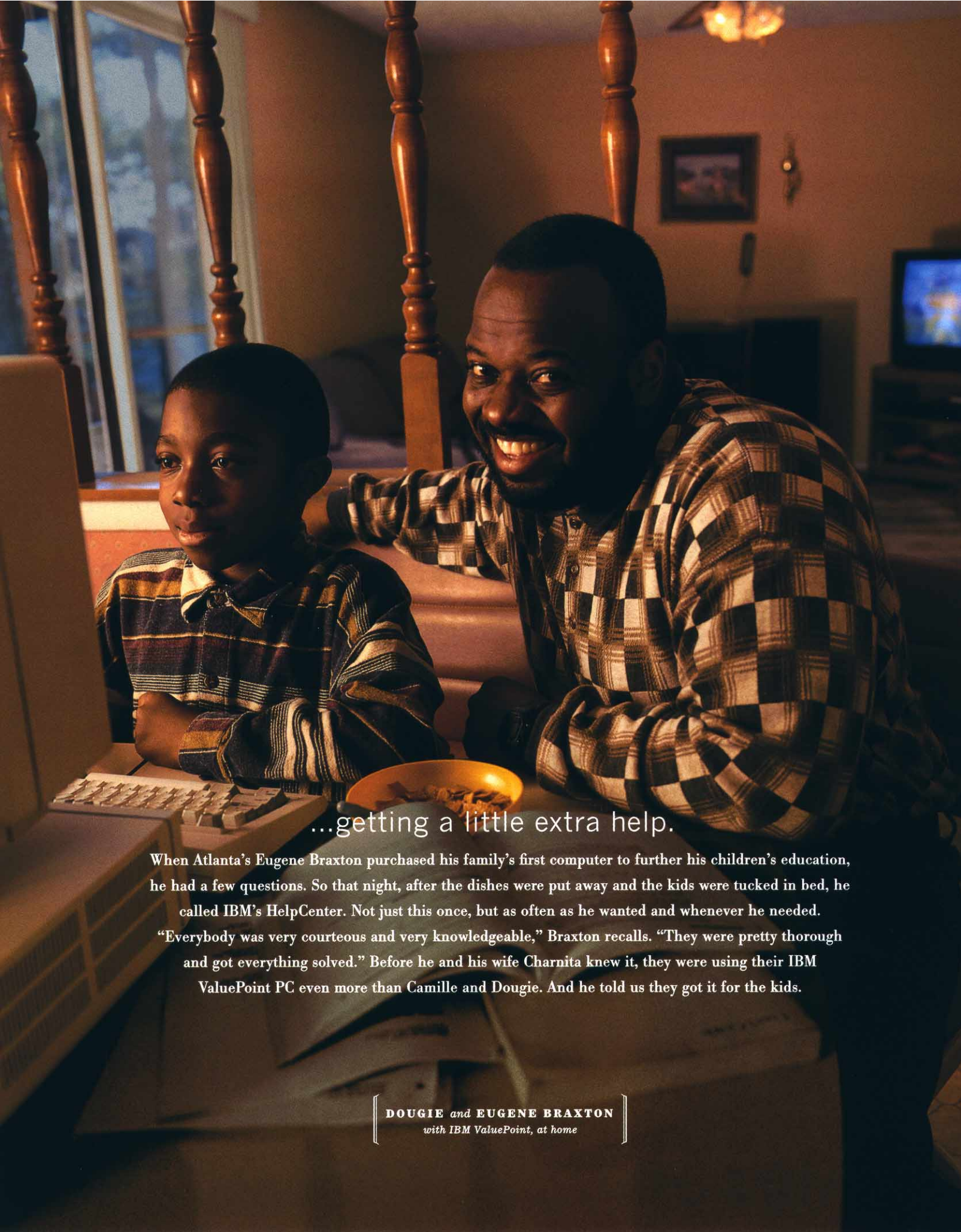
Last year, we re-established IBM South Africa, and moved headquarters for our entire African operations to Johannesburg from Milan, Italy.

In Latin America, where we've long had a strong presence, IBM continues to expand its operations. In Argentina, an IBM team won an outsourcing contract to manage the information needs of that country's social security system. In Brazil, we developed systems to plan and control production processes, as well as manage materials and inventory, at Honda's new automobile plant in the Amazon.

Around the world, modern information technology has become an economic equalizer. IBM is in these markets to sell products and market services. But we can also be a force for positive change. Through our global experience and advanced solutions, businesses and governments in emerging nations are leapfrogging outdated technology – and landing squarely in the 21st century.

You are a parent on a mission

staring at a large cardboard box in the middle of your living room. A personal computer. The inevitable purchase of the '90s. After months of subtle pressure from your spouse (and not-so-subtle pressure from your 10-year-old), you've finally made the investment. Fax modem. CD-ROM. Prodigy. Games your kids talk about in their sleep. The works. Now it's time to break open the bubble wrap and see if this hot rod for the Information Superhighway comes with directions. Or maybe a wrench.



...getting a little extra help.

When Atlanta's Eugene Braxton purchased his family's first computer to further his children's education, he had a few questions. So that night, after the dishes were put away and the kids were tucked in bed, he called IBM's HelpCenter. Not just this once, but as often as he wanted and whenever he needed. "Everybody was very courteous and very knowledgeable," Braxton recalls. "They were pretty thorough and got everything solved." Before he and his wife Charnita knew it, they were using their IBM ValuePoint PC even more than Camille and Dougie. And he told us they got it for the kids.

DOUGIE *and* **EUGENE BRAXTON**
with IBM ValuePoint, at home

Whatever your **needs**, we're working with **you**

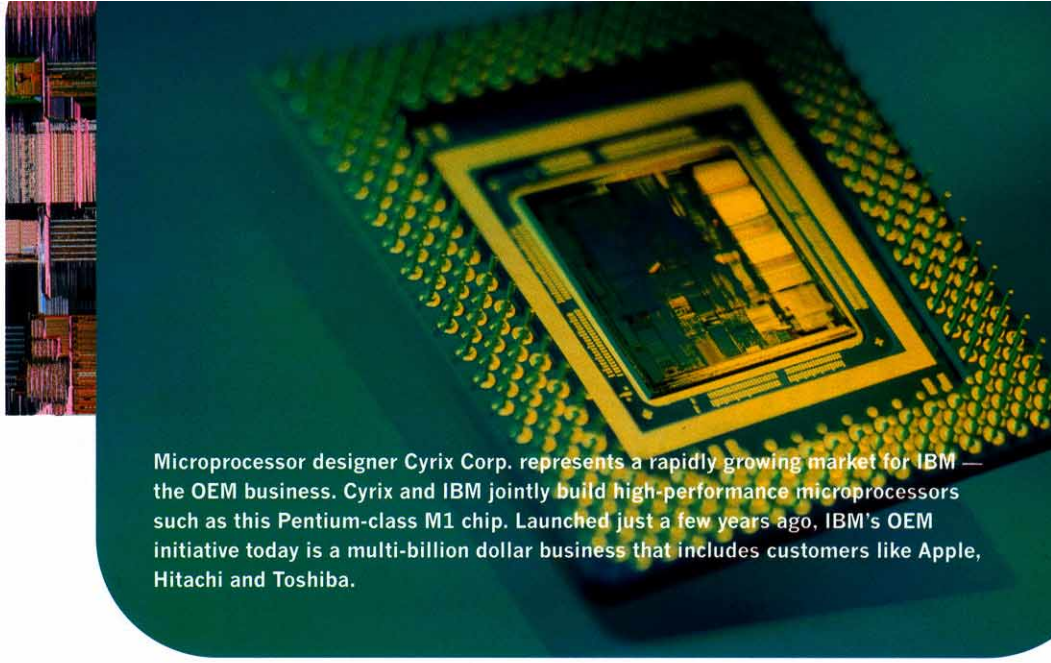
COMMUTING BY CHOPPER: **In the Gulf of Mexico, IBM Petroleum Industry client manager Marty Koszewski steps aboard the *Western Spirit*, one of a fleet of seismic ships operated by Western Atlas International, Inc. Western Atlas uses IBM mainframes, POWERparallel supercomputers and shipboard RS/6000 workstations to gather and analyze detailed seismographic data for the petroleum industry.**

THINK of the typical IBM customer. Who comes to mind? Big companies? Government agencies? Universities?

At one time, that was probably true. Today, IBM works with a truly diverse group of customers. Consumers. Small businesses. Even competitors who buy or license our technologies and incorporate them into their products.

We've found that all of our customers – including our traditional "large" customers – want to work with us in new and different ways. So we're developing strategies and adjusting our operations to meet their needs.

Many customers, for example, like to simply pick up the phone and order products from us. Customers bought nearly $1 billion in products last year from our IBM Direct and PC Direct U.S. telesales operations – a year-to-year sales increase of almost 750 percent for IBM Direct alone. Total PC Direct customers now number more than 100,000. And we've established similar telesales operations throughout Europe, Latin America and Asia Pacific. Our presence in retail stores is also soaring. In Japan, for example, IBM PC dealers doubled last year, from 500 to 1,000.



Microprocessor designer Cyrix Corp. represents a rapidly growing market for IBM — the OEM business. Cyrix and IBM jointly build high-performance microprocessors such as this Pentium-class M1 chip. Launched just a few years ago, IBM's OEM initiative today is a multi-billion dollar business that includes customers like Apple, Hitachi and Toshiba.

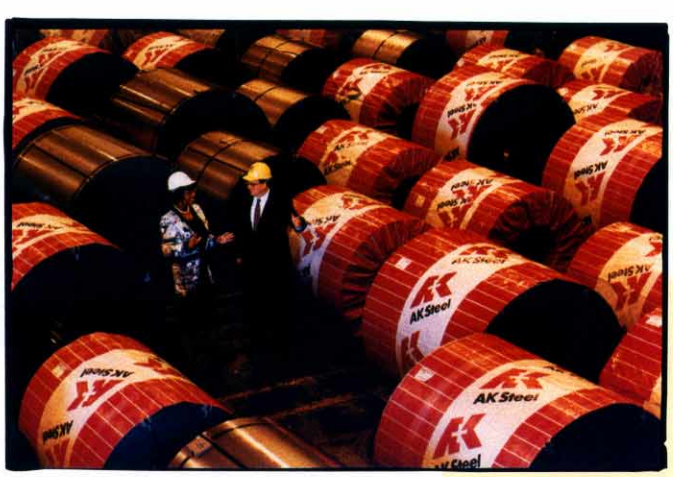
Customers who need immediate help with an IBM product can call 24-hour-a-day operations, such as IBM's HelpCenter in the U.S. During 1994, the HelpCenter answered more than 3 million calls.

Last year, we fundamentally realigned our global sales and distribution force. Instead of being organized and managed by geography, today nearly all IBMers who call on customers belong to an industry group – insurance, petroleum, transportation, banking, government – or are specialists in our product platforms, like AS/400, RS/6000 or OS/2. The logic behind the change is straightforward. Customers around the world told us they want to work with people who are familiar with the dynamics and challenges of their business – not just IBM's – and they want to work with specialists who know how technology can help them run their business.

Some customers prefer to hand over the keys and let IBM manage their information systems, freeing them to focus on what they do best. This business – known as outsourcing or managed operations – is growing rapidly. IBM's worldwide managed operations units signed $7.5 billion in new business in 1994, bringing the value of committed business to nearly $28 billion.

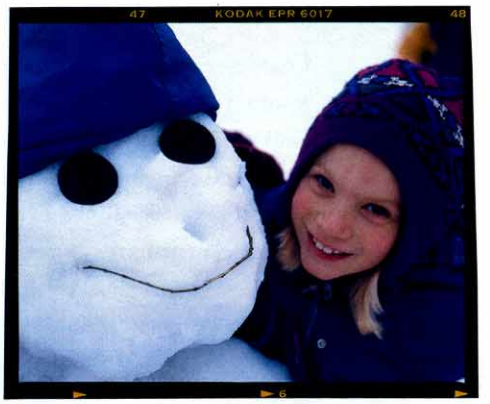
IBM's OEM (original equipment manufacturer) activities continue to grow quickly. In this business, IBM sells or licenses technology, such as disk drives, chips and subsystems, to other technology companies. From a standing start in 1992, OEM generated more than $3 billion in 1994 and is projected to grow faster than the rest of the industry in 1995. Sales are primarily driven by our storage and semiconductor divisions, whose customers today include Apple, Cyrix, Hitachi and Toshiba.

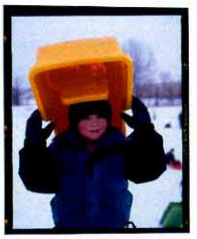
Big companies or parents with big questions – today's IBM customers want to work with us on their terms. We're happy to oblige.

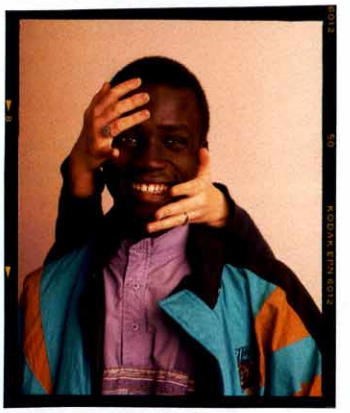


} Outsourcing success: **With support from IBM subsidiary Integrated Systems Solutions Corp. (ISSC), AK Steel is saving millions of dollars a month in operating costs and improving customer service. The results: in under 18 months, AK Steel went from least to most profitable U.S. integrated steel manufacturer. Here, ISSC programmer Janet Stewart and AK Steel Executive Vice President Mark Essig discuss processes to further streamline finished inventory.**

Our corporate **responsibility**: investing in **the future**







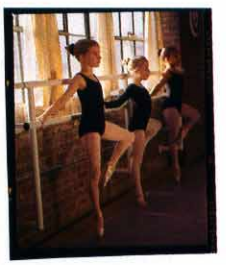
It is perhaps the greatest gift we can give our children – a future full of promise and hope. This past year, IBM committed the majority of its corporate philanthropic efforts to two endeavors designed to improve prospects for the future – education and the environment. These initiatives are in conjunction with our ongoing support of health and human services, the arts, culture and higher education.

Our greatest focus in 1994 was a program known as Reinventing Education. Aimed at kindergarten through grade 12, this program calls upon local U.S. school districts to partner with IBM in a dramatic and deeply rooted restructuring of primary and secondary schools. The goal is to support nothing less than fundamental school restructuring and broad-based, systemic change to improve student performance throughout the nation.

IBM's first partner in this effort is North Carolina's Charlotte-Mecklenburg School (CMS) System, which serves some 85,000 students in 123 primary and secondary schools. In September, CMS announced the construction of a unique, four-school Education Village on a 200-acre campus adjacent to IBM's Charlotte facility.

Designed to educate some 5,200 students and to train teachers throughout North Carolina's largest school district in new methods, the Village will function much as a teaching hospital does with doctors. The Village will feature state-of-the-art teaching facilities at two elementary schools, one middle school and a high school. Rather than use traditional age/grade classifications, the Village will cultivate performance groups of students who will advance to new groups once they've mastered the material – without regard to age or grade.

The schools in the Education Village will set high performance standards, and focus on language skills such as reading, writing and speaking in the early years. By graduation, each student will be expected to be fluent in at least two foreign languages.



Technology will also play a vital role at the Education Village. Not only will it comprise part of the classroom curriculum and teacher training, but it will also connect schools to community centers and to students' homes – effectively lengthening the school day.

The Education Village is the first example of a school system committed to Reinventing Education. We hope it becomes a role model for the nation.

In addition to education, IBM supports research on ways to preserve and protect the environment. The IBM Environmental Research Program has provided technology grants to major universities and research institutions around the world to stimulate the study of environmental problems using computer-based technologies. The program focuses on ways in which modeling and simulation techniques, remote sensing, database development and data-collection technologies offer new knowledge and understanding in the environmental arena.

Areas of research range from the conservation of biological diversity to the study of global climate change, from acid rain deposition to urban and regional air quality, from optimizing groundwater remediation to protecting coral reefs and mangrove systems. IBM technology is a powerful tool in the study of these global environmental issues.

IBM also upholds environmental responsibility with respect to its own operations. Information on IBM's environmental programs and performance is provided in "IBM and the Environment," a report available from First Chicago, as noted on the inside back cover of this annual report.

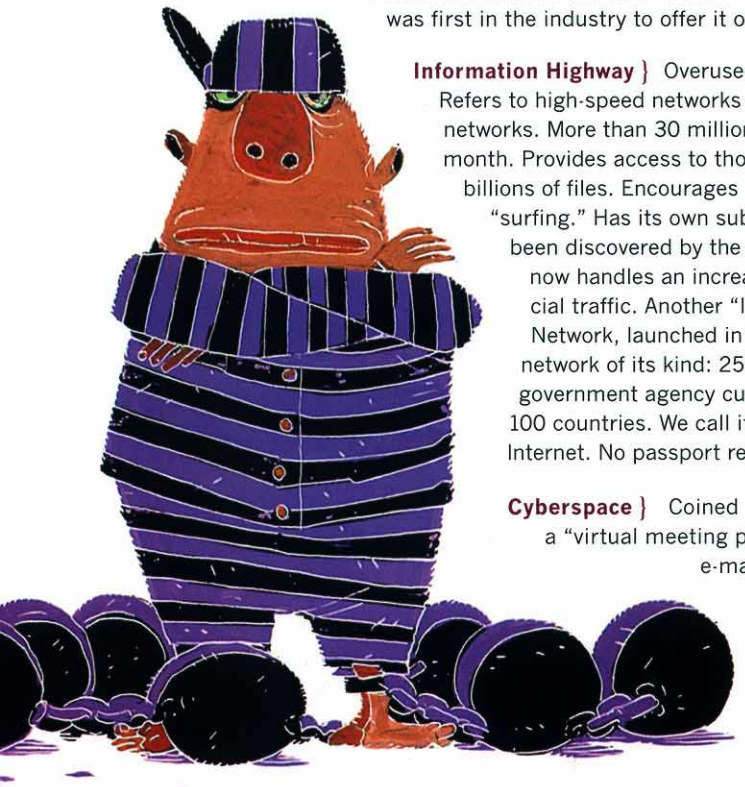
Is your bandwidth "gooey"?

(a low-RISC guide to talking the Tech)

Bandwidth } Transmission capacity. The number of bits and bytes that can be sent through a given system or network. A good thing to have lots of, especially with the coming of videoconferencing, telemedicine, and other data-intensive, multimedia online applications. Explains how "Star Wars" can be reduced to itty bitty bits, sent through a cable and reassembled in your living room and why high-bandwidth technologies like ATM (see below) are a major investment area for IBM.

GUI } Pronounced "goo-ey." Short for Graphical User Interface, or point-and-click. Based on the amazing fact that most humans don't like typing long strings of programming instructions. GUI replaces them with easy-to-use icons, menus and pointing mouses. User-friendly. Good for operator self-esteem. The Workplace Shell in IBM's OS/2 Warp operating system is very GUI, making computing simple, more natural, almost fun.

RAID } Not a police bust. Stands for Redundant Array of Independent Disks. Distributes your data over several smaller interconnected disk drives instead of one big one. Gives you faster data retrieval and better protection against data loss. If one drive crashes (believe it or not, this has happened), your data is quickly reconstructed from redundant data on the other disks. Very smart. RAID Level 5 is the most popular version, and IBM was first in the industry to offer it on everything from PCs to mainframes.



Information Highway } Overused, but still very relevant. Actually, high*ways* is more precise. Refers to high-speed networks of networks, including the Internet, the mother of all networks. More than 30 million users. An estimated 1 million newcomers per month. Provides access to thousands of databases, billions of files. Encourages data browsing, directory "surfing." Has its own subculture and lingo, but has been discovered by the business community and now handles an increasing volume of commercial traffic. Another "I-Way," the IBM Global Network, launched in 1994, is the largest network of its kind: 25,000 business and government agency customers, more than 100 countries. We call it the Businessperson's Internet. No passport required.

Cyberspace } Coined by a science-fiction writer in the '80s. Now a fact. Refers to a "virtual meeting place" of online networks, databases, electronic forums, e-mail, Internet, etc. Doesn't really exist, except when you use it. Bigger than life. Multidimensional. Instantaneous. Even as you read this, thousands of social and professional transactions are taking place in cyberspace. The final frontier. Makes you tingle.

Multithreading/Multitasking } Hard to spell, but very important. Multitasking is your operating system's ability to handle several users or applications simultaneously. Lets you print a document while sending e-mail. Or while hunting for clues in *Myst*. Multithreading breaks up a single complex program into smaller, more manageable chunks.The chunks are run separately but simultaneously, then reassembled. Makes more efficient use of all available processing capacity. Boosts processing speed. Ideal for Parallel Processing (see below). A key feature in advanced operating systems like OS/2 Warp.

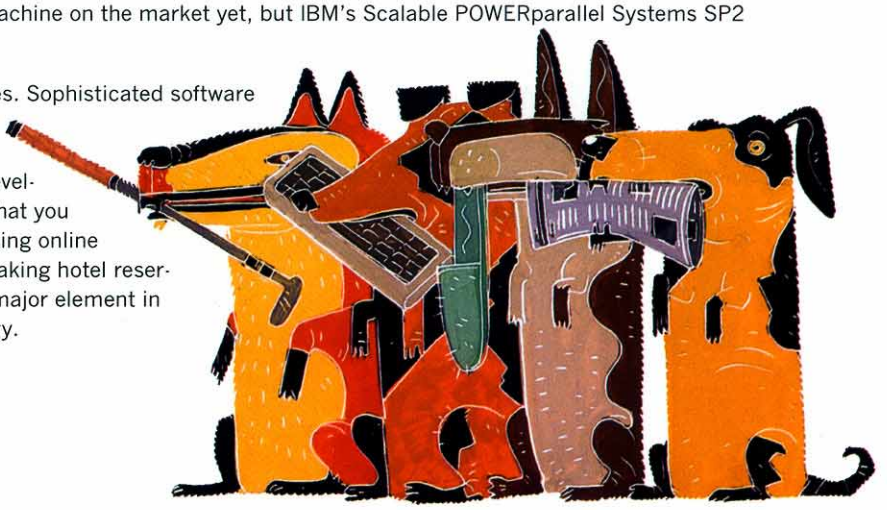
Parallel Processing } Power in numbers. Puts clusters of microprocessors, rather than one large (and expensive) processor, to work on the same computing problem. Efficient. Cost-effective. Upgrades easily and boosts reliability: if one microprocessor fails, the rest keep plugging away. Not that we're bragging, but one of our POWERparallel supercomputers using 512 processors is the world's fastest, most powerful general-purpose computer, capable of some 136 billion calculations per second. It does in one second the work of 25,000 mathematicians performing a complex calculation every minute for 73 years. Now there's an Olympic sport.

ATM } Not the cash machine thing, exactly, but part of it. Stands for Asynchronous Transfer Mode. Describes a switching technology for sending voice, video and other digital data on the same line, at the same time, and at speeds up to 1,000 times faster than conventional networks. Key information-highway technology. Boosts "bandwidth" (see above). A must for data-intensive online applications like movies-on-demand. Very wave-of-the-future and a building block of IBM's network-centric computing strategy.

RISC } Way better than it sounds. Short for Reduced Instruction Set Computer. A computer architecture using fewer, simpler processing instructions, executed more frequently. Lots more efficient. Lots faster than conventional chips (Intel's X86 comes to mind). A leading example of RISC is PowerPC, IBM's new microprocessor family found inside IBM's RS/6000 and AS/400 and debuting soon in PCs and POWERparallel supercomputers.

TeraFLOP } Sounds like something your stockbroker should warn you about. Actually measures computer performance: one TeraFLOP equals 1 trillion FLoating Operations Per second. HUge. Don't even try to guess how many zeros (it's 12). There's no TeraFLOP-class machine on the market yet, but IBM's Scalable POWERparallel Systems SP2 will get there. Soon.

Intelligent Agents } Your dream employees. Sophisticated software that does complex tasks, researches information, finds whatever you need on the information highways and byways. Still in development, but promising. You tell the agent what you want, and it's off, combing databases, perusing online catalogs, monitoring your stock portfolio, making hotel reservations, etc. The ultimate timesaver, and a major element in IBM's push for "Human-Centered" technology.



We are IBM

We have two fundamental missions. First, 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. Second, we translate these advanced technologies into value for our customers worldwide – through our sales and professional services units in North America, Europe/Middle East/Africa, Asia Pacific and Latin America.

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

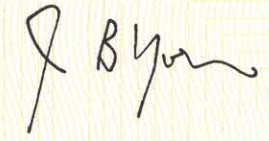
IBM maintains an effective internal control structure. It consists, in part, of organizational arrangements with clearly defined lines of responsibility and delegation of authority, and comprehensive systems and control procedures. We believe this structure provides reasonable assurance that transactions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

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

Price Waterhouse LLP, independent accountants, is retained to examine IBM's financial statements. Their 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



Jerome B. York
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 48 through 78, present fairly, in all material respects, the financial position of International Business Machines Corporation and its subsidiaries at December 31, 1994 and 1993, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1994, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

As discussed in the note on accounting changes on pages 53 and 54, the company changed its methods of accounting for postemployment benefits in 1993 and income taxes in 1992. We concur with these changes.

Price Waterhouse LLP

Price Waterhouse LLP
1177 Avenue of the Americas
New York, NY 10036
January 20, 1995

overview

IBM has made substantial progress during 1994 in stabilizing its operations, rebuilding its balance sheet, improving its cost structure, and increasing shareholder value. The actions taken during the past two years to "right-size" the company have improved IBM's competitiveness in the rapidly changing market for information technology products and services. As a result, the company returned to profitability for the first time since 1990.

Overall, the company's hardware offerings remain under price and competitive pressure. Revenue growth was strong for RISC System/6000* products, merchant-market semiconductors, and Original Equipment Manufacturer (OEM) files, while Application System/400* (AS/400) products showed moderate growth. Although mainframe processor revenue declined, it was stronger than expected. In addition, introduction of CMOS technology is progressing well and the broader use of these products in parallel processing is expected to continue. Personal computer revenue grew, but at a slower rate than certain competitors and the industry as a whole. The company believes that the restructuring actions taken this year will, in the long run, lead to improved performance in this area. It is also anticipated that the pressures on price and margin will remain for all hardware offerings. The company's services offerings continue to grow rapidly, but remain at margins lower than the company's traditional hardware offerings.

While much progress has been made, IBM must continue its pace of change as it focuses increasingly on revenue growth, improving the time to market with new products, re-engineering its business processes, and reducing its cost and expense structure.

results of operations

(Dollars in millions)	1994	1993	1992
Revenue	$ 64,052	$ 62,716	$ 64,523
Cost	38,768	38,568	35,069
Gross profit	25,284	24,148	29,454
Total expense without restructuring charges	20,129	24,000	26,835
Restructuring charges	–	8,945	11,645
Net earnings (loss) before income taxes	$ 5,155	$ (8,797)	$ (9,026)
Net earnings (loss)	$ 3,021	$ (8,101)	$ (4,965)
Gross profit margin	39.5%	38.5%	45.6%

Revenue as reported in the United States was $24.1 billion, a decrease of 6.2 percent compared to 1993. When adjusted for the Federal Systems Company (FSC) sale, which is discussed on page 47, U.S. revenue grew 3.0 percent in 1994, following a 4.3 percent increase in 1993 over 1992. Revenue from Europe was $23.0 billion, an increase of 5.8 percent over 1993, following a 12.8 percent decrease in 1993 from 1992. Asia-Pacific revenue grew 13.4 percent to $11.4 billion compared to 1993, following a 3.6 percent increase over 1992 levels. Revenue from Canada was $2.5 billion, an increase of 15.8 percent over 1993, following a 6.1 percent decrease

in 1993 versus 1992. Latin America revenue decreased .7 percent to $3.0 billion in 1994, following a 3.7 percent increase in 1993 over 1992.

The overall gross profit margin has been relatively stable for the last two years at approximately 39 percent. The gross profit margins continue to be affected by hardware pricing pressures and the company's shift to services revenue, which has lower gross profit margins than its hardware offerings.

The company reported net earnings of $3,021 million ($5.02 per common share), a net loss of $8,101 million ($14.22 per common share), and a net loss of $4,965 million ($8.70 per common share) for 1994, 1993, and 1992, respectively.

When adjusted for the FSC sale ($248 million or $.43 per common share) and the effect of increased amortization resulting from the change in software amortization periods ($192 million or $.33 per common share), net earnings for 1994 were $2,965 million ($4.92 per common share). This compares to a full-year 1993 net loss of $96 million ($.25 per common share) excluding the FSC results ($105 million or $.18 per common share), the effects of a restructuring charge of $7,996 million ($14.02 per common share), and the cumulative effect of $114 million ($.20 decrease in earnings per common share) as a result of the company's adoption of Statement of Financial Accounting Standards (SFAS) 112, "Employers' Accounting for Postemployment Benefits." In 1992, the company had net earnings of $1,328 million ($2.32 per common share) after excluding the FSC results of $89 million ($.16 per common share), the effects of a restructuring charge of $8,282 million ($14.51 per common share), and the cumulative benefit to earnings of $1,900 million ($3.33 per common share) as a result of the company's adoption of SFAS 109, "Accounting for Income Taxes."

hardware sales

(Dollars in millions)	1994	1993	1992
Total revenue	$ 32,344	$ 30,591	$ 33,755
Total cost	21,300	20,696	19,698
Gross profit	$ 11,044	$ 9,895	$ 14,057
Gross profit margin	34.1%	32.3%	41.6%

Worldwide revenue from hardware sales increased 5.7 percent from 1993, following a decrease of 9.4 percent in 1993 from 1992. Worldwide gross profit dollars from hardware sales increased 11.6 percent from 1993, following a decrease of 29.6 percent in 1993 from 1992.

Revenue from processors decreased 2.8 percent from 1993, following a 27.6 percent decrease in 1993 from 1992. These decreases were primarily due to declines in System/390* processor revenue, resulting from continuing competitive pricing pressures associated with these products. AS/400 product revenue grew in 1994 over 1993, as the new advanced series processors showed strong growth. AS/400 product revenue declined in 1993 from 1992, primarily in Europe, due to lower volumes.

Personal systems revenue grew 14.2 percent in 1994 over 1993, following a 27.6 percent increase in 1993 over 1992. The increases resulted from higher revenue from personal computers and strong growth for the RISC System/6000 products. The personal computer revenue continues to reflect severe price competition.

Storage products revenue decreased 26.1 percent in 1994 from 1993, following a decrease of 21.2 percent in 1993 from 1992. These declines were a result of continuing price competition across most storage products.

OEM hardware revenue grew 151.2 percent in 1994 over 1993, following a 132.1 percent increase in 1993 over 1992. These increases are primarily attributable to increased sales of merchant-market semiconductors and low-end storage files.

Information on revenue by classes of similar products or services is included on pages 74 and 75. The product trends demonstrated in this discussion and in that disclosure are indicative, in all material respects, of hardware sales activity.

The increase in hardware sales gross profit margin in 1994 was primarily driven by cost improvements in System/390 processors, offset by lower personal computer margins resulting from price pressures. Although the overall hardware margin increased, it continued to be impacted by pricing pressures on high-end products and personal computers. The decrease in 1993 gross profit margin from 1992 reflected pricing pressures on high-end products and personal computers. In addition, personal computer revenue, which carries a lower gross profit margin, was a proportionally larger part of hardware sales.

software

(Dollars in millions)	1994	1993	1992
Total revenue	$ 11,346	$ 10,953	$ 11,103
Total cost	4,680	4,310	3,924
Gross profit	$ 6,666	$ 6,643	$ 7,179
Gross profit margin	58.8%	60.7%	64.7%

Software revenue increased 3.6 percent in 1994 from 1993, following a decline of 1.4 percent in 1993 from 1992. The increase in 1994 was primarily due to higher one-time-charge revenue associated with RISC System/6000 computer placements. The decline in 1993 was primarily a result of lower one-time-charge revenue reflecting decreased AS/400 computer placements.

Software gross profit dollars increased .3 percent in 1994 from 1993, following a decrease of 7.5 percent in 1993 from 1992. The 1994 software gross profit dollars and margin were affected by a change in the company's software amortization periods effective January 1, 1994. This change was a result of a continuing review of the company's portfolio of software offerings, software amortization periods, and recoverability of the capitalized investment in software products. The change reduced amortization periods to a maximum of four years to recognize more rapid advances in software technology and thus a shorter period over which to recover capitalized costs. This change resulted in increased amortization costs after tax of $192 million ($.33 per common share). Excluding the effects of this change, gross profit dollars would have increased 4.8 percent and the gross

profit margin would have been 61.4 percent in 1994. The decrease in gross profit margin in 1993 from 1992 was partially a result of lower one-time-charge revenue as previously discussed and a higher level of program product write-offs that were recorded as a result of the continuing review of the company's portfolio of software offerings. Write-offs in 1994, 1993, and 1992, excluding the effects of changes in amortization lives, were $491 million, $327 million, and $62 million, respectively.

services

(Dollars in millions)	1994	1993	1992
Services	$ 9,715	$ 7,648	$ 5,530
Federal Systems Company	–	2,063	1,822
Services revenue excluding maintenance	9,715	9,711	7,352
Cost	7,769	8,279	6,051
Gross profit	$ 1,946	$ 1,432	$ 1,301
Gross profit margin	20.0%	14.7%	17.7%
Maintenance revenue	$ 7,222	$ 7,295	$ 7,635
Cost	3,635	3,545	3,430
Gross profit	$ 3,587	$ 3,750	$ 4,205
Gross profit margin	49.7%	51.4%	55.1%
Total services revenue	$ 16,937	$ 17,006	$ 14,987
Cost	11,404	11,824	9,481
Gross profit	$ 5,533	$ 5,182	$ 5,506
Gross profit margin	32.7%	30.5%	36.7%

Services revenue, excluding maintenance, on an as-reported basis, was flat when compared to 1993. The 1994 results do not include operational results from FSC, which were included in 1993 and 1992 results. When adjusted for the effects of the FSC sale, services revenue continued to show strong overall growth, increasing 27.0 percent in 1994 over 1993, following an increase of 38.3 percent in 1993 over 1992. The increases were primarily driven by strong growth in managed operations for both systems and networks, consulting, and systems integration activity.

Services gross profit dollars, excluding maintenance, increased 35.9 percent, following an increase of 10.1 percent in 1993 over 1992. Adjusted for the FSC sale, 1994 gross profit dollars increased 54.0 percent over 1993, and 7.3 percent in 1993 versus 1992. The 1993 gross profit dollars were impacted by cost adjustments that were required on certain older contracts that were not expected to be profitable. The services gross profit margins adjusted for the FSC activity, excluding maintenance, were 20.0 percent, 16.5 percent, and 21.3 percent in 1994, 1993, and 1992, respectively.

Maintenance revenue decreased 1.0 percent from 1993, following a decrease of 4.4 percent in 1993 from 1992. Gross profit dollars decreased 4.4 percent year-over-year, following a decrease of 10.8 percent in 1993 from

1992. Maintenance revenue and gross profit margins continue to be adversely affected by the competitive environment and resulting pricing pressures on maintenance offerings. This trend is expected to continue.

rentals and financing

(Dollars in millions)	1994	1993	1992
Total revenue	$ 3,425	$ 4,166	$ 4,678
Total cost	1,384	1,738	1,966
Gross profit	$ 2,041	$ 2,428	$ 2,712
Gross profit margin	59.6%	58.3%	58.0%

Rentals and financing revenue decreased 17.8 percent from 1993, following a decrease of 10.9 percent in 1993 from 1992. Rentals and financing gross profit dollars decreased 15.9 percent from 1993, following a decrease of 10.5 percent in 1993 from 1992. These decreases are a result of lower financing volumes and reduced prices of IBM products being financed.

operating expenses

(Dollars in millions)	1994	1993	1992
Selling, general and administrative	$ 15,916	$ 18,282	$ 19,526
Percentage of revenue	24.8%	29.2%	30.3%
Research, development and engineering	$ 4,363	$ 5,558	$ 6,522
Percentage of revenue	6.8%	8.9%	10.1%

Selling, general and administrative (SG&A) expense decreased 12.9 percent from 1993, which followed a decrease of 6.4 percent in 1993 from 1992. The 1994 decrease includes the before-tax gain from the FSC sale. Without this gain, SG&A decreased 10.9 percent. These decreases reflect the results of the company's focus on productivity, restructuring programs, and expense controls. Work-force-related SG&A decreased 6.9 percent from 1993, which followed a decrease of 11.7 percent from 1992. The component of SG&A that is not work force related decreased in 1994, primarily as a result of the gain from the FSC sale, lower provisions for accounts receivable, and increased royalty/patent income over 1993 levels. Late in 1994, the Mexican economy suffered severe disruptions, which caused a rapid decline in the Mexican Peso. As a result, the company incurred a $27 million exchange loss, which is recorded in SG&A.

Research, development and engineering expense decreased 21.5 percent in 1994, following a decrease of 14.8 percent in 1993 from 1992. The reductions reflect the company's focus on productivity and expense controls, which resulted in elimination of redundant efforts and reprioritization of development activities to areas such as microprocessors, RISC technology, networking, personal computers, and desktop software.

restructuring charges

No restructuring charges were recorded in 1994. Restructuring charges were $8.9 billion in 1993 and $11.6 billion in 1992. These charges include expenses associated with work force reductions, facility consolidations, capacity reductions, and other related actions to streamline the company. These charges are discussed further on pages 60 and 61.

other income

Other income, principally interest, was $1.4 billion in 1994, an increase of 23.7 percent from 1993, which almost doubled when compared to 1992 levels. The 1994 increase reflects higher levels of available cash and higher interest rates versus 1993. The 1993 increase over 1992 reflects higher levels of available cash and higher interest rates in countries whose economic environment is highly inflationary, notably Brazil. Although other income increased, exchange losses from currency revaluations of cash largely offset the increase. Exchange losses are reflected in SG&A expense.

In July 1994, the Brazilian government converted to a new currency, the Real. The new currency is tied to the U.S. dollar as part of the government's economic plan to reduce inflation and stabilize the economy. If the changes in Brazil are successful, it is anticipated that the economic plan will have the effect of lowering the company's interest income and interest expense, as well as the exchange gains and losses associated with the local currency cash deposits and borrowings. Other income and interest expense amounts decreased significantly during the second half of 1994 compared with previous periods of 1994 and 1993 as a result of this change. Conversely, the Mexican Peso and economy continue to experience disruption. While the company's operations in Mexico are not as significant as its Brazilian operations, high-priority attention is being given to strategies to minimize exchange impacts.

provision for income taxes

The provision for income taxes resulted in a charge of $2,134 million in 1994, a benefit of $810 million in 1993, and a benefit of $2,161 million in 1992. The 1994 provision was based on earnings before income taxes of $5,155 million, resulting in an effective tax rate of 41 percent for 1994. The effective tax rates of (9) percent in 1993 and (24) percent in 1992 were principally due to limited tax benefits on restructuring charges, along with a high effective tax rate on earnings in certain non-U.S. operations. Excluding the effects of restructuring charges, the effective tax rates were 94 percent in 1993 and 46 percent in 1992. The high effective tax rate in 1993 resulted from earnings in non-U.S. operations of $1.3 billion at an average tax rate of 50.2 percent, offset by a loss before taxes in the United States of $1.1 billion at a tax rate of 44.5 percent.

The company accounts for income taxes under SFAS 109, "Accounting for Income Taxes," which provides for recognition of deferred tax assets if realization of such assets is more likely than not. In assessing the likelihood of realization, management considered estimates of future taxable income. The total amount of U.S. federal taxable income needed to realize U.S. federal deferred tax assets, net of valuation allowances, is approximately

$14.0 billion as compared to approximately $15.0 billion in 1993. In estimating the amount of U.S. taxable income that may be available to the company to utilize as many deferred tax assets as possible, the last three years' U.S. taxable income was considered. This was approximately $200 million (estimated income) in 1994, $(1.2) billion loss for 1993, and $4.4 billion income for 1992. In addition, consideration was given to the impact of the announced restructuring actions on the company's future taxable income and tax planning strategies related to research and development costs.

changes in accounting principles

The company implemented SFAS 112, "Employers' Accounting for Postemployment Benefits," effective January 1, 1993. The cumulative effect of adopting this standard, which is discussed further on page 54, was a one-time charge of $114 million (net of approximately $61 million of income tax benefits). Most of this charge was included in U.S. operations.

Effective January 1, 1992, the company implemented SFAS 109, "Accounting for Income Taxes." The cumulative effect of adopting this standard was a one-time benefit to net earnings of $1,900 million for recognition of previously unrecognized tax benefits.

fourth quarter

For the quarter ended December 31, 1994, the company had net earnings of $1,230 million ($2.06 per common share) compared to net earnings of $382 million ($.62 per common share) in the fourth quarter of 1993. Revenue for the fourth quarter of 1994 totaled $19.9 billion, an increase of 2.6 percent when compared to the same period of 1993. Fourth quarter 1994 revenue increased 6.6 percent over 1993 levels when adjusted for the sale of FSC.

On a geographic basis, revenue from Europe was $7.6 billion in the fourth quarter, an increase of 7.8 percent over the same period of last year. Asia-Pacific revenue grew 10.9 percent to $3.4 billion compared to the fourth quarter of 1993. Revenue from Canada was $.8 billion, an increase of 19.4 percent over 1993's fourth quarter. U.S. fourth-quarter revenue was $7.0 billion, an increase of 4.6 percent over the same period of last year after adjusting for the FSC sale. Revenue from Latin America declined 6.5 percent to $1.1 billion compared to the fourth quarter of 1993.

Revenue gains resulting from currency rate fluctuation were largely offset by increases in costs and expenses due to currency. Revenue on a constant currency basis grew approximately 3 percent in the quarter.

Total hardware sales increased 2.5 percent to $10.6 billion in the fourth quarter compared to the same period of 1993, while total software revenue grew 6.9 percent to $3.3 billion. Services revenue increased 3.8 percent to $3.3 billion or 31.4 percent when adjusted for the sale of FSC compared to the fourth quarter of 1993. Maintenance revenue increased 1.9 percent to $1.8 billion in the quarter over the prior year, and rentals and financing revenue declined 12.5 percent to $862 million.

Within specific hardware product areas, AS/400 and RISC System/6000 revenue continued to show strong growth. Mainframe and high-end storage products revenue declined primarily as a result of year-over-year price reductions. Personal computer revenue declined with particular weakness in the U.S. Revenue from sales of OEM products continued to show strong growth, particularly in the semiconductor area.

The company's overall gross profit margin, which has held steady for the last two years, was 40.6 percent compared to 38.2 percent in the fourth quarter of 1993. Total expenses, including net interest expense, declined 10.9 percent in the fourth quarter of 1994 compared to the same period of 1993.

financial condition

The company's financial condition improved significantly during 1994, with increases in cash and stockholders' equity and decreases in outstanding debt and total liabilities.

working capital

(Dollars in millions)	1994	1993
Current assets	$ 41,338	$ 39,202
Current liabilities	29,226	33,150
Working capital	$ 12,112	$ 6,052
Current ratio	1.41:1	1.18:1

Current assets increased $2.1 billion due to increases in cash, cash equivalents, and marketable securities of $3.4 billion and accounts receivable of $2.1 billion, offset by decreases of $1.2 billion in inventories and $2.2 billion in prepaid expenses. The increase in cash, cash equivalents, and marketable securities is primarily attributable to cash generated from operations and $1.5 billion in proceeds from the sale of FSC, offset by net cash utilized to settle outstanding debt of $6.1 billion, and net cash outflow of $2.8 billion due to the company's restructuring programs. The increase in accounts receivable largely reflects strong year-end business volumes, and the company's efforts to reduce the securitization and factoring of receivables. The decline in inventories from year-end 1993 levels results from ongoing efforts to better manage the company's inventories, particularly personal computer inventories. Lower prepaid expenses resulted from the disposition of FSC net assets, which were being held for sale, as well as a decrease in current deferred tax assets.

Current liabilities decreased $3.9 billion from December 31, 1993, with declines of $2.5 billion in short-term debt and $2.5 billion in other accrued expenses and liabilities, offset by a net increase of $1.1 billion in other current liabilities (increases in taxes, accounts payable, and compensation and benefits, and a slight decrease in deferred income). The reduction in short-term debt is driven by the company's efforts to reduce its overall debt obligations, while the decline in other accrued expenses and liabilities is due to lower restructuring accrual balances from implementation of the company's restructuring programs.

investments

The company's capital expenditures for plant, rental machines and other property were $3.1 billion for the year ended December 31, 1994, a decrease of $.1 billion from 1993. The net book value of plant, rental machines and other property declined $.9 billion from 1993, primarily due to depreciation exceeding current levels of capital additions.

In addition to software development expense included in research, development and engineering expense, the company capitalized $1.4 billion of software costs during 1994, versus the $1.5 billion capitalized in 1993. Amortization of capitalized software costs amounted to $2.1 billion for 1994, an increase of $.1 billion from 1993. This amortization included $.3 billion in accelerated amortization of capitalized software costs resulting from the software amortization change implemented in the first quarter of 1994. This change is discussed on pages 38 and 39.

debt and equity

(Dollars in millions)	1994	1993
Short-term debt	$ 9,570	$ 12,097
Long-term debt	12,548	15,245
Total debt	$ 22,118	$ 27,342
Stockholders' equity	$ 23,413	$ 19,738
Long-term debt/equity	53.6%	77.2%

Long-term debt declined $2.7 billion from December 31, 1993, due to the company's continuing focus on reduction of its outstanding debt obligations; long-term debt issued in support of the company's financing activities declined $1.9 billion, while "core" long-term debt declined $.8 billion in 1994.

Other non-current liabilities increased $2.8 billion from year-end 1993, due primarily to the redesignation of restructuring reserves in addition to increases in postretirement benefit reserves.

The company has accrued for environmental matters, including estimated costs of cleanup of Superfund sites, operating facilities, and restoration and monitoring costs related to the closure of facilities. The company also has environmental programs in place which include investment in state-of-the-art facilities for environmental protection as well as other programs to ensure compliance with government regulations and the company's commitment to responsible environmental practices. Environmental costs, including costs associated with complying with existing environmental regulations, are not expected to materially affect the company's financial position or results of operations in future periods. Further discussion appears in note L on pages 61 and 62.

Stockholders' equity increased $3.7 billion from December 31, 1993, resulting from increases of $2.4 billion in retained earnings, $1.0 billion in translation adjustments, and $.3 billion in common stock transactions.

currency rate fluctuations

Approximately 90 percent of the company's non-U.S. business is conducted in local currency environments. With the majority of worldwide currencies strengthening versus the U.S. dollar in 1994, assets and liabilities denominated in local currencies translate into more U.S. dollars. Changes in net worth arising from these currency fluctuations are accumulated in the translation adjustments component of stockholders' equity. As of December 31, 1994, the cumulative translation adjustment was $2.7 billion, an increase of $1.0 billion over 1993.

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

The company has been, to a great degree, buffered from currency risk in its business operations by manufacturing, developing and procuring a significant portion of its product line in non-U.S. countries, so that costs reflect local economic conditions. Also, financial hedging instruments are used to minimize currency risks related to the company's customer financing transactions and the repatriation of dividends and royalties. Currency rate variations did not have a material effect on the company's operating results in 1994, 1993, or 1992. Revenue gains in 1994, resulting from currency rate fluctuations, were largely offset by increases in costs and expenses due to currency movements.

liquidity

In December 1993, the company entered into a $10.0 billion committed global credit facility as part of the company's ongoing efforts to ensure appropriate levels of liquidity. As of December 31, 1994, $9.4 billion was unused and still available. Further discussion appears in note T on page 71.

At year-end 1994, the company had a net balance of $1.8 billion in assets under management from the securitization of lease and trade receivables. This amount is $1.3 billion lower than the 1993 year-end balance of $3.1 billion. Further discussion appears in note U on page 71.

During 1994, the company issued, in lieu of purchasing on the open market, 5.7 million shares of common stock, which has been sold to employees under the IBM Employees 1990 Stock Purchase Plan. Also, during 1994, the company contributed .7 million shares of common stock, as well as cash, to the IBM Retirement Plan Trust Fund.

In October of 1994, Moody's Investors Service upgraded its short-term debt rating for IBM and its rated subsidiaries to "Prime-1" from "Prime-2."

The following table summarizes the company's cash flow from operating, investing, and financing activities as prescribed by Generally Accepted Accounting Principles (GAAP), as reflected in the Consolidated Statement of Cash Flows on page 50:

(Dollars in millions)	1994	1993	1992
Net cash provided from (used in):			
Operating activities	$ 11,793	$ 8,327	$ 6,274
Investing activities	(3,426)	(4,202)	(5,878)
Financing activities	(6,412)	(1,914)	654
Effect of exchange rate changes on cash and cash equivalents	106	(796)	(549)
Net change in cash and cash equivalents	$ 2,061	$ 1,415	$ 501

The improvement in 1994 cash flow from operations, compared with the 1993 period, was mainly driven by the increase in earnings and lower inventories, offset by cash outlays associated with the company's restructuring activities.

The period-to-period improvement in cash flow from investing activities primarily results from the proceeds derived from the sale of FSC in the first quarter of 1994.

The increase in net cash outflow from financing activities in 1994 is due principally to the company's ongoing efforts to reduce its overall outstanding debt obligations.

The company's "core" business involves the sales of information technology products and services as distinct from its customer financing and certain other activities. The company believes it is important to understand the different dynamics of these two businesses. Therefore, the company has derived a model for separately measuring cash flow of the "core" business. The model is not intended to replace the GAAP cash flow above, but is supplementary in nature. Under this model, "core" cash flow from operations was approximately $6.9 billion in 1994. Operations, as defined in this model, includes operating and investing activities, but excludes the impact of changes in customer financing assets and net cash proceeds from securitization of trade accounts receivable, which are viewed as financing in nature.

financing risks

Customer financing is an integral part of the company's total worldwide offerings. Financial results of customer financing can be found on pages 62 through 65. Inherent in customer financing are certain risks: credit, interest rate, currency and residual value. The company manages credit risk through comprehensive credit evaluations and pricing practices. To manage the risks associated with an uncertain interest rate environment, the company pursues a funding strategy of substantially matching the terms of its debt with the terms of its assets. Currency risks are managed by denominating liabilities in the same currency as the assets.

Residual value risk is managed by developing projections of future equipment values at lease inception, reevaluating these projections periodically, and effectively deploying remarketing capabilities to recover residual values, and potentially earning a profit. In 1994 and 1993, the remarketing effort generated profits. The following table depicts an approximation of the unguaranteed residual value maturities for the company's sales-type leases, as well as a projection of net book value of operating leases at the end of the lease terms as of December 31, 1993 and 1994. The following schedule excludes approximately $50 million of estimated residual value associated with non-information technology equipment.

	Total		Run Out of 1994 Residual Value Balance				
(Dollars in millions)	1993	1994	1995	1996	1997	1998	1999
Sales-type leases	$ 760	$ 535	$ 210	$ 200	$ 95	$ 25	$ 5
Operating leases	250	140	75	40	20	5	–
Total residual value	$ 1,010	$ 675	$ 285	$ 240	$ 115	$ 30	$ 5

federal systems company

The sale of FSC to Loral Corporation for $1.503 billion in cash had a closing date of March 1, 1994, and was effective January 1, 1994. This transaction resulted in an after-tax net gain of $248 million ($.43 per common share) in the company's first-quarter 1994 results. The net gain reflects the impact of certain contractual, employee postemployment, and other obligations, which included amounts for the Advanced Automation System contract for the Federal Aviation Authority, that the company recorded as part of the sale. The sale also resulted in a decrease of $752 million in prepaid expenses and other current assets, which represents the net assets associated with FSC. Additionally, as a result of this sale, approximately 10,000 people have either transferred to Loral, retired, or are on a preretirement leave from the company.

FSC marketed specialized products and services to the defense, space, and other agencies of the U.S. government and several non-U.S. governments. Federal Systems Marketing, which sells the company's standard products to government agencies, was not part of the transaction. In 1993, FSC had, on a stand-alone basis, net earnings of $58 million on revenues of $2.3 billion.

employees

				Percentage Changes	
	1994	1993	1992	1994-93	1993-92
IBM/wholly owned subsidiaries	219,839	256,207	301,542	(14.2)%	(15.0)%
Less than wholly owned subsidiaries	23,200	10,989	6,468	111.1%	69.9%
Complementary	35,000	35,000	29,000	0.0%	20.7%

As of December 31, 1994, regular employees were down 36,368 from 1993 and 81,703 from 1992. The company continues to form business entities to enhance efficiencies and achieve its strategic objectives. Some of these entities, while less than wholly owned, are consolidated into the company's financial statements. The increase in employees in the less than wholly owned subsidiaries category in 1994 results primarily from the formation of the following IBM business ventures: Technology Service Solutions (U.S.) – 4,920; Information Services Group Limited (South Africa) – 1,400; and Integrated Systems Solutions Corporation (Australia) – 1,059.

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

looking forward

Although the company returned to profitability in 1994, significant challenges remain. The company must continue to focus on productivity improvements, growth industries and emerging markets, costs and implementation of its long-term strategies. This is particularly true within the Personal Computer Company and desktop software. In 1995, the company will reduce its expenses as re-engineering and restructuring programs continue. The company plans to reduce total annual expenses $8.0 billion from 1992 levels by mid-1996. This is $1.0 billion more than its previously stated goal. At year-end 1994, annual expenses had decreased by $6.3 billion when compared with full-year 1992 levels.

CONSOLIDATED STATEMENT OF OPERATIONS
International Business Machines Corporation and Subsidiary Companies

(Dollars in millions except per share amounts)

For the year ended December 31:	Notes	1994	1993	1992
Revenue:				
Hardware sales		$ 32,344	$ 30,591	$ 33,755
Software		11,346	10,953	11,103
Services		9,715	9,711	7,352
Maintenance		7,222	7,295	7,635
Rentals and financing	N	3,425	4,166	4,678
Total revenue		64,052	62,716	64,523
Cost:				
Hardware sales		21,300	20,696	19,698
Software		4,680	4,310	3,924
Services		7,769	8,279	6,051
Maintenance		3,635	3,545	3,430
Rentals and financing		1,384	1,738	1,966
Total cost		38,768	38,568	35,069
Gross profit		25,284	24,148	29,454
Operating expenses:				
Selling, general and administrative		15,916	18,282	19,526
Research, development and engineering	I	4,363	5,558	6,522
Restructuring charges	J	–	8,945	11,645
Total operating expenses		20,279	32,785	37,693
Operating income (loss)		5,005	(8,637)	(8,239)
Other income, principally interest		1,377	1,113	573
Interest expense	K	1,227	1,273	1,360
Earnings (loss) before income taxes		5,155	(8,797)	(9,026)
Provision (benefit) for income taxes	H	2,134	(810)	(2,161)
Net earnings (loss) before changes in accounting principles		3,021	(7,987)	(6,865)
Effect of changes in accounting principles	B	–	(114)	1,900
Net earnings (loss)		3,021	(8,101)	(4,965)
Preferred stock dividends		84	47	–
Net earnings (loss) applicable to common shareholders		$ 2,937	$ (8,148)	$ (4,965)
Per share of common stock amounts:				
Before changes in accounting principles		$ 5.02	$ (14.02)	$ (12.03)
Effect of changes in accounting principles	B	–	(.20)	3.33
Net earnings (loss) applicable to common shareholders		$ 5.02	$ (14.22)	$ (8.70)

Average number of common shares outstanding:
1994–584,958,699; 1993–573,239,240; 1992–570,896,489

The notes on pages 52 through 78 are an integral part of this statement.

(Dollars in millions)

At December 31:	Notes	1994	1993
Assets			
Current assets:			
Cash		$ 1,240	$ 873
Cash equivalents		6,682	4,988
Marketable securities	C	2,632	1,272
Notes and accounts receivable – trade, net of allowances		14,018	11,676
Sales-type leases receivable		6,351	6,428
Other accounts receivable		1,164	1,308
Inventories	D	6,334	7,565
Prepaid expenses and other current assets		2,917	5,092
Total current assets		41,338	39,202
Plant, rental machines and other property	E	44,820	47,504
Less: Accumulated depreciation		28,156	29,983
Plant, rental machines and other property – net		16,664	17,521
Software, less accumulated amortization (1994, $10,793; 1993, $10,143)		2,963	3,703
Investments and sundry assets	F	20,126	20,687
Total assets		$ 81,091	$ 81,113
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	H	$ 1,771	$ 1,589
Short-term debt	G	9,570	12,097
Accounts payable		3,778	3,400
Compensation and benefits		2,702	2,053
Deferred income		3,475	3,575
Other accrued expenses and liabilities		7,930	10,436
Total current liabilities		29,226	33,150
Long-term debt	G	12,548	15,245
Other liabilities	L	14,023	11,177
Deferred income taxes	H	1,881	1,803
Total liabilities		57,678	61,375
Contingencies	M		
Stockholders' equity:			
Preferred stock, par value $.01 per share – shares authorized: 150,000,000 shares issued: 1994 – 11,145,000; 1993 – 11,250,000	V	1,081	1,091
Common stock, par value $1.25 per share – shares authorized: 750,000,000 shares issued: 1994 – 588,180,244; 1993 – 581,388,475		7,342	6,980
Retained earnings		12,352	10,009
Translation adjustments		2,672	1,658
Treasury stock, at cost (shares: 1994 – 469,500; 1993 – 2,679)		(34)	–
Total stockholders' equity		23,413	19,738
Total liabilities and stockholders' equity		$ 81,091	$ 81,113

The notes on pages 52 through 78 are an integral part of this statement.

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

(Dollars in millions)

For the year ended December 31:	1994	1993	1992
Cash flow from operating activities:			
Net earnings (loss)	$ 3,021	$ (8,101)	$ (4,965)
Adjustments to reconcile net earnings (loss) to cash provided from operating activities:			
Effect of changes in accounting principles	–	114	(1,900)
Effect of restructuring charges	(2,772)	5,230	8,312
Depreciation	4,197	4,710	4,793
Deferred income taxes	825	(1,335)	(3,356)
Amortization of software	2,098	1,951	1,466
(Gain) loss on disposition of investment assets	(11)	151	54
Other changes that provided (used) cash:			
Receivables	653	1,185	1,052
Inventories	1,518	583	704
Other assets	187	1,865	110
Accounts payable	305	359	(311)
Other liabilities	1,772	1,615	315
Net cash provided from operating activities	11,793	8,327	6,274
Cash flow from investing activities:			
Payments for plant, rental machines and other property	(3,078)	(3,154)	(4,751)
Proceeds from disposition of plant, rental machines and other property	900	793	633
Investment in software	(1,361)	(1,507)	(1,752)
Purchases of marketable securities and other investments	(3,866)	(2,721)	(3,284)
Proceeds from marketable securities and other investments	2,476	2,387	3,276
Proceeds from the sale of Federal Systems Company	1,503	–	–
Net cash used in investing activities	(3,426)	(4,202)	(5,878)
Cash flow from financing activities:			
Proceeds from new debt	5,335	11,794	10,045
Payments to settle debt	(9,445)	(8,741)	(10,735)
Short-term borrowings less than 90 days–net	(1,948)	(5,247)	4,199
Preferred stock transactions–net	(10)	1,091	–
Common stock transactions–net	318	122	(90)
Cash dividends paid	(662)	(933)	(2,765)
Net cash (used in) provided from financing activities	(6,412)	(1,914)	654
Effect of exchange rate changes on cash and cash equivalents	106	(796)	(549)
Net change in cash and cash equivalents	2,061	1,415	501
Cash and cash equivalents at January 1	5,861	4,446	3,945
Cash and cash equivalents at December 31	$ 7,922	$ 5,861	$ 4,446
Supplemental data:			
Cash paid during the year for:			
Income taxes	$ 287	$ 452	$ 1,297
Interest	$ 2,132	$ 2,410	$ 3,132

The notes on pages 52 through 78 are an integral part of this statement.

(Dollars in millions)

	Preferred Stock	Common Stock	Retained Earnings	Translation Adjustments	Treasury Stock	Total
1992						
Stockholders' equity, January 1, 1992	$ –	$ 6,531	$ 26,983	$ 3,196	$ (31)	$ 36,679
Net loss			(4,965)			(4,965)
Cash dividends declared–common stock			(2,765)			(2,765)
Common stock issued under employee plans (442,581 shares)		26				26
Purchases (8,097,681 shares) and sales (8,073,124 shares) of treasury stock under employee plans–net			(129)		6	(123)
Tax reductions–employee plans		6				6
Translation adjustments				(1,234)		(1,234)
Stockholders' equity, December 31, 1992	–	6,563	19,124	1,962	(25)	27,624
1993						
Net loss			(8,101)			(8,101)
Cash dividends declared–common stock			(905)			(905)
Cash dividends declared–preferred stock			(47)			(47)
Preferred stock issued (11,250,000 shares)	1,091					1,091
Common stock issued under employee plans (3,765,854 shares)		159				159
Common stock issued to U.S. pension plan fund (5,828,970 shares)		258				258
Purchases (6,099,023 shares) and sales (6,452,566 shares) of treasury stock under employee plans–net			(62)		25	(37)
Translation adjustments				(304)		(304)
Stockholders' equity, December 31, 1993	1,091	6,980	10,009	1,658	–	19,738
1994						
Net earnings			3,021			3,021
Cash dividends declared–common stock			(585)			(585)
Cash dividends declared–preferred stock			(84)			(84)
Preferred stock purchased and retired (105,000 shares)	(10)					(10)
Common stock issued under employee plans (6,120,255 shares)		318				318
Common stock issued to U.S. pension plan fund (671,030 shares)		39				39
Purchases (1,401,740 shares) and sales (934,919 shares) of treasury stock under employee plans–net			(9)		(34)	(43)
Tax reductions–employee plans		5				5
Translation adjustments				1,014		1,014
Stockholders' equity, December 31, 1994	$ 1,081	$ 7,342	$ 12,352	$ 2,672	$ (34)	$ 23,413

The notes on pages 52 through 78 are an integral part of this statement.

A } significant accounting policies

Principles of Consolidation

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

Revenue

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

Selling Expenses

Selling expenses are charged against income as incurred.

Income Taxes

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

Translation of Non-U.S. Currency Amounts

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

Cash Equivalents

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

Inventories

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

Depreciation

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

Software

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

Retirement Plans and Nonpension Postretirement Benefits

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

Goodwill

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

Common Stock

Common stock refers to the $1.25 par value capital stock, as designated in the company's Certificate of Incorporation. Earnings (loss) per common share amounts are computed by dividing earnings (loss) after deduction of preferred stock dividends by the average number of common shares outstanding in the period.

B } accounting changes

Effective January 1, 1994, the company implemented SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." Adoption of this standard had no impact on the company's Consolidated Statement of Operations, and the Consolidated Statement of Financial Position was not materially affected. Prior years' consolidated financial statements have not been restated to reflect this change.

Effective January 1, 1993, the company implemented SFAS 112, "Employers' Accounting for Postemployment Benefits." While the company was generally in compliance with the standard prior to adoption, a charge was taken to recognize the cost of certain benefits, primarily related to healthcare for employees on disability. The cumulative effect of adopting this standard was a one-time charge of $114 million (net of approximately $61 million of income tax benefits). Prior years' consolidated financial statements were not restated to reflect this change.

In 1992, the company implemented SFAS 109, "Accounting for Income Taxes." This standard superseded the previous accounting standard for income taxes, SFAS 96, which the company adopted in 1988. Under SFAS 109, the company recognizes deferred tax assets if it is more likely than not that a benefit will be realized. The cumulative effect of this accounting change, which was to recognize previously unrecognized tax benefits for years prior to January 1, 1992, increased net earnings for 1992 by $1,900 million, or $3.33 per common share.

The Financial Accounting Standards Board issued SFAS 114, "Accounting by Creditors for Impairment of a Loan," in May 1993 and SFAS 118, "Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosure," an amendment of SFAS 114, in October 1994. These standards prescribe impairment measurements and reporting related to certain loans. SFAS 114 and SFAS 118 are effective for fiscal years beginning after December 15, 1994. The implementation of these standards is not expected to have a material effect on the financial position or results of operations of the company.

C } marketable securities

	At December 31:	
(Dollars in millions)	1994	1993
U.S. government securities	$ 1,020	$ 702
Time deposits and other bank obligations	459	515
Non-U.S. government securities and other fixed-term obligations	1,153	55
Total, which approximates market value	$ 2,632	$ 1,272

D } inventories

	At December 31:	
(Dollars in millions)	1994	1993
Finished goods	$ 1,442	$ 1,906
Work in process	4,636	5,539
Raw materials	256	120
Total	$ 6,334	$ 7,565

E } plant, rental machines and other property

(Dollars in millions)	At December 31: 1994	1993
Land and land improvements	$ 1,437	$ 1,422
Buildings	13,093	13,314
Plant, laboratory and office equipment	27,084	29,829
	41,614	44,565
Less: Accumulated depreciation	26,299	28,576
	15,315	15,989
Rental machines and parts	3,206	2,939
Less: Accumulated depreciation	1,857	1,407
	1,349	1,532
Total	$ 16,664	$ 17,521

F } investments and sundry assets

(Dollars in millions)	At December 31: 1994	1993
Net investment in sales-type leases*	$ 15,838	$ 17,518
Less: Current portion–net	6,351	6,428
	9,487	11,090
Deferred taxes	4,533	4,521
Prepaid pension cost	1,528	532
Non-current customer loan receivables	1,311	882
Installment payment receivables	817	703
Investments in business alliances	380	650
Goodwill, less accumulated amortization (1994, $648;1993, $462)	427	646
Other investments and sundry assets	1,643	1,663
Total	$ 20,126	$ 20,687

** 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 $535 million and $760 million at December 31, 1994 and 1993, and is reflected net of unearned income at these dates of approximately $2,600 million and $3,100 million, respectively. Scheduled maturities of minimum lease payments outstanding at December 31, 1994, expressed as a percentage of the total, are approximately as follows: 1995, 40 percent; 1996, 33 percent; 1997, 18 percent; 1998, 7 percent; 1999 and after, 2 percent.*

G } debt

short-term debt

(Dollars in millions)	At December 31: 1994	1993
Commercial paper	$ 2,544	$ 3,735
Short-term loans	2,977	4,356
Long-term debt: Current maturities	4,049	4,006
Total	$ 9,570	$ 12,097

The weighted-average interest rates for commercial paper at December 31, 1994 and 1993, were 4.9 percent and 3.9 percent, respectively. The weighted average interest rates for short-term loans at December 31, 1994 and 1993, were 6.6 percent and 5.9 percent, respectively.

long-term debt

(Dollars in millions)	Maturities	At December 31: 1994	1993
U.S. Dollars:			
Debentures :			
7-1/2%	2013	$ 550	$ 550
8-3/8%	2019	750	750
Notes :			
5-5/8% to 7-5/8%	1995-2002	3,325	4,267
7-3/4% to 8-7/8%	1995-1997	–	102
9% to 9-7/8%	1995-2000	641	692
Medium-term note program: 4.1% to 9.9%	1995-2008	2,803	1,734
Other U.S. dollars: 4.0% to 9.5%	1995-2012	558	1,765
		8,627	9,860
Other currencies (average interest rate at December 31, 1994, in parentheses):			
Japanese yen (4.5%)	1995-2014	4,769	5,057
Swiss francs (5.0%)	1995-1996	629	699
European currency units (9.1%)	1995	400	1,044
Canadian dollars (10.3%)	1995-1999	638	852
French francs (7.3%)	1995-2002	858	809
Australian dollars (9.6%)	1995-1997	326	253
Other (9.7%)	1995-2017	371	696
		16,618	19,270
Less: Net unamortized discount		21	19
		16,597	19,251
Less: Current maturities		4,049	4,006
Total		$ 12,548	$ 15,245

Annual maturity and sinking fund requirements in millions of dollars on long-term debt outstanding at December 31, 1994, are as follows: 1995, $4,049; 1996, $3,105; 1997, $2,769; 1998, $2,240; 1999, $315; 2000 and beyond, $4,140.

H } taxes

(Dollars in millions)	1994	1993	1992
For the year ended December 31:			
Earnings (loss) before income taxes:			
U.S. operations	$ 1,574	$ (6,073)	$ (7,678)
Non-U.S. operations	3,581	(2,724)	(1,348)
	$ 5,155	$ (8,797)	$ (9,026)
The provision (benefit) for income taxes by geographic operations is as follows:			
U.S. operations	$ 654	$ (505)	$ (2,179)
Non-U.S. operations	1,480	(305)	18
Total provision (benefit) for income taxes	$ 2,134	$ (810)	$ (2,161)
The components of the provision (benefit) for income taxes by taxing jurisdiction are as follows:			
U.S. federal:			
Current	$ 49	$ (4)	$ (115)
Deferred	74	(890)	(2,390)
Net deferred investment tax credits	–	(51)	(54)
	123	(945)	(2,559)
U.S. state and local:			
Current	68	26	(14)
Deferred	–	23	3
	68	49	(11)
Non-U.S.:			
Current	1,192	554	1,378
Deferred	751	(468)	(969)
	1,943	86	409
Total provision (benefit) for income taxes	2,134	(810)	(2,161)
Social security, real estate, personal property, and other taxes	2,465	2,614	3,067
Total taxes	$ 4,599	$ 1,804	$ 906

The non-U.S. deferred income tax provision was reduced $106 million due to the utilization of operating loss carryforwards in 1994.

The impact of tax law changes on deferred tax assets and liabilities was not material to the company's financial results in 1994 and 1992 and was a benefit of $170 million in 1993.

Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes.

The significant components of deferred tax assets and liabilities included on the balance sheet were as follows:

(Dollars in millions)	1994	1993*
At December 31:		
Deferred Tax Assets		
Retiree medical benefits	$ 2,500	$ 1,961
Restructuring charges	2,446	5,253
Capitalized R&D	2,057	1,739
Foreign tax credits	1,380	885
Alternative minimum tax credits	738	729
Inventory	633	621
Foreign tax loss carryforwards	469	989
Doubtful accounts	453	480
General business credits	452	452
Equity alliances	445	309
State and local tax loss carryforwards	370	566
Employee benefits	363	480
Intracompany sales and services	357	440
Depreciation	249	234
U.S. federal tax loss carryforwards	230	1,093
Warranty	163	125
Retirement benefits	127	124
Software income deferred	78	186
Other	2,685	2,521
Gross deferred tax assets	16,195	19,187
Less: Valuation allowance	4,551	5,035
Total deferred tax assets	$ 11,644	$ 14,152
Deferred Tax Liabilities		
Sales-type leases	$ 2,862	$ 3,118
Depreciation	1,653	1,537
Software costs deferred	1,283	1,824
Retirement benefits	1,061	1,069
Other	823	1,379
Gross deferred tax liabilities	$ 7,682	$ 8,927

**Reclassified to conform with 1994 presentation.*

The valuation allowance applies to U.S. federal tax credit and net operating loss carryforwards, state and local net deferred tax assets and net operating loss carryforwards, and net operating losses in certain foreign jurisdictions that may expire before the company can utilize them. The net change in the total valuation allowance for the year ended December 31, 1994, was a decrease of $484 million.

The estimated reversal periods for the largest deductible temporary differences are: Retiree Medical – 1 to 30 years; Restructuring – 1 to 5 years.

The consolidated effective income tax rate was 41 percent in 1994, (9) percent in 1993, and (24) percent in 1992.

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:	1994	1993	1992
Statutory rate	35%	(35)%	(34)%
U.S. valuation allowance related to restructuring	–	20	6
Foreign tax differential	5	7	5
State and local, net	1	–	–
Other	–	(1)	(1)
Effective rate	41%	(9)%	(24)%

For tax return purposes, the company has available tax credit carryforwards of approximately $2,944 million, of which $369 million expire in 1996, $776 million expire in 1998, $576 million expire in 1999, and the remainder thereafter. The company also has federal, state and local, and foreign tax loss carryforwards, the tax effect of which is $1,069 million. Most of these carryforwards are available for fourteen years or have an indefinite carryforward period.

Undistributed earnings of non-U.S. subsidiaries included in consolidated retained earnings amounted to $11,280 million at December 31, 1994, $10,915 million at December 31, 1993, and $12,182 million at December 31, 1992. 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. Accordingly, no material provision has been made for taxes that might be payable upon remittance of such earnings nor is it practicable to determine the amount of this liability.

I } research, development and engineering

Research, development and engineering expenses amounted to $4,363 million in 1994, $5,558 million in 1993, and $6,522 million in 1992. Expenditures for product-related engineering included in these amounts were $981 million, $1,127 million, and $1,439 million in 1994, 1993, and 1992, respectively.

Expenditures of $3,382 million in 1994, $4,431 million in 1993, and $5,083 million in 1992 were made for research and development activities covering basic scientific research and the application of scientific advances to the development of new and improved products and their uses. Of these amounts, software-related activities were $793 million, $1,097 million, and $1,161 million in 1994, 1993, and 1992, respectively.

J } restructuring actions

In 1993 and 1992, the company recorded restructuring charges of $8.9 billion before taxes ($8.0 billion after taxes or $14.02 per common share) and $11.6 billion before taxes ($8.3 billion after taxes or $14.51 per common share), respectively, as part of restructuring programs to streamline and reduce resources utilized in the business. These charges and their subsequent utilization are summarized in the following table:

(Dollars in billions)	Amounts Charged in 1993 and 1992*	Amounts Utilized at Year-end 1994	Amounts to be Utilized in 1995
Work force related	$ 11.5	$ 10.5	$ 1.0
Manufacturing capacity	4.9	4.0	.9
Excess space	3.4	3.0	.4
Other	.7	.7	–
Total restructuring charges	$ 20.5	$ 18.2	$ 2.3**

** Includes redistribution among categories, as described in detail below.*

*** $1.4 billion included in Other accrued expenses and liabilities and $.9 billion reduction to Plant, rental machines and other property in the Consolidated Statement of Financial Position at December 31, 1994.*

As of December 31, 1994, the company has determined that restructuring reserve balances are adequate to cover committed restructuring actions. Based on the actual restructuring actions in 1994, it was necessary to redistribute by category $1.2 billion of the $20.5 billion assumed in the original restructuring plans. The company reduced reserve balances designated for manufacturing capacity actions by $1.2 billion and increased amounts originally designated for work-force-related and excess space actions by $.1 billion and $1.1 billion, respectively. All remaining restructuring actions have been announced as of December 31, 1994, and it is estimated that approximately $1.3 billion of the remaining $2.3 billion of restructuring reserves will be utilized by March 31, 1995, with the remaining amounts being fully utilized prior to December 31, 1995.

The company records restructuring charges against operations and provides a reserve based on the best information available at the time the decision is made to undertake the restructuring action. The reserves are considered utilized when specific restructuring criteria are met, indicating the planned restructuring action has occurred. Work-force-related reserves are considered utilized at payment for termination or acceptance of other contractual arrangements.

Manufacturing capacity reserves are considered utilized based on execution of planned actions at each affected location. The reserve for excess space is utilized when the remaining lease obligations are settled or the space has been vacated and made available for sublease. It is the company's policy to continue to charge depreciation, rental, and other operating costs relating to manufacturing capacity and excess space to ongoing operations while they remain in business use. Salaries and benefits are charged to operations while the employee is actively employed.

The $11.4 billion of work-force-related reserves taken in 1992 and 1993 contemplated worldwide staff reductions of approximately 110,000 people. Through 1994, approximately 98,000 people have left the company under these programs. The $.1 billion increase in work-force-related reserves was primarily a result of higher than planned costs associated with staff reductions in Europe.

The manufacturing capacity reserves were reduced by $1.2 billion due to the combination of increased demand for selected products, increased asset requirements in several significant new Microelectronics Division joint ventures, as well as a higher level of sales to third parties than originally planned. The excess space accrual increased by $1.1 billion as a result of additional lease space being vacated, primarily within the United States as a result of work force reductions and more efficient utilization of owned space allowing for consolidation of leased space.

Remaining cash outlays associated with work-force-related activities are expected to total $3.7 billion of which $1.7 billion will be expended in 1995. Remaining amounts relate to the pension plan curtailment portion of the charge and other postretirement payments which will be made as required for funding appropriate pension and other postretirement benefits in future years. Remaining manufacturing capacity actions will not involve substantial cash outlays. Cash requirements related to excess space charges are expected to be expended as follows: $635 million in 1995, $418 million in 1996, $391 million in 1997, and $999 million in 1998 and beyond.

K } interest on debt

Interest on borrowings of the company and its subsidiaries amounted to $2,006 million in 1994, $2,298 million in 1993, and $2,698 million in 1992. Of these amounts, $20 million in 1994, $46 million in 1993, and $101 million in 1992 were capitalized. The remainder was charged to cost of rentals and financing, and interest expense. The lower levels of expense were a result of decreases in total debt outstanding of $5.2 billion in 1994 versus 1993 and $2.0 billion in 1993 versus 1992. The average interest rate for total debt was 8.0 percent, 7.7 percent, and 9.6 percent in 1994, 1993, and 1992, respectively.

L } other liabilities and environmental

Other liabilities consists principally of accruals for nonpension postretirement benefits, indemnity, and retirement plan reserves for non-U.S. employees, and restructuring charges. More detailed discussions of these liabilities appear in note S, "Nonpension Postretirement Benefits," on pages 69 through 71; note R, "Retirement Plans," on pages 67 through 69; and note J, "Restructuring Actions," on pages 60 and 61.

In addition, the company continues to participate in environmental assessments and cleanups at a number of locations, including operating facilities, previously owned facilities, and Superfund sites. The company accrues for all known environmental liabilities for remediation cost when a cleanup program becomes probable and costs can be reasonably estimated. Estimated environmental costs associated with post-closure activities, such as the removal and restoration of chemical storage facilities and monitoring, are accrued when the decision is made to close a facility. The amounts accrued, which are undiscounted and do not reflect any insurance recoveries, were $179 million and $77 million at December 31, 1994 and 1993, respectively. The increase in the

accrual relates to expected costs of post-closure activities, reassessment of remediation activities at operating facilities, and participation at additional Superfund sites.

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

M } contingencies

On February 25, 1993, a consolidated and amended class action complaint was filed against the company in the United States District Court for the Southern District of New York alleging violations of Section 12 of the Securities Act of 1933 and Section 10 of the Securities Exchange Act of 1934. The complaint alleges, among other matters, that the company disseminated false and misleading statements concerning its financial condition and dividends during certain periods of 1992, as a result of which plaintiffs were injured in connection with their purchases of IBM stock during the period of September 30, 1992, through December 14, 1992.

The plaintiffs seek unspecified money damages. The company believes it has good defenses to the allegations raised in the consolidated complaint and intends to defend itself vigorously. The company does not believe that the ultimate outcome of this matter will have a material effect on its results of operations or its financial position.

N } customer financing

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

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

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

statement of financial position

At December 31:	Customer Financing		IBM with Customer Financing on an Equity Basis	
(Dollars in millions)	1994	1993	1994	1993
Assets:				
Cash and cash equivalents	$ 1,304	$ 2,096	$ 6,618	$ 3,765
Notes and accounts receivable	–	–	9,602	8,177
Net investment in sales-type leases	15,977	17,518	–	–
Working capital financing receivables	2,539	1,898	–	–
Loans receivable	3,910	3,615	–	–
Inventories	101	143	6,246	7,466
Plant, rental machines and other property, net of accum. depreciation	2,672	2,627	15,319	15,788
Other assets	2,167	2,551	16,516	16,679
Investment in customer financing	–	–	4,175	5,524
Total assets	$ 28,670	$ 30,448	$ 58,476	$ 57,399
Liabilities and stockholders' equity:				
Taxes, accrued expenses, and other liabilities	$ 6,487	$ 6,417	$ 32,109	$ 31,450
Debt	19,164	21,131	2,954	6,211
Total liabilities	25,651	27,548	35,063	37,661
Stockholders' equity/invested capital	3,019	2,900	23,413	19,738
Total liabilities and stockholders' equity	$ 28,670	$ 30,448	$ 58,476	$ 57,399

statement of operations

For the year ended December 31:	Customer Financing			IBM with Customer Financing on an Equity Basis		
(Dollars in millions)	1994	1993	1992	1994	1993	1992
Finance and other income:						
Finance income	$ 2,026	$ 2,485	$ 2,699	$ –	$ –	$ –
Rental income, net of depreciation	338	285	337	589	692	962
Sales	1,160	1,391	1,384	59,991	57,483	58,646
Other income	933	850	505	1,423	1,184	955
Total finance and other income	4,457	5,011	4,925	62,003	59,359	60,563
Interest and other costs and expenses	3,245	3,994	3,947	56,848	68,156	69,589
Net earnings (loss) before income taxes	1,212	1,017	978	5,155	(8,797)	(9,026)
Provision (benefit) for income taxes	505	443	406	2,134	(810)	(2,161)
Net earnings (loss) before changes in accounting principles	707	574	572	3,021	(7,987)	(6,865)
Effects of changes in accounting principles	–	–	–	–	(114)	1,900
Net earnings (loss)	$ 707	$ 574	$ 572	$ 3,021	$ (8,101)	$ (4,965)

statement of cash flows

For the year ended December 31:	Customer Financing			IBM with Customer Financing on an Equity Basis		
(Dollars in millions)	1994	1993	1992	1994	1993*	1992*
Net cash provided from operating activities	$ 2,669	$ 3,004	$ 3,414	$ 8,393	$ 4,499	$ 5,248
Net cash used in investing activities	(249)	(284)	(4,176)	(2,446)	(3,094)	(4,090)
Net cash (used in) provided from financing activities	(3,294)	(1,680)	1,094	(3,118)	(234)	(440)
Effect of exchange rate changes on cash and cash equivalents	82	(47)	(21)	24	(749)	(528)
Net change in cash and cash equivalents	(792)	993	311	2,853	422	190
Cash and cash equivalents at January 1	2,096	1,103	792	3,765	3,343	3,153
Cash and cash equivalents at December 31	$ 1,304	$ 2,096	$ 1,103	$ 6,618	$ 3,765	$ 3,343

**Reclassified to conform with 1994 presentation.*

Customer financing debt at December 31, 1994, consisted of borrowings directly with external financial institutions of $16,052 million and intracompany borrowings of $3,112 million. Intracompany borrowings are made pursuant to loan agreements between the parties at market rates of interest.

Customer financing earnings yielded a return on average invested capital of 24.5 percent in 1994, compared to 18.4 percent in 1993. Included within these results are intracompany services and fees received for tax benefits provided to the company resulting from tax deferrals generated by financing transactions. Such fees are eliminated from the Consolidated Statement of Operations. The 1994 earnings include income resulting from IBM Credit Corporation's litigation settlement with Comdisco, Inc. and from IBM Credit Corporation's sale of IBM Credit Investment Management Corporation.

The provision for income taxes for customer financing is based on the statutory income tax rate of each country, calculated on a separate return basis.

O } rental expense and lease commitments

Rental expense, including amounts charged to inventories and fixed assets, excluding amounts charged to restructuring, was $1,276 million in 1994, $1,686 million in 1993, and $2,108 million in 1992. The table below depicts gross minimum rental commitments, under non-cancellable leases; amounts related to vacant space, the majority of which the company had reserved for in restructuring charges; and sublease commitments. These amounts generally reflect activities related to office space.

(Dollars in millions)	1995	1996	1997	1998	1999	Beyond 1999
Gross rental commitments	$ 1,220	$ 1,072	$ 925	$ 827	$ 717	$ 2,594
Vacant space	383	351	310	277	215	619
Sublease commitments	70	76	72	67	53	99

P } long-term performance plan

In April 1994, stockholders approved the IBM 1994 Long-Term Performance Plan, which provides incentive awards for officers and other key employees. The plan is administered by the Executive Compensation and Management Resources Committee of the Board of Directors. The Committee determines the type of award to be granted, which may include stock, a stock option, a Stock Appreciation Right (SAR), cash, or any combination thereof. The number of shares that may be issued under the plan for awards granted wholly or partly in stock during the five-year term of the plan is 29,105,600, which is 5% of the outstanding common stock as determined on February 10, 1994. Prior to April 25, 1994, stock options were issued under the IBM 1989 Long-Term Performance Plan and the IBM 1986 and predecessor Stock Option Plans.

Options allow the purchase of IBM's common stock at 100 percent of the market price on the date of grant and have a maximum duration of 10 years. Payment by the optionee upon exercise of an option may be made using IBM stock, as well as cash.

SARs offer eligible optionees the alternative of electing not to exercise the related stock option, but to receive payment in cash and/or stock, equivalent to the difference between the option price and the average market price of IBM stock on the date of exercising the right.

The following table summarizes option activity during 1994 and 1993:

Number of shares under option	1994	1993
Balance at January 1	29,260,724	35,621,963
Options granted	6,863,219	13,744,772
Options exercised	(235,044)	–
Options terminated	(1,825,582)	(20,106,011)
Balance at December 31	34,063,317	29,260,724
Exercisable at December 31	16,666,537	14,636,324

In April 1993, the committee of the Board of Directors then responsible for administering the plan, the Nominating and Executive Compensation Committee, approved management's plan to allow optionees, other than executive officers, to voluntarily forfeit all of their existing IBM stock options, granted from 1984 through 1992, in exchange for a fewer number of new stock option grants. Under this program, 18,054,615 options, at average prices ranging from $66.94 to $159.50, were terminated and 7,405,090 new options, at a price of $47.88, were granted subject to certain conditions for vesting and exercise.

The options exercised in 1994 were at an average option price of $46.42 per share. There were no options exercised in 1993. The shares under option at December 31, 1994, and December 31, 1993, were at option prices ranging from $43.00 to $159.50 per share.

There were 27,842,801 and 6,011,858 unused shares carried forward and made available for granting in the subsequent year as of December 31, 1994, and 1993, respectively.

Q } stock purchase plan

The IBM Employees 1990 Stock Purchase Plan enables employees who are not participants in IBM's stock option programs to purchase IBM common stock through payroll deductions of up to 10 percent of eligible compensation. The price an employee pays for a share of stock is 85 percent of the average market price on the date the employee has accumulated sufficient funds to buy a share.

In July 1993, the Board of Directors approved management's plan to issue, instead of purchase on the open market, stock to be sold to employees under the plan. On October 25, 1994, the Board of Directors approved management's plan to revert to purchasing IBM common stock on the open market for sale to employees as part of this plan.

During 1994, employees purchased 6,576,030 shares, including 906,629 treasury shares, for which $350 million was paid to IBM. There were 15,126,471 reserved unissued shares available for purchase under the plan at December 31, 1994.

R } retirement plans

The company and its subsidiaries have retirement plans covering substantially all regular employees. The total cost of all plans for 1994, 1993, and 1992 was $681 million, $1,525 million, and $838 million, respectively.

Net periodic pension cost of the U.S. retirement plan and selected non-U.S. plans for the years ended December 31 included the following components:

	U.S. Plan			Non-U.S. Plans		
	1994	1993	1992	1994	1993	1992
Expected long-term rate of return on plan assets	9.5%	9.5%	9.5%	5.5-9%	5-10%	5-12%
(Dollars in millions)						
Service cost:						
Benefits earned during the period	$ 542	$ 571	$ 586	$ 467	$ 576	$ 603
Termination incentive expenses	–	263	355	–	–	–
Interest cost on the projected benefit obligation	2,033	1,909	1,671	1,107	1,064	1,060
Return on plan assets:						
Actual	327	(3,990)	(1,216)	329	(3,036)	(998)
Deferred	(2,826)	1,605	(1,047)	(1,540)	1,891	(166)
Net amortizations	(65)	(62)	(88)	19	12	24
Curtailment losses	–	431	–	269	215	–
Net periodic pension cost	$ 11	$ 727	$ 261	$ 651	$ 722	$ 523
Total net periodic pension cost for all non-U.S. plans				$ 667	$ 798	$ 577

Net periodic pension cost is determined using the Projected Unit Credit actuarial method. Prior service cost is amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits. An assumption is made for modified career average plans such that the average earnings base period will be updated to the years prior to retirement.

Termination incentive expenses represent the cost of special retirement benefits offered to employees for a short period of time in exchange for voluntary termination of service. Curtailment losses reflect the significant reductions in the expected years of future service caused by termination programs and represent the immediate recognition of associated prior service cost and a portion of previously unrecognized actuarial losses.

The curtailment losses and termination charges, referred to above, were accrued as restructuring charges in 1993 and 1992.

In 1994, the company introduced a non-qualified U.S. Supplemental Executive Retirement Plan (SERP) effective January 1, 1995, which will be phased in over three years. The SERP, which is unfunded, provides eligible executives defined pension benefits, outside the IBM Retirement Plan, based on average earnings, years of service, and age at retirement. At December 31, 1994, the projected benefit obligation was $64 million of which $61 million ($73 million of unrecognized prior service cost and $12 million of unrecognized actuarial gains) is subject to amortization. The remaining $3 million has been accrued in the Consolidated Statement of Financial Position. Net periodic pension cost for this plan was $3 million in 1994. These amounts are not reflected in the net periodic pension cost and funded status of the U.S. retirement plan.

The table below provides information on the status of the U.S. retirement plan, and selected non-U.S. plans that represent approximately 97 percent of the total non-U.S. accumulated benefit obligations.

The funded status at December 31 was as follows:

	U.S. Plan		Non-U.S. Plans	
	1994	1993	1994	1993
Assumptions:				
Discount rate	8.25%	7.25%	5.0-9.0%	5-9.25%
Long-term rate of compensation increase	5.0%	5.0%	2.8-7.0%	2.8-6.6%
(Dollars in millions)				
Actuarial present value of benefit obligations:				
Vested benefit obligation	$ (22,553)	$ (24,736)	$ (15,454)	$ (12,342)
Accumulated benefit obligation	$ (24,186)	$ (26,325)	$ (16,743)	$ (13,544)
Projected benefit obligation	$ (25,783)	$ (29,024)	$ (18,751)	$ (16,129)
Plan assets at fair value	26,780	28,198	17,424	16,159
Projected benefit obligation less than (in excess of) plan assets	997	(826)	(1,327)	30
Unrecognized net loss (gain)	1,224	1,550	(17)	(1,184)
Unrecognized prior service cost	248	1,282	276	304
Unrecognized net asset established at January 1, 1986	(1,334)	(1,474)	(152)	(145)
Prepaid (accrued) pension cost recognized in the statement of financial position	$ 1,135	$ 532	$ (1,220)	$ (995)

The U.S. plan's projected benefit obligation decreased in 1994 primarily as a result of a change in the discount rate and a plan amendment. The change in the discount rate decreased the projected benefit obligation $3,055 million. The plan amendment reduced the projected benefit obligation and unrecognized prior service cost $959 million.

It is the company's practice to fund amounts for pensions sufficient to meet the minimum requirements set forth in applicable employee benefit and tax laws, and such additional amounts as the company may determine to be appropriate from time to time. In July 1993, the Board of Directors authorized the issuance of up to 15 million shares of IBM common stock to be contributed to the IBM Retirement Plan Trust Fund through 1994. Through December 31, 1994, the company has contributed 6,500,000 shares to the fund. The assets of the various plans include corporate equities, government securities, corporate debt securities, and income-producing real estate.

U.S. Plan: U.S. regular, full-time, and part-time employees are covered by a noncontributory plan which is funded by company contributions to an irrevocable trust fund, which is held for the sole benefit of employees. On October 5, 1994, the company announced major changes to the plan that take place starting in 1995. Under a new formula, which will be phased in over five years, retirement benefits will be determined based on points accumulated for each year worked and final average compensation. To preserve benefits of employees close to retirement, service and earnings credit will continue to accrue under the current core formula through the year 2000 and upon retirement, current employees will receive the benefit from either the new or current formulas, whichever is higher. Benefits become vested upon the completion of five years of service. The number of individuals receiving benefits at December 31, 1994 and 1993, was 85,009 and 77,664, respectively.

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

S } 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. In 1993, the company applied plan cost maximums to those who retired prior to January 1, 1992. These maximums will take effect beginning with the year 2001. Plan cost maximums were established in 1990 for those employees retiring after December 31, 1991.

The accumulated postretirement benefit obligation was determined by application of the terms of medical, dental, and life insurance plans, including the effects of established maximums on covered costs, together with relevant actuarial assumptions. These actuarial assumptions include healthcare cost trend rates projected ratably from 12.0 percent in 1995 to 6 percent in the year 2007.

The effect of a 1 percent annual increase in these assumed cost trend rates would increase the accumulated postretirement benefit obligation by approximately $52 million; the annual costs would not be materially affected.

Net periodic postretirement benefit cost for the years ended December 31 included the following components:

	1994	1993	1992
Expected long-term rate of return on plan assets	9.5%	9.5%	9.5%
(Dollars in millions)			
Service cost:			
Benefits attributed to service during the period	$ 51	$ 53	$ 78
Termination incentive expenses	–	–	71
Interest cost on the accumulated postretirement benefit obligation	512	566	485
Return on plan assets:			
Actual	22	(201)	(67)
Deferred	(125)	84	(59)
Net amortizations and other	(38)	29	(61)
Curtailment loss	–	732	–
Net periodic postretirement benefit cost	$ 422	$ 1,263	$ 447

In the Consolidated Statement of Operations, the curtailment loss and termination expenses referred to above are included in restructuring charges.

The table below provides information on the status of the plans.

The funded status at December 31 was as follows:

	1994	1993
Assumed discount rate	8.25%	7.25%
(Dollars in millions)		
Accumulated postretirement benefit obligation:		
Retirees	$ (5,411)	$ (5,761)
Fully eligible active plan participants	(567)	(673)
Other active plan participants	(530)	(927)
Total	(6,508)	(7,361)
Plan assets at fair value	1,028	1,366
Accumulated postretirement benefit obligation in excess of plan assets	(5,480)	(5,995)
Unrecognized net loss	505	1,431
Unrecognized prior service cost	(744)	(828)
Accrued postretirement benefit cost recognized in the statement of financial position	$ (5,719)	$ (5,392)

In 1994, the accumulated postretirement benefit obligation decreased $649 million as a result of the change in the assumed discount rate.

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

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

T } lines of credit

As part of the company's ongoing efforts toward greater efficiency of its treasury activities and to ensure appropriate liquidity levels, in December 1993, the company entered into a $10.0 billion committed global credit facility. Unused committed lines of credit from this global facility and other previously existing committed and uncommitted lines of credit at December 31, 1994, were $15.1 billion, compared to $15.7 billion at December 31, 1993. Interest rates on borrowings vary from country to country depending on local market conditions.

U } sales and securitization of receivables

The company received total cash proceeds of approximately $12.6 billion and $6.8 billion in 1994 and 1993 from the sale and securitization of primarily trade receivables. At year-end 1994, the company had a net balance of $1.8 billion in assets under management from the securitization of lease and trade receivables. This amount is $1.3 billion lower than the 1993 year-end balance of $3.1 billion. No material gain or loss resulted from these transactions. Recourse amounts associated with the aforementioned sales and securitization activities are expected to be minimal, and adequate reserves are in place to cover potential losses.

Prepaid expenses and other current assets on the December 31, 1993, Consolidated Statement of Financial Position included $751 million of net assets that had been reclassified pending the sale of FSC, as discussed on page 47.

V } preferred stock

On June 7, 1993, the company issued 11.25 million shares of Series A Preferred Stock, represented by 45 million depositary shares. The preferred stock is not convertible into, or exchangeable for, shares of any other class or classes of stock of the company. The preferred stock has priority for dividends over the company's common stock. Dividends on the preferred stock are cumulative and accrue from the date of original issue at a rate of $7.50 per share (equivalent to $1.875 per depositary share). The preferred stock is not redeemable prior to July 1, 2001. Thereafter, the company, at its option, may redeem the preferred stock, in whole or in part, at any time at a redemption price per share of $100 ($25 per depositary share), plus accrued and unpaid dividends. Upon any dissolution, liquidation or winding up of the affairs of the company, holders of the preferred stock will be entitled to receive $100 per share ($25 per depositary share) plus accrued and unpaid dividends before any distribution to holders of the company's common stock. See note Z, "Subsequent Events," on page 78 for additional information regarding this subject.

W } financial instruments

The following table summarizes the carrying amount and estimated fair value of the company's significant financial instruments, derivative and non-derivative, both on and off the balance sheet:

	At December 31, 1994		At December 31, 1993*	
(Dollars in millions)	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Cash and cash equivalents	$ 7,922	$ 7,922	$ 5,861	$ 5,861
Marketable securities	2,632	2,632	1,272	1,272
Loans and other long-term receivables-net	3,857	3,813	3,609	3,609
Working capital financing receivables-net	2,539	2,539	1,898	1,898
Long-term investments	68	68	179	178
Non-trade accounts payable and accruals**	(1,437)	(1,437)	(1,759)	(1,759)
Short-term debt	(9,570)	(9,570)	(12,097)	(12,097)
Long-term debt	(12,548)	(12,000)	(15,245)	(15,840)
Derivatives:+				
Interest rate and currency swap agreements	2	201	(37)	(147)
Option contracts	8	8	36	43
Forward exchange contracts	–	–	2	(45)
Financial guarantees	–	(727)	–	(749)

**Reclassified to conform with 1994 presentation.*

***Excludes amounts related to restructuring discussed in note J on pages 60 and 61.*

+The estimated fair value of derivatives both on and off balance sheet at December 31, 1994, consists of assets of $448 million and liabilities of $239 million.

In assessing the fair value of these financial instruments, the company has used a variety of methods and assumptions, which were based on estimates of market conditions and risks existing at that time. For certain instruments, including cash and cash equivalents, non-trade accounts payable and accruals, and short-term debt, it was assumed that the carrying amount approximated fair value for the majority of these instruments because of their short maturities. Quoted market prices or dealer quotes for the same or similar instrument were used for the majority of marketable securities, long-term investments, and long-term debt. Other techniques, such as option pricing models, estimated discounted value of future cash flows, replacement cost, and termination cost, have been used to determine fair value for the remaining financial instruments. These values merely represent a general approximation of possible value and may never actually be realized.

In the normal course of business, the company enters into a variety of derivative instruments solely for the purpose of currency exchange rate and interest rate risk management.

The majority of the company's derivative transactions relates to the matching of liabilities to assets associated with its worldwide customer financing business. The company issues debt, using the most efficient capital markets and products, which may result in a currency or interest rate mismatch. Interest rate or currency swaps are then used by the company to match the interest rates and currencies of its debt to the related customer financing receivables.

To a much lesser extent, interest rate swaps are used to rebalance the fixed versus floating mix on the company's "core" debt. Interest rate swap contracts are principally one to five years in duration. The company also uses an internal regional center to manage the cash of its subsidiaries in a cost effective manner. This regional center principally uses currency swaps to deliver local currency denominated funding predominantly to the company's European subsidiaries. The terms of the currency swaps are generally less than five years.

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

The company has used derivative instruments as an element of its risk management strategy for many years. Although derivatives entail a risk of non-performance by counterparties, the company manages this risk by establishing explicit dollar and term limitations which 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 condition in the future.

The notional value of derivative instruments held at year end, which provides an indication of the extent of the company's involvement in such instruments but does not represent its exposure to market risk, was as follows:

(Dollars in billions)	1994	1993*
Option contracts	$ 4.4	$ 1.6
Interest rate and currency swap agreements	19.2	17.2
Forward exchange contracts	.6	.3

**Reclassified to conform with 1994 presentation.*

The costs associated with entering into derivative contracts are generally amortized over the life of the instruments and are not material to the company's results. Unamortized premiums are included in prepaid assets. Interest rate differentials accruing under interest rate swaps which receive hedge accounting treatment are recognized over the life of the contracts in interest expense. Derivative instruments which qualify as hedges of net investments in subsidiaries are included in prepaid assets, and gains and losses are included in stockholders' equity. For purchased options which hedge anticipated transactions, gains and losses are deferred and recognized in other income in the same period that the underlying transaction occurs or expires. At December 31, 1994, there were no material deferred gains or losses. All written options, except those that qualify as hedges of net investments, are marked to market monthly, as are some purchased options which do not qualify for hedge accounting. These options appear on the balance sheet in prepaid assets or other liabilities. The related gains and losses are recognized immediately in other income. Although these options do not qualify for hedge accounting, they are used by the company as part of its overall risk management program.

The company originates financing for customers in a variety of industries and throughout the world. The company has a diversified portfolio of capital equipment financings for end users. With the growth of the company's working capital financing business in 1994, the concentration of such financings for certain large dealers and remarketers of information industry products has become more significant. All such loans are collateralized by the inventory and accounts receivable of the dealers and remarketers. The company does not believe that this risk will have a material adverse effect on its financial position or results of operations.

IBM has guaranteed certain loans and commitments of various ventures to which it is a party. Additionally, the company is contingently liable for certain receivables sold with recourse. These commitments, which in the aggregate were approximately $.9 billion and $2 billion at December 31, 1994 and 1993 respectively, are not expected to have a material adverse effect on the company's financial position or results of operations.

X } segment information

IBM is in the business of providing customer solutions through the use of advanced information technologies. The company operates primarily in the single industry segment that creates value by offering a variety of solutions that include, either singularly or in some combination, services, software, systems, products, financing, and technologies. The schedule on page 75 shows revenue by classes of similar products or services. Financial information by geographic area is summarized on pages 76 and 77.

For purposes of classifying similar information technology products, user programmable equipment having the capability of manipulating data arithmetically or logically and making calculations, in a manner directly addressable by the user through the operation of a stored program, has been classified as processors. Processors includes high-end and midrange products. Personal systems includes personal computers, power personal systems, and RISC System/6000 products. Other workstations includes display-based terminals and consumer and financial systems. Storage consists of externally attached direct access storage devices and tape storage devices. Other peripherals consists of advanced function printers and telecommunication devices. OEM hardware consists primarily of revenue from the sale of semiconductors and low-end storage files to external customers.

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

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

Some products logically fit in more than one class and are assigned to a specific class based on a variety of factors. Over time, products tend to overlap, merge into, or split from existing classes as a result of changing technologies, market perceptions, and/or customer use. For example, market demand may create requirements for

technological enhancements to permit a peripheral product to be functionally integrated with a display, a telecommunication device, and a processor to form a workstation. Such interchangeability and technological progress tend to make year-to-year comparisons less valid than they would be in an industry less subject to rapid change.

Revenue by Classes of Similar Products or Services

	Consolidated			U.S. Only		
(Dollars in millions)	1994	1993*	1992*	1994	1993*	1992*
Information technology:						
Processors**	$ 9,784	$ 10,071	$ 13,916	$ 3,235	$ 3,179	$ 4,818
Workstations:						
Personal systems**	11,500	10,067	7,887	4,769	4,578	3,033
Other workstations**	1,538	2,006	2,671	463	689	874
Peripherals:						
Storage**	3,551	4,808	6,105	1,375	1,898	2,400
Other peripherals**	2,006	2,149	2,970	810	901	1,202
OEM hardware	3,248	1,293	557	1,677	726	365
Software	11,346	10,953	11,103	3,926	3,898	3,883
Services	9,715	7,648	5,530	3,709	3,037	1,724
Maintenance	7,222	7,295	7,635	2,648	2,726	2,809
Financing and other	4,142	4,109	3,984	1,506	1,754	1,360
Subtotal	64,052	60,399	62,358	24,118	23,386	22,468
Federal Systems Company	–	2,317	2,165	–	2,317	2,165
Total	$ 64,052	$ 62,716	$ 64,523	$ 24,118	$ 25,703	$ 24,633

** Reclassified to conform with 1994 presentation.*

***Hardware only, includes applicable rental revenue, excludes functions not embedded, software, and maintenance.*

Y } geographic areas

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

Non-U.S. subsidiaries operating in local currency environments account for approximately 90 percent of the company's non-U.S. revenue. The remaining 10 percent is from subsidiaries and branches operating in U.S. dollars or in highly inflationary environments.

In the Europe/Middle East/Africa area, European operations accounted for approximately 95 percent of revenue in 1994, 1993, and 1992.

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

(Dollars in millions)	1994	1993*	1992*
United States			
Revenue – Customers	$ 24,118	$ 25,703	$ 24,633
Interarea transfers	6,336	7,297	7,524
Total	$ 30,454	$ 33,000	$ 32,157
Net earnings (loss)	969	(5,566)	(5,545)
Assets at December 31	37,156	38,333	42,109
Europe/Middle East/Africa			
Revenue – Customers	$ 23,034	$ 21,779	$ 24,971
Interarea transfers	1,787	1,071	1,154
Total	$ 24,821	$ 22,850	$ 26,125
Net earnings (loss)	1,086	(1,695)	(1,728)
Assets at December 31	25,816	24,566	26,770
Asia Pacific			
Revenue – Customers	$ 11,365	$ 10,020	$ 9,672
Interarea transfers	1,876	1,452	1,875
Total	$ 13,241	$ 11,472	$ 11,547
Net earnings (loss)	567	(443)	126
Assets at December 31	12,619	12,778	12,837
Americas			
Revenue – Customers	$ 5,535	$ 5,214	$ 5,247
Interarea transfers	4,257	3,458	3,452
Total	$ 9,792	$ 8,672	$ 8,699
Net earnings (loss)	498	(251)	157
Assets at December 31	7,783	7,359	6,990
eliminations			
Revenue	$ (14,256)	$ (13,278)	$ (14,005)
Net (loss) earnings	(99)	(32)	125
Assets	(2,283)	(1,923)	(2,001)
consolidated			
Revenue	$ 64,052	$ 62,716	$ 64,523
Net earnings (loss)	3,021	(7,987)	(6,865)
Assets at December 31	81,091	81,113	86,705

**Net (loss) earnings before effect of changes in accounting for postemployment benefits (1993) and income taxes (1992).*

Z } subsequent events

On January 11, 1995, the company commenced a tender offer to purchase for cash any and all of the Series A Preferred Stock represented by 44.6 million outstanding depositary shares for a price of $25.00 net per depositary share. Under the offer, depositary shares tendered and purchased by the company will not receive or otherwise be entitled to the regular quarterly cash dividend expected to be paid for the first quarter of 1995 and also will not receive any accrued dividends for that period. The offer is not conditioned upon any minimum number of depositary shares being tendered. The offer and withdrawal rights expired on February 8, 1995. The company has purchased 34.1 million depositary shares under this offer.

On January 31, 1995, the Board of Directors authorized the company to repurchase up to $2.5 billion of IBM common shares on the open market. The company plans to purchase the shares from time to time, depending on market conditions.

five-year comparison of selected financial data

(Dollars in millions except per share amounts)	1994	1993	1992	1991	1990
For the year:					
Revenue	$ 64,052	$ 62,716	$ 64,523	$ 64,766	$ 68,931
Net earnings (loss) before changes in accounting principles	3,021	(7,987)	(6,865)	(598)	5,967
Per share of common stock	5.02	(14.02)	(12.03)	(1.05)	10.42
Effect of accounting changes*	–	(114)	1,900	(2,263)	–
Per share of common stock	–	(.20)	3.33	(3.96)	–
Net earnings (loss)	3,021	(8,101)	(4,965)	(2,861)	5,967
Per share of common stock	5.02	(14.22)	(8.70)	(5.01)	10.42
Cash dividends paid on common stock	585	905	2,765	2,771	2,774
Per share of common stock	1.00	1.58	4.84	4.84	4.84
Investment in plant, rental machines and other property	3,078	3,232	4,698	6,502	6,548
Return on stockholders' equity	13.6%	–	–	–	14.8%
At end of year:					
Total assets	$ 81,091	$ 81,113	$ 86,705	$ 92,473	$ 87,568
Net investment in plant, rental machines and other property	16,664	17,521	21,595	27,578	27,241
Working capital	12,112	6,052	2,955	7,018	13,313
Total debt	22,118	27,342	29,320	26,947	19,545
Stockholders' equity	23,413	19,738	27,624	36,679	42,553

**1993, postemployment benefits; 1992, income taxes; 1991, nonpension postretirement benefits.*

selected quarterly data

(Dollars in millions except per share and stock prices)	Revenue	Gross Profit	Net Earnings (Loss)	Per Share Common Stock Earnings (Loss)	Per Share Common Stock Dividends	Stock Prices+ High	Stock Prices+ Low
1994 First quarter	$ 13,373	$ 4,940	$ 392	$ .64	$ .25	$ 60.00	$ 51.38
Second quarter	15,351	6,104	689	1.14	.25	65.00	51.38
Third quarter	15,431	6,154	710	1.18	.25	71.38	54.50
Fourth quarter	19,897	8,086	1,230	2.06	.25	76.38	67.38
Total	$ 64,052	$ 25,284	$ 3,021	$ 5.02	$ 1.00		
1993 First quarter	$ 13,058	$ 5,162	$ (399)*	$ (.70)*	$ .54	$ 57.13	$ 45.88
Second quarter	15,519	5,974	(8,036)	(14.10)	.54	54.38	47.13
Third quarter	14,743	5,602	(48)	(.12)	.25	49.75	40.63
Fourth quarter	19,396	7,410	382	.62	.25	59.88	42.13
Total	$ 62,716	$ 24,148	$ (8,101)	$ (14.22)**	$ 1.58		

** Includes charge of $114 million, or $.20 per common share, cumulative effect of change in accounting for postemployment benefits.*

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

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

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

Annual Meeting
The IBM Annual Meeting of Stockholders will be held on Tuesday, April 25, 1995 at 10 a.m. at the Ovens Auditorium, 2700 East Independence Blvd., Charlotte, North Carolina.

IBM on the Internet
Financial results, news on new IBM products and services and insights from company executives are available via IBM's home page on the Internet. The address is http://www.ibm.com

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

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

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

The IBM Dividend Reinvestment Plan booklet tells how stockholders may automatically reinvest dividends to purchase additional IBM stock.

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

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

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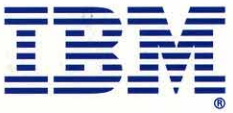

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