IBM,

its view of a "network-centric" future
driven by the desire of people and enterprises to connect to
other people and enterprises around the world
and leverage information using powerful new technologies
that transcend distance and time,
lower boundaries between markets, cultures and individuals
and actually deliver solutions that fulfill the promise of
universal connectivity — plus a report on IBM's 1995 performance...

(in 10 words or less).

The interactive version of IBM's 1995 Annual Report can be found on the World Wide Web at: http://www.ibm.com/IBM/ar95

(1) vision

Last year I told you that the question about IBM was no longer one of survival. IBM had been stabilized and strengthened. The important question – the relevant question – was, could IBM grow?

By just about any measure, the answer in 1995 was that IBM could indeed grow.

IBM reported record revenues last year, topping $70 billion for the first time. Our rate of revenue growth — 12 percent over the previous year — was the best in more than a decade.

We doubled our earnings to $6.3 billion, excluding a one-time charge related to the acquisition of Lotus Development Corp. and two special items taken in the fourth quarter.

Our cash flow was very strong. We ended the year with $7.7 billion in cash — and that's after spending $5.7 billion to repurchase IBM stock and $2.9 billion to acquire Lotus.

One of the best indicators of our progress — and the one that probably matters most to investors — is market value. Last year IBM's market value grew by $6.9 billion, an increase of 16 percent. Since the summer of 1993, when we announced our restructuring program, through year-end 1995, IBM's market value improved nearly $27 billion.

Just as significant, I believe, is that IBM is growing pretty much across the board, and that our businesses with the greatest growth potential are the ones that are growing the most:

- Services grew to become our second-largest source of revenue, up 31 percent over 1994. Today IBM is the world's largest information

FINANCIAL HIGHLIGHTS
International Business Machines Corporation and Subsidiary Companies

(DOLLARS IN MILLIONS EXCEPT PER SHARE AMOUNTS)	*1995*	*1994*
For the year:		
Revenue	$ 71,940	$ 64,052
Earnings before income taxes	$ 7,813	$ 5,155
Income taxes	$ 3,635	$ 2,134
Net earnings	$ 4,178	$ 3,021
Per share of common stock	$ 7.23	$ 5.02
Cash dividends paid on common stock	$ 572	$ 585
Per share of common stock	$ 1.00	$ 1.00
Investment in plant, rental machines and other property	$ 4,744	$ 3,078
Average number of common shares outstanding (in millions)	569	585
At end of year:		
Total assets	$ 80,292	$ 81,091
Net investment in plant, rental machines and other property	$ 16,579	$ 16,664
Working capital	$ 9,043	$ 12,112
Total debt	$ 21,629	$ 22,118
Stockholders' equity	$ 22,423	$ 23,413
Number of regular, full-time employees	225,347	219,839
Number of common stockholders	668,931	713,060

technology services company, with more than 80,000 people providing consulting, systems integration and solution development services worldwide.

REVENUE *($ in billions)*

- Few people know it, but IBM is the world's largest software company, too. Our acquisition of Lotus helped increase our software revenues 12 percent to $12.6 billion. We're already seeing encouraging results from the merger. Since we combined, the installed base of Lotus Notes has more than doubled. More Notes installations (we call them "seats") were sold in the last half of 1995 than in the whole prior six-year life of the product. We expect continued robust growth with the recent introduction of Notes Release 4, which has many enhanced features for the Internet.
- We continued to revamp and strengthen our hardware offerings. New products introduced in the past 12 months accounted for nearly half of last year's $35.6 billion in total hardware sales, which grew 10 percent from 1994.
- Our OEM revenue — sales of components and technology to other companies — grew 38 percent last year to $4.5 billion. That's about three and a half times greater than 1993 OEM revenues. Our microelectronics unit was the biggest driver of this growth, with OEM sales of more than $2 billion in 1995.
- Revenues increased in every geographic area, with the most significant growth in our

Asia Pacific region. Last year the Netherlands and Switzerland became our tenth and eleventh countries to each generate more than $1 billion in revenue. We continue to grow rapidly in China, India, South Africa and other emerging nations. IBM is today the leading computer company in China.

And, we are making investments that will fuel continued growth:

- In 1995 we increased our capital spending for the first time since 1991, investing in high-growth areas such as semiconductor manufacturing and services. Last year we invested $4.7 billion, up from $3.1 billion in 1994.
- We are making select strategic acquisitions, most notably Lotus and, more recently, Tivoli Systems. As opportunities arise to strengthen our ability to serve our customers, there will likely be others.
- We are expanding and investing in our most important asset — IBM people. Last year we hired about 15,000 new people, most of them for our sales and services businesses. In fact, our overall workforce grew in 1995. We began implementing an incentive-based compensation system that pays better rewards to our star performers at all levels of the company. We're taking an intensive look at our overall compensation system to make sure we are paying at competitive levels. And, we are revving up all-new employee training programs that increase skills and career development.

Just about any way you look at IBM — from performance to potential — we are growing.

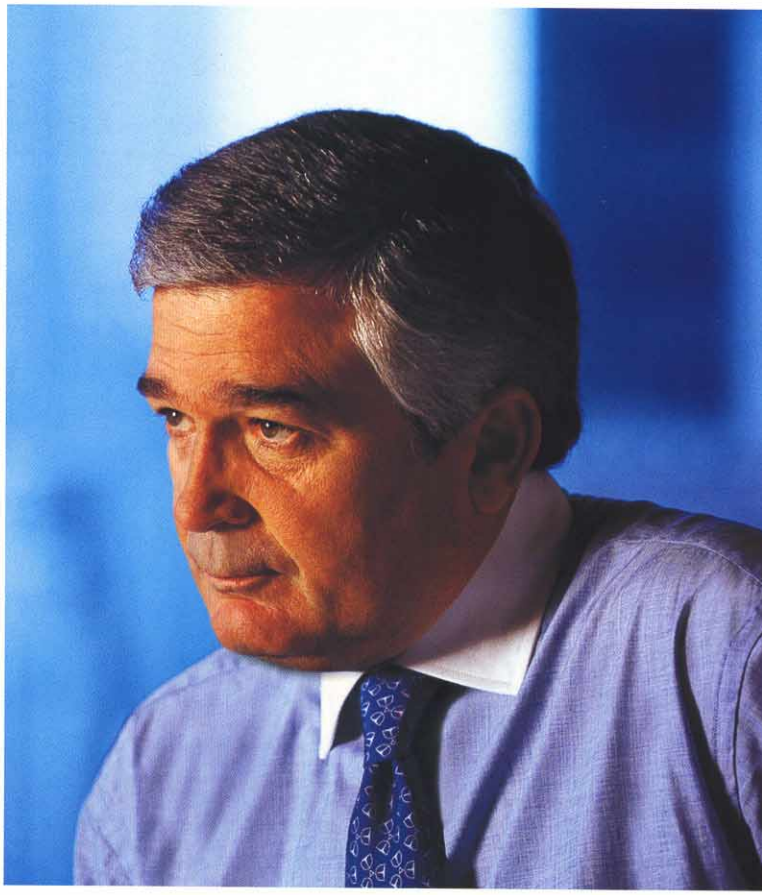
So now what? Now that our financial foundation is again strong, now that we are growing, now that we seem to have some momentum — what's the next mountain?

Which brings me to the V-word.

Almost three years ago — July 1993 — I announced a massive restructuring of IBM. We were having serious financial problems. In fact, financially it was the worst year in our proud history. No one suffered more than our employees, who were stunned. For everyone else — customers, shareholders, suppliers, analysts — it was red alert.

During the press conference, I said, "The last thing IBM needs *right now* is a vision." Almost immediately, there was a lot of whooping and hollering in the media about IBM wandering, visionless, through the wilderness.

So it's with an enormous sense



Louis V. Gerstner, Jr. CHAIRMAN AND CHIEF EXECUTIVE OFFICER

NET EARNINGS *($ in billions)* 93 94 95

of irony that now, almost three years later, I say this: What IBM needs most *right now* is a vision.

I don't mean a slogan. I don't mean promises and vaporware (announced products that don't exist now and never will). I don't mean here's-what's-good-for-IBM-and-therefore-it's-good-for-you-too.

Here's what I do mean:

We've seen great changes in computing before — from centralized mainframes to decentralized PCs to distributed client/server computing.

We now realize that client/server is not a full-blown phase of computing. It's the leading edge of what will be the next phase — what we call network-centric computing. I'll admit it's a cumbersome name, if not out-and-out dull. (I'd like to come up with something snappier, but I think it's too late.) But what we call it is less important than what it describes: a powerful change that has sweeping implications for individuals and institutions of all kinds.

From a pure technology perspective, the networked world begins with new communications capabilities that allow digital networks to handle rich sources of information: video, high-resolution images, voice and music. High transmission speed also allows these networks to support interaction — real-time collaboration between people.

TOTAL EXPENSES AS A PERCENTAGE OF REVENUE *(after adjustments)*

The Internet, of course, stands as the most prominent living representation of global networking. Some estimates say a billion people will have Internet access by the year 2000. Yet, as with previous market shifts, the driving force of this change is not raw technology. After all, the Internet has been around — albeit quietly — for 25 years.

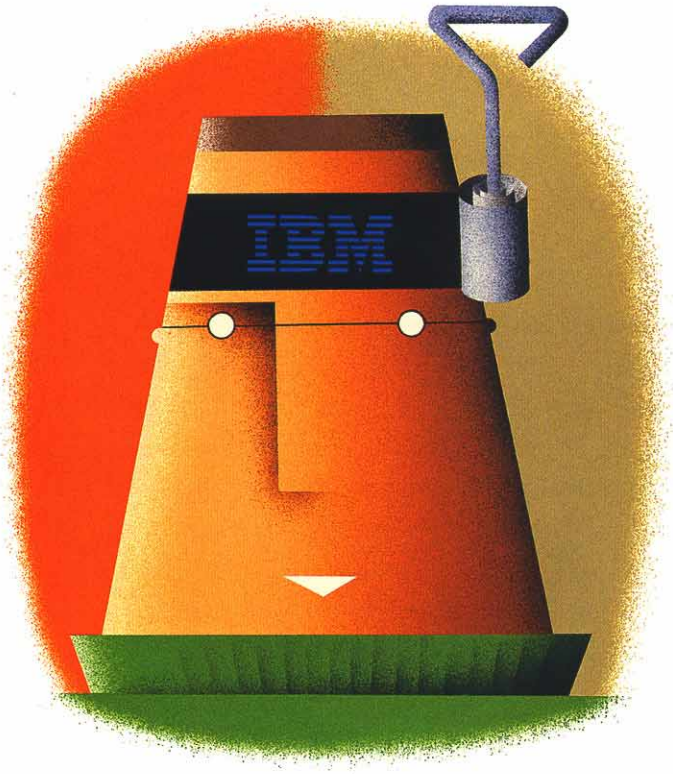
The real catalyst of this new era is a powerful set of emerging customer priorities. Everywhere you look today, businesses and institutions alike, you see the need for things like more speed to market, more flexibility and nimbleness, accelerated global expansion, and more customer and supplier integration. People around the world are finding that networks are highly effective tools to meet these priorities, and to communicate across and among enterprises and people.

And because networks can support interactivity and transport rich content, they are redefining things like value, competitiveness and the very nature of commercial transactions. Networks are changing the way we work, receive government services, educate our children and enjoy entertainment. We're already seeing people and organizations use networks to do real work and get real results. They're moving from surfing to working, from browsing to buying. You'll see examples of that throughout this Annual Report.

So this convergence of two powerful forces — customer need and advanced network technology — leads IBM to a strategy, or vision, that is simple and clear, and consistent with our company mission. IBM will lead the transition to network-centric computing by:

- Continuing to create the advanced products and technologies needed to make powerful networks real; and
- Working with our customers to help them fully exploit these networks.

First, customers. Our customers look to IBM to provide the skills and expertise that will allow them to use networks in meaningful ways. They are asking for our assistance in extending their assets and brands to reach new markets and customers via networks. That's why services is one of



Last year, IBM's OEM business – sales of components and technology to other companies – grew 38 percent to $4.5 billion. That's about three and a half times greater than in 1993.

our fastest-growing businesses and now our second largest.

Unlike some in our industry, we don't want to displace our customers by inserting ourselves in front of their own customers. Our job is to help our customers leverage their information to their advantage. After all, the most important and valuable content in the world is the intellectual property housed in the information systems of corporations and institutions. Most of this information resides in IBM databases and is processed by IBM computing systems. We are rapidly adapting our systems and delivering new services that allow customers to move their content to networks — and do it with the security and reliability they have come to expect from IBM.

An increasing number of customers are signing up with the IBM Global Network, the world's largest data network and Internet services provider. We run it as sort of an "information utility," giving customers the option of subscribing to a rich portfolio of applications and as much or as little computing power and connectivity as they need. They pay for only what they use, sometimes on a usage or transaction basis (most people now call it "per click"). For IBM, this has the added advantage of creating a recurring revenue stream.

On the technology side of the equation, we are moving on many fronts.

We are developing and bringing to market new networking technologies — Web servers, groupware, intelligent agents and encryption technologies for secure electronic transactions, to name just a few.

Our strengthened financial position gives us the flexibility to consider acquisitions that will broaden and complement our offerings and worldwide development teams. Where these make good business sense for both parties, we move quickly. Our mergers with Lotus and Tivoli Systems are the two most visible recent examples.

I should add that far more important than the technologies we gain through these moves are the thousands of talented people who bring to IBM fresh perspective and drive. They are very welcome additions to the IBM family.

Perhaps the greatest product opportunity we see lies in leveraging IBM's vast existing portfolio — scalable servers, middleware, networking, systems management, microelectronics, storage. We've worked hard to put all our products on the absolute leading edge of technology, to ensure they are cost-competitive with any offerings in the industry, support open industry standards and work effectively in distributed computing environ-

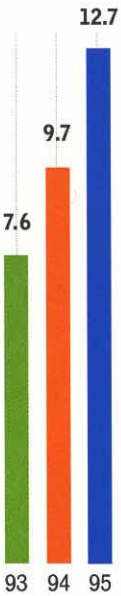
CAPITAL INVESTMENTS *($ in billions)*

Nearly half of 1995's $35.6 billion in hardware revenue was generated by products introduced in the past 12 months.

ments. All of this work and investment will serve us well as we move into the networked world.

Consider the implications of global networks as they become the locus of commerce and communications and, over time, of computing itself. Databases expand enormously. Transactions skyrocket. Demand grows rapidly for products that move, manage, store, process, present and protect all of this information.

This is one of the reasons we shipped to customers more mainframe computing power in 1995 than in any year in history. In fact, in the fourth quarter of 1995 alone, we shipped 80 percent more mainframe computing power than in the fourth quarter of 1994.



SERVICES REVENUE *($ in billions)*

So this new model of computing does not displace or replace everything that has existed in previous models. And its success does not depend on some piece of "killer" technology created and controlled by any one company. In fact, the networked world — by definition — must remain open to support seamless access and navigation to people and information. The very market forces that are creating it will repel any company's attempt to erect proprietary walls. Customers will simply not embrace innovation created to enrich the inventor without enriching the network.

Perhaps IBM's greatest strength as we pursue these opportunities is our experience. Simply put, network-centric computing feels right to us. We understand powerful computing, how to solve complex problems, how to work with customers to develop global solutions. We've been doing this, with great success, for decades.

Of course, in a company of IBM's size and breadth, not every strategic project and priority fits neatly under the network-centric computing banner. With vigor and determination, we continue to pursue our OEM, emerging market and consumer strategies.

We continue to invest heavily in research and development. I should note here that in 1995, IBM was number one in U.S. patents issued for the third consecutive year. And we beat our own record in receiving more patents than any company in any year.

We continue to fine-tune IBM's operations to improve efficiency and productivity, mostly through our reengineering projects. Since 1993, these projects have reduced cost and expense by more than $7 billion.

But for the first time in nearly 30 years, we have an opportunity to align virtually every part of IBM in a single direction. Network-centric computing has emerged as our integrating strategy — the vision guiding our investments, products, services and our people.

o o o

Two final thoughts:

First, it's easy to get caught up in the potential and promise of these new technologies, and how we see them applied by people and institutions. Yet, some people are concerned — rightly — that

this technology is creating a lot of new issues regarding privacy, security, censorship and universal access, and the possibility of a world of haves and have-nots. These are all legitimate concerns, and we must deal with them.

As a leader in creating networks and as a citizen of the world, we at IBM take our responsibilities seriously. We will do everything we can — and work with governments and others — to help ensure that our technology works to the benefit of all people, everywhere. If properly managed, these technologies, rather than creating new problems, can solve centuries-old problems for people and societies. The powerful networks we are building can bring the best doctors to the neediest patients. They can bring education to children in remote villages. They can bring information and the whole rest of the world to the oppressed.

• • •

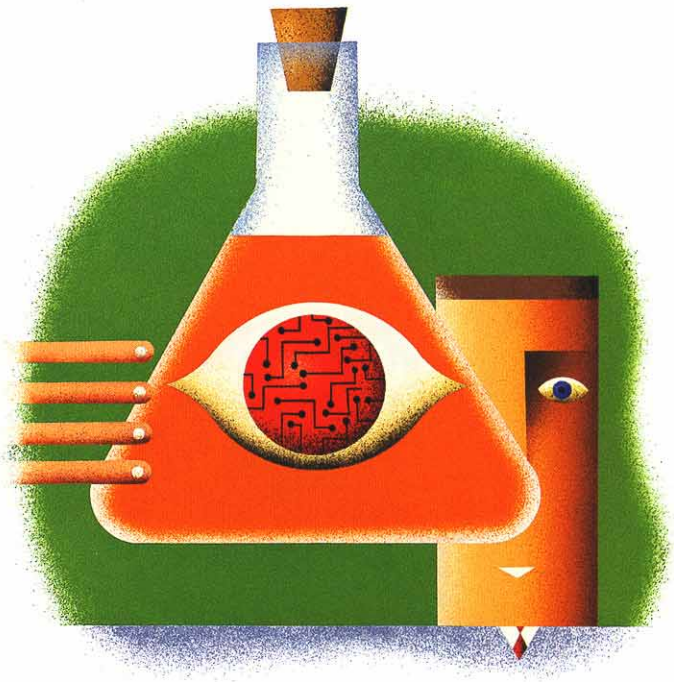
Finally, I want to personally thank the people who brought IBM back from the brink to this new point of opportunity — the employees of IBM, most of whom are shareholders.

You never, never, never quit. Others said IBM was dead, but you rolled up your sleeves, picked up the bricks and rebuilt your company, day by day, product by product, customer by customer. Wherever I was in the IBM world, at night I saw the lights still on in your offices. The next morning, I saw all the empty pizza boxes.

We're not done yet — because we'll never be done. But the fact that we've come this far this fast is testimony to your grit and to your stubborn determination to win.

I'm very proud to work alongside you.

Thank you.



For the third year in a row, IBM led in the number of U.S. patents issued, and our 1,383 patents were the most ever issued to any company in any year.

Louis V. Gerstner, Jr.
CHAIRMAN AND CHIEF EXECUTIVE OFFICER

(2) bits

The face of computing is changing. Again.

Truly significant change is easy to miss — and dismiss — in an industry synonymous with all things new, improved and leading edge. But this change is not just about technology getting smaller, faster, more powerful. It's far more profound, more expansive. It affects the heart and soul of every business and institution in the world. It's changing the way we live and work. The way we teach our children. How we communicate with one another.

We're talking about a universally connected world. A new era, driven chiefly by customers — organizations and individuals discovering the power of networks.

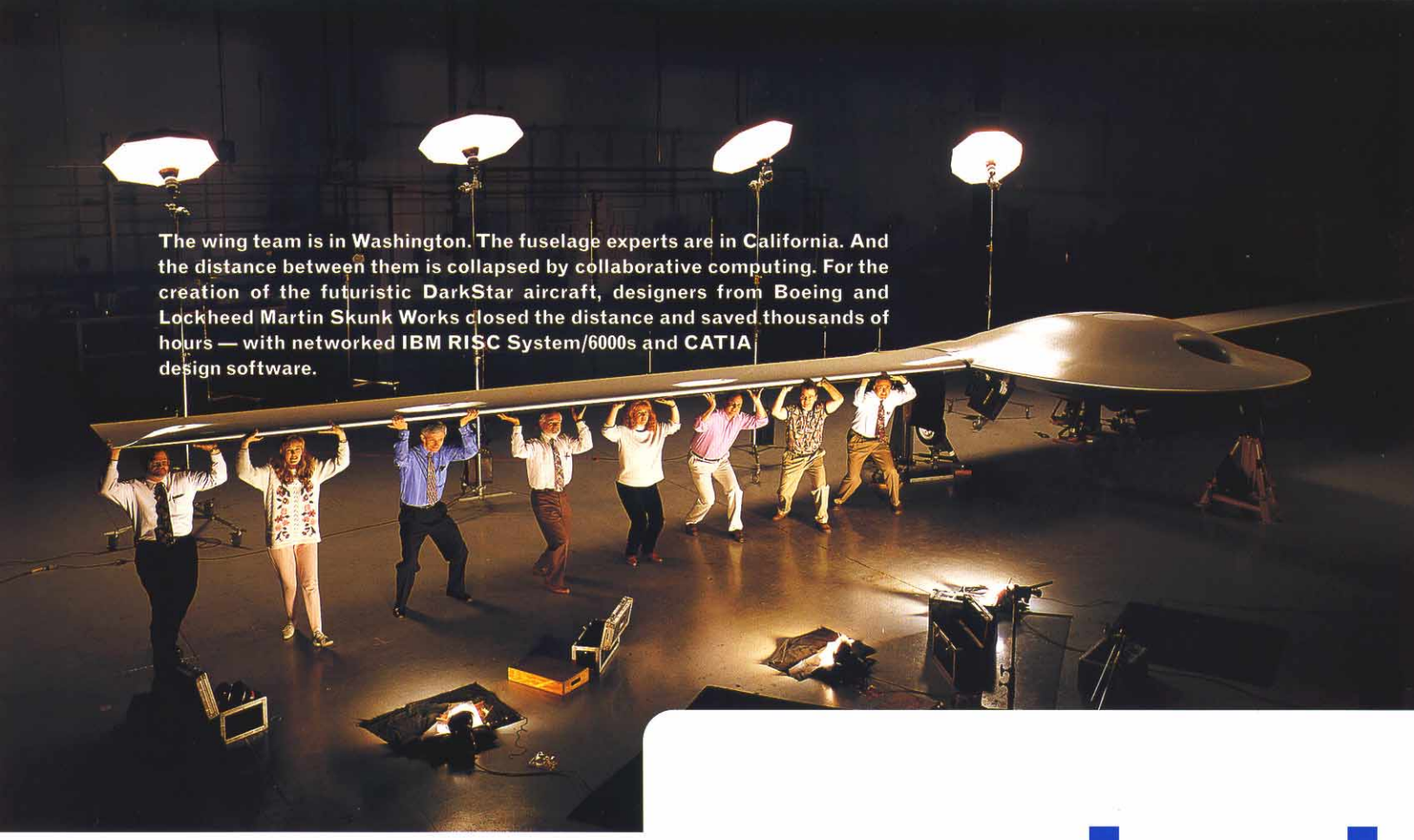
In terms of technology, two intertwined forces are at play. It begins with bits, the elemental language of computers — zeros and ones — a language IBM has spoken fluently for decades. Business information, medical records, art, music, film. All are being digitized. Conversion into bits gives information a digital passport to travel across global networks — such as the Internet — to digital devices like PCs or TV set-top boxes.

The second transformation is radically reshaping networks themselves. Powerful new communications technologies are giving networks the bandwidth they need to handle rich but space-consuming content, like movies, MRI scans or great works of art. And with the speed to support interaction over the network. Two-way communication. True collaboration.

Together, digital content and high-speed networks make the once-improbable entirely possible. Things like "distance learning" — teachers teaching and students learning, though not in the same classroom. And "telemedicine," allowing physicians in different hospitals to consult and examine the same medical histories, X-rays, CAT scans.

Using a health application network, the Greater Dayton Area Hospital Association will deliver critical medical information to 2,300 physicians throughout Ohio. State universities in Florida are creating an online digital library starting with 100,000 journal articles, with plans to grow indefinitely. The Lutherhalle Wittenberg museum in Germany is digitizing the world's largest collection of 16th-century Reformation documents. And IBM is helping them all.

IBM is committed to helping create this network-centric world. Simply stated, the network is the unifying strategy of IBM. It drives our investments. It touches virtually every product in our portfolio. And it will touch you soon.



The wing team is in Washington. The fuselage experts are in California. And the distance between them is collapsed by collaborative computing. For the creation of the futuristic DarkStar aircraft, designers from Boeing and Lockheed Martin Skunk Works closed the distance and saved thousands of hours — with networked **IBM RISC System/6000s** and **CATIA** design software.

(3) mind

A long, long time ago, we were taught that two heads are better than one. Intuitively, we understood. And we learned from experience the advantages of teamwork and collaboration.

Then we went to work on stand-alone PCs. Powerful tools, but we remembered the lessons of our youth, and we struggled to take advantage of linking distant — and disparate — PCs.

Enter network-centric computing.

With networks, we bridge the distance between people who need to collaborate, share ideas, solve problems together.

Far more than a '90s spin on "connectivity," the networked world is the digital alternative to bringing people together in the same room — to work on a product design, brainstorm a new strategy, spark a creative thought.

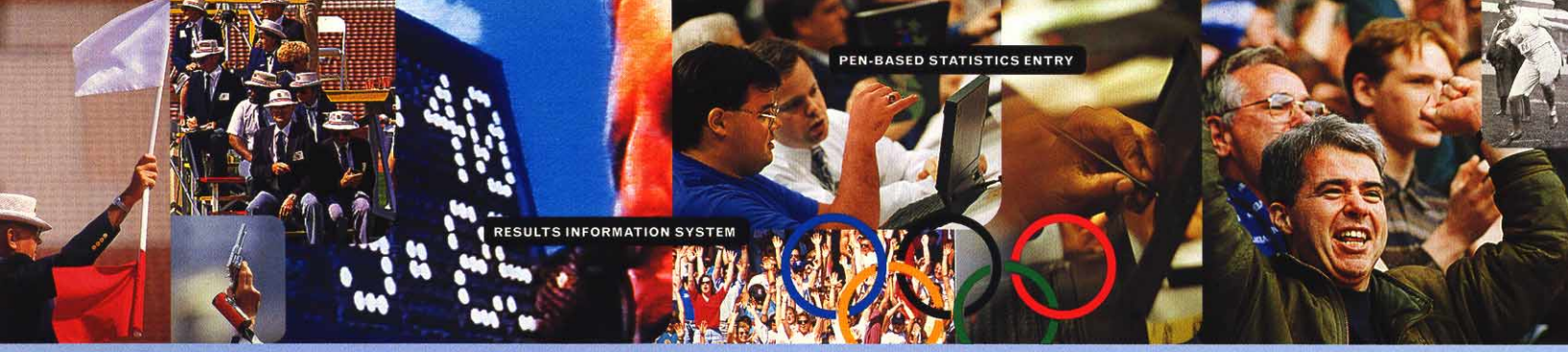
This powerful approach to working is paying off. It's allowing SmithKline Beecham to connect 5,000 researchers around the world with outside clinical groups to speed the introduction of new pharmaceutical products.

It's why leading consulting firms like Andersen Consulting and Coopers & Lybrand, whose fortunes rise and fall based on the most ephemeral commodity of all — thought leadership — have embraced Lotus Notes as a new, networked way to do business. The plasma of their organizations — and of many, many others — is ideas. And the ability of people to share them. Improve them. By working together.

share

Leapfrogging generations of technology, the Shanghai Posts and Telecommunications Administration (SPT), China's largest telecommunications agency, is going directly to advanced network computing. SPT and IBM designed and built an ATM-based regional information superhighway that supports collaboration — using interactive videoconferencing and video-on-demand — between SPT's customers. Future network enhancements will enable distance learning for universities, remote diagnosis for hospitals and online government services.

"A project of this complexity normally requires hundreds of designers and takes years to complete," says Bob Fischer, chief engineer on the project that produced the world's most sophisticated unpiloted reconnaissance aircraft. "Because we could pull together the best team electronically, we finished DarkStar in just 11 months with 50 people."



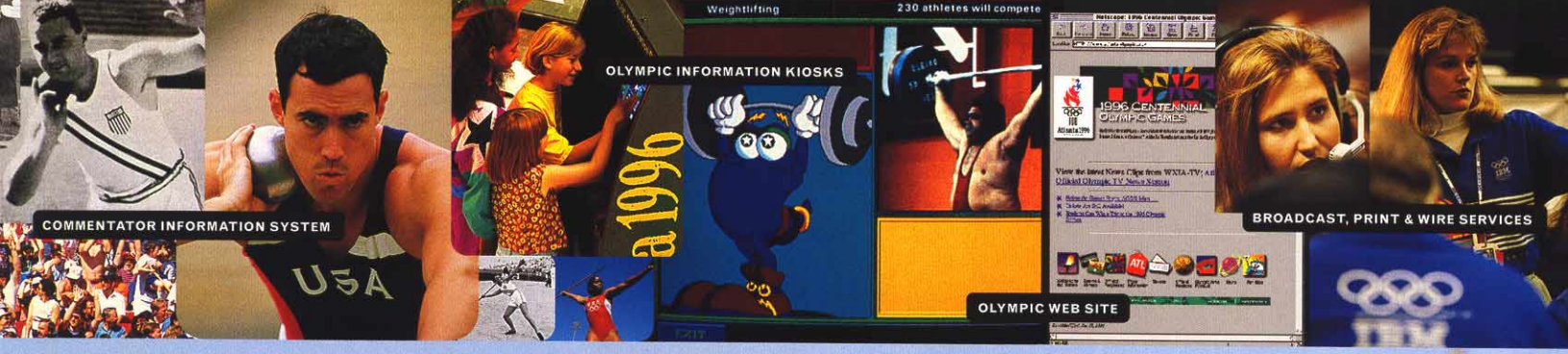
(4) liquid

A 16-pound globe of steel thuds onto a patch of sod, joining a thousand other Olympic moments — some trivial, some historic. Times, records, scores, distances, triumphs, failures. All are significant to someone, somewhere. But how will you know?

In any event of Olympic scale and complexity, the amount of information distributed to people is constrained by rigid — but very real — dimensions of time and space: minutes in a newscast or column inches of newsprint.

Network-centric computing lifts these constraints, triggering a free-form flow of information that ripples out from the Olympic Village to the Global Village. Information becomes available. Accessible. In context. To anyone interested. When they want it.

Information in liquid form. For sports fans, it's a matter of convenience and personal interest. For businesses, governments and institutions, information is often their central asset. It's how they



compete and grow and serve their customers. For them, networked computing means the swift, fluid movement of information to decision makers within their enterprise and beyond — to customers, suppliers, distributors, partners.

IBM is working with organizations like the Atlanta Committee for the Olympic Games that are pioneering the application of networked computing. How they use information makes the difference between triumph. And failure.

The Centennial Olympic Games in Atlanta: a billion-dollar enterprise operating under the expectant gaze of the planet. For the first time in Olympic history, one company — IBM — is providing a total information technology solution. IBM is creating custom applications to support Olympic administrators, 10,000 athletes, 2 million spectators and broadcasters reaching an expected audience of 3.5 billion. Those solutions draw on an array of IBM products, from System/390 servers and DB2 databases to OS/2 on wireless ThinkPads. Event results will be disseminated via an Olympic Internet site designed by IBM and supported by an IBM SP2 supercomputer. As the exclusive World Wide Information Technology Sponsor for the next three Olympic Games, IBM will transfer its Olympic solutions from Atlanta to Nagano, Japan in 1998 and Sydney, Australia in 2000.

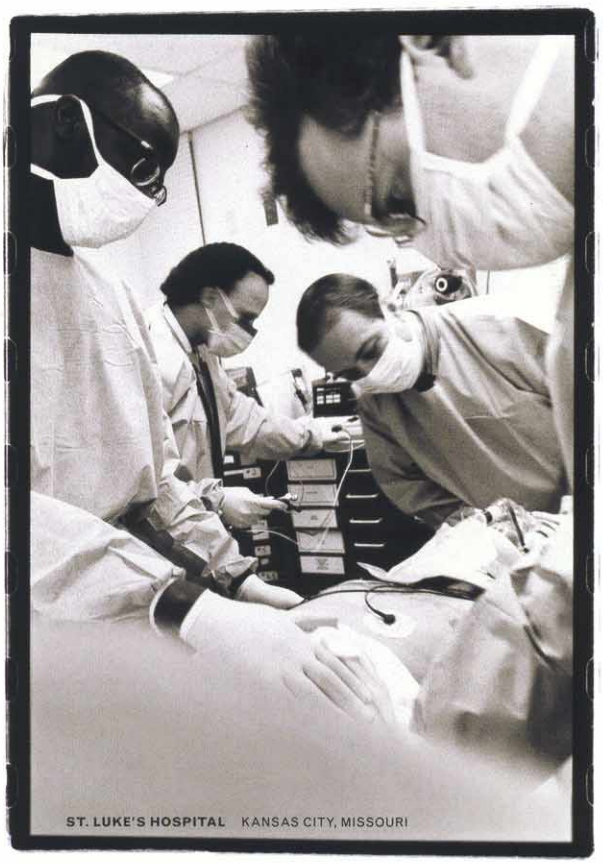
(5) now

The value of information is seldom a function of volume. For information to be truly valuable, it must be pertinent. Accurate. Timely. Targeted. And most of all, available to the people who need it. When they need it.

So, while networks can provide access to unprecedented volumes of information, their usefulness really depends on tools that connect the right information, with the right person, right now.

Like financial news. Information about changing marketplace dynamics. Or even the latest weather report. Perishable information. Knowledge with a shelf life measured in minutes, seconds.

IBM technologies connect customers to the information they need. Network-based intelligent agents, for example. One IBM technology, infoSage, constantly scans more than 2,200 sources of business content to find information personalized to your specific request. It then delivers that information



ST. LUKE'S HOSPITAL KANSAS CITY, MISSOURI

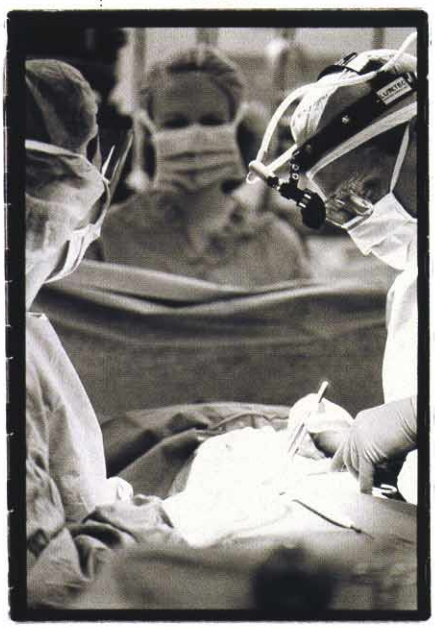
11:15AM FAMILY CONSULTATION

10:05AM TRIAGE

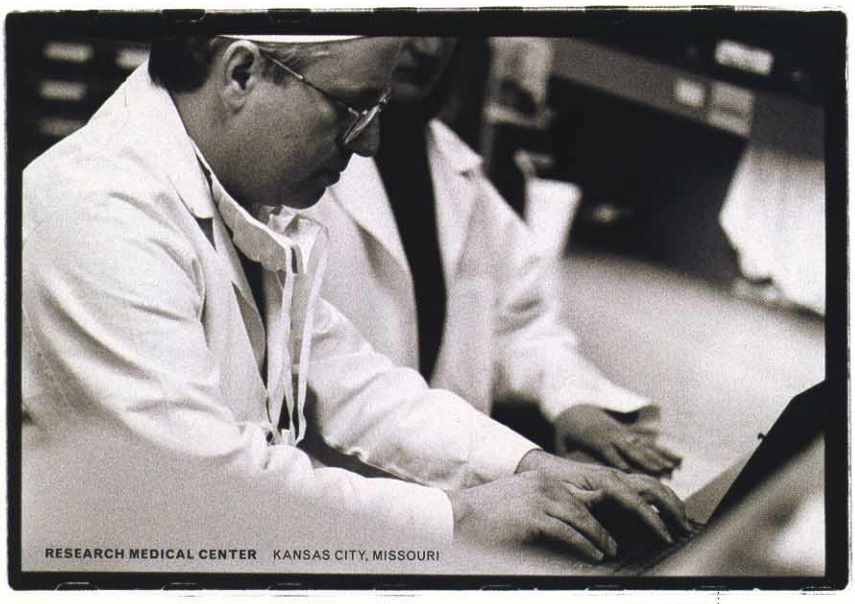
09:31AM MEDVAC ALERT

03:40 PM TRANSPLANT SURGERY

02:00 PM RETRIEVAL SURGERY



02:20 PM ORGAN TO MEDVAC



12:35 PM XPEDITE MATCH

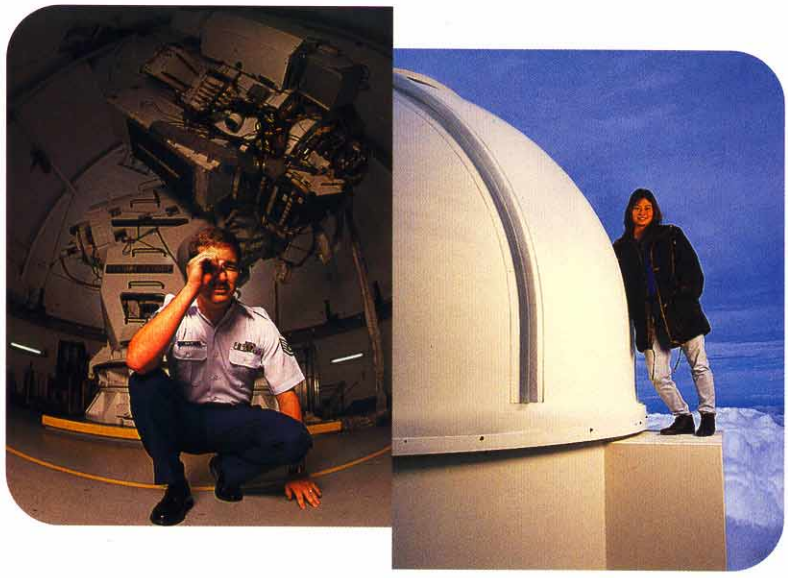
Wasted time and human error are the critical inhibitors to successfully matching donor organs with waiting recipients. The United Network for Organ Sharing (UNOS) has improved and accelerated the process by almost 12 precious hours by replacing phone lists and fax machines with a custom Lotus Notes application called Xpedite. Notes contains names and critical details of recipients across the United States. When an organ becomes available, Xpedite instantly identifies the right potential recipients and automatically "alerts" emergency medical teams.

via E-mail or the World Wide Web, packaged as a personalized newsletter, if you like.

Working with a British development partner — Multimedia Archive and Retrieval Systems — the IBM Digital Library has taken the music library of EMI Music Publishing and made it available online to producers of films, videos and television programming. And at BJC Health Systems, IBM, Kodak and Southwestern Bell created a network linking 15 hospitals. One application allows physicians to work together to reach a diagnosis using digital radiology images shared across a fiber-optic network.

Networks that deliver just the right information. Think of it as the difference between surfing and working.

For 25 years, Oreste Candia has crafted Bottega Veneta's fine leather handbags and accessories the same way — by hand. But if Bottega's manufacturing process hasn't changed, its distribution network, built around IBM's Continuous Replenishment Process, is 21st century. An IBM AS/400 at Bottega's Vicenza, Italy plant shares sales and inventory data with 20 retail stores worldwide via the IBM Global Network. "We can keep a close eye on purchasing trends and instantly respond," says Giuseppe Pilotto, chief information officer. "The network gives us a vital link to our stores we could never afford to build."



(6) reach

Work locally. Compete — and compute — globally. Networks let you do that.

They level the playing field for small businesses. And help organizations large and small reshape the how, where and when of their operations. Bringing employees, customers and suppliers together in entirely new, more effective ways.

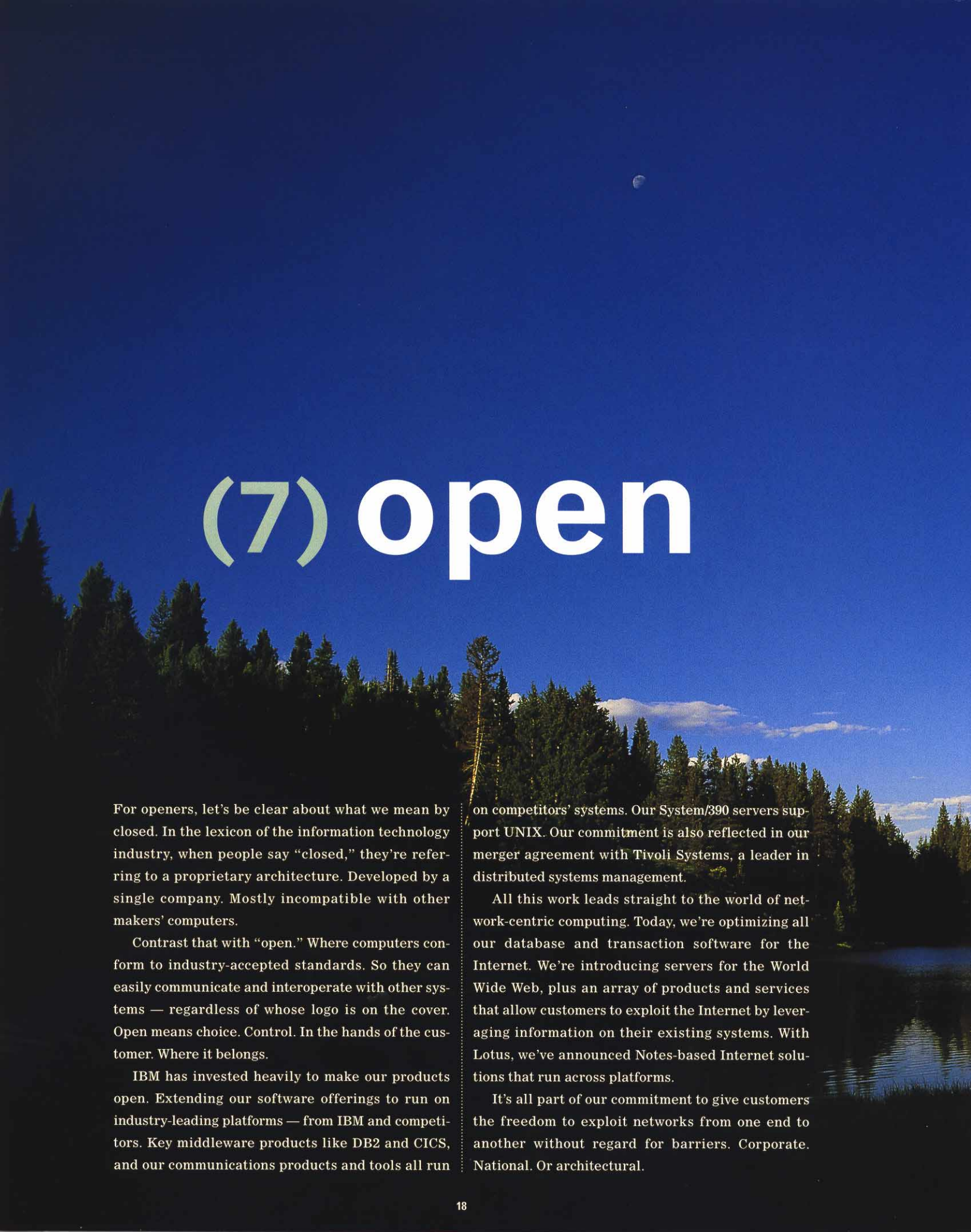
We're helping create the networked environment that makes all this possible. Take publishing, for example. IBM's innovative Cryptolope technology lets major music producers, movie studios, publishers, writers, artists, photographers and other intellectual property owners distribute their works across the Internet — and makes sure they are paid and their copyrights are protected.

Similarly, we're working to promote electronic commerce by ensuring that financial transactions are standard and secure. We played a key role in developing the technological aspects of a landmark network security agreement among MasterCard, VISA and others to ensure secure payments on the Internet. And we created infoMarket, an Internet-based marketplace where publishers can securely distribute their information and users can find specific Web content. IBM generates revenue on a "per transaction" basis.

Customers even subscribe to computing power itself. An increasing number are leveraging the IBM Global Network, the world's largest data network and the largest Internet services provider worldwide.

With IGN, customers can access and exploit a portfolio of networked applications and connect their operations around the world — without having to build a global network themselves. They use and pay for only what they need. IBM as information utility company.

U.S. Air Force Staff Sgt. Steve Baker and Rockwell Power Systems' Laurie Bosque are part of a team tracking thousands of objects orbiting Earth — everything from asteroids to man-made space debris. They rely on an IBM SP2 supercomputer at the Maui High Performance Computing Center connected to the U.S. Air Force Phillips Laboratory's powerful telescope perched atop Mt. Haleakala. The SP2 renders fast, detailed image enhancements for users networked throughout the world, including NASA and the Jet Propulsion Laboratory.



(7) open

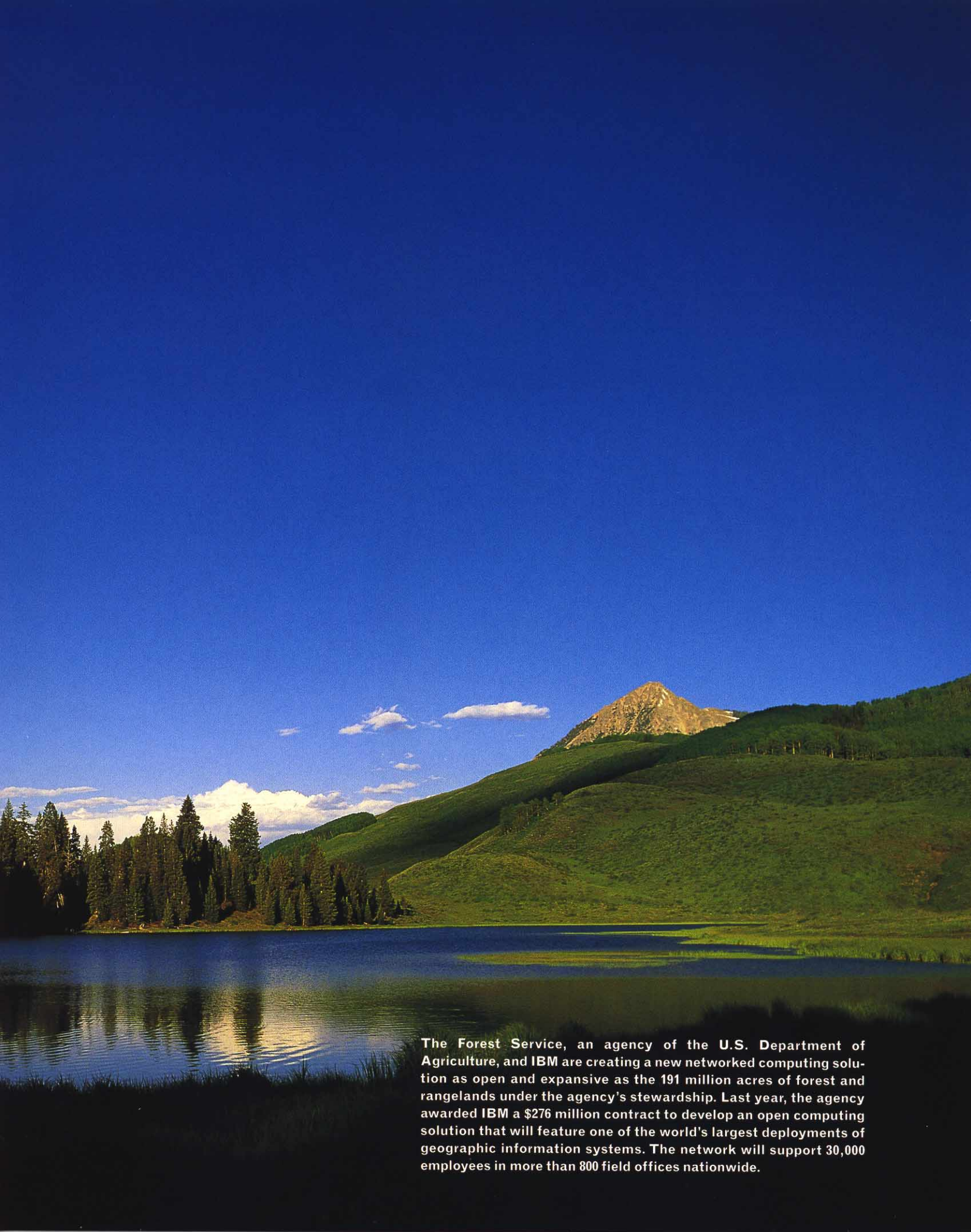
For openers, let's be clear about what we mean by closed. In the lexicon of the information technology industry, when people say "closed," they're referring to a proprietary architecture. Developed by a single company. Mostly incompatible with other makers' computers.

Contrast that with "open." Where computers conform to industry-accepted standards. So they can easily communicate and interoperate with other systems — regardless of whose logo is on the cover. Open means choice. Control. In the hands of the customer. Where it belongs.

IBM has invested heavily to make our products open. Extending our software offerings to run on industry-leading platforms — from IBM and competitors. Key middleware products like DB2 and CICS, and our communications products and tools all run on competitors' systems. Our System/390 servers support UNIX. Our commitment is also reflected in our merger agreement with Tivoli Systems, a leader in distributed systems management.

All this work leads straight to the world of network-centric computing. Today, we're optimizing all our database and transaction software for the Internet. We're introducing servers for the World Wide Web, plus an array of products and services that allow customers to exploit the Internet by leveraging information on their existing systems. With Lotus, we've announced Notes-based Internet solutions that run across platforms.

It's all part of our commitment to give customers the freedom to exploit networks from one end to another without regard for barriers. Corporate. National. Or architectural.



The Forest Service, an agency of the U.S. Department of Agriculture, and IBM are creating a new networked computing solution as open and expansive as the 191 million acres of forest and rangelands under the agency's stewardship. Last year, the agency awarded IBM a $276 million contract to develop an open computing solution that will feature one of the world's largest deployments of geographic information systems. The network will support 30,000 employees in more than 800 field offices nationwide.

(8) invisible

In a networked world, it's easy to lose sight of a few things. Like complexity. And the physical elements of computing — memory, storage, software — that now reside on your desktop PC or in your enterprise system.

How so? Consider how it's done today. To perform even the simplest function on your very powerful PC, you press a key or click a mouse button that stirs the innards of the machine. And computing happens.

But in a network-centric environment, when the communications link between the computer and the network is fast enough, cheap enough, and has virtually unlimited bandwidth, things like applications, data, storage and even some of the processing can migrate out of sight. To the network.

With them go the complexity of computing — systems management, upgrades, and a shelf full of applications. In return, you get networked access to more computing power than could ever be economically justified inside a stand-alone PC. Automatic upgrades. Continually updated content. And performance like you've never seen.

One last thing. Consider the effect of more and more devices becoming digital. Set-top TV boxes. Smart machine tools and household appliances. In some of today's automobiles, the cost of microelectronics surpasses the cost of steel. Researchers at one U.S. university are embedding microprocessors into doorknobs, apparel, even shoes. Digital devices interlinked in the network. Complexity fades. Computing recedes. Becomes ubiquitous. Invisible.

When 10 Brazilian retail banks united to compete for commercial customers against the giants of their industry, their edge was networked computing. The group, called TradeNet, uses the IBM Global Network to offer a portfolio of financial services no single member could provide alone. The banks have reduced their costs, while giving commercial customers a single connection to the network where they can conduct transactions with one bank or across all 10.

(9) edge

Most of our customers don't awaken from dreams of exotic advances in asynchronous transfer mode technology; or polymorphism as it applies to object-oriented programming. For them, hubs may well be wheel covers; servers, restaurant staff.

Our customers are bankers. Manufacturers. Government officials. Educators. They're focused on improving efficiency. Entering new markets. Compressing development cycles. Outwitting competitors. Basically, getting an edge.

Make no mistake. We're moving fast to deliver the advanced technologies needed to make powerful networks real. Massively parallel servers, microprocessors, groupware, database software, switches, systems management tools. And more.

But raw technology in itself doesn't give customers an edge. That's why we're investing just as aggressively in services and expertise to help our customers exploit network technology and put it to good use.

An increasing number of our services experts specialize in translating network-centric computing into value for specific industries.

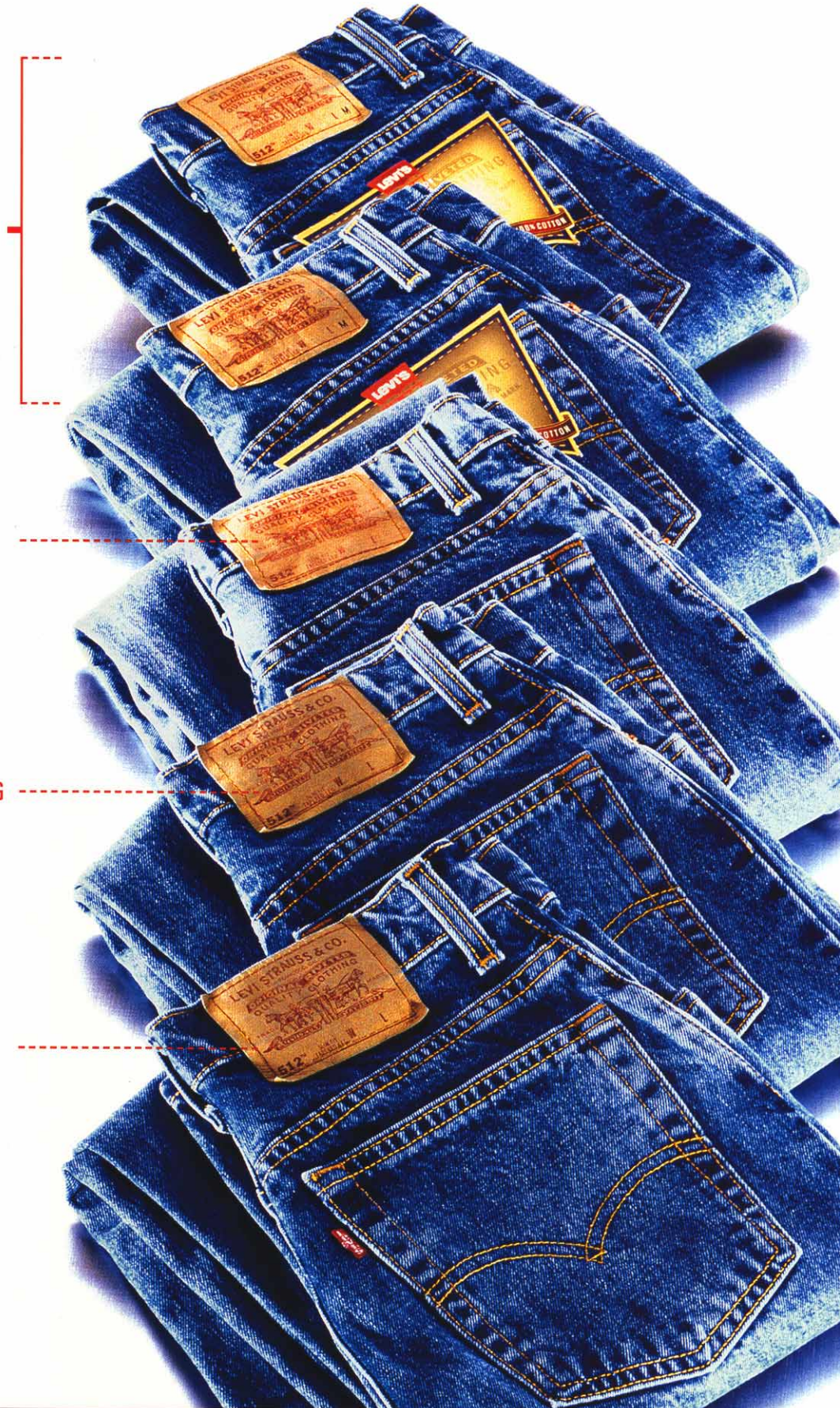
We've established an Internet consulting practice to help customers transform their businesses with networks, and do so securely.

And by year-end, we'll add another 1,000 Internet professionals — consultants and systems integration experts — working on even more network solutions.

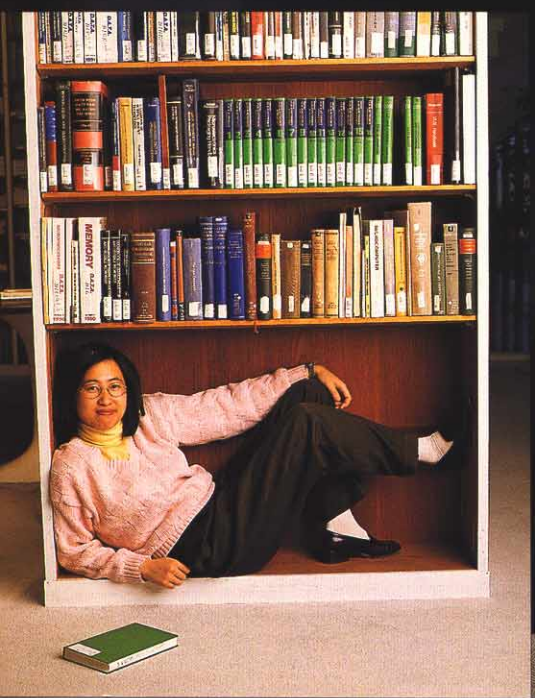
To help ensure that the performance of its dealers is every bit as high as its cars, Paris-based PSA Peugeot Citroen is tapping the IBM Global Network to link its 4,200 independent dealers across 11 European countries. Networked applications are improving operations and offering customers enhanced service. For example, dealers can now locate a vehicle with the exact features desired by a customer — anywhere in the dealer network. Live videoconferences for training, product announcements and marketing meetings, and an online parts inventory system are among applications now under development.

Efficiency at managing, loading and unloading massive cargo ships makes the Port of Colombo in Sri Lanka one of the busiest — and most competitive — in south Asia. To keep the freight flowing so vessels can get back to sea quickly, the port connects 20 of its largest shippers' computer systems into its own network — which is anchored by an IBM System/390 server, a dozen RISC System/6000s and hundreds of IBM PCs. Together with Japan Port Consultants Ltd. and Mitsui Shipbuilding and Construction Co. Ltd., IBM helped implement the network solution, which manages everything from billing to berthing schedules and container handling operations, including yard planning, yard operations and vessel planning.

There's a new wrinkle in denim. Levi Strauss & Co. is using a networked Lotus Notes solution to offer women an industry-first: affordable individually fit jeans. Customers try on prototype jeans in an Original Levi's Store. Once the customer is satisfied with the fit, the information is entered into the Notes database and transmitted to a Levi's factory. A pattern is precision-cut by computer-controlled tools, the jeans are hand-sewn and, if requested, shipped directly to the customer's home.

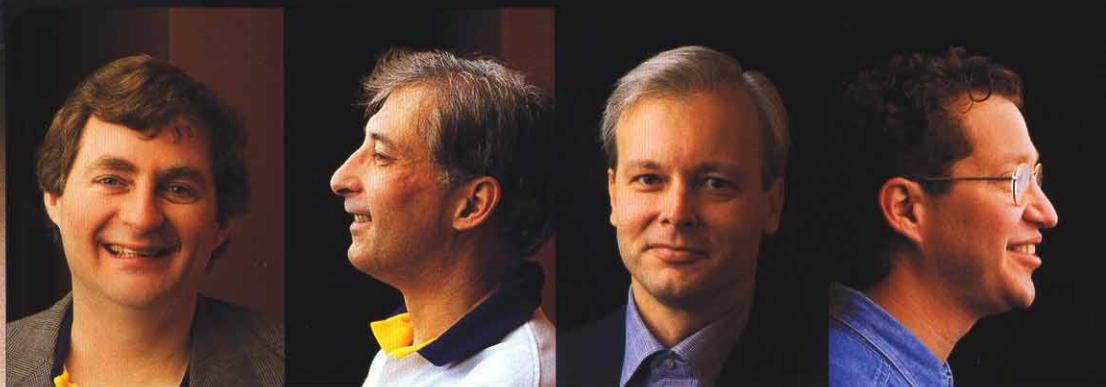


Lauretta Jones is an expert in creating screen interfaces that help even novice computer users navigate complex applications. The IBM researcher is part of a team that made unemployment benefits applications available on computer kiosks. That work is now being adapted for touch-screen systems that let people use the Internet to shop for and obtain consumer loans.



Lisa Su joined the IBM Research Division last year. She's part of a team developing advanced semiconductor devices for future generations of IBM's advanced microprocessors.

The latest version of Lotus Notes — Release 4 — features hundreds of enhancements, including new Internet capabilities. Part of the group at Lotus subsidiary Iris Associates, which pioneered the concept of groupware (from left): Len Kawell, vice president; Mussie Shore, chief designer; Ray Ozzie, Iris president; Steve Beckhardt, vice president; Tim Halvorsen, vice president.



A team at IBM's Yamato Laboratory in Japan has developed one of the world's smallest full-featured PCs — IBM's new Palm Top PC110. Weighing a scant 630 grams (about 1.5 pounds), the unit not only connects easily to public telephone networks, it contains a phone receiver and microphone that let it "be" a phone. Team members (from left): Yoshihisa Sueta, Tetsuya Kaku, Junko Minagawa, Eiki Shibata, Yohgoh Tanabe, Shichiro Miyashita.

(10) smart

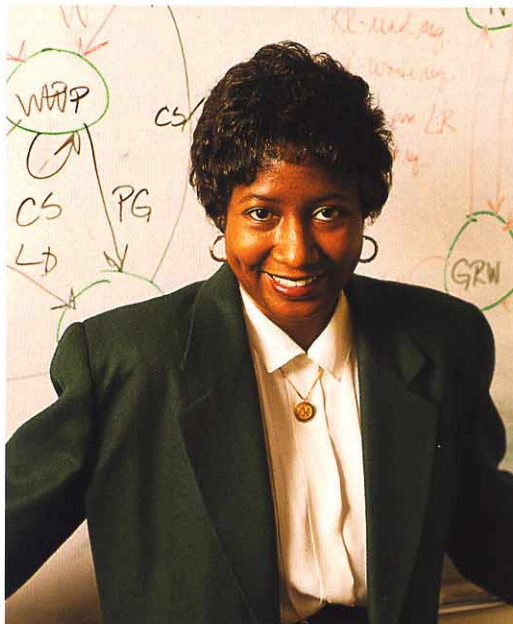
By now the message, we hope, is clear. Network-centric computing is coming fast. It will change the world. And it's the integrating strategy of IBM.

Getting there requires continued improvements in communications technology. In processing and software. In the creation of networked, rather than stand-alone, applications and customer solutions. A truly networked world may take a while to achieve. But it's already happening, and its advent is driving IBM's investments and priorities.

Even as we work to make the networked world real, to deliver on its promise for our customers, we continue to explore. Innovate. Create. And nurture some of the brightest minds in the business.

For the past three years, IBM has led in the number of patents awarded by the U.S. Patent Office. Last year in the United States we more than doubled our hiring of people with Ph.D.s in electrical engineering and computer science – and hired a full 10 percent of the total number of these Ph.D.s entering the workforce.

Because in an industry and a world changing as fast as ours, it can be tough to know exactly when the next great idea's time will come. What's not hard — for a company with the depth and breadth of IBM — is being ready.



From her desktop at IBM's Thomas J. Watson Research Center, Sandra Johnson Baylor runs simulations that mimic the performance of supercomputers that are among the largest on Earth. Her work produces design refinements that squeeze extra performance from "clusters" of microprocessors in IBM parallel computing systems.

Words that didn't

surfing

Pleasant-sounding, but too passive and imprecise. Implies network users spend a lot of time wandering aimlessly through cyberspace. In fact, a growing number are going online to conduct a phenomenal amount of business, both commercial and personal. Ditto for "browsing," which suggests the kind of idle absorption done in front of a TV. Call us radical, but we think the modern network user is moving beyond window shopping.

paradigm

Cliche. Too bad, because the concept is still quite useful. Means a set of theories or assumptions that shapes the thinking of an entire society or industry — that is, until something better comes along. Like network-centric computing. In a startlingly short time, the once-firm belief in the necessity of ever-more powerful stand-alone PCs has given way to the logic of increasingly powerful and accessible networks. Called a "paradigm shift," which is also cliche, but succinctly explains why so many of our customers are migrating to the networked world. Besides, we suspect "new paradigm" won't be so hard on the ears when people actually see one.

client/server

Important. But not for the reasons we thought a few years ago. Not the end-all in computing, but the first stirrings of the networked world. Client/server is a phase in the continuum of systems linking to ever-more powerful networks. It describes the here and now in computing. And don't worry. You *can* get there from here.

zzzzzzzzz

The idea is right. Too bad this isn't a word. (See TCP/IP.) Refers to what you'd rather be doing at night instead of worrying about the security of your computer systems. And in fact, as networks gain more users and branch into more personal and commercial spaces, concerns about privacy and security have risen. That's why IBM and other information industry leaders are developing a host of security-related processes and products, from encryption systems to anti-virus software to sophisticated electronic "firewalls" that keep unwanted Internet traffic out of your private network. In the information age, network security is an obvious priority for the industry. But it shouldn't keep you up at night. We're working on it.

make the list

reengineering

Apt, but for some people, too theoretical. Describes a fundamental transformation of basic business processes — from assembly lines to payroll to corporate structure — to make the most efficient use of time, resources and information. Networks — within an organization and beyond an organization's walls — can make reengineering real. Eliminates unnecessary steps. Reduces cycle times. Good for the bottom line. And considerably more interesting than flow charts.

TCP/IP

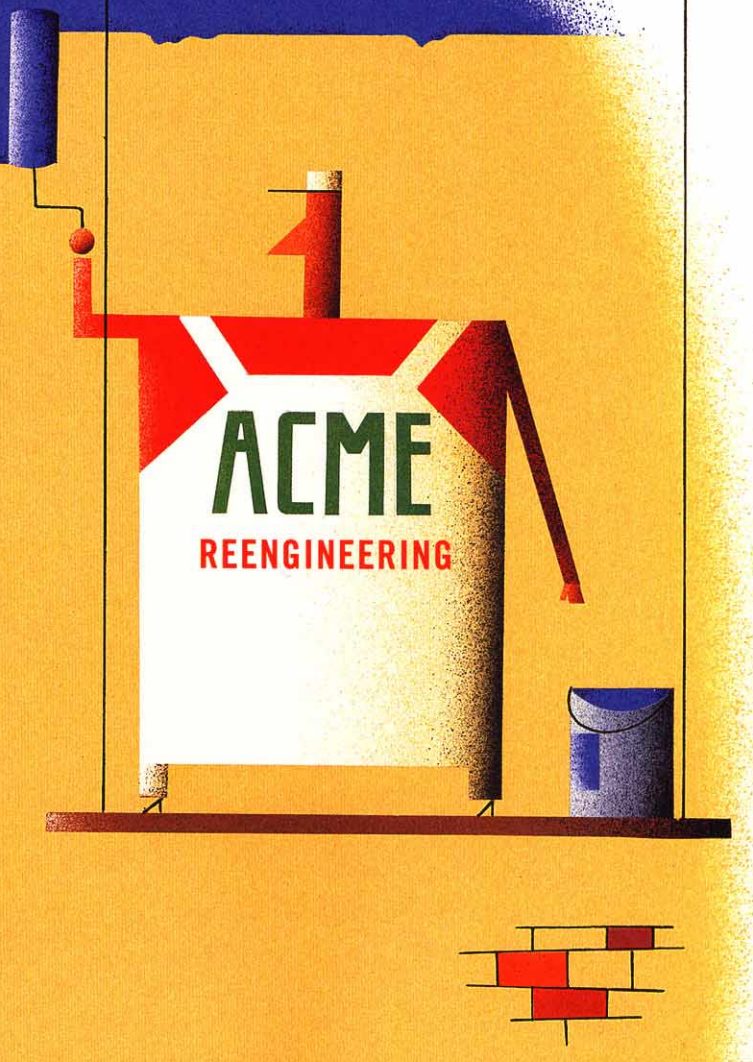
Not even a word. But TCP/IP, or Transmission Control Protocol/Internet Protocol, is singlehandedly responsible for the universal connectivity the Internet provides. A set of technical standards that allows chunks of data — text, pictures, sound, graphics, you name it — to flow from one computer to another, with ease, and error-free. Key to home pages, Web sites, browsers and much of network-centric computing's ease of use and seamless "transparency." So while you may never have to say TCP/IP, you're already depending on it.

homogeneous

Sounds too much like a dairy product. In "homogeneous" computing, all the pieces work together because they're the same. One architecture, probably one vendor, one way of doing things. Heterogeneous computing is more complicated, but preserves customer preference, flexibility and investments. Network-centric computing combines the best of both — seamlessness and ease of use with choice and control left where it belongs. With customers, not vendors.

multimedia

Misunderstood. For most people, it means a shiny, 4-inch-diameter disk packed with digital words, pictures and sounds — neat, as far as it goes, but it has little to do with what's coming soon. Networked multimedia. Video-on-demand. Live, fully interactive events. Research and reference resources far too large for local storage, yet available instantly and updated constantly. Not exactly what comes to mind when you think of "multimedia." But it will be.



everywhere

Not quite, but getting there. While network-centric computing is taking off on the commercial front, it's just starting to make the consumer scene — in unexpected ways. Sure, someday consumers will feast on movies-on-demand and interactive TV. But their first taste of networked computing will come — is coming — as businesses use it to provide new and better products and services. Internet malls. Home banking. Real estate. Auto financing. The impact to consumers isn't glaringly obvious today. But it should be staggering in time.

A final word.

It might be commitment. Or involvement. Citizenship. Perhaps just plain old heart.

Whatever word you use, it's what you find anywhere you look in IBM, in any part of the world — an unwavering sense of responsibility for other people, both inside and outside the company; a focused determination to improve the communities in which we work and live.

It's also an IBM tradition going way, way back. Many things about IBM have changed. This, however, has been cherished, encouraged and underscored.

Over the last 10 years, IBM has been the largest corporate contributor of cash, equipment and people — more than $1.2 billion — to non-profit organizations and educational institutions across the U.S. and around the world. In 153 countries, we help people use information technology to help other people. In South Africa, for example, we've trained rural teachers on the use of technology in schools. In Sweden, we helped create a CD-ROM about AIDS/HIV as part of a public awareness program.

One of our top priorities is education. In the U.S., we established a $25 million grant program in 1994, "Reinventing Education," to help states and school districts embrace technology and take other steps to reform and revitalize the K-12 public education system. To date we have awarded 10 grants across the country, and we're already seeing some exciting changes — the way teachers are trained in Philadelphia, the way math and science are taught in Dallas and how learning is assessed in Vermont. Cincinnati is increasing the length of the school day and year.

West Virginia is exploring meaningful ways to harness the power of the Internet for instruction. Cabell Midland High School in Huntington was one of the first to incorporate the Internet in the classroom for research projects and homework assignments. Eventually, students and teachers at more than 900 West Virginia schools will be connected to the Internet.

Our education initiatives also extend to improving the environment. Through the IBM Environmental Research Program, we've awarded grants totaling $16 million to support research at 14 major universities and research institutions around the world. Research, all being conducted through computer-based technology, ranges from regional air quality to global climate changes, and from environmental design to biological diversity.

In Australia, for example, researchers are using computer visualization to better understand how to conserve coral reefs in several Southeast Asian countries. IBM is also sponsoring researchers who are developing an environmental information and modeling system to devise strategies to control the loss of productive land in the arid subtropics of Chile. (To get a copy of our report, "IBM and the Environment," see page 81.)

We're also committed to creating an environment inside IBM that reflects the diversity and changing needs of society. In 1995, we doubled our dependent care fund to $50 million to support our child and elder care programs. *Working Mother* magazine rated both IBM and Lotus two of the best companies in 1995 for working parents. This is the tenth year IBM has been on the list and the eighth consecutive year we've been in the top 10.

"I think buying a computer is going to be as normal as buying a car or a television. It's going to be something every family has."
AMY SMITH

"I've got a couple of friends that have moved away. They're on the Internet and have E-mail addresses and I can still talk to them. If I called them on the phone, my bill would be outrageous."
BENJAMIN REID

"Technology is good unless it keeps us from thinking."
WENDY ROMANOWSKI

"Research on the Net is cool because you know that you're connecting with somebody who could be across the world and you're finding out things from 10,000 miles away."
NATHAN JACKSON

"I look at computers more as tools than toys now. They give you a chance to be an active part of what you are learning instead of just reading words."
LARA TURLEY

"The stuff we see on TV commercials, like the guy in the desert using the video phone on his wrist... when is that going to happen?"
HEATHER SPENCER

"My parents don't have a clue on how to even turn a computer on."
BENJAMIN REID

"One of the reasons I became interested in physical therapy was because of information I found on Web sites."
TARA DRYER

CABELL MIDLAND HIGH SCHOOL HUNTINGTON, WEST VIRGINIA 11TH & 12TH GRADERS

IBM has two fundamental missions.

(1) 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.

(2) Second, we translate these advanced technologies into value for our customers through our professional solutions businesses worldwide.

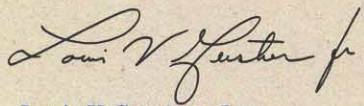
Responsibility for the integrity and objectivity of the financial information presented in this Annual Report rests with IBM management. The accompanying financial statements have been prepared in conformity with generally accepted accounting principles, applying certain estimates and judgments as required.

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

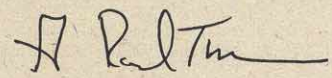
To assure the effective administration of internal control, we carefully select and train our employees, develop and disseminate written policies and procedures, provide appropriate communication channels, and foster an environment conducive to the effective functioning of controls. We believe that it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

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

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



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



G. Richard Thoman
Senior Vice President and
Chief Financial Officer

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

In our opinion, the accompanying consolidated financial statements, appearing on pages 50 through 78, present fairly, in all material respects, the financial position of International Business Machines Corporation and its subsidiaries at December 31, 1995 and 1994, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1995, 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 55 and 56, the company changed its method of accounting for postemployment benefits in 1993. We concur with this change.

Price Waterhouse LLP

Price Waterhouse LLP
1177 Avenue of the Americas
New York, NY 10036
January 19, 1996

Overview

IBM made significant progress during 1995 in implementing its fundamental strategies of transforming its traditional businesses to position them for the emerging network-centric computing market and rapidly expanding its newer, high-growth businesses. As a result, the company reported record revenues, with the best rate of revenue growth since 1984.

Overall, as advances in network technology continue to create new and powerful applications for our customers, the demand for computing power remains high. In 1995, shipments of System/390* servers delivered 59 percent more power than in the prior year. Revenues from servers grew 9.0 percent, reflecting the delivery of significant price/performance improvements to our customers.

Revenue growth continued to be strong for Original Equipment Manufacturer (OEM) merchant-market semiconductors and low-end storage files. Personal systems clients continued to show growth, in both personal computers and RISC System/6000* products. While revenue from storage products continued to decline, shipments of the RAMAC* II product in the fourth quarter of 1995 were strong.

The company's services offerings continued to show strong growth and are now the second largest source of revenue, behind hardware sales. The services gross profit margin remains lower than the company's hardware offerings.

The company's software revenues grew primarily as a result of the acquisition of Lotus Development Corporation (Lotus), which is discussed further on pages 47 and 48. On July 5, 1995, the company acquired all outstanding shares of Lotus for approximately $3.2 billion ($2.9 billion in net cash). The company considers Lotus to be an applications-enabling software company engaged in high-growth segments of the software market. It is believed that the acquisition of Lotus provides the company with an opportunity to successfully advance workgroup technology from local area network environments to enterprisewide environments.

While much progress has been made, IBM must continue its pace of change as it focuses increasingly on revenue growth, introduction of new offerings in the network-centric computing market, and aligning its cost and expense structure in strategic solutions areas.

Results of Operations

(DOLLARS IN MILLIONS)	*1995*	*1994*	*1993*
Revenue	$ 71,940	$ 64,052	$ 62,716
Cost	41,573	38,768	38,568
Gross profit	30,367	25,284	24,148
Total expense without restructuring charges	22,554	20,129	24,000
Restructuring charges	–	–	8,945
Net earnings (loss) before income taxes	$ 7,813	$ 5,155	$ (8,797)
Net earnings (loss)	$ 4,178	$ 3,021	$ (8,101)
Gross profit margin	42.2%	39.5%	38.5%

The following table summarizes the year-to-year percentage change in the company's revenue by geographic area:

	Percentage Change	
	1995-94	*1994-93**
Total IBM	12.3%	6.0%
North America	11.1	4.1
United States	11.1	3.0
Canada	11.7	15.8
Europe/Middle East/Africa	9.6	5.8
Asia Pacific	22.2	13.4
Latin America	6.3	(.7)

**1993 revenue was reduced for revenue associated with the Federal Systems Company, which was sold in 1994.*

The overall gross profit margin increased to 42.2 percent, a 2.7 point improvement over 1994, following a 1.0 point improvement in 1994 over 1993. The increases are primarily driven by improved margins in hardware sales resulting from cost improvements across most major product lines. The gross profit margins also continue to be affected by hardware pricing pressures and the company's shift to services revenue, which has a lower gross profit margin than the company's hardware and software offerings.

The company reported net earnings of $4,178 million ($7.23 per common share), $3,021 million ($5.02 per common share) and a net loss of $8,101 million ($14.22 per common share) for 1995, 1994 and 1993, respectively.

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

(DOLLARS IN MILLIONS)	*1995*	*1994*	*1993*
Net earnings after tax as reported	$ 4,178	$ 3,021	$ (8,101)
Lotus purchased in-process research and development (pages 47 and 48)	1,840	–	–
1995 4th Quarter special items (pages 42 and 43)	431	–	–
Effects of Federal Systems Company (FSC) sale (page 48)	(115)	(248)	(105)
Software amortization change (page 40)	–	192	–
Restructuring charge (page 62)	–	–	7,996
SFAS 112 (page 56)	–	–	114
Adjusted net earnings	$ 6,334	$ 2,965	$ (96)
Adjusted earnings after tax per common share	$ 11.02	$ 4.92	$ (.25)

Hardware Sales

(DOLLARS IN MILLIONS)	1995	1994	1993
Total revenue	$ 35,600	$ 32,344	$ 30,591
Total cost	21,862	21,300	20,696
Gross profit	$ 13,738	$ 11,044	$ 9,895
Gross profit margin	38.6%	34.1%	32.3%

Worldwide revenue from hardware sales increased 10.1 percent from 1994, following an increase of 5.7 percent in 1994 from 1993. Worldwide gross profit dollars from hardware sales increased 24.4 percent from 1994, following an increase of 11.6 percent in 1994 from 1993.

Revenue from servers increased 9.0 percent from 1994, following a 2.7 percent decrease versus 1993. The 1995 increase reflected higher revenue from AS/400*, RISC System/6000 and POWERparallel* servers, as well as a slight increase in System/390 server revenue. System/390 shipments measured in MIPS increased 59 percent and 41 percent in 1995 and 1994, respectively, while POWERparallel shipments more than doubled in 1995 over 1994. Although System/390 revenue grew in 1995, it continues to experience competitive pricing pressures. The 1994 decrease was primarily due to declines in System/390 revenue, resulting from competitive pricing pressures, partially offset by AS/400 server revenue growth in 1994 over 1993, as the new advanced series of servers showed strong growth.

Personal system clients revenue grew 15.1 percent from 1994, following a 17.7 percent increase in 1994 from 1993. These increases resulted from higher revenue from personal computers and strong growth from RISC System/6000 clients.

Storage products revenue decreased 6.9 percent in 1995 from 1994, following a decrease of 26.1 percent in 1994 from 1993. These declines were a result of continuing price competition across most storage products. Although revenue decreased in 1995 from 1994, fourth quarter shipments of the RAMAC II product were strong.

OEM hardware revenue grew 38.2 percent in 1995 versus 1994, following a 151.2 percent increase in 1994 over 1993. These increases were 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 in note Y on pages 75 and 76. The product trends demonstrated in this discussion and in that disclosure are indicative, in all material respects, of hardware sales activity.

The increase in the 1995 hardware sales gross profit margin was driven by System/390 servers due to the increased shipment of the new Complementary Metal Oxide Semiconductor (CMOS) servers. In addition, personal computer clients, RISC System/6000 servers and OEM products showed improved gross profit margins in 1995 versus 1994. The increase in hardware sales gross profit margin in 1994 versus 1993 was primarily driven by cost improvements in System/390 servers, offset by lower personal computer client margins. Although the overall hardware sales margin has been increasing, it continues to be adversely impacted by pricing pressures on System/390 servers, personal computer clients and storage products.

Services

(DOLLARS IN MILLIONS)	1995	1994	1993
Services	$ 12,714	$ 9,715	$ 7,648
Federal Systems Company	–	–	2,063
Services revenue excluding maintenance	12,714	9,715	9,711
Cost	10,042	7,769	8,279
Gross profit	$ 2,672	$ 1,946	$ 1,432
Gross profit margin	21.0%	20.0%	14.7%
Maintenance revenue	$ 7,409	$ 7,222	$ 7,295
Cost	3,651	3,635	3,545
Gross profit	$ 3,758	$ 3,587	$ 3,750
Gross profit margin	50.7%	49.7%	51.4%
Total services revenue	$ 20,123	$ 16,937	$ 17,006
Cost	13,693	11,404	11,824
Gross profit	$ 6,430	$ 5,533	$ 5,182
Gross profit margin	32.0%	32.7%	30.5%

Services revenue, excluding maintenance, increased 30.9 percent in 1995 from 1994. The 1994 results, on an as-reported basis, did not include operational results from FSC, which were included in 1993 results. When adjusted for the effects of the FSC sale, services revenue increased 27.0 percent in 1994 over 1993. These increases were primarily driven by strong growth in outsourcing of systems and networks, consulting and systems integration activity.

Services gross profit dollars, excluding maintenance, increased 37.4 percent in 1995 versus 1994, following an increase of 35.9 percent in 1994 over 1993. Adjusted for the FSC sale, 1994 gross profit dollars increased 54.0 percent over 1993. The 1993 gross profit dollars were impacted by adjustments required on certain older contracts that were not expected to be profitable. The 1993 services gross profit margin adjusted for the FSC activity, excluding maintenance, was 16.5 percent.

Maintenance revenue increased 2.6 percent in 1995 from 1994, following a decrease of 1.0 percent in 1994 from 1993. Gross profit dollars increased 4.7 percent year over year, following a decrease of 4.4 percent in 1994 from 1993. Maintenance revenue and gross profit dollar improvements were the results of currency benefits in 1995. Maintenance revenue and gross profit margins continue to be adversely affected by the competitive environment and resulting pricing pressures on maintenance offerings, as well as, in 1995, a mix toward products having lower profit margins. This trend is expected to continue.

Software

(DOLLARS IN MILLIONS)	1995	1994	1993
Total revenue	$ 12,657	$ 11,346	$ 10,953
Total cost	4,428	4,680	4,310
Gross profit	$ 8,229	$ 6,666	$ 6,643
Gross profit margin	65.0%	58.8%	60.7%

Software revenue increased 11.6 percent in 1995 from 1994, following an increase of 3.6 percent in 1994 from 1993. The increase in 1995 was primarily due to revenue generated by products offered by Lotus, which was purchased on July 5, 1995, and whose results are included in the company's 1995 results. The increase in 1994 was primarily due to higher one-time charge revenue associated with RISC System/6000 placements.

Software gross profit dollars increased $1,563 million (23.4%) in 1995 from 1994, following an increase of $23 million (.3%) in 1994 from 1993. As the company continues its efforts to deliver software solutions to satisfy its customers needs, a number of changes have evolved which have the effect of reducing cost levels.

In the normal course of business, the amounts spent for software products are either charged to research, development and engineering expense or capitalized; then subsequently amortized as cost over the product's useful life. As the company continues to improve the pace at which new products are introduced in the marketplace, an increased percentage of the spending is charged to expense, resulting in a growth of research, development and engineering expense dollars from year to year. Because a lesser percentage of the spending is capitalized, the result is lower software capital additions from year to year ($.8 billion in 1995 and $1.4 billion in 1994). Also, in reaction to changes in the marketplace, in 1994 the company reduced the amortization periods for its software products to a maximum of four years. The combined effects of these changes have resulted in lower software carrying values in the company's Consolidated Statement of Financial Position ($2,419 million, $2,963 million and $3,703 million at December 31, 1995, 1994 and 1993, respectively). In addition to reducing the amount of costs to be amortized in future periods, these lower balances will lessen the company's risk of impairment and write-offs of its software products due to changes in the marketplace. The amounts written off were $344 million in 1995, $491 million in 1994 and $327 million in 1993.

While these changes have contributed to the growth in software gross profit in 1995, they were partially offset by higher vendor royalty costs as the company continues to seek solutions for its customers from many sources.

The reduction in amortization periods, which was made in 1994, resulted in a charge that year to software cost of $296 million. Excluding the effect of this charge, gross profit dollars would have been $6,962 million and the gross profit margin would have been 61.4 percent in 1994.

Rentals and Financing

(DOLLARS IN MILLIONS)	1995	1994	1993
Total revenue	$ 3,560	$ 3,425	$ 4,166
Total cost	1,590	1,384	1,738
Gross profit	$ 1,970	$ 2,041	$ 2,428
Gross profit margin	55.4%	59.6%	58.3%

Rentals and financing revenue increased 3.9 percent from 1994, following a decrease of 17.8 percent in 1994 from 1993. The growth in 1995 revenue was a result of increases in new financing originations versus 1994. However, revenue was down from 1993 as older leases (1993 and prior originations) continued to expire. Rentals and financing gross profit dollars decreased 3.4 percent from 1994, following a decline of 15.9 percent in 1994 from 1993. These decreases were a reflection of both declining volumes and rental prices on high-end products over the past few years, as well as a changing country mix.

Operating Expenses

(DOLLARS IN MILLIONS)	*1995*	*1994*	*1993*
Selling, general and administrative	$ 16,766	$ 15,916	$ 18,282
Percentage of revenue	23.3%	24.8%	29.2%
Research, development and engineering	$ 6,010	$ 4,363	$ 5,558
Less: Lotus purchased in-process research and development	1,840	–	–
Adjusted research, development and engineering	$ 4,170	$ 4,363	$ 5,558
Percentage of revenue	5.8%	6.8%	8.9%

Selling, general and administrative (SG&A) expense increased 5.3 percent from 1994, which followed a decrease of 12.9 percent in 1994 from 1993. The 1995 results included two special items: a $626 million charge for work force separations and asset reductions and a one-time gain of $175 million due to the settlement of certain contractual obligations resulting from the 1994 sale of FSC. The 1994 results included the before-tax gain from the FSC sale ($382 million). Excluding these items, 1995 SG&A expense would have increased .1 percent, and the decrease in 1994 would have been 10.9 percent. In addition, the 1995 results included six months of amortization of goodwill and operating expenses resulting from the acquisition of Lotus, which amounted to approximately $471 million. Without the two special items and the Lotus expenses, 1995 SG&A expense would have decreased 2.8 percent from 1994. The company continues to focus on productivity, reengineering, expense controls and prioritization of spending in order to have competitive expense to revenue levels.

Research, development and engineering expense increased 37.7 percent in 1995, following a decrease of 21.5 percent in 1994 from 1993. The increase was a result of a $1,840 million charge for purchased in-process research and development in connection with the Lotus acquisition. Excluding this item, research, development and engineering expense would have decreased 4.4 percent in 1995. Additionally, changes in the software development process coupled with an increased pace to market continued to reduce the software capitalization rate, which increased charges to research, development and engineering expense from period to period. The reductions in both years reflected the company's continued focus on productivity and expense controls, which resulted in elimination of redundant efforts and reprioritization of development activities to such areas as network-centric computing, microprocessors, RISC technology, networking, personal computers and desktop software.

Other Income/Interest Expense

(DOLLARS IN MILLIONS)	1995	1994	1993
Other income, principally interest	$ 947	$ 1,377	$ 1,113
Interest expense	725	1,227	1,273

Other income, principally interest, was $.9 billion in 1995, a decrease of 31.3 percent from 1994, following an increase of 23.7 percent in 1994 over 1993. The 1995 decrease reflected the continuing impact of the switch to the Real currency by Brazil effective July 1994 and generally lower levels of cash balances versus 1994. The 1994 increase reflected higher levels of available cash and higher interest rates versus 1993.

In July 1994, the Brazilian government converted to a new currency, the Real. The new currency was part of the government's economic plan to reduce inflation and stabilize the economy. This change had 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 and all of 1995 when compared to prior periods.

Provision for Income Taxes

The provision for income taxes was a charge of $3,635 million in 1995, $2,134 million in 1994 and a benefit of $810 million in 1993. The 1995 provision was based on earnings before income taxes of $7,813 million, resulting in an effective tax rate of 47 percent for 1995, as compared to the 1994 provision, which was based on earnings of $5,155 million, resulting in an effective tax rate of 41 percent. The higher rate in 1995 resulted from expensing the purchased in-process research and development as part of the acquisition of Lotus with no corresponding tax benefit. Without the effect of this item, the tax rate would have been 38 percent. The effective tax rate of (9) percent in 1993 was principally due to limited tax benefits on restructuring charges, along with a high effective tax rate on earnings in certain non-U.S. operations.

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 $11.0 billion as compared to approximately $14.0 billion in 1994 and $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 two years' U.S. taxable income was considered. This was approximately $4.8 billion (estimated income) in 1995 and a $549 million loss in 1994. In addition, consideration was given to the impact of prior years' restructuring actions on the company's future taxable income and to tax planning strategies related to research and development costs.

Fourth Quarter

For the quarter ended December 31, 1995, the company had revenue of $21.9 billion, a 10.2 percent increase over the same period of 1994. Net earnings in the fourth quarter were $1,711 million ($3.09 per common share), compared to net earnings of $1,230 million ($2.06 per common share) in the fourth quarter of 1994. In the fourth quarter of 1995, the company recorded a pretax charge of $663 million to cover work force separation costs and asset reductions ($626 million) and a software write-down ($37 million). These charges were partially offset by a one-time gain of $175 million from the settlement of certain contractual obligations resulting

from the 1994 sale of FSC. The company's fourth-quarter 1995 net earnings would have been approximately $2.0 billion, or $3.66 per common share, before these special items.

Revenue increased in all but one geographic area in the fourth quarter. United States revenue was $7.8 billion, an increase of 12.0 percent compared to the fourth quarter a year ago. Revenue from Europe/Middle East/Africa rose 7.1 percent year over year to $8.1 billion, Asia Pacific revenue grew 19.3 percent to $4.1 billion, and revenue from Canada rose 2.6 percent to $.8 billion. Latin America revenue declined 3.3 percent from the same period of 1994 to $1.1 billion.

Currency had an approximately 2 percent favorable effect on revenue in the fourth quarter.

Hardware sales revenue increased 7.9 percent to $11.5 billion, compared to the same period of last year. Personal computer, RISC System/6000 and System/390 revenue increased. AS/400 revenue declined compared to the fourth quarter of last year as a result of ongoing product transitions. Storage product revenue also fell due to year-over-year price reductions.

Services revenue grew 24.8 percent over the previous year to $4.1 billion, reflecting continued strength across the company's services categories, including outsourcing of systems and networks, consulting, systems integration, networking and availability services, and education.

Software revenue was $3.6 billion, an increase of 9.0 percent compared to the fourth quarter of 1994. Maintenance revenue increased .9 percent year over year to $1.8 billion, while revenue from rentals and financing revenue grew 6.3 percent to $916 million.

The total gross profit margin was 41.7 percent in the fourth quarter, compared to 40.6 percent in the same period of 1994.

Total expenses, before the special items, rose slightly compared to last year's fourth quarter, primarily due to goodwill amortization and operating expenses related to Lotus, which was acquired on July 5, 1995.

Financial Condition

During 1995, the company took a number of actions that are reflected in the Consolidated Statement of Financial Position at December 31, 1995, including expenditures of $5.7 billion for the repurchase of common and preferred capital stock, $2.9 billion net cash payments for the acquisition of Lotus, and $2.1 billion in payments related to restructuring charges incurred in prior periods.

Working Capital

(DOLLARS IN MILLIONS)	At December 31 1995	1994
Current assets	$ 40,691	$ 41,338
Current liabilities	31,648	29,226
Working capital	$ 9,043	$ 12,112
Current ratio	1.29:1	1.41:1

Current assets declined $.6 billion from year-end 1994, with a reduction in total cash, cash equivalents and marketable securities of $2.8 billion, offset by increases in accounts receivable of $1.9 billion and prepaid expenses of $.3 billion. The decrease in total cash, cash equivalents and marketable securities

resulted primarily from the stock repurchases, the acquisition of Lotus and restructuring payments, offset by cash generated from operations. The increase in accounts receivable reflected strong year-end business volumes.

Total current liabilities increased $2.4 billion from December 31, 1994, with increases of $.9 billion in taxes payable and $2.0 billion in short-term debt, offset by a net decrease of $.5 billion in other current liabilities (a decrease in other accrued expenses and liabilities, and increases in accounts payable, and compensation and benefits). The increase in taxes payable is due to improvement in the company's operating results in certain geographies. Short-term debt increased to support the growth in customer financing assets. The decline in other accrued expenses and liabilities resulted from lower restructuring accrual balances due to implementation of the company's restructuring programs.

Investments

The company's capital expenditures for plant, rental machines and other property were $4.7 billion for the year ended December 31, 1995, an increase of $1.6 billion from 1994. The increase reflects the company's continuing investment in high-growth advanced technology areas such as microelectronics and in the managing of customers' information technology as part of the company's rapidly growing services business.

In addition to software development expense included in research, development and engineering expense, the company capitalized $.8 billion of software costs during 1995, versus the $1.4 billion capitalized in 1994. Amortization of capitalized software costs amounted to $1.6 billion for 1995, a decrease of $.5 billion from 1994 (which included $.3 billion in accelerated amortization resulting from a software amortization change implemented in the first quarter of 1994).

Investments and sundry assets were $20.6 billion at December 31, 1995, an increase of $.5 billion from December 31, 1994, primarily the result of increases in prepaid pension assets and the goodwill associated with the acquisition of Lotus, offset by a decline in deferred tax assets.

Debt and Equity

(DOLLARS IN MILLIONS)	*1995*	*1994*
Short-term debt	$ 11,569	$ 9,570
Long-term debt	10,060	12,548
Total debt	$ 21,629	$ 22,118
Stockholders' equity	$ 22,423	$ 23,413
Total debt/total capitalization	49.1%	48.6%

The ratio of total debt to total capitalization increased in 1995 primarily due to the retirement of repurchased capital stock during the year; total debt declined by $.5 billion due to the retirement of $1.0 billion of "core" debt, offset by an increase of $.5 billion in debt to maintain a constant leverage in customer financing.

Other non-current liabilities of $14.4 billion increased $.3 billion from year-end 1994, principally due to increases in non-current postretirement benefit liabilities and deferred income, offset by declines in restructuring accrual balances.

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 that 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 of 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 M on pages 62 and 63.

Stockholders' equity declined $1.0 billion from December 31, 1994, primarily as a result of common and preferred stock repurchases, partially offset by the company's net earnings from operating results. The repurchased shares were retired and restored to the status of authorized but unissued.

Currency Rate Fluctuations

Approximately 90 percent of the company's non-U.S. business is conducted in local currency environments. Currency rate variations had favorable effects on revenue results of approximately 4 percent in 1995, 2 percent in 1994 and an unfavorable impact of 3 percent in 1993. As worldwide currencies strengthen versus the U.S. dollar, 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, 1995, the cumulative translation adjustment was $3.0 billion, an increase of $.4 billion over 1994.

In high-inflation environments, like 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 uses a variety of financial hedging instruments to minimize currency risks related to customer financing transactions and the repatriation of dividends and royalties. Further discussion on currency and hedging appears in note X on pages 72 through 75.

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, 1995, $8.9 billion was unused and still available. Further discussion appears in note V on page 72.

At year-end 1995, the company had a net balance of $1.2 billion in assets under management from the securitization of lease and trade receivables. This amount is $.6 billion lower than the 1994 year-end balance of $1.8 billion. Further discussion appears in note W on page 72.

In April 1995, Duff & Phelps upgraded its credit ratings for IBM and its rated subsidiaries' senior long-term debt to "A+" from "A" and its preferred stock rating to "A" from "A-".

In August 1995, Moody's Investors Service upgraded its credit ratings on the senior long-term debt of IBM and its rated subsidiaries to "A-1" from "A-3" and on IBM's preferred stock to "A-1" from "Baa-1".

Fitch Investors Service, in December 1995, upgraded its credit ratings for IBM and its rated subsidiaries' senior long-term debt to "A+" from "A", short-term debt to "F-1+" from "F-1", and its preferred stock rating to "A" from "A-".

The following table summarizes the company's cash flows from operating, investing and financing activities as prescribed by Generally Accepted Accounting Principles (GAAP), and reflected in the Consolidated Statement of Cash Flows on page 52:

(DOLLARS IN MILLIONS)	*1995*	*1994*	*1993*
Net cash provided from (used in):			
Operating activities	$ 10,708	$ 11,793	$ 8,327
Investing activities	(5,052)	(3,426)	(4,202)
Financing activities	(6,384)	(6,412)	(1,914)
Effect of exchange rate changes on cash and cash equivalents	65	106	(796)
Net change in cash and cash equivalents	$ (663)	$ 2,061	$ 1,415

Net cash provided from operating activities declined $1.1 billion from the 1994 period reflecting a decrease in cash flows due to net changes in operating assets and liabilities (primarily customer financing receivables), offset by the improvement in net earnings.

The $1.6 billion increase in funds used in investing activities from the 1994 period is attributable to the company's acquisition of Lotus in July 1995, partially offset by net cash inflows from the sale of marketable securities during 1995. In addition, the 1994 period reflects $1.5 billion in proceeds from the sale of FSC.

Net cash used in financing activities for 1995 resulted principally from implementation of the company's preferred and common stock repurchase programs, offset by higher levels of short-term borrowings associated with customer financing.

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 sectors. 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, but is supplementary in nature. Under this model, "core" cash flow from operations was approximately $7.1 billion in 1995, excluding the Lotus acquisition. 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 in note O on pages 63 through 66. Inherent in customer financing are certain risks: credit, interest rate, currency and residual value. The company manages credit risk through comprehensive credit evaluations and pricing practices. To manage the risks associated with an uncertain interest rate environment, the company pursues a funding strategy of substantially matching the terms of its debt with the terms of its assets. Currency risks are managed by denominating liabilities in the same currency as the assets.

Residual value risk is managed by developing projections of future equipment values at lease inception, reevaluating these projections periodically, and effectively deploying remarketing capabilities to recover residual values and potentially earn a profit. In 1995 and 1994, 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, 1994 and 1995. The following table excludes approximately $50 million of estimated residual value associated with non-information technology equipment.

	Total			*Run Out of 1995 Residual Value Balance*			
(DOLLARS IN MILLIONS)	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999 and beyond*
Sales-type leases	$ 760	$ 535	$ 470	$ 165	$ 130	$ 135	$ 40
Operating leases	250	140	295	105	80	90	20
Total residual value	$ 1,010	$ 675	$ 765	$ 270	$ 210	$ 225	$ 60

Lotus Development Corporation

On July 5, 1995, the company acquired all outstanding shares of Lotus for approximately $3.2 billion ($2.9 billion in net cash).

The company engaged a nationally recognized, independent appraisal firm to express an opinion on the fair market value of the assets acquired to serve as a basis for allocation of the purchase price to the various classes of assets. The appraisal included both tangible and identifiable intangible assets, as well as software technology. The company allocated the total purchase price as follows:

(DOLLARS IN MILLIONS)	
Tangible net assets	$ 325
Identifiable intangible assets	542
Current software products	290
Purchased in-process research and development	1,840
Goodwill	540
Deferred tax liabilities related to identifiable intangible assets	(291)
Total	$ 3,246

The tangible net assets consisted primarily of cash, accounts receivable, land, buildings, leasehold improvements and other personal property. The identifiable intangible assets consisted of trademarks ($369 million) and assembled work force, employee agreements, and leasehold interests totaling $173 million. The identifiable intangible assets and goodwill will be amortized on a straight-line basis over a five-year period.

The software technology valuation was accomplished through the application of an income approach. Projected debt-free income, revenue net of provision for operating expenses, income taxes and returns on requisite assets were discounted to a present value. This approach was used for each of the Lotus product lines. Software technology was divided into two categories: current software products and in-process research and development.

Current software products included: "Current products" representing products currently in the marketplace as of the acquisition date and "In development-complete" for products still in the development stage and technologically feasible.

The fair market value of the purchased current software products was determined to be $290 million. This amount was recorded as an asset and is being amortized on a straight-line basis over two years.

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

As a result of the valuation, the fair market value of the purchased in-process research and development was determined to be $1,840 million. In accordance with applicable accounting rules, this amount was expensed upon acquisition in the third quarter of 1995.

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 reflected the impact of certain contractual, employee postemployment, and other obligations, which included amounts for the Advanced Automation System contract for the Federal Aviation Administration. In the fourth quarter of 1995, the company recorded a before-tax gain of $175 million due to the conclusion of those contractual obligations between the company and Loral Corporation. Additionally, as a result of this sale, approximately 10,000 people transferred to Loral, retired, or are on a preretirement leave from the company. The company has concluded all its contractual obligations related to this sale.

In 1993, FSC had, on a stand-alone basis, net earnings of $58 million on revenues of $2.3 billion.

Employees

				Percentage Changes	
	1995	*1994*	*1993*	*1995-94*	*1994-93*
IBM/wholly owned subsidiaries	225,347	219,839	256,207	2.5%	(14.2)%
Less than wholly owned subsidiaries	26,868	23,200	10,989	15.8	111.1
Complementary	38,000	35,000	35,000	8.6	0.0

As of December 31, 1995, regular employees increased 5,508 from 1994 mainly due to hiring in high-growth areas of the business and emerging markets, and to acquisition of business entities, particularly Lotus. Some of these entities, while less than wholly owned, are consolidated into the company's financial statements. The increase of employees in the less than wholly owned subsidiaries category in 1995 is due primarily to MiCRUS, a newly formed U.S. subsidiary with 763 employees, and Technology Service Solutions, an existing U.S. subsidiary with 7,717 employees, an increase of 2,797 employees over last year.

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

Looking Forward

The record revenue the company reported in 1995 is one indication that its fundamental strategies are working. However, there are still many challenges ahead. To remain the leader in translating advanced information technology into value for customers, IBM must be at the forefront of change in the emerging model for network-centric computing. This means constantly improving the company's mix of offerings, continuing the focus on productivity and efficiency improvements, and concentrating on the emerging growth areas around the world. It means identifying solutions and quickly introducing them to the company's portfolio; and sometimes adding business partners, as with the acquisition of Lotus and the announced merger with Tivoli Systems – both leading software companies, with products and technology that complement and strengthen IBM's offerings. There is much opportunity ahead, and the company is prepared to seize it.

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*	*1995*	*1994*	*1993*
Revenue:				
Hardware sales		$ 35,600	$ 32,344	$ 30,591
Services		12,714	9,715	9,711
Software		12,657	11,346	10,953
Maintenance		7,409	7,222	7,295
Rentals and financing	O	3,560	3,425	4,166
Total revenue		71,940	64,052	62,716
Cost:				
Hardware sales		21,862	21,300	20,696
Services		10,042	7,769	8,279
Software		4,428	4,680	4,310
Maintenance		3,651	3,635	3,545
Rentals and financing		1,590	1,384	1,738
Total cost		41,573	38,768	38,568
Gross profit		30,367	25,284	24,148
Operating expenses:				
Selling, general and administrative	I	16,766	15,916	18,282
Research, development and engineering	J	6,010	4,363	5,558
Restructuring charges	K	–	–	8,945
Total operating expenses		22,776	20,279	32,785
Operating income (loss)		7,591	5,005	(8,637)
Other income, principally interest		947	1,377	1,113
Interest expense	L	725	1,227	1,273
Earnings (loss) before income taxes		7,813	5,155	(8,797)
Provision (benefit) for income taxes	H	3,635	2,134	(810)
Net earnings (loss) before change in accounting principle		4,178	3,021	(7,987)
Effect of change in accounting principle	B	–	–	(114)
Net earnings (loss)		4,178	3,021	(8,101)
Preferred stock dividends and transaction costs		62	84	47
Net earnings (loss) applicable to common shareholders		$ 4,116	$ 2,937	$ (8,148)
Per share of common stock amounts:				
Before change in accounting principle		$ 7.23	$ 5.02	$ (14.02)
Effect of change in accounting principle	B	–	–	(.20)
Net earnings (loss) applicable to common shareholders		$ 7.23	$ 5.02	$ (14.22)

Average number of common shares outstanding:
1995 – 569,384,029; 1994 – 584,958,699; 1993 – 573,239,240

The notes on pages 54 through 78 are an integral part of this statement.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
International Business Machines Corporation and Subsidiary Companies

(DOLLARS IN MILLIONS)

At December 31:	*Notes*	*1995*	*1994*
Assets			
Current assets:			
Cash		$ 1,746	$ 1,240
Cash equivalents		5,513	6,682
Marketable securities	X	442	2,632
Notes and accounts receivable – trade, net of allowances		16,450	14,018
Sales-type leases receivable		5,961	6,351
Other accounts receivable		991	1,164
Inventories	D	6,323	6,334
Prepaid expenses and other current assets		3,265	2,917
Total current assets		40,691	41,338
Plant, rental machines and other property	E	43,981	44,820
Less: Accumulated depreciation		27,402	28,156
Plant, rental machines and other property – net		16,579	16,664
Software, less accumulated amortization (1995, $11,276; 1994, $10,793)		2,419	2,963
Investments and sundry assets	F	20,603	20,126
Total assets		$ 80,292	$ 81,091
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	H	$ 2,634	$ 1,771
Short-term debt	G	11,569	9,570
Accounts payable		4,511	3,778
Compensation and benefits		2,914	2,702
Deferred income		3,469	3,475
Other accrued expenses and liabilities		6,551	7,930
Total current liabilities		31,648	29,226
Long-term debt	G	10,060	12,548
Other liabilities	M	14,354	14,023
Deferred income taxes	H	1,807	1,881
Total liabilities		57,869	57,678
Contingencies	N		
Stockholders' equity:			
Preferred stock, par value $.01 per share – shares authorized: 150,000,000 shares issued: 1995 – 2,610,711; 1994 – 11,145,000	S	253	1,081
Common stock, par value $1.25 per share – shares authorized: 750,000,000 shares issued: 1995 – 548,199,013; 1994 – 588,180,244	S	7,488	7,342
Retained earnings		11,630	12,352
Translation adjustments		3,036	2,672
Treasury stock, at cost (shares: 1995 – 424,583; 1994 – 469,500)		(41)	(34)
Net unrealized gain on marketable securities		57	–
Total stockholders' equity		22,423	23,413
Total liabilities and stockholders' equity		$ 80,292	$ 81,091

The notes on pages 54 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:	*1995*	*1994*	*1993*
Cash flow from operating activities:			
Net earnings (loss)	$ 4,178	$ 3,021	$ (8,101)
Adjustments to reconcile net earnings (loss) to cash provided from operating activities:			
Effect of change in accounting principle	–	–	114
Effect of restructuring charges	(2,119)	(2,772)	5,230
Depreciation	3,955	4,197	4,710
Deferred income taxes	1,392	825	(1,335)
Amortization of software	1,647	2,098	1,951
Purchased in-process research and development	1,840	–	–
(Gain) loss on disposition of fixed and other assets	(339)	(11)	151
Other changes that provided (used) cash:			
Receivables	(530)	653	1,185
Inventories	107	1,518	583
Other assets	(1,100)	187	1,865
Accounts payable	659	305	359
Other liabilities	1,018	1,772	1,615
Net cash provided from operating activities	10,708	11,793	8,327
Cash flow from investing activities:			
Payments for plant, rental machines and other property	(4,744)	(3,078)	(3,154)
Proceeds from disposition of plant, rental machines and other property	1,561	900	793
Acquisition of Lotus Development Corporation – net	(2,880)	–	–
Investment in software	(823)	(1,361)	(1,507)
Purchases of marketable securities and other investments	(1,315)	(3,866)	(2,721)
Proceeds from marketable securities and other investments	3,149	2,476	2,387
Proceeds from the sale of Federal Systems Company	–	1,503	–
Net cash used in investing activities	(5,052)	(3,426)	(4,202)
Cash flow from financing activities:			
Proceeds from new debt	6,636	5,335	11,794
Short-term borrowings less than 90 days – net	2,557	(1,948)	(5,247)
Payments to settle debt	(9,460)	(9,445)	(8,741)
Preferred stock transactions – net	(870)	(10)	1,091
Common stock transactions – net	(4,656)	318	122
Cash dividends paid	(591)	(662)	(933)
Net cash used in financing activities	(6,384)	(6,412)	(1,914)
Effect of exchange rate changes on cash and cash equivalents	65	106	(796)
Net change in cash and cash equivalents	(663)	2,061	1,415
Cash and cash equivalents at January 1	7,922	5,861	4,446
Cash and cash equivalents at December 31	$ 7,259	$ 7,922	$ 5,861
Supplemental data:			
Cash paid during the year for:			
Income taxes*	$ 1,453	$ 649	$ 813
Interest	$ 1,720	$ 2,132	$ 2,410

**Prior years restated to include withholding taxes paid on repatriation of dividends and royalties from foreign subsidiaries.*

The notes on pages 54 through 78 are an integral part of this statement.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
International Business Machines Corporation and Subsidiary Companies

(DOLLARS IN MILLIONS)	*Preferred Stock*	*Common Stock*	*Retained Earnings*	*Translation Adjustments*	*Treasury Stock*	*Net Unrealized Gain on Marketable Securities*	*Total*
1993							
Stockholders' equity, January 1, 1993	$ –	$ 6,563	$ 19,124	$ 1,962	$ (25)	$ –	$ 27,624
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
1995							
Net earnings			4,178				4,178
Cash dividends declared – common stock			(572)				(572)
Cash dividends declared – preferred stock			(20)				(20)
Common stock purchased and retired (50,906,300 shares)		(655)	(4,209)				(4,864)
Preferred stock purchased and retired (8,534,289 shares)	(828)		(42)				(870)
Common stock issued under employee plans (4,271,948 shares)		279					279
Purchases (4,662,047 shares) and sales (4,706,964 shares) of treasury stock under employee plans – net			(57)		(7)		(64)
Conversion of debentures (6,653,121 shares)		471					471
Tax reductions – employee plans		51					51
Translation adjustments				364			364
Net unrealized gain on marketable securities						57	57
Stockholders' equity, December 31, 1995	$ 253	$ 7,488	$ 11,630	$ 3,036	$ (41)	$ 57	$ 22,423

The notes on pages 54 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 non-monetary assets and liabilities of non-U.S. subsidiaries and branches that operate in U.S. dollars, or whose economic environment is highly inflationary, are translated at approximate exchange rates prevailing when acquired. All other assets and liabilities are translated at year-end exchange rates. Inventories charged to cost of sales and depreciation are translated at historical exchange rates. All other income and expense items are translated at average rates of exchange prevailing during the year. Gains and losses that result from translation are included in earnings.

Cash Equivalents

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

Inventories

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

Depreciation

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

Software

Costs related to the conceptual formulation and design of licensed programs are expensed as research and development. Costs incurred subsequent to establishment of technological feasibility to produce the finished product are capitalized. The annual amortization of the capitalized amounts is the greater of the amount computed based on the estimated revenue distribution over the products' revenue-producing lives, or the straight-line method, and is applied over periods ranging up to four years. Periodic reviews are performed to ensure that unamortized program costs remain recoverable from future 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 for 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 and transaction costs by the average number of common shares outstanding in the period.

B Accounting Changes

The company implemented new accounting standards in 1995, 1994 and 1993. None of these standards had a material effect on the financial position or results of operations of the company.

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

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

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

In 1995, the company adopted the American Institute of Certified Public Accountants Statement of Position (SOP) 93-7, "Reporting on Advertising Costs." This SOP provides guidance on financial reporting of advertising costs in annual financial statements. The company was generally in conformance with this SOP prior to adoption.

Effective January 1, 1994, the company implemented SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities." This standard addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities.

Effective January 1, 1993, the company implemented SFAS 112, "Employers' Accounting for Postemployment Benefits." While the company was generally in conformance 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.

In October 1995, the Financial Accounting Standards Board issued SFAS 123, "Accounting for Stock Based Compensation," which is effective for 1996. Under SFAS 123, companies can elect, but are not required, to recognize compensation expense for all stock-based awards, using a fair value methodology. The company expects to implement in 1996 the disclosure only provisions, as permitted by SFAS 123.

C Risks and Uncertainties

The company is a leader in the creation, development and manufacture of advanced information technologies, including computer systems, software, networking systems, storage devices and microelectronics. These advanced technologies are translated into value for our customers worldwide through our sales and professional services units in more than 150 countries. At December 31, 1995, approximately 65 percent of the company's net assets were located outside the United States, primarily in the major economically developed countries of Europe and Asia, with the highest being approximately 15 percent in Japan. Additional geographic information on the company's assets can be found in note AA on pages 77 and 78.

The diversity and breadth of the company's product and services offerings, customers, and geographic operations mitigate significantly the risk that a severe impact will occur in the near term as a result of changes in its customer base, competition, sources of supply, or composition of its markets. As a result, it is unlikely that any one event, such as loss of any individual customer or supplier, entrance of new competitors into specific markets, or decline in business conditions in particular markets would have a severe impact on the company's operating results.

Management uses estimates in preparing the consolidated financial statements, in conformity with generally accepted accounting principles. Significant estimates include collectibility of accounts receivable, warranty costs, profitability on long-term contracts, as well as recoverability of capitalized software costs, long-term fixed assets and residual values. The company regularly assesses these estimates and, while actual results may differ from these estimates, management believes that material changes will not occur in the near term.

D Inventories

(DOLLARS IN MILLIONS)	At December 31: 1995	1994
Finished goods	$ 1,241	$ 1,442
Work in process	4,990	4,636
Raw materials	92	256
Total	$ 6,323	$ 6,334

E Plant, Rental Machines and Other Property

(DOLLARS IN MILLIONS)	At December 31: 1995	1994
Land and land improvements	$ 1,348	$ 1,437
Buildings	12,653	13,093
Plant, laboratory and office equipment	26,658	27,084
	40,659	41,614
Less: Accumulated depreciation	25,604	26,299
	15,055	15,315
Rental machines and parts	3,322	3,206
Less: Accumulated depreciation	1,798	1,857
	1,524	1,349
Total	$ 16,579	$ 16,664

F Investments and Sundry Assets

(DOLLARS IN MILLIONS)	At December 31: 1995	1994*
Net investment in sales-type leases**	$ 14,007	$ 14,751
Less: Current portion – net	5,961	6,351
	8,046	8,400
Deferred taxes	3,376	4,533
Prepaid pension cost	2,535	1,528
Non-current customer loan receivables	2,390	2,398
Installment payment receivables	844	817
Investments in business alliances	509	380
Goodwill, less accumulated amortization (1995, $913; 1994, $648)	870	427
Other investments and sundry assets	2,033	1,643
Total	$ 20,603	$ 20,126

*Reclassified to conform to 1995 presentation.

**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 $470 million and $535 million at December 31, 1995 and 1994, respectively, and is reflected net of unearned income at these dates of approximately $2,100 million and $2,600 million, respectively. Scheduled maturities of minimum lease payments outstanding at December 31, 1995, expressed as a percentage of the total, are approximately as follows: 1996, 45 percent; 1997, 30 percent; 1998, 17 percent; 1999, 7 percent; and 2000 and after, 1 percent.

G Debt

Short-term debt

(DOLLARS IN MILLIONS)	At December 31: 1995	1994
Commercial paper	$ 4,933	$ 2,544
Short-term loans	3,755	2,977
Long-term debt: Current maturities	2,881	4,049
Total	$ 11,569	$ 9,570

The weighted-average interest rates for commercial paper at December 31, 1995 and 1994, were approximately 5.7 percent and 4.9 percent, respectively. The weighted-average interest rates for short-term loans at December 31, 1995 and 1994, were approximately 6.6 percent for both years.

Long-term debt

(DOLLARS IN MILLIONS)	Maturities	At December 31: 1995	1994
U.S. Dollars:			
Debentures:			
7%	2025	$ 600	$ –
7%	2045	150	–
7-1/2%	2013	550	550
8-3/8%	2019	750	750
Notes :			
5-1/2% to 7-1/2%	1996-2002	3,025	3,325
7-1/2% to 9-1/2%	1996-2001	186	641
Medium-term note program: 5.8% average	1996-2008	1,730	2,803
Other U.S. dollars: 5.4% to 7.9%	1996-2012	416	558
		7,407	8,627
Other currencies (average interest rate at December 31, 1995, in parentheses):			
Japanese yen (3.6%)	1996-2014	4,149	4,769
Swiss francs (5.1%)	1996	43	629
European currency units (9.1%)	1995	–	400
Canadian dollars (10.1%)	1996-1999	431	638
French francs (9.7%)	1996-2002	358	858
Australian dollars (7.8%)	1996-1998	320	326
Other (10.1%)	1996-2017	256	371
		12,964	16,618
Less: Net unamortized discount		23	21
		12,941	16,597
Less: Current maturities		2,881	4,049
Total		$ 10,060	$ 12,548

Annual maturity and sinking fund requirements in millions of dollars on long-term debt outstanding at December 31, 1995, are as follows: 1996, $2,881; 1997, $3,197; 1998, $1,500; 1999, $440; 2000, $1,783; 2001 and beyond, $3,163.

H Taxes

(DOLLARS IN MILLIONS)	1995	1994	1993
For the year ended December 31:			
Earnings (loss) before income taxes:			
U.S. operations	$ 2,149	$ 1,574	$ (6,073)
Non-U.S. operations	5,664	3,581	(2,724)
	$ 7,813	$ 5,155	$ (8,797)
The provision (benefit) for income taxes by geographic operations is as follows:			
U.S. operations	$ 1,538	$ 654	$ (505)
Non-U.S. operations	2,097	1,480	(305)
Total provision (benefit) for income taxes	$ 3,635	$ 2,134	$ (810)
The components of the provision (benefit) for income taxes by taxing jurisdiction are as follows:			
U.S. federal:			
Current	$ 85	$ 49	$ (4)
Deferred	1,075	74	(890)
Net deferred investment tax credits	–	–	(51)
	1,160	123	(945)
U.S. state and local:			
Current	65	68	26
Deferred	–	–	23
	65	68	49
Non-U.S.:			
Current	2,093	1,192	554
Deferred	317	751	(468)
	2,410	1,943	86
Total provision (benefit) for income taxes	3,635	2,134	(810)
Social security, real estate, personal property and other taxes	2,566	2,465	2,614
Total taxes	$ 6,201	$ 4,599	$ 1,804

The effect of tax law changes on deferred tax assets and liabilities did not have a significant impact on the company's effective tax rate in 1995 and 1994 and had a beneficial impact of $170 million in 1993.

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

(DOLLARS IN MILLIONS)	At December 31: 1995	1994*
Deferred Tax Assets		
Retiree medical benefits	$ 2,632	$ 2,500
Restructuring charges	2,003	2,446
Capitalized research and development	1,772	2,057
Foreign tax credits	1,183	1,380
Alternative minimum tax credits	859	738
Inventory	674	633
Doubtful accounts	517	453
General business credits	452	452
Equity alliances	407	445
Employee benefits	405	363
Intracompany sales and services	325	357
Foreign tax loss carryforwards	303	469
State and local tax loss carryforwards	236	370
Warranty	233	163
Software income deferred	205	199
Depreciation	172	249
Retirement benefits	101	127
U.S. federal tax loss carryforwards	–	230
Other	2,800	2,564
Gross deferred tax assets	15,279	16,195
Less: Valuation allowance	3,868	4,551
Total deferred tax assets	$ 11,411	$ 11,644
Deferred Tax Liabilities		
Sales-type leases	$ 2,898	$ 2,862
Retirement benefits	1,919	1,061
Depreciation	1,787	1,653
Software costs deferred	967	1,283
Other	1,320	823
Gross deferred tax liabilities	$ 8,891	$ 7,682

**Reclassified to conform to 1995 presentation.*

The estimated reversal periods for the largest deductible temporary differences are: Retiree Medical – 1 to 30 years; Restructuring – 1 to 7 years.

The valuation allowance applies to U.S. federal tax credits, state and local net deferred tax assets and net operating loss carryforwards, and net operating losses in certain foreign jurisdictions that may expire before the company can utilize them. The net change in the total valuation allowance for the year ended December 31, 1995, was a decrease of $683 million, of which approximately $600 million was due to the realization of previously unrecognized benefits in the current year. It is reasonably possible that the deferred tax asset valuation allowance could decrease significantly in the near term, depending on the company's ability to generate sufficient taxable income in multiple tax jurisdictions.

The consolidated effective income tax rate was 47 percent in 1995, 41 percent in 1994 and (9) percent in 1993.

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:	*1995*	*1994**	*1993**
Statutory rate	35%	35%	(35)%
U.S. valuation allowance	(2)	–	20
Foreign tax differential	2	5	7
State and local – net	1	1	–
Other	2	–	(1)
Effective rate before purchased in-process research and development	38%	41%	(9)%
Purchased in-process research and development	9	–	–
Effective rate	47%	41%	(9)%

**Reclassified to conform to 1995 presentation.*

For tax return purposes, the company has available tax credit carryforwards of approximately $2,866 million, of which $67 million expire in 1996, $776 million expire in 1998, $692 million expire in 1999 and the remainder thereafter. The company also has state and local, and foreign tax loss carryforwards, the tax effect of which is $539 million. Most of these carryforwards are available for ten or more years.

Undistributed earnings of non-U.S. subsidiaries included in consolidated retained earnings amounted to $12,565 million at December 31, 1995, $11,280 million at December 31, 1994 and $10,915 million at December 31, 1993. 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 Advertising

The company expenses advertising costs as incurred. Advertising expense amounted to $1,219 million, $977 million and $716 million in 1995, 1994 and 1993, respectively.

J Research, Development and Engineering

Research, development and engineering expenses amounted to $6,010 million in 1995, $4,363 million in 1994 and $5,558 million in 1993. Expenditures for product-related engineering included in these amounts were $783 million, $981 million and $1,127 million in 1995, 1994 and 1993, respectively.

Expenditures of $5,227 million in 1995, $3,382 million in 1994 and $4,431 million in 1993 were made for research and development activities covering basic scientific research and the application of scientific advances to the development of new and improved products and their uses. Of these amounts, software-related activities were $2,997 million, $793 million and $1,097 million in 1995, 1994 and 1993, respectively.

Included in the 1995 research, development and engineering expenses as part of software-related activities was a $1,840 million charge for purchased in-process research and development in connection with the acquisition of Lotus in July 1995.

K 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. As of December 31, 1995, the company had utilized all of the restructuring reserve balances except $225 million, which is necessary for actions that have been delayed into 1996.

Remaining cash outlays associated with work-force-related activities are expected to total $2.0 billion, of which $.5 billion will be expended in 1996. 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. Cash requirements related to excess space charges are expected to be expended as follows: $413 million in 1996, $321 million in 1997, $282 million in 1998 and $851 million in 1999 and beyond.

L Interest on Debt

Interest paid and accrued on borrowings of the company and its subsidiaries amounted to $1,600 million in 1995, $2,006 million in 1994 and $2,298 million in 1993. Of these amounts, $23 million in 1995, $20 million in 1994 and $46 million in 1993 were capitalized. The remainder was charged to cost of rentals and financing, and interest expense. The lower levels of expense were a result of lower average interest rates and a decrease of total debt outstanding of $.5 billion in 1995 versus 1994 and a decrease of total debt outstanding of $5.2 billion in 1994 versus 1993. The average interest rate for total debt was 7.2 percent, 8.0 percent and 7.7 percent in 1995, 1994 and 1993, respectively.

M 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 U, "Nonpension Postretirement Benefits," on pages 70 through 72; note T, "Retirement Plans," on pages 68 through 70; and note K, "Restructuring Actions," above.

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 $223 million and $179 million at December 31, 1995 and 1994, respectively. The increase in the accrual relates to expected costs of post-closure activities and reassessment of remediation activities at operating facilities.

The amounts accrued do not cover sites that are in the preliminary stages of investigation where neither the company's percentage of responsibility nor the extent of cleanup required has been identified. Also excluded is the cost of internal environmental protection programs that are primarily preventive in

nature. Estimated environmental costs are not expected to materially impact the financial position or results of the company's operations in future periods. However, environmental cleanup periods are protracted in length, and environmental costs in future periods are subject to changes in environmental remediation regulations.

N Contingencies

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

O Customer Financing

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

The following schedules reflect the financial position, 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, development and services businesses, management believes that the aforementioned type of comparative disclosure enhances the understanding and analysis of the consolidated financial statements.

Statement of Financial Position

At December 31: (DOLLARS IN MILLIONS)	*Customer Financing* 1995	*Customer Financing* 1994*	*IBM with Customer Financing on an Equity Basis* 1995	*IBM with Customer Financing on an Equity Basis* 1994*
Assets:				
Cash and cash equivalents	$ 808	$ 1,304	$ 6,451	$ 6,618
Notes and accounts receivable	–	–	10,981	10,729
Net investment in sales-type leases	14,096	14,890	–	–
Working capital financing receivables	3,886	2,539	–	–
Loans receivable	5,481	4,997	–	–
Inventories	87	101	6,252	6,246
Plant, rental machines and other property, net of accum. depreciation	2,924	2,672	15,101	15,319
Other assets	2,164	2,167	13,901	15,389
Investment in customer financing	–	–	4,768	4,175
Total assets	$ 29,446	$ 28,670	$ 57,454	$ 58,476
Liabilities and stockholders' equity:				
Taxes, accrued expenses and other liabilities	$ 6,592	$ 6,487	$ 33,124	$ 32,109
Debt	19,722	19,164	1,907	2,954
Total liabilities	26,314	25,651	35,031	35,063
Stockholders' equity/invested capital	3,132	3,019	22,423	23,413
Total liabilities and stockholders' equity	$ 29,446	$ 28,670	$ 57,454	$ 58,476

**Reclassified to conform to 1995 presentation.*

Statement of Operations

For the year ended December 31:	*Customer Financing*			*IBM with Customer Financing on an Equity Basis*		
(DOLLARS IN MILLIONS)	*1995*	*1994*	*1993*	*1995*	*1994*	*1993*
Finance and other income:						
Finance income	$ 2,110	$ 2,026	$ 2,485	$ –	$ –	$ –
Rental income, net of depreciation	415	338	285	469	589	692
Sales	1,001	1,160	1,391	67,588	59,991	57,483
Other income	367	933	850	1,473	1,423	1,184
Total finance and other income	3,893	4,457	5,011	69,530	62,003	59,359
Interest and other costs and expenses	2,782	3,245	3,994	61,717	56,848	68,156
Net earnings (loss) before income taxes	1,111	1,212	1,017	7,813	5,155	(8,797)
Provision (benefit) for income taxes	428	505	443	3,635	2,134	(810)
Net earnings (loss) before change in accounting principle	683	707	574	4,178	3,021	(7,987)
Effect of change in accounting principle	–	–	–	–	–	(114)
Net earnings (loss)	$ 683	$ 707	$ 574	$ 4,178	$ 3,021	$ (8,101)

Statement of Cash Flows

For the year ended December 31:	*Customer Financing*			*IBM with Customer Financing on an Equity Basis*		
(DOLLARS IN MILLIONS)	*1995*	*1994*	*1993*	*1995*	*1994*	*1993*
Net cash provided from operating activities	$ 3,712	$ 2,669	$ 3,004	$ 9,250	$ 8,393	$ 4,499
Net cash used in investing activities	(3,968)	(249)	(284)	(3,338)	(2,446)	(3,094)
Net cash used in financing activities	(198)	(3,294)	(1,680)	(6,186)	(3,118)	(234)
Effect of exchange rate changes on cash and cash equivalents	(42)	82	(47)	107	24	(749)
Net change in cash and cash equivalents	(496)	(792)	993	(167)	2,853	422
Cash and cash equivalents at January 1	1,304	2,096	1,103	6,618	3,765	3,343
Cash and cash equivalents at December 31	$ 808	$ 1,304	$ 2,096	$ 6,451	$ 6,618	$ 3,765

Customer financing debt at December 31, 1995, consisted of borrowings with external financial institutions of $15,418 million and intracompany borrowings of $4,304 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 22.6 percent in 1995, compared to 24.5 percent in 1994. 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 included income resulting from IBM Credit Corporation's litigation settlement with Comdisco, Inc., and from IBM Credit Corporation's sale of IBM Credit Investment Management Corporation.

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.

P Rental Expense and Lease Commitments

Rental expense, including amounts charged to inventories and fixed assets and excluding amounts charged to restructuring, was $1,145 million in 1995, $1,276 million in 1994 and $1,686 million in 1993. The table below depicts gross minimum rental commitments, under non-cancelable leases; amounts related to vacant space, which the company had reserved for in restructuring charges and other actions; and sublease income commitments. These amounts generally reflect activities related to office space.

(DOLLARS IN MILLIONS)	*1996*	*1997*	*1998*	*1999*	*2000*	*Beyond 2000*
Gross rental commitments	$ 1,191	$ 1,035	$ 930	$ 794	$ 694	$ 2,263
Vacant space	424	374	333	259	236	590
Sublease income commitments	105	94	82	68	60	109

Q Long-Term Performance Plan

Incentive awards are provided to officers and other key employees under the terms of the IBM 1994 Long-Term Performance Plan (the "Plan"), which was approved by stockholders in April 1994. The Plan is administered by the Executive Compensation and Management Resources Committee of the Board of Directors. The committee determines the type and certain terms, including vesting provisions of the award to be granted, which may include stock, restricted stock, stock options, Stock Appreciation Rights (SARs), 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 approximated 5 percent of the outstanding common stock as determined on February 10, 1994. Prior to April 25, 1994, awards were issued under the IBM 1989 Long-Term Performance Plan 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 optionees upon exercise of an option may be made using IBM stock, as well as cash.

SARs provide eligible employees the difference between the average IBM stock price on the date of grant and the average market price of the stock on the date of exercising the right. SARs can be issued in tandem or combination with options, and payment can be made to the employee in cash and/or stock of equivalent value, at the company's discretion. There were approximately 2.7 million SARs outstanding at December 31, 1995, that were issued in 1993 at $46.31 in combination with options. Under the terms of the award, the SARs vest over four years and expire in 2003.

The following table summarizes option activity of the Long-Term Performance Plans during 1995, 1994 and 1993:

Number of shares under option	*1995*	*1994*	*1993*
Balance at January 1	34,063,317	29,260,724	35,621,963
Options granted	6,468,702	6,863,219	13,744,772
Options exercised	(3,695,789)	(235,044)	–
Options terminated	(2,553,327)	(1,825,582)	(20,106,011)
Balance at December 31	34,282,903	34,063,317	29,260,724
Exercisable at December 31	19,176,410	16,666,537	14,636,324

In April 1993, the Nominating and Executive Compensation Committee, the committee of the Board of Directors then responsible for administering the plan, 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 1995 and 1994 were at an average option price of $50.76 and $46.42 per share, respectively. There were no options exercised in 1993. The shares under option at December 31, 1995, were at the following exercise prices*:

	Options Outstanding			*Options Currently Exercisable*	
	No. of Options	*Wtd. Avg. Exercise Price*	*Wtd. Avg. Contractual Life (in years)*	*No. of Options*	*Wtd. Avg. Exercise Price*
$ 43 – 80	20,914,604	$ 57	8	6,630,591	$ 50
$ 81 – 90	2,763,325	89	6	2,545,045	90
$ 91 – 100	2,538,160	96	5	2,003,960	97
$101 – 120	4,365,299	111	3	4,295,299	111
$121 – 160	3,701,515	137	3	3,701,515	137
	34,282,903			19,176,410	

**Shares under option at December 31, 1994 and 1993, were at option prices ranging from $43.00 to $159.50 per share.*

There were 20,975,229 and 27,842,801 unused shares available for granting under the 1994 Long-Term Performance Plan as of December 31, 1995 and 1994, respectively. As of December 31, 1993, there were 6,011,858 shares available under the 1989 Long-Term Performance Plan.

R Stock Purchase Plan

The IBM Employees 1995 Stock Purchase Plan enables employees and selected officers and executives to purchase full or fractional shares of IBM common stock through payroll deductions of up to 10 percent of eligible compensation. The price an employee pays is 85 percent of the average market price on the last day of an applicable pay period.

During 1995, employees purchased 4,479,340 shares, all of which were treasury shares, for which $344 million was paid to IBM. There were 23,312,881 reserved unissued shares available for purchase under the plan at December 31, 1995.

S Stock Repurchase Programs

During 1995, the IBM Board of Directors authorized the company to purchase up to $7.5 billion of IBM common stock. The company repurchased 50,906,300 shares at a cost of $4,864 million during 1995, which resulted in a reduction of $63,632,875 in the stated capital (par value) associated with common stock. No shares were repurchased in 1994 or 1993. The repurchased shares were retired and restored to the status of authorized but unissued shares. The company plans to purchase shares on the open market from time to time, depending on market conditions.

Also during 1995, the IBM Board of Directors authorized the company to purchase all of its outstanding Series A 7 1/2 percent preferred stock depositary shares. The company repurchased 8,534,289 shares at a cost of $870 million during 1995, which resulted in a reduction of $85,343 in the stated capital (par value) associated with preferred stock. The repurchased shares were retired and restored to the status of authorized but unissued shares. The company plans to purchase remaining shares on the open market and in private transactions from time to time, depending on market conditions.

T Retirement Plans

The company and its subsidiaries have defined benefit retirement plans covering substantially all regular employees. The total cost of all plans for 1995, 1994 and 1993 was $165 million, $681 million and $1,525 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*		
	1995	*1994*	*1993*	*1995*	*1994*	*1993*
Expected long-term rate of return on plan assets	9.25%	9.5%	9.5%	6.25-10%	5.5-9%	5-10%
(DOLLARS IN MILLIONS)						
Service cost:						
Benefits earned during the period	$ 315	$ 542	$ 571	$ 386	$ 467	$ 576
Termination incentive expenses	–	–	263	–	–	–
Interest cost on the projected benefit obligation	2,098	2,033	1,909	1,325	1,107	1,064
Return on plan assets:						
Actual	(5,500)	327	(3,990)	(1,848)	329	(3,036)
Deferred	2,958	(2,826)	1,605	403	(1,540)	1,891
Net amortizations	(123)	(65)	(62)	12	19	12
Curtailment losses	–	–	431	128	269	215
Net periodic pension cost	$ (252)	$ 11	$ 727	$ 406	$ 651	$ 722
Total net periodic pension cost for all non-U.S. plans				$ 417	$ 667	$ 798

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 in 1993 represented 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. In 1993, the curtailment losses and termination charges, referred to above, were included in restructuring charges.

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, 1995 and 1994, the projected benefit obligation was $82 million and $64 million, respectively. The net unrecognized costs of the SERP were $64 million and $61 million, and the amounts included in the Consolidated Statement of Financial Position were pension liabilities of $18 million and $3 million as of December 31, 1995 and 1994, respectively. These amounts are in addition to the U.S. retirement plan financial information included herein.

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

The funded status at December 31 was as follows:

	U.S. Plan		*Non-U.S. Plans*	
	1995	*1994*	*1995*	*1994*
Assumptions:				
Discount rate	7.25%	8.25%	4.5-9%	5.0-9.0%
Long-term rate of compensation increase	5.0%	5.0%	1.5-6.5%	2.8-7.0%
(DOLLARS IN MILLIONS)				
Actuarial present value of benefit obligations:				
Vested benefit obligation	$ (26,413)	$ (22,553)	$ (17,788)	$ (15,454)
Accumulated benefit obligation	$ (28,070)	$ (24,186)	$ (18,771)	$ (16,743)
Projected benefit obligation	$ (30,235)	$ (25,783)	$ (20,294)	$ (18,751)
Plan assets at fair value	31,209	26,780	19,693	17,424
Projected benefit obligation less than (in excess of) plan assets	974	997	(601)	(1,327)
Unrecognized net loss (gain)	1,976	1,224	(436)	(17)
Unrecognized prior service cost	230	248	267	276
Unrecognized net asset established at January 1, 1986	(1,193)	(1,334)	(143)	(152)
Prepaid pension cost (pension liability) recognized in the Consolidated Statement of Financial Position	$ 1,987	$ 1,135	$ (913)	$ (1,220)

The effect on the company's results of operations and financial condition from changes in the estimates and assumptions used in computing pension expense and prepaid pension cost or pension liability is mitigated by the delayed recognition provisions of SFAS 87, "Employers' Accounting for Pensions," with the exception of the effects of curtailments and early terminations, which are recognized immediately.

The U.S. plan's projected benefit obligation increased in 1995 primarily as a result of a change in the discount rate assumption, which increased the projected benefit obligation $3,217 million.

It is the company's practice to fund amounts for pensions sufficient to meet the minimum requirements set forth in applicable employee benefit laws and with regard to local tax laws. Additional amounts are contributed from time to time when deemed appropriate by the company. Liabilities for amounts in excess of these funding levels are accrued and reported in the company's Consolidated Statement of Financial Position. 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 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. In 1994, the company announced major changes to the plan that took effect in 1995. Under a new formula, which is being phased in over five years, retirement benefits will be determined based on points accumulated for each year worked and final average compensation. 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, these 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, 1995 and 1994, was 92,133 and 85,009, 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.

U Nonpension Postretirement Benefits

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

The accumulated postretirement benefit obligation was determined by application of the terms of medical, dental and life insurance plans, including the effects of established maximums on covered costs, together with relevant actuarial assumptions. These actuarial assumptions included a projected healthcare cost trend rate of 6 percent.

The effect of a 1 percent annual increase in the assumed healthcare cost trend rate would increase the accumulated postretirement benefit obligation at December 31, 1995, by approximately $35 million; the 1995 annual costs would not be materially affected.

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

	1995	*1994*	*1993*
Expected long-term rate of return on plan assets	9.25%	9.5%	9.5%
(DOLLARS IN MILLIONS)			
Service cost	$ 40	$ 51	$ 53
Interest cost on the accumulated postretirement benefit obligation	520	512	566
Return on plan assets:			
Actual	(198)	22	(201)
Deferred	116	(125)	84
Net amortizations and other	(123)	(38)	29
Curtailment loss	–	–	732
Net periodic postretirement benefit cost	$ 355	$ 422	$ 1,263

In the Consolidated Statement of Operations for 1993, the curtailment loss referred to above was included with restructuring charges.

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

The funded status at December 31 was as follows:

	1995	*1994*
Assumed discount rate	7.25%	8.25%
(DOLLARS IN MILLIONS)		
Accumulated postretirement benefit obligation:		
Retirees	$ (5,661)	$ (5,411)
Fully eligible active plan participants	(704)	(567)
Other active plan participants	(653)	(530)
Total	(7,018)	(6,508)
Plan assets at fair value	886	1,028
Accumulated postretirement benefit obligation in excess of plan assets	(6,132)	(5,480)
Unrecognized net loss	718	505
Unrecognized prior service cost	(660)	(744)
Accrued postretirement benefit cost recognized in the Consolidated Statement of Financial Position	$ (6,074)	$ (5,719)

In 1995, the increase in the accumulated postretirement benefit obligation of $510 million resulted principally from the change in the assumed discount rate, partially offset by a decrease in the projected healthcare cost trend rate and plan cost experience.

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.

V Lines of Credit

In December 1993, as part of IBM's ongoing efforts toward greater efficiency of its treasury activities, and to ensure appropriate liquidity levels, 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, 1995, were $14.6 billion, compared to $15.1 billion at December 31, 1994. Interest rates on borrowings vary from country to country depending on local market conditions.

W Sale and Securitization of Receivables

The company received total cash proceeds of approximately $3.4 billion and $12.6 billion in 1995 and 1994, respectively, from the sale and securitization of primarily trade receivables. At year-end 1995, the company had a net balance of $1.2 billion in assets under management from the securitization of lease and trade receivables, compared to $1.8 billion at year-end 1994. 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.

X Financial Instruments

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

In assessing the fair value of these financial instruments, both derivative and non-derivative, the company has used a variety of methods and assumptions, which were based on estimates of market conditions and risks existing at December 31, 1995 and 1994. Quoted market prices or dealer quotes for the same or similar instrument were used for the majority of marketable securities, long-term investments and long-term debt. Other techniques, such as option pricing models, estimated discounted value of future cash flows, replacement cost and termination cost, have been used to determine fair value for the remaining financial instruments. These values represent a general approximation of possible value and may never actually be realized.

Financial Instruments On-Balance Sheet (excluding derivatives)

Financial assets for which carrying values approximate fair value include cash and cash equivalents, marketable securities, notes and other accounts receivable and other investments.

Financial liabilities for which carrying values approximate fair value include accounts payable and other accrued expenses and liabilities, as well as short-term debt. The fair value of the company's long-term debt was approximately $10,100 million and $12,000 million at December 31, 1995 and 1994, respectively.

The company originates financing for customers in a variety of industries throughout the world, and has a diversified portfolio of capital equipment financing for end users and working capital financing for dealers. With the growth of the company's working capital financing business, the concentration of such financings for certain large dealers and remarketers of information industry products has become more significant. Such loans are typically 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.

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

Marketable securities and other investments

At December 31:

(DOLLARS IN MILLIONS)	*Carrying Value* 1995	1994*
Current marketable securities:		
U.S. government securities	$ 222	$ 1,020
Time deposits and other bank obligations	93	459
Non-U.S. government securities and other fixed-term obligations	127	1,153
Total	$ 442	$ 2,632
Non-current marketable securities:**		
Time deposits and other bank obligations	$ 97	$ –
Non-U.S. government securities and other fixed-term obligations	72	82
Total	$ 169	$ 82
Other investments:**		
Alliance investments on cost method	$ 128	$ 121

**Reclassified to conform to 1995 presentation.*
***Included within Investments and Sundry Assets on the Consolidated Statement of Financial Position.*

Financial Instruments Off-Balance Sheet (excluding derivatives)

IBM has guaranteed certain loans and financial commitments of affiliates. The fair market values of these financial guarantees were $794 million and $727 million at December 31, 1995 and 1994, respectively. Additionally, the company is contingently liable for commitments of various ventures to which it is a party and for certain receivables sold with recourse. These commitments, which in the aggregate were approximately $200 million and $900 million at December 31, 1995 and 1994, respectively, are not expected to have a material adverse effect on the company's financial position or results of operations.

The company's dealers had unused lines of credit available from IBM for working capital financing of approximately $1.0 billion and $.9 billion at December 31, 1995 and 1994, respectively.

Derivative Financial Instruments

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

	At December 31, 1995			*At December 31, 1994**		
(DOLLARS IN MILLIONS)	*Notional Value*	*Carrying Value*	*Fair Value***	*Notional Value*	*Carrying Value*	*Fair Value***
Interest rate and currency contracts	$ 13,600	$ (88)	$ (161)	$ 19,800	$ 2	$ 201
Option contracts	4,800	18	41	4,400	8	8
Total	$ 18,400	$ (70)	$ (120)	$ 24,200	$ 10	$ 209

Bracketed amounts are liabilities.
**Reclassified to conform to 1995 presentation.*
***The estimated fair value of derivatives both on- and off-balance sheet at December 31, 1995 and 1994, consists of assets of $153 million and $448 million and liabilities of $273 million and $239 million, respectively.*

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

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

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

Interest and currency rate differentials accruing under interest rate and currency contracts related to the customer financing business are recognized over the life of the contracts in interest expense, and the effects of contracts related to intracompany funding are recognized over the life of the contract in interest income. For purchased options that hedge anticipated transactions, gains and losses are deferred and recognized in other income in the same period that the underlying transaction occurs or expires. At December 31, 1995 and 1994, there were no material deferred gains or losses. The premiums associated with entering into option contracts are generally amortized over the life of the options and are not material to the company's results. Unamortized premiums are included in prepaid assets. All written options are marked to market monthly and are not material to the company's results.

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

Y Segment Information

IBM is in the business of providing customer solutions through the use of advanced information technologies. The company operates primarily in the single industry segment that creates value by offering a variety of solutions that include, either singularly or in some combination, services, software, systems, products, financing and technologies. The schedule on page 76 shows revenue by classes of similar products or services. Financial information by geographic area is summarized in note AA on pages 77 and 78.

For purposes of classifying similar information technology products, general purpose computer systems that operate on a large class of applications are classified as processor servers when the systems are simultaneously used by multiple users at one time, or as clients when the systems are used by one user at a time. Servers include the System/390, POWERparallel, AS/400, RISC System/6000 and personal computer server products. Personal systems clients include personal computers and RISC System/6000 client products. Other clients include display-based terminals and consumer and financial systems. Storage consists of externally attached direct access storage devices 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)	*1995*	*1994**	*1993**	*1995*	*1994**	*1993**
Information technology:						
Processors:						
Servers**	$ 12,597	$ 11,553	$ 11,869	$ 4,464	$ 3,958	$ 4,003
Clients:						
Personal systems**	11,199	9,731	8,269	4,401	4,046	3,754
Other clients**	1,478	1,538	2,006	480	463	689
Peripherals:						
Storage**	3,306	3,551	4,808	1,121	1,375	1,898
Other peripherals**	2,085	2,006	2,149	764	810	901
OEM hardware	4,490	3,248	1,293	2,824	1,677	726
Services	12,714	9,715	7,648	4,606	3,709	3,037
Software	12,657	11,346	10,953	4,117	3,926	3,898
Maintenance	7,409	7,222	7,295	2,618	2,648	2,726
Financing and other	4,005	4,142	4,109	1,394	1,506	1,754
Subtotal	71,940	64,052	60,399	26,789	24,118	23,386
Federal Systems Company	–	–	2,317	–	–	2,317
Total	$ 71,940	$ 64,052	$ 62,716	$ 26,789	$ 24,118	$ 25,703

**Reclassified to conform to 1995 presentation.*
***Hardware only, includes applicable rental revenue, excludes functions not embedded, software and maintenance.*

Z Subsequent Events

On January 31, 1996, the company announced it had entered into a definitive merger agreement under which the company will commence a cash tender offer for Tivoli Systems Inc. at $47.50 per share. Tivoli, based in Austin, Texas, is a leading provider of systems management software and services that help customers reduce the cost and complexity of managing distributed client/server networks of personal computers and workstations.

The net cash cost of the transaction to the company is expected to be $743 million, including the purchase of Tivoli's outstanding shares, the vesting of a portion of the employee stock options, fees and expenses, less Tivoli's current cash.

When the merger is completed, it will result in a one-time charge to the company's earnings. The charge primarily involves expensing, as called for by accounting requirements, of amounts assigned to research and development of Tivoli software that has not reached technological feasibility. The charge will be taken in the quarter in which the merger is completed. The specific amount of the charge cannot be determined at this time based on currently available information.

AA Geographic Areas

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

Non-U.S. subsidiaries operating in local currency environments account for approximately 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 1995, 1994 and 1993.

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)	*1995*	*1994*	*1993**
United States			
Revenue – Customers	$ 26,789	$ 24,118	$ 25,703
Interarea transfers	10,553	6,336	7,297
Total	$ 37,342	$ 30,454	$ 33,000
Net earnings (loss)	599	969	(5,566)
Assets at December 31	38,584	37,156	38,333
Europe/Middle East/Africa			
Revenue – Customers	$ 25,238	$ 23,034	$ 21,779
Interarea transfers	2,530	1,787	1,071
Total	$ 27,768	$ 24,821	$ 22,850
Net earnings (loss)	2,271	1,086	(1,695)
Assets at December 31	24,066	25,816	24,566
Asia Pacific			
Revenue – Customers	$ 13,892	$ 11,365	$ 10,020
Interarea transfers	2,698	1,876	1,452
Total	$ 16,590	$ 13,241	$ 11,472
Net earnings (loss)	1,098	567	(443)
Assets at December 31	12,789	12,619	12,778
Americas			
Revenue – Customers	$ 6,021	$ 5,535	$ 5,214
Interarea transfers	5,333	4,257	3,458
Total	$ 11,354	$ 9,792	$ 8,672
Net earnings (loss)	324	498	(251)
Assets at December 31	7,530	7,783	7,359
Eliminations			
Revenue	$ (21,114)	$ (14,256)	$ (13,278)
Net earnings	(114)	(99)	(32)
Assets	(2,677)	(2,283)	(1,923)
Consolidated			
Revenue	$ 71,940	$ 64,052	$ 62,716
Net earnings (loss)	4,178	3,021	(7,987)
Assets at December 31	80,292	81,091	81,113

**Net (loss) before effect of change in accounting for postemployment benefits.*

Five-Year Comparison of Selected Financial Data

(DOLLARS IN MILLIONS EXCEPT PER SHARE AMOUNTS)	1995	1994	1993	1992	1991
For the year:					
Revenue	$ 71,940	$ 64,052	$ 62,716	$ 64,523	$ 64,766
Net earnings (loss) before changes in accounting principles	4,178	3,021	(7,987)	(6,865)	(598)
Per share of common stock	7.23	5.02	(14.02)	(12.03)	(1.05)
Effect of accounting changes*	–	–	(114)	1,900	(2,263)
Per share of common stock	–	–	(.20)	3.33	(3.96)
Net earnings (loss)	4,178	3,021	(8,101)	(4,965)	(2,861)
Per share of common stock	7.23	5.02	(14.22)	(8.70)	(5.01)
Cash dividends paid on common stock	572	585	905	2,765	2,771
Per share of common stock	1.00	1.00	1.58	4.84	4.84
Investment in plant, rental machines and other property	4,744	3,078	3,232	4,698	6,502
Return on stockholders' equity	18.5%	14.3%**	–	–	–
At end of year:					
Total assets	$ 80,292	$ 81,091	$ 81,113	$ 86,705	$ 92,473
Net investment in plant, rental machines and other property	16,579	16,664	17,521	21,595	27,578
Working capital	9,043	12,112	6,052	2,955	7,018
Total debt	21,629	22,118	27,342	29,320	26,947
Stockholders' equity	22,423	23,413	19,738	27,624	36,679

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

**Restated to conform to 1995 presentation. Preferred stock dividends and transaction costs are deducted from net earnings and preferred stock par value is deducted from stockholders' equity in the calculation.

Selected Quarterly Data

(DOLLARS IN MILLIONS EXCEPT PER SHARE AND STOCK PRICES)

				Per Share Common Stock			
	Revenue	Gross Profit	Net Earnings (Loss)	Earnings (Loss)	Dividends	Stock Prices** High	Stock Prices** Low
1995							
First quarter	$ 15,735	$ 6,664	$ 1,289	$ 2.12	$ .25	$ 85.13	$ 70.25
Second quarter	17,531	7,631	1,716	2.97	.25	99.38	82.25
Third quarter	16,754	6,921	(538)	(.96)	.25	114.63	91.63
Fourth quarter	21,920	9,151	1,711	3.09	.25	102.38	87.75
Total	$ 71,940	$ 30,367	$ 4,178	$ 7.23*	$ 1.00		
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		

*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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Stockholders with questions about their accounts should contact:

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or via the Internet at:
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To transfer stocks, write to:

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Stock Transfer Department
Mail Suite 4680
14 Wall Street
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(Registered mail is recommended when stock is mailed.)

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

Investors with other requests may write to:

IBM Stockholder Relations
IBM Corporation
One Old Orchard Road
Armonk, New York 10504

Stockholder Communications

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

Annual Meeting

The IBM Annual Meeting of Stockholders will be held on Tuesday, April 30, 1996, at 10 a.m. at the Atlanta Civic Center, 395 Piedmont Ave., N.E., Atlanta, Georgia.

IBM Stock

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

IBM on the Internet

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

Literature for IBM Stockholders

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

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

An audiocassette recording of the 1995 Annual Report is available for sight-impaired stockholders.

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

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 environmental, safety and energy programs.

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

General Information

For answers to general questions about IBM from within the continental United States, call (800) 426-3333; from outside the continental United States, call (520) 574-4600.

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