

CONSOLIDATED STATEMENT OF EARNINGS

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

(Dollars in millions except per share amounts)				
FOR THE YEAR ENDED DECEMBER 31:	NOTES	2006	2005	2004
Revenue:				
Global Services		\$48,247	\$47,407	\$46,283
Hardware		22,499	24,343	31,193
Software		18,204	16,830	16,141
Global Financing		2,379	2,407	2,608
Other		94	147	68
Total Revenue		91,424	91,134	96,293
Cost:				
Global Services		34,972	35,093	35,078
Hardware		14,175	15,803	22,008
Software		2,693	2,534	2,489
Global Financing		1,182	1,091	1,046
Other		107	81	103
Total Cost		53,129	54,602	60,724
Gross Profit		38,295	36,532	35,569
Expense and Other Income:				
Selling, general and administrative		20,259	21,314	20,079
Research, development and engineering	Q	6,107	5,842	5,874
Intellectual property and custom development income		(900)	(948)	(1,169)
Other (income) and expense		(766)	(2,122)	(23)
Interest expense	K&L	278	220	139
Total Expense and Other Income		24,978	24,306	24,900
Income from Continuing Operations Before Income Taxes		13,317	12,226	10,669
Provision for income taxes	P	3,901	4,232	3,172
Income from Continuing Operations		9,416	7,994	7,497
Discontinued Operations:				
Income/(loss) from discontinued operations, net of tax		76	(24)	(18)
Income before cumulative effect of change in accounting principle		9,492	7,970	7,479
Cumulative effect of change in accounting principle, net of tax*	B	—	(36)	—
Net Income		\$ 9,492	\$ 7,934	\$ 7,479
Earnings/(Loss) per Share of Common Stock:				
Assuming Dilution:				
Continuing operations	S	\$ 6.06	\$ 4.91	\$ 4.39
Discontinued operations	S	0.05	(0.01)	(0.01)
Before cumulative effect of change in accounting principle	S	6.11	4.90	4.38
Cumulative effect of change in accounting principle*		—	(0.02)	—
Total	S	\$ 6.11	\$ 4.87	\$ 4.38
Basic:				
Continuing operations	S	\$ 6.15	\$ 4.99	\$ 4.48
Discontinued operations	S	0.05	(0.02)	(0.01)
Before cumulative effect of change in accounting principle	S	6.20	4.98	4.47
Cumulative effect of change in accounting principle*	S	—	(0.02)	—
Total	S	\$ 6.20	\$ 4.96	\$ 4.47
Weighted-Average Number of Common Shares Outstanding:				
Assuming dilution		1,553,535,384	1,627,632,662	1,707,231,708
Basic		1,530,806,987	1,600,591,264	1,674,959,086

* Reflects implementation of FASB Interpretation No. 47. See note B, "Accounting Changes," on page 72 for additional information.

The accompanying notes on pages 62 through 115 are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

(Dollars in millions except per share amounts)

AT DECEMBER 31:	NOTES	2006	2005
Assets			
Current assets:			
Cash and cash equivalents		\$ 8,022	\$ 12,568
Marketable securities	D	2,634	1,118
Notes and accounts receivable—trade (net of allowances of \$221 in 2006 and \$267 in 2005)		10,789	9,540
Short-term financing receivables (net of allowances of \$307 in 2006 and \$422 in 2005)	F	15,095	13,750
Other accounts receivable (net of allowances of \$15 in 2006 and \$7 in 2005)		964	1,138
Inventories	E	2,810	2,841
Deferred taxes	P	1,806	1,765
Prepaid expenses and other current assets		2,539	2,941
Total current assets		44,660	45,661
Plant, rental machines and other property	G	36,521	34,261
Less: Accumulated depreciation	G	22,082	20,505
Plant, rental machines and other property—net	G	14,440	13,756
Long-term financing receivables	F	10,068	9,628
Prepaid pension assets	V	10,629	20,625
Goodwill	I	12,854	9,441
Intangible assets—net	I	2,202	1,663
Investments and sundry assets	H	8,381	4,974
Total Assets		\$103,234	\$105,748
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	P	\$ 4,670	\$ 4,710
Short-term debt	K&L	8,902	7,216
Accounts payable		7,964	7,349
Compensation and benefits		4,595	3,325
Deferred income		8,587	7,319
Other accrued expenses and liabilities		5,372	5,233
Total current liabilities		40,091	35,152
Long-term debt	K&L	13,780	15,425
Retirement and nonpension postretirement benefit obligations	V	13,553	13,779
Other liabilities	M	7,304	8,294
Total Liabilities		74,728	72,650
Contingencies and Commitments	O		
Stockholders' equity:	N		
Common stock, par value \$.20 per share and additional paid-in capital		31,271	28,926
Shares authorized: 4,687,500,000			
Shares issued (2006—2,008,470,383; 2005—1,981,259,104)			
Retained earnings		52,432	44,734
Treasury stock, at cost (shares: 2006—501,987,771; 2005—407,279,343)		(46,296)	(38,546)
Accumulated gains and (losses) not affecting retained earnings	N	(8,901)	(2,016)
Total Stockholders' Equity		28,506	33,098
Total Liabilities and Stockholders' Equity		\$103,234	\$105,748

The accompanying notes on pages 62 through 115 are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

(Dollars in millions)			
FOR THE YEAR ENDED DECEMBER 31:	2006	2005*	2004*
Cash Flow from Operating Activities from Continuing Operations:			
Net income	\$ 9,492	\$ 7,934	\$ 7,479
(Income)/loss from discontinued operations	(76)	24	18
Adjustments to reconcile income from continuing operations to cash provided by operating activities:			
Depreciation	3,907	4,147	3,959
Amortization of intangibles	1,076	1,041	956
Stock-based compensation	846	1,043	1,578
Deferred income taxes	1,724	2,185	1,794
Net gain on asset sales and other	(175)	(1,525)	(420)
Other than temporary declines in securities and other investments	4	9	20
Change in operating assets and liabilities, net of acquisitions/divestitures:			
Receivables (including financing receivables)	(512)	2,219	2,613
Inventories	112	202	(291)
Pension assets	234	(1,562)	(1,284)
Other assets/other liabilities	(885)	(100)	(900)
Accounts payable	355	(536)	411
Pension liabilities	(1,084)	(166)	(584)
Net Cash Provided by Operating Activities from Continuing Operations	15,019	14,914	15,349
Cash Flow from Investing Activities from Continuing Operations:			
Payments for plant, rental machines and other property	(4,362)	(3,842)	(4,368)
Proceeds from disposition of plant, rental machines and other property	430	1,107	1,311
Investment in software	(804)	(792)	(688)
Purchases of marketable securities and other investments	(28,555)	(4,526)	(8,718)
Proceeds from disposition of marketable securities and other investments	25,542	4,180	8,830
Divestiture of businesses, net of cash transferred	—	932	25
Acquisition of businesses, net of cash acquired	(3,799)	(1,482)	(1,738)
Net Cash Used in Investing Activities from Continuing Operations	(11,549)	(4,423)	(5,346)
Cash Flow from Financing Activities from Continuing Operations:			
Proceeds from new debt	1,444	4,363	2,438
Short-term borrowings/(repayments) less than 90 days—net	1,834	(232)	1,073
Payments to settle debt	(3,400)	(3,522)	(4,538)
Common stock transactions—net	(6,399)	(6,506)	(5,361)
Cash dividends paid	(1,683)	(1,250)	(1,174)
Net Cash Used in Financing Activities from Continuing Operations	(8,204)	(7,147)	(7,562)
Effect of exchange rate changes on cash and cash equivalents	201	(789)	405
Net cash used in discontinued operations from:			
Operating activities	(12)	(40)	(83)
Net change in cash and cash equivalents	(4,546)	2,515	2,763
Cash and cash equivalents at January 1	12,568	10,053	7,290
Cash and Cash Equivalents at December 31	\$ 8,022	\$ 12,568	\$ 10,053
Supplemental Data:			
Income taxes paid—net of refunds received	\$ 2,068	\$ 1,994	\$ 1,837
Interest paid	\$ 1,082	\$ 866	\$ 705
Capital lease obligations	\$ 36	\$ 287	\$ 110
Equity securities received as divestiture consideration**	\$ —	\$ 430	\$ —

* Reclassified to conform with 2006 presentation.

**Lenovo equity valued at \$542 million net of lock-up provisions of \$112 million. See note C, "Acquisitions/Divestitures," on pages 77 and 78 for additional information.

The accompanying notes on pages 62 through 115 are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

(Dollars in millions)

	COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED GAINS AND (LOSSES) NOT AFFECTING RETAINED EARNINGS	TOTAL
2004					
Stockholders' equity, January 1, 2004	\$23,490	\$31,971	\$(24,034)	\$(1,896)	\$29,531
Net income plus gains and (losses) not affecting retained earnings:					
Net income		7,479			\$ 7,479
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives (net of tax benefit of \$112)				(199)	(199)
Foreign currency translation adjustments (net of tax benefit of \$93*)				1,055	1,055
Minimum pension liability adjustment (net of tax benefit of \$540)				(1,066)	(1,066)
Net unrealized gains on marketable securities (net of tax expense of \$30)				45	45
Total gains and (losses) not affecting retained earnings					(165)
Subtotal: Net income plus gains and (losses) not affecting retained earnings					\$ 7,314
Cash dividends declared—common stock		(1,174)			(1,174)
Common stock issued under employee plans (25,293,484 shares)	3,033				3,033
Purchases (422,338 shares) and sales (2,840,648 shares) of treasury stock under employee plans—net		(128)	237		109
Other treasury shares purchased, not retired (78,562,974 shares)			(7,275)		(7,275)
Decrease in shares remaining to be issued in acquisition	(6)				(6)
Income tax benefits—stock transactions	156				156
Stockholders' equity, December 31, 2004	\$26,673	\$38,148	\$(31,072)	\$(2,061)	\$31,688

* Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.

The accompanying notes on pages 62 through 115 are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

(Dollars in millions)

	COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED GAINS AND (LOSSES) NOT AFFECTING RETAINED EARNINGS	TOTAL
2005					
Stockholders' equity, January 1, 2005	\$26,673	\$38,148	\$(31,072)	\$(2,061)	\$31,688
Net income plus gains and (losses) not affecting retained earnings:					
Net income		7,934			\$ 7,934
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized gains on SFAS No. 133 cash flow hedge derivatives (net of tax expense of \$502)				891	891
Foreign currency translation adjustments (net of tax expense of \$345*)				(1,153)	(1,153)
Minimum pension liability adjustment (net of tax expense of \$320)				290	290
Net unrealized gains on marketable securities (net of tax expense of \$8)				17	17
Total gains and (losses) not affecting retained earnings					45
Subtotal: Net income plus gains and (losses) not affecting retained earnings					\$ 7,979
Cash dividends declared—common stock		(1,250)			(1,250)
Common stock issued under employee plans (18,572,017 shares)	2,257				2,257
Purchases (606,697 shares) and sales (2,594,786 shares) of treasury stock under employee plans—net		(98)	197		99
Other treasury shares purchased, not retired (90,237,800 shares)			(7,671)		(7,671)
Decrease in shares remaining to be issued in acquisition	(24)				(24)
Income tax benefits—stock transactions	20				20
Stockholders' equity, December 31, 2005	\$28,926	\$44,734	\$(38,546)	\$(2,016)	\$33,098

* Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.
The accompanying notes on pages 62 through 115 are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

INTERNATIONAL BUSINESS MACHINES CORPORATION AND SUBSIDIARY COMPANIES

(Dollars in millions)

	COMMON STOCK AND ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED GAINS AND (LOSSES) NOT AFFECTING RETAINED EARNINGS	TOTAL
2006					
Stockholders' equity, January 1, 2006	\$28,926	\$44,734	\$(38,546)	\$ (2,016)	\$33,098
Net income plus gains and (losses) not affecting retained earnings:					
Net income		9,492			\$ 9,492
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives (net of tax benefit of \$178)				(342)	(342)
Foreign currency translation adjustments (net of tax benefit of \$225*)				1,020	1,020
Minimum pension liability adjustment (net of tax expense of \$900)				1,881	1,881
Net unrealized gains on marketable securities (net of tax expense of \$34)				53	53
Total gains and (losses) not affecting retained earnings					2,613
Adjustments to initially adopt SFAS No. 158:					
Prior service costs (net of tax expense of \$494)				871	871
Net gains/(losses) (net of tax benefit of \$6,028)				(10,371)	(10,371)
Transition assets/(obligations) (net of tax expense of \$1)				2	2
Subtotal: Net income plus gains and (losses) not affecting retained earnings and adjustments to adopt SFAS No. 158					\$ 2,607
Cash dividends declared—common stock		(1,683)			(1,683)
Common stock issued under employee plans (27,211,279 shares)	2,322				2,322
Purchases (633,769 shares) and sales (3,489,803 shares) of treasury stock under employee plans—net		(111)	272		161
Other treasury shares purchased, not retired (97,564,462 shares)			(8,022)		(8,022)
Decrease in shares remaining to be issued in acquisition	(3)				(3)
Income tax benefits—stock transactions	26				26
Stockholders' equity, December 31, 2006	\$31,271	\$52,432	\$(46,296)	\$ (8,901)	\$28,506

* Foreign currency translation adjustments are presented gross with associated hedges shown net of tax.

The accompanying notes on pages 62 through 115 are an integral part of the financial statements.