

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	2004	2003	2002
Revenue:				
Global Services		\$ 46,213	\$ 42,635	\$ 36,360
Hardware		31,154	28,239	27,456
Software		15,094	14,311	13,074
Global Financing		2,608	2,826	3,232
Enterprise Investments/Other		1,224	1,120	1,064
Total Revenue		96,293	89,131	81,186
Cost:				
Global Services		34,637	31,903	26,812
Hardware		21,929	20,401	20,020
Software		1,919	1,927	2,043
Global Financing		1,045	1,248	1,416
Enterprise Investments/Other		731	634	611
Total Cost		60,261	56,113	50,902
Gross Profit		36,032	33,018	30,284
Expense and Other Income:				
Selling, general and administrative	q	19,384	17,852	18,738
Research, development and engineering	r	5,673	5,077	4,750
Intellectual property and custom development income		(1,169)	(1,168)	(1,100)
Other (income) and expense		(23)	238	227
Interest expense	k & l	139	145	145
Total Expense and Other Income		24,004	22,144	22,760
Income from Continuing Operations Before Income Taxes		12,028	10,874	7,524
Provision for income taxes	p	3,580	3,261	2,190
Income from Continuing Operations		8,448	7,613	5,334
Discontinued Operations:				
Loss from discontinued operations	c	18	30	1,755
Net Income		\$ 8,430	\$ 7,583	\$ 3,579

CONSOLIDATED STATEMENT OF EARNINGS (continued)

International Business Machines Corporation and Subsidiary Companies

(Dollars in millions except per share amounts)

FOR THE YEAR ENDED DECEMBER 31:	Notes	2004	2003	2002
Earnings/(Loss) per Share of Common Stock:				
Assuming Dilution:				
Continuing operations	t	\$ 4.94	\$ 4.34	\$ 3.07
Discontinued operations	t	(0.01)	(0.02)	(1.01)
Total	t	\$ 4.93	\$ 4.32	\$ 2.06
Basic:				
Continuing operations	t	\$ 5.04	\$ 4.42	\$ 3.13
Discontinued operations	t	(0.01)	(0.02)	(1.03)
Total	t	\$ 5.03	\$ 4.40	\$ 2.10
Weighted-Average Number of Common Shares Outstanding:				
Assuming dilution		1,708,872,279	1,756,090,689	1,730,941,054
Basic		1,674,959,086	1,721,588,628	1,703,244,345

The accompanying notes on pages 49 through 91 are an integral part of the financial statements.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

International Business Machines Corporation and Subsidiary Companies

(Dollars in millions)

AT DECEMBER 31:	Notes	2004	2003*
Assets			
Current assets:			
Cash and cash equivalents		\$ 10,053	\$ 7,290
Marketable securities	d	517	357
Notes and accounts receivable—trade (net of allowances of \$277 in 2004 and \$352 in 2003)		10,522	10,026
Short-term financing receivables (net of allowances of \$681 in 2004 and \$733 in 2003)	f	15,801	17,583
Other accounts receivable (net of allowances of \$13 in 2004 and \$16 in 2003)		1,813	1,314
Inventories	e	3,316	2,942
Deferred taxes	p	2,229	2,542
Prepaid expenses and other current assets		2,719	2,608
Total current assets		46,970	44,662
Plant, rental machines and other property	g	36,385	36,153
Less: Accumulated depreciation	g	21,210	21,464
Plant, rental machines and other property—net	g	15,175	14,689
Long-term financing receivables	f	10,950	10,741
Prepaid pension assets	w	20,394	18,426
Investments and sundry assets	h	5,468	7,294
Goodwill	i	8,437	6,921
Intangible assets—net	i	1,789	1,724
Total Assets		\$ 109,183	\$ 104,457

* Reclassified to conform with 2004 presentation.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (continued)

International Business Machines Corporation and Subsidiary Companies

(Dollars in millions)

AT DECEMBER 31:	Notes	2004	2003*
Liabilities and Stockholders' Equity			
Current liabilities:			
Taxes	p	\$ 4,728	\$ 5,475
Short-term debt	k & l	8,099	6,646
Accounts payable		9,444	8,460
Compensation and benefits		3,804	3,671
Deferred income		7,175	6,492
Other accrued expenses and liabilities		6,548	6,879
Total current liabilities		39,798	37,623
Long-term debt	k & l	14,828	16,986
Retirement and nonpension postretirement benefit obligations	w	15,883	14,251
Other liabilities	m	8,927	7,733
Total Liabilities		79,436	76,593
Contingencies and commitments			
Stockholders' equity:			
Common stock, par value \$.20 per share and additional paid-in capital	n	18,355	16,269
Shares authorized: 4,687,500,000			
Shares issued (2004-1,962,687,087; 2003-1,937,393,604)			
Retained earnings		44,525	37,525
Treasury stock, at cost (shares: 2004-317,094,633; 2003-242,884,969)		(31,072)	(24,034)
Accumulated gains and (losses) not affecting retained earnings		(2,061)	(1,896)
Total Stockholders' Equity		29,747	27,864
Total Liabilities and Stockholders' Equity		\$ 109,183	\$ 104,457

* Reclassified to conform with 2004 presentation.

The accompanying notes on pages 49 through 91 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:

	2004	2003*	2002*
Cash Flow from Operating Activities from Continuing Operations:			
Income from continuing operations	\$ 8,448	\$ 7,613	\$ 5,334
Adjustments to reconcile income from continuing operations to cash provided by operating activities:			
Depreciation	3,959	3,961	3,691
Amortization of intangibles	956	955	802
Deferred income taxes	2,081	1,126	(67)
Net gain on assets sales and other	(420)	(275)	(343)
Other than temporary declines in securities and other investments	20	50	58
Noncash portion of special actions	—	—	1,350
Change in operating assets and liabilities, net of acquisitions/divestitures:			
Receivables	2,613	2,024	4,125
Inventories	(291)	293	793
Pension assets	(1,284)	(1,409)	(4,227)
Other assets	(200)	(567)	(44)
Accounts payable	411	617	(55)
Pension liabilities	(584)	(286)	83
Other liabilities	(303)	467	2,288
Net Cash Provided by Operating Activities from Continuing Operations	15,406	14,569	13,788
Cash Flow from Investing Activities from Continuing Operations:			
Payments for plant, rental machines and other property	(4,368)	(4,393)	(4,753)
Proceeds from disposition of plant, rental machines and other property	1,311	1,039	775
Investments in software	(688)	(581)	(597)
Purchases of marketable securities and other investments	(8,718)	(6,471)	(1,582)
Proceeds from disposition of marketable securities and other investments	8,830	7,023	1,185
Divestiture of businesses	25	97	1,233
Acquisition of businesses	(1,738)	(1,836)	(3,158)
Net Cash Used in Investing Activities from Continuing Operations	(5,346)	(5,122)	(6,897)

* Reclassified to conform with 2004 presentation.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

International Business Machines Corporation and Subsidiary Companies

(Dollars in millions)

FOR THE YEAR ENDED DECEMBER 31:	2004	2003*	2002*
Cash Flow from Financing Activities from Continuing Operations:			
Proceeds from new debt	2,438	1,573	6,726
Short-term borrowings/(repayments) less than 90 days—net	1,073	777	(4,087)
Payments to settle debt	(4,538)	(5,831)	(5,812)
Common stock transactions—net	(5,418)	(3,232)	(3,087)
Cash dividends paid	(1,174)	(1,085)	(1,005)
Net Cash Used in Financing Activities from Continuing Operations	(7,619)	(7,798)	(7,265)
Effect of exchange rate changes on cash and cash equivalents	405	421	148
Net cash used in discontinued operations	(83)	(162)	(722)
Net change in cash and cash equivalents	2,763	1,908	(948)
Cash and cash equivalents at January 1	7,290	5,382	6,330
Cash and Cash Equivalents at December 31	\$ 10,053	\$ 7,290	\$ 5,382
Supplemental Data:			
Cash paid during the year:			
Income taxes	\$ 1,837	\$ 1,707	\$ 1,841
Interest	\$ 705	\$ 853	\$ 831

Noncash Investing and Financing Activities:

In 2002, the noncash portion of the purchase price paid to PwCC is a significant noncash investing activity. This transaction is described on pages 59 and 60.

* Reclassified to conform with 2004 presentation.

The accompanying notes on pages 49 through 91 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
2002					
Stockholders' equity, January 1, 2002	\$ 14,248	\$ 30,142	\$ (20,114)	\$ (828)	\$ 23,448
Net income plus gains and (losses) not affecting retained earnings:					
Net income		3,579			\$ 3,579
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives during 2002 (net of tax benefit of \$372)				(659)	(659)
Foreign currency translation adjustments (net of tax benefit of \$197)				850	850
Minimum pension liability adjustment (net of tax benefit of \$1,574)				(2,765)	(2,765)
Net unrealized losses on marketable securities (net of tax benefit of \$8)				(16)	(16)
Total gains and (losses) not affecting retained earnings					(2,590)
Subtotal: Net income plus gains and (losses) not affecting retained earnings					\$ 989
Cash dividends declared—common stock		(1,005)			(1,005)
Common stock issued under employee plans (7,255,995 shares)	440	4			444
Purchases (189,797 shares) and sales (12,873,502 shares) of treasury stock under employee plans—net		(475)	1,311		836
Other treasury shares purchased, not retired (48,481,100 shares)			(4,212)		(4,212)
Treasury shares issued to fund the U.S. pension fund (24,037,354 shares)		(576)	2,447		1,871
Shares issued/to be issued in the PwCC acquisition (3,677,213 shares issued)	43	(114)	355		284
Decrease in shares remaining to be issued in acquisition	(9)				(9)
Tax effect—stock transactions	136				136
Stockholders' equity, December 31, 2002	\$ 14,858	\$ 31,555	\$ (20,213)	\$ (3,418)	\$ 22,782

The accompanying notes on pages 49 through 91 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
2003					
Stockholders' equity, January 1, 2003	\$ 14,858	\$ 31,555	\$ (20,213)	\$ (3,418)	\$ 22,782
Net income plus gains and (losses) not affecting retained earnings:					
Net income		7,583			\$ 7,583
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives during 2003 (net of tax benefit of \$51)				(91)	(91)
Foreign currency translation adjustments (net of tax benefit of \$125)				1,768	1,768
Minimum pension liability adjustment (net of tax benefit of \$124)				(162)	(162)
Net unrealized gains on marketable securities (net of tax expense of \$3)				7	7
Total gains and (losses) not affecting retained earnings					1,522
Subtotal: Net income plus gains and (losses) not affecting retained earnings					\$ 9,105
Cash dividends declared—common stock		(1,085)			(1,085)
Common stock issued under employee plans (16,445,473 shares)	1,205	(282)			923
Purchases (291,921 shares) and sales (5,992,342 shares) of treasury stock under employee plans—net		(246)	582		336
Other treasury shares purchased, not retired (49,994,514 shares)			(4,403)		(4,403)
Shares to be issued in the PwCC acquisition	8				8
Decrease in shares remaining to be issued in acquisition	(4)				(4)
Tax effect—stock transactions	202				202
Stockholders' equity, December 31, 2003	\$ 16,269	\$ 37,525	\$ (24,034)	\$ (1,896)	\$ 27,864

The accompanying notes on pages 49 through 91 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	\$ 16,269	\$ 37,525	\$ (24,034)	\$ (1,896)	\$ 27,864
Net income plus gains and (losses) not affecting retained earnings:					
Net income		8,430			\$ 8,430
Gains and (losses) not affecting retained earnings (net of tax):					
Net unrealized losses on SFAS No. 133 cash flow hedge derivatives during 2004 (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					\$ 8,265
Cash dividends declared—common stock		(1,174)			(1,174)
Common stock issued under employee plans (25,293,484 shares)	1,815	(129)			1,686
Purchases (422,338 shares) and sales (2,840,648 shares) of treasury stock under employee plans—net		(127)	237		110
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)
Tax effect—stock transactions	277				277
Stockholders' equity, December 31, 2004	\$ 18,355	\$ 44,525	\$ (31,072)	\$ (2,061)	\$ 29,747

The accompanying notes on pages 49 through 91 are an integral part of the financial statements.