



IBM

1985 Annual Report



## Contents:

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- 1 Financial Highlights
- 2 Letter to Stockholders
- 5 Partnerships:  
“Each party contributes; each benefits.”
- 16 1985 in Review
- 25 Financial Report
  - Report of Management*
  - Report of Independent Accountants*
  - Earnings*
  - Management Discussion—Results of Operations*
  - Financial Position*
  - Management Discussion—Financial Condition*
  - Funds Flow*
  - Stockholders' Equity*
  - Notes to Financial Statements*
  - Five-Year Comparison of Financial Data*
  - Supplemental Financial Information*
- 46 Directors and Officers
- 48 IBM Organization
  - Stockholder Information

## IBM's operations:

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IBM's operations are primarily in the field of information-handling systems, equipment and services to solve the increasingly complex problems of business, government, science, space exploration, defense, education, medicine and many other areas of human activity. IBM's products include information processing products and systems, program products, telecommunications systems, office systems, typewriters, copiers, educational and testing materials, and related supplies and services. Most products are both leased and sold through IBM's worldwide marketing organizations. Selected products are marketed and distributed through authorized dealers and remarketers.

## Cover:

*The IBM 5126 Technician Terminal, pictured here, is a key element of General Motors' Computerized Automotive Maintenance System (GM-CAMS), a joint development effort of the Buick Motor Division, other units of General Motors, including Electronic Data Systems (EDS), and IBM. The terminal, which consists of an IBM Personal Computer, touch-sensitive screen and GM and IBM-developed software, is designed to quickly and accurately diagnose and isolate electronic problems in GM vehicles. When linked to GM's centralized system, maintained by EDS, the terminal will receive current diagnostic software and repair information and provide GM with valuable feedback on repair activities. Buick will begin marketing GM-CAMS to its dealers this year. The project with GM, a long-standing IBM customer, represents the diversity of IBM's associations with others in activities from research and development to manufacturing and marketing.*



# Financial Highlights

for the year ended December 31, 1985

International Business Machines Corporation

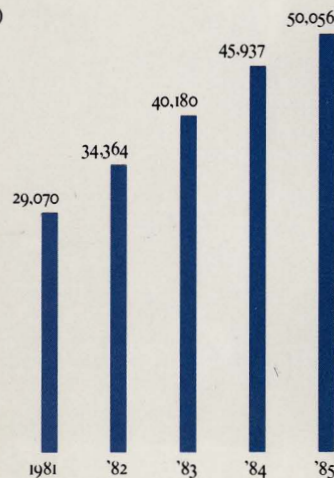
(Dollars in millions except per share amounts)

	1985	1984
<b>Highlights of the year:</b>		
Gross income from sales, services and rentals . . . . .	\$ 50,056	\$ 45,937
Earnings before income taxes . . . . .	\$ 11,619	\$ 11,623
Income taxes . . . . .	\$ 5,064	\$ 5,041
Net earnings . . . . .	\$ 6,555	\$ 6,582
Per share . . . . .	\$10.67	\$10.77
Cash dividends paid . . . . .	\$ 2,703	\$ 2,507
Per share . . . . .	\$ 4.40	\$ 4.10
Investment in plant, rental machines and other property . . .	\$ 6,430	\$ 5,473
Return on stockholders' equity . . . . .	22.4%	26.5%

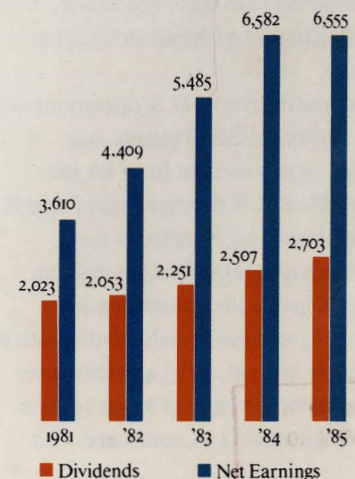
## At end of year:

Total assets . . . . .	\$ 52,634	\$ 42,808
Net investment in plant, rental machines and other property . .	\$ 19,680	\$ 16,363
Working capital . . . . .	\$ 14,637	\$ 10,735
Long-term debt . . . . .	\$ 3,955	\$ 3,269
Stockholders' equity . . . . .	\$ 31,990	\$ 26,489
Number of employees . . . . .	405,535	394,930
Number of stockholders . . . . .	798,152	792,506

**Gross Income**  
(Millions of dollars)



**Net Earnings/Dividends**  
(Millions of dollars)



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# To the Stockholders

IBM's worldwide business health is strong despite a difficult year for the computer industry.

An uncertain North American economy, currency fluctuations, sluggish capital spending by our customers, and an early 1985 pause in high-end processor installations had an adverse impact on IBM's performance for the full-year 1985. However, our quarterly results improved each quarter during 1985.

Worldwide net earnings for the year ended December 31, 1985, were \$6,555 million, down 0.4 percent from 1984's earnings of \$6,582 million. Net earnings were \$10.67 per share in 1985, compared with \$10.77 per share for the same period in 1984. The after-tax margin was 13.1 percent in 1985, compared with 14.3 percent in 1984. Average shares outstanding were 614.1 million in 1985 and 611.4 million in 1984.

Earnings before income taxes were \$11,619 million in 1985 and \$11,623 million in 1984. Before-tax margins were 23.2 percent in 1985 and 25.3 percent in 1984.

Worldwide gross income was \$50,056 million in 1985, up 9.0 percent from the prior year's \$45,937 million. Even though currency rates had a favorable effect in the second half of 1985, the full-year impact was still negative compared with 1984. It is estimated that if currency rates had remained the same as in 1984, gross income would have been \$400 million higher in 1985, yielding a revenue growth rate of 9.8 percent, while net earnings would have been \$40 million higher, yielding an increase of 0.2 percent.

Gross income from non-U.S. operations in 1985, included in consolidated results, was \$21,545 million, up 16.0 percent from \$18,566 million in 1984. Non-U.S. net earnings of \$3,078 million in 1985 showed an increase of 19.0 percent over 1984's earnings of \$2,587 million.

As IBM anticipated, the quarter ended December 31, 1985, was particularly strong with net earnings of \$2,681 million, up 23.4 percent over 1984's fourth-quarter earnings of \$2,172 million. Per share earnings were \$4.36, compared with

\$3.55 for the 1984 period. Gross income for the fourth quarter of 1985 was \$17,155 million, compared with \$14,496 million for the fourth quarter of 1984, an increase of 18.4 percent.

Total orders for 1985 showed good growth over the prior year. Worldwide shipments for the full year were higher than in 1984, with substantially all of the growth continuing to be in the non-U.S. portions of the business. Fourth-quarter shipment growth was due mostly to the strength of the 3090 processors and high-end storage devices, along with growth in typewriters, printers and personal computers.

There is an absence of convincing evidence the North American economy is showing sus-

tained improvement, and we are approaching 1986 with caution. We are managing our costs, expenses and other resources carefully. Product costs and expenses in 1985 reflect increases in productivity over the prior year, and we expect this direction to continue throughout 1986. We remain optimistic about the future of IBM and the overall computer industry. Our continuing investments in research, development and facilities have positioned us for future growth.

## Resilient Performance

IBM's results gained strength steadily during the course of 1985, reaching a peak in the fourth quarter. In a trying year for our industry, as well

*Paul J. Rizzo, vice chairman, John R. Opel, chairman of the board, and John F. Akers, president and chief executive officer*





as for our company, IBM's resilient performance stands out and reaffirms the fundamental soundness of our business. There is reason for continued optimism about IBM's long-term prospects in the underlying and growing need to manage information and improve productivity in virtually every aspect of human activity.

### **Strong Product Line**

In part, our confidence is built on IBM's product line—already strong, and growing stronger as a result of continuing investments in research, development and engineering. During 1985, about half of our shipments came from products newly introduced or significantly improved within the past 24 months. This extends a record of sustained innovation that is notable for any company, and essential in our highly competitive industry.

For customers with large-scale computing requirements, for example, new 3090 processors offer improved price/performance and exceptional flexibility. They can perform significantly faster than IBM's previous top-of-the-line systems, while an optional extension can operate specialized programs for engineers and scientists at even greater speeds.

IBM pioneered and continues to lead in technology and quality with the industry's most advanced high-capacity disk storage devices. Models introduced last year offer up to 5 billion characters of storage, twice as much as before.

New software introduced last year spans the range from programming that improves the performance of multiple operating systems to a product for use by researchers in the developing field of artificial intelligence.

During 1985, we added to our desktop computing options. Lower-cost and higher-capacity models joined the industry's broadest line of compatible personal computers. In addition, PC capability was extended to new models of our System/36 and Series/1 processors, providing customers with even greater flexibility in meeting their office computing needs. We added new

functions to our Selectric System/2000 line of typewriters and introduced economical desktop printers for use with IBM and other popular personal computers.

In their first year as merged companies, ROLM Corporation and IBM continued to strengthen the relationships between their products. ROLM added to the capabilities and enlarged the capacity of its PhoneMail voice messaging system; it is now being marketed by both organizations. A new ROLM product extends advanced voice and data communications to IBM's most powerful personal computer models and can provide PC users with high-speed access to IBM office systems programs stored in central computers.

To assist customers in linking their operations—within an office, a building or an entire organization—the company added new communications capabilities. The IBM Token-Ring Network is a local area network with the potential of attaching large numbers of personal computers and devices from IBM, ROLM or others. It is a key building block in our continuing commitment to telecommunications and to helping customers to integrate their office systems.

### **Areas of Growth**

As the North American economy softened during 1985, much of IBM's growth came in our operations in Europe, the Asia/Pacific area and Latin America, where our business was up substantially from the previous year.

Installations of large-scale processors increased sharply in the latter part of 1985, as a result of our ability to improve shipment schedules for new 3090 systems. This achievement is a credit to the many men and women of IBM who developed and then delivered—well ahead of original schedules—a system of exceptional quality.

Shipments of high-capacity disk storage devices also showed strong growth. While demand for IBM Personal Computers did not climb as steeply as in the past several years,

deliveries still increased during 1985. Typewriter sales were also vigorous, reflecting acceptance of the company's Selectric System/2000 line.

Revenues from software continued as one of the fastest-growing areas of our business, with strong growth in operating systems and general-purpose and application programs.

### **Improved Efficiency, Productivity**

During 1985, we took actions to improve IBM's efficiency and reduce expenses, while we continued making the investments that are essential to capitalize on the opportunities before the company.

The skills, experience and loyalty of IBM employees are among the company's most important assets. While improving efficiency, we maintained our long record of full employment in 1985, through a combination of workload balancing, retraining and prudent controls on hiring. We expect to continue these actions in 1986. Early in 1985, we also put stringent expense controls in place. As a result, we were able to reduce spending in many categories of expense well below the rates of the prior year.

To improve service to customers and increase efficiency, IBM reorganized its U.S. marketing operations in 1985. Responsibility for managing the distribution of IBM products through authorized dealers and remarketers was consolidated within a single division. And, effective January 1, 1986, two restructured marketing units began offering the full line of IBM products to customers within their respective geographic areas.

As a result of our history of continuing investments in more efficient plant and equipment, unit manufacturing costs reached an all-time low last year. Although we selectively reduced planned expenditures during 1985, IBM invested an additional \$10.8 billion in research, development and engineering, and plant, property and equipment. We expect these investments, and the improved productivity that is their direct result, to continue in 1986.



### **MCI to Acquire SBS**

During the year, IBM, Aetna Life & Casualty and MCI Communications Corporation reached agreements in principle under which MCI would acquire substantially all the assets and operations of Satellite Business Systems (SBS).

Under the agreements, IBM has purchased Aetna's interests in SBS. MCI will issue approximately 47 million shares of common stock to IBM in exchange for the SBS assets and operations. Completion of the merger is subject to the approval of the FCC and review under the provisions of the Hart/Scott/Rodino Act.

IBM has a continuing interest in the telecommunications services industry. We believe that combining the operations of SBS and MCI will strengthen both organizations, as well as competition in the industry, and telecommunications customers will benefit.

### **Prospects for the Future**

Varying rates of economic growth and capital investment, changes in international trade and tax policies and currency fluctuations may continue to affect near-term growth for our industry. However, we continue to be optimistic about IBM's long-range prospects.

We believe demand for our products and services has always been driven by scientific and technological progress; by continuous improvements in price/performance and quality; by development of new products that help make our customers more efficient in everything they do; and by the steady emergence of new problems to be solved to better the lives of people around the world.

We see no changes in any of those long-range fundamentals, however uneven rates of growth may be in the short term.

### **Deficit Reduction**

While we are optimistic about the future, our experience in 1985 makes it clear that much

depends on the United States setting its economic house in order, beginning with reduction of the federal deficit.

Debt service on the deficit depletes resources that could be more productively applied to strengthening our economy and our society.

Because it has kept interest rates higher than they would otherwise have been, the deficit also has been a significant factor in the overly strong U. S. dollar, relative to other currencies. The effect on the economy and on many of our customers is double-edged: a flood tide of imports into the United States, with profound consequences for our industrial sector; and a significant disadvantage for U. S. companies which depend on export business, as the strong dollar makes their products less competitive in other countries.

The dollar's strength has recently moderated, and the Congress' renewed interest in deficit reduction is a positive first step. We all will have a stake in the difficult choices that must be made over the next several years to achieve meaningful and lasting change.

### **Continuing Partnerships**

Just as no country is an island in today's global marketplace, an international company like IBM continues to rely on many interdependent resources and relationships as we participate in the growth of this remarkable industry.

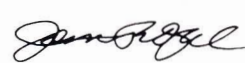
Our associations may be with customers, suppliers, remarketers or university researchers. The results may be innovative products and services to meet new opportunities, advances in science and technology, or ways of demonstrating that we are a responsible and responsive citizen of the countries and communities around the world in which we do business. Each party contributes; each benefits.


The following pages describe the range of these relationships. Some are traditional and long-standing, while others are distinctly new. All of them point the way to our future.

### **People are Key**

In large measure, IBM's prospects rest with our people, who have confirmed once again that they are remarkably energetic, resourceful and dedicated, whether in adverse circumstances or expansive ones. We are deeply grateful for their continued support and mindful that they are the best assurance of the company's continued prosperity.

January 28, 1986, by order of the Board of Directors

  
John R. Opel  
Chairman of the Board

  
John F. Akers  
President and  
Chief Executive Officer



## Partnerships:

"Each party contributes; each benefits."

With worldwide revenue projected to surpass one trillion dollars in the 1990s, the information-handling industry may become the world's largest. Within that opportunity, there are countless needs to be met and solutions to be found—for business, government and individuals.

To participate fully in all aspects of this growth, IBM is expanding existing relationships, and forming new ones, with others whose skills, resources and interests complement our own. The results are already evident across the range of the company's activities, and in the ways information technology is being expanded to respond to economic and social needs around the world.



*At the National Institute for Deaf Children in Paris, children learn to speak more clearly with the aid of a speech training system developed at the IBM France Scientific Center. Here, a child working with a therapist matches his speech to a prototype pattern displayed on an IBM Personal Computer screen. Visual feedback allows the child to adjust his pitch until he makes the correct sound.*







*An Oakland, Calif., shipping concern, operating in the Asia-Pacific basin, uses modern ships and equipment, as well as IBM and ROLM products, to cut days off normal shipping schedules. The company's most recent acquisition, an IBM 3090 processor, further expands its information-handling capabilities.*



**F**or many customers, IBM is a partner of long-standing. As the management and communication of information become even more deeply integrated into their operations, the need for customers and IBM people to work closely together grows as well. While products and programs, service and support continue to take new forms, the objective remains the same—improved productivity at an affordable cost.



*Buyers from a department store chain based in Los Angeles learn to use systems that improve operations such as inventory management. The company links its six department store divisions and four specialty store chains through a centralized data processing center. The network includes 17,000 terminals in 300 locations with access to centralized data bases.*

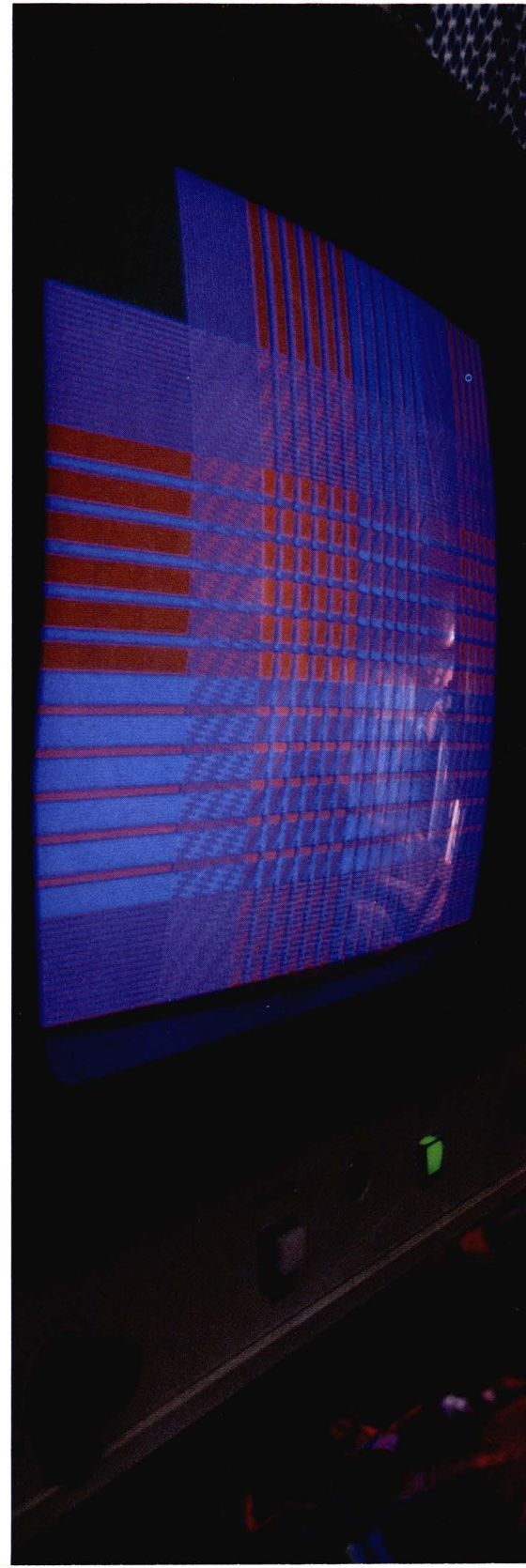


Partnerships with industry provide the insight into new opportunities and the products and services to respond to them. The goal may be participating in the growth of telecommunications in Japan, or creating a product that helps preserve the vitality of a centuries-old Italian industry. From joint ventures to cooperative development projects, IBM works with organizations in ways that can be both entrepreneurial and international in scope.

*Representatives of the Italian textile industry and IBM programmers developed a program that allows manufacturers to view simulated woven cloth patterns on a color display screen. This eliminates the need for costly preproduction samples and allows a more rapid response to customer requirements.*



*IBM Japan and Nippon Telegraph and Telephone Corporation (NTT) announced a joint venture to provide telecommunications services and other products. The worldwide telecommunications market is expected to triple over the next 10 years.*









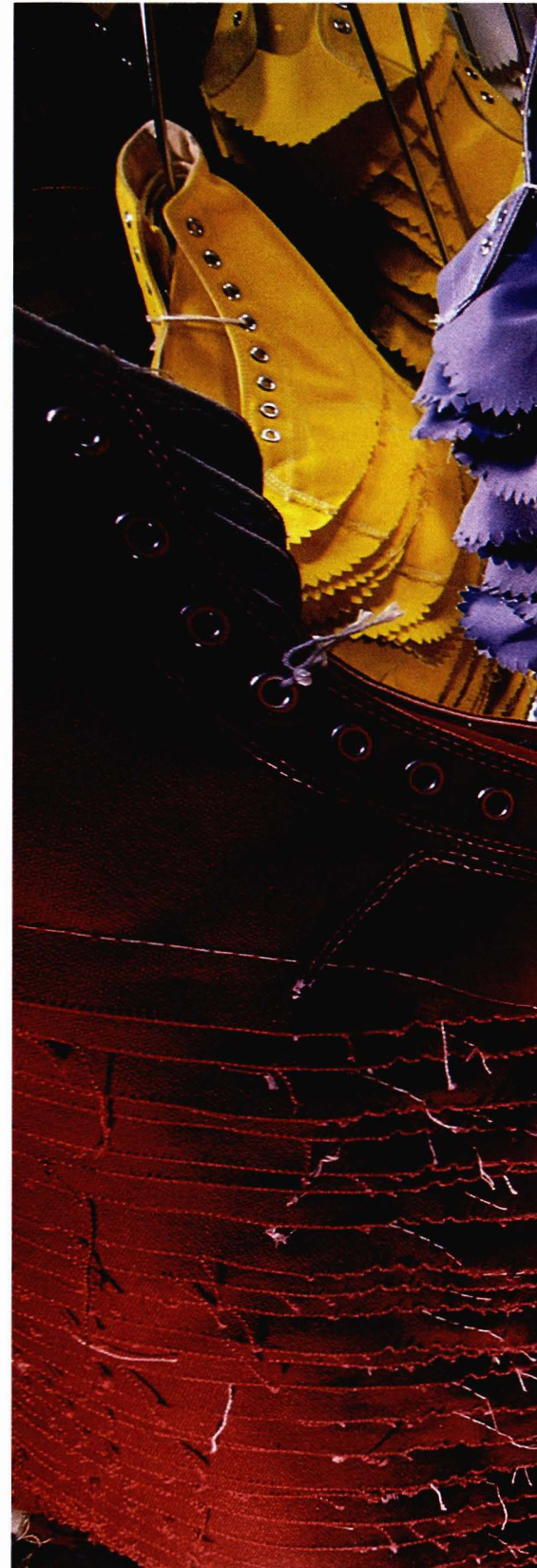
*An athletic shoe manufacturer uses CADAM®, a program for computer augmented design and manufacturing developed by CADAM, Inc. and licensed by IBM, to efficiently design footwear. CADAM is one example of the many products, programs and services integrated with IBM offerings to provide solutions to customers' specialized needs.*

To help meet customers' needs, IBM relies on more than 100,000 suppliers worldwide. From widely used components to specialized software products, their contributions become part of a comprehensive IBM solution for requirements in banking, retailing and other industries.

At the same time, IBM reaches more customers in more places in partnership with a worldwide network of companies that remarket its products. They include retail dealers in typewriters and personal computers; firms which tailor IBM products to perform specialized tasks by adding their own hardware or software or a combination of both; and even existing customers, who remarket IBM products to their own agents, dealers or affiliates.



*IBM engineers and product support people visited more than 2,200 dealers last year to demonstrate the capabilities of the company's new Personal Computer printers. Authorized dealers such as this one in Atlanta reach millions of potential customers for IBM products.*













*IBM Germany is involved in a joint effort with the University of Karlsruhe to develop a prototype university network and to explore new approaches to university education. The network, which includes equipment loaned by IBM, will link a variety of computer systems from different manufacturers.*

University research into the technologies that underpin our industry is one aspect of IBM's partnerships with the academic and scientific communities. Others include support of a supercomputer research facility and the study of manufacturing systems.

The company participates in research that both adds to the world's basic store of knowledge and solves real and urgent human problems. Results may shed new light on the nature of matter or improve satellite image processing for agricultural and environmental purposes in Latin America, Spain and Africa.



*Dr. Kenneth Wilson, Nobel Laureate and head of the Center for Theory and Simulation in Science and Engineering at Cornell University in Ithaca, N.Y., directs efforts to establish a supercomputer facility there. One of five such projects sponsored by the National Science Foundation (NSF) in the U.S., the effort at Cornell also involves New York State, Floating Point Systems and IBM.*







*Students at the Urban League Job Training Center in San Diego, Calif., prepare for jobs in areas such as word processing and data entry. It is one of 57 major centers located throughout the United States, to which IBM has provided equipment, training materials and loaned instructors. The centers have trained more than 14,000 people since 1968.*



IBM strives to meet local needs as a responsible corporate citizen in the 132 countries and many communities around the world in which it does business. Frequently, the company joins in partnerships with government, education, community-service and cultural organizations. IBM also encourages and assists employees in their individual efforts by contributing funds, equipment—and sometimes the full-time services of employees themselves. As the community benefits, so do IBM, its customers and its people.



*An actress is made up for her part in one of a series of contemporary Chinese dramas being sponsored by IBM in Hong Kong.*



Large systems and powerful desktop computers and workstations were among a stream of innovative information-handling products that strengthened IBM's product line in 1985.

Advanced technologies extended the speed and capacity of mid-range systems and storage devices, while automated manufacturing techniques produced high-quality, price-competitive displays, printers and typewriters. New products designed to meet the specialized needs of the scientific and engineering communities also were announced during the year.

The IBM Token-Ring Network and other telecommunications products made it easier for customers to tie together an array of information products.

IBM continued to invest considerable resources in research and development efforts under way at its research centers and laboratories to ensure a continuing flow of products.

The company expanded its commitment to community programs as well, strengthening partnerships in such areas as education and job training.

### Large computer systems

Introduction of two new high-end processors and enhancements to the IBM 308X computer series extended the power and price/performance options available to customers with large and rapidly growing information processing requirements.

The IBM 3090 model 200 processor, announced in February, contains two central processors and up to 64 million characters of central storage. The system can execute instructions almost twice as fast as a comparable IBM 3081 processor in commercial applications and about three times faster in scientific and engineering applications. The model 400 processor, with four central processors and up

to 128 million characters of central storage, can process information almost twice as fast as the model 200.

Both 3090 models can be equipped with an expanded storage that allows automatic transfer of data to and from central storage at speeds significantly faster than those available with conventional input/output devices.

A vector processing facility for the new high-end computers also was introduced in 1985. The enhancement enables the processors to run many engineering and scientific programs up to three times faster than a 3090 processor without the feature.

The 3090 also features a unique serviceability facility that continually monitors the system's functions. Should a problem develop, the facility informs the user, then with the user's authorization, automatically reports the detected problem to an IBM support center.

Improvements to two of the operating systems for large computers extended their function across a range of business, scientific

and engineering applications. Enhancements included: a system assist that gives customers improved performance when using multiple operating systems; a software facility that increases the availability of certain data base and data communications programs; and a multitasking facility that enables customers to run scientific and engineering applications more efficiently. Also introduced was a fiber optic channel-extender link that enables computer peripherals to be installed further from the central computer.

In August, the first 3090 model 200 was shipped to a customer, nearly three months ahead of schedule. Planned first shipment of the model 400 processor was advanced to the fourth quarter of 1986.

### Storage devices

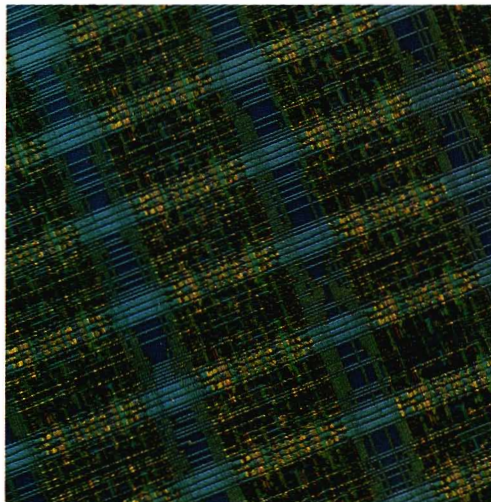
Two new models in the IBM 3380 family of disk storage devices featured disk technology and recording head improvements. The extended capability models offer users of large computers nearly a 15 percent performance improvement when compared with earlier models. The larger unit has twice the maximum storage capacity of previous models.

Up to four of the extended capacity models can be tied together, enabling a data processing operation to double its storage capacity without requiring additional floor space, power or air conditioning.

Also announced were expanded cache memories for the IBM 3880 models 21 and 23 storage control units. Cache storage is an intermediate storage area that speeds the flow of data between storage devices and the computer.

### Mid-range systems

IBM extended the computing options available to customers with medium-size information processing requirements, introducing desktop versions of its System/36 and Series/1 computers. Numerous enhancements to other mid-range systems also were announced.



*The IBM 3090 model 200 processor features emitter-coupled logic circuit technology that contributes to the improved performance of the new system.*





*A leading cosmetics manufacturer in Japan has installed an IBM 3380 disk storage device to facilitate order tracking and billing.*

The IBM System/36 PC, a powerful desktop computer directed at the data processing needs of departments within a large organization, combines a compact System/36 processor and a directly attached IBM Personal Computer, PC XT® or Personal Computer AT®. The system enables customers to use programs and data from both the System/36 and PC families, and to communicate with other System/36 or host computers. The computer also can support up to four locally attached workstations.

Two desktop versions of the Series/1 computer enable customers to employ existing Series/1 applications or extend Series/1 networks to smaller operations within their organizations. Based on the IBM Personal Computer AT and a modified model of the IBM PC XT, the low-end Series/1 models make use of a central processing unit fabricated on a single integrated logic chip.

Customers with larger System/36 processors can increase the power and flexibility of their systems by adding optional memory cards.

Increased use of high-speed bipolar technology and a high-density logic module has resulted in a more cost-efficient mid-range version of the System/38 processor. The new model 18 delivers 10 percent better performance at a 12 percent lower price.

Programs that enable the System/38 to function in office networks, and equipment enhancements that allow users to double the number of workstations they can locally attach to their systems also were introduced.

An innovative programming package—VM/SP-Entry—extends the power and flexibility of IBM's VM operating system to customers with IBM 4361 processors for about half the cost of earlier VM products.

In addition, special channel attachment devices and supporting programming make it possible for Series/1 customers with networks of IBM Personal Computers to use their Series/1 processors as "gateways" to communicate with other PC networks or host computers.

#### **Personal computers**

Low-cost models of the IBM PC XT and powerful PC workstations were among the personal computer products introduced.

Two new versions of the IBM PC XT give customers additional choices in selecting a personal computer to fit their needs. One configuration is equipped with a single diskette

drive; the other features two diskette drives. Both models can be upgraded to include a fixed-disk drive.

A new model of the IBM Personal Computer AT features a fixed-disk drive that can accommodate 50 percent more information than was possible with earlier IBM PCs. The new AT can be equipped with a second fixed-disk drive, giving the computer a maximum capacity of more than 60 million characters of storage.

For users with more sophisticated information-handling requirements, the IBM 3270 Personal Computer AT doubles the processing power of the earlier 3270 PC workstation. Two other 3270 Personal Computer AT workstations



*A major German auto manufacturer uses IBM Series/1 computers tied to two IBM 4361 processors for assembly line control and communication of last-minute order changes.*



can use data from System/370 host computers to create and display color charts, diagrams and drawings as well as text.

IBM Japan expanded the IBM Multistation computer family, announcing the IBM 5540 and 5560 Multistations and new models of the IBM 5550 Multistation, offering enhanced color graphics and increased fixed-disk capacity. An English-language version of the IBM Personal Computer JX also became available in several Far East countries.

#### PC program products

IBM extended the capabilities of its Personal Decision series with the announcement in 1985 of several enhancements. These enhancements provide the business/professional user with greater flexibility in a wide range of data processing applications. Four new products that extend the capabilities of the IBM Assistant series also were introduced.

The company expanded its offering of educational application programs, making

available 34 new software products for use with IBM PCs. The new offerings include a 16-program biology and a four-program physics series, along with additions to IBM's Earth Science and Private Tutor series.

#### Displays

A new color display station and two low-cost terminal products extended the data entry options available to customers in 1985.

The IBM 3179 model G display, the first 3179 display with color graphics capabilities, is designed for use with IBM System/370 host computers.

The IBM 3161 and 3163 display stations are inexpensive, compact workstations featuring built-in capability to emulate both non-IBM terminals and IBM display stations.

#### Telecommunications products

A token-ring network and several other telecommunications products introduced in the past year make it easier for customers with decentralized information systems to

transmit text, data and graphics information among their offices and operations.

The IBM Token-Ring Network is a high-speed local area network designed initially to connect IBM PCs within a building or in a campus environment. The network facilitates a user's ability to share information, printers and devices and files with other users.

To meet the need for efficient, quality service in the rapidly growing field of information processing networks, a new network support center was established in Atlanta.

IBM Japan introduced a nationwide information network service for customers who are establishing enhanced information networks for specific industries. The Network Management Service also can benefit companies offering data bank and remote computing services.

The IBM 3708 network conversion unit enables terminals, PCs and workstations to communicate more easily with host computers using IBM's Systems Network Architecture. Customers with IBM 3710 network controllers can take advantage of the same conversion function with a new communications adapter.

A new terminal multiplexer allows IBM 3270 PC terminals to be connected directly to control units up to 6,000 feet away using the IBM Cabling System. Modems designed for use with PCs, display stations and non-IBM terminals also were introduced.

#### Typewriters and printers

Four new models in the IBM Selectric® System/2000 typewriter family provide added flexibility in keying, editing and storing documents for customers with large text processing requirements. The IBM Wheelwriter® Systems/20 and 40 and the IBM Quietwriter® Systems/20 and 40 feature detached keyboards with cursor controls that facilitate text editing. They also include a display that shows both text and

*A fashionable restaurant in Paris uses a terminal banking application offered by a major French bank to handle its daily transactions. The videobank application operates on an IBM videotex system.*







*A special keyboard for the Chinese-language version of the IBM 5550 Multistation enables customers to enter Chinese characters into the system.*

operator prompts, and a battery back-up that protects the memory if power is disrupted. Both System/40 models provide additional functions through pluggable application program cartridges. Removable storage cartridges offer users added storage capacity.

A graphics model of the IBM Quietwriter printer was introduced in 1985. It offers customers high-resolution graphics that match the sharpness and clarity of the unit's text printing. A low-cost, compact version of the IBM Wheelprinter also was announced.

An economical new electronic typewriter provides customers with much of the advanced function available with earlier models of the Selectric System/2000 typewriter family. The IBM Actionwriter 1 typewriter features a built-in microprocessor to assist typists with many commonly used functions. The typewriter also has a correction memory that facilitates minor copy editing.

Two low-cost, desktop printers that can produce high-quality text and graphics for personal computer users were announced. The IBM Proprinter attaches to both IBM and other widely used personal computers. It features complete graphics capabilities and a special

paper-feed mechanism that allows the use of single-sheet paper, multipart forms or envelopes without removing continuous forms already in the printer.

The IBM Color Jetprinter is a seven-color inkjet printer that can print on 8½-by-11-inch transparencies, some coated papers and most standard bond papers. Designed for the graphics requirements of the business professional, the Jetprinter can produce color charts, graphs, spreadsheets and text.

The IBM 3812 Pageprinter, a tabletop printer for PCs and larger IBM computers, uses electrophotographic technology to print up to 12 pages a minute. The printer can be shared by as many as eight PC users in an office or department or by users on an IBM local area network.

Using IBM's Advanced Function Printing software, the IBM 3820 laser printer can provide distributed printing of text, graphics, forms and digitized images on both sides of a sheet of standard bond paper. The unit can be connected to medium and large processors.

#### **Engineering and scientific products**

Sophisticated analytical equipment and expert system program products were among the offerings announced last year for the engineering and scientific communities.

The IR/38, an advanced, benchtop spectrometer developed and marketed by IBM Instruments, Inc., is a high-performance instrument for repetitive chemical analyses. The IBM 9630 gas chromatograph is a powerful analytical tool designed for use in the chemical, pharmaceutical and food industries.

In August, IBM announced two program products that can help a variety of computer users, including engineers and scientists, create expert systems for tasks ranging from oil exploration to banking. Expert systems are a new type of computer application that makes use of large stores of information to find solutions to problems beyond the scope of conventional computer programming. Expert System Environment/VM is a development tool for constructing and using knowl-

edge bases. VM Programming in Logic can be used for artificial intelligence research and development.

#### **Consumer/Financial systems**

The IBM 4700 Personal Computer workstation combines the productivity benefits of PC applications with products and programs designed specifically for the financial services industry. The 4700 PC enables bank employees at a remote office to extract information from data bases in the firm's main computer, and modify the information locally using PC applications.

The IBM 4702 processor expands the ability of remote offices to carry out many typical banking transactions while on-line with the institution's main computers.

A fault-tolerant system, the IBM System/88 is designed to ensure continuous system availability for customers with critical on-line transaction processing requirements. The System/88 uses redundant components and special programming to provide uninterrupted



*The IBM Proprinter, introduced in 1985, offers personal computer users the option of printing single sheets of paper and envelopes without removing computer paper already in the printer.*



systems support to workstation-intensive industries such as banking, transportation and retailing. The new system includes processors and programming developed and manufactured by Stratus Computer, Inc., under an agreement that provides IBM non-exclusive remarketing rights for selected Stratus products.

### Manufacturing systems

Automated manufacturing processes received added attention in the last year as several new industrial computers and manufacturing software products were introduced.

An entry-level model of the IBM 5531 industrial computer enables small manufacturers to run many of their information-handling applications on the manufacturing floor. Designed for extended operation in areas prone to harsh conditions, the new unit can serve as an equipment controller, a tracking terminal for work in progress or a supervisory workstation.

Two more powerful industrial computers extend the performance available to customers

of IBM's industrial computer products. The IBM 7531 and 7532 computers can be used for tasks ranging from machine monitoring to distributed numerical control processing and production control.

Also announced were an industrial color graphics display designed for use in manufacturing environments, and program products that facilitate maintenance scheduling and communications with programmable controllers and other plant applications.

### Federal Systems Division

The Federal Aviation Administration (FAA) awarded the company's Federal Systems Division (FSD) a contract to upgrade the computer systems at the agency's 20 air traffic control centers around the U.S. Part of an FAA effort to modernize the air traffic system, the processors will aid flight controllers monitoring and directing aircraft flying between U.S. airports.

FSD also received two major contracts involving the National Aeronautics and Space

Administration (NASA) in 1985. One contract covers the definition and preliminary design of the data management system for the first permanently manned U.S. space station. The second calls for IBM to upgrade the computer system in the Mission Control Center at NASA's Johnson Space Center in Houston.

### ROLM Corporation

ROLM Corporation has been awarded a NASA contract valued at nearly \$15 million to install a new business communications system at the Johnson Space Center. The contract calls for ROLM to install an advanced communications control system, digital telephones and desktop telecommunications devices, and a supporting cable and fiber optics distribution system.

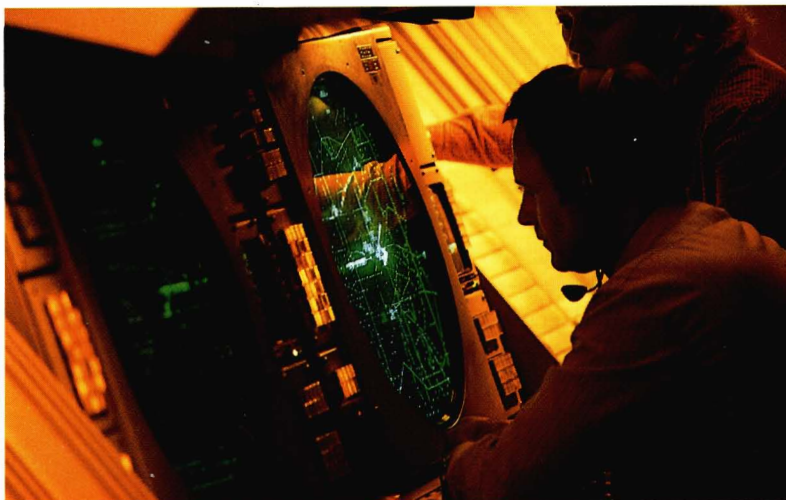
ROLM introduced an enhanced version of its Central Attendant Service that enables customers to provide better telephone service to callers at a lower cost. Enhancements to the ROLM PhoneMail voice messaging system that increase its capacity, reliability and flexibility also were announced.

ROLM's Juniper II, a voice/data communications product which complements IBM Personal Computers, offers users voice and data features, including terminal emulation, one-touch log-on for data calls, two-way speakerphone and powerful digital telephone functions. Juniper II also allows PC users to transfer information to and from an IBM host computer or another PC at rates significantly higher than a standard modem.

The divestiture of ROLM's Mil-Spec Computer Division was completed in June. The division was acquired by the Loral Corporation of New York City. Sale of the unit fulfills the terms of the consent decree that ROLM and IBM entered into with the U.S. Department of Justice as a precondition of the companies' merger.

### Research and development

A new one-million-bit computer memory chip that operates twice as fast as the company's previously announced one-million-bit chip



*Air traffic controllers undergo training at the Federal Aviation Administration Technical Center near Atlantic City, N.J. IBM has been awarded a major contract to upgrade the computers supporting the system.*





*This form is a fractal representation of a mathematical object called a Mandelbrot set. IBM mathematician Benoit Mandelbrot recently was recognized for originating the theory of fractal geometry.*

has been fabricated by engineers at IBM's Burlington, Vt., laboratory. The experimental chip occupies two-thirds the space of the prior memory chip. Sample chips have been fabricated on existing production lines and operated at speeds that make them among the fastest megabit memory chips ever reported.

Researchers at IBM's Yorktown, N.Y., research center have fabricated the densest integrated circuits yet reported on two types of experimental integrated circuit chips. The novel fabrication process allows scientists to shrink electronic circuits into an area 16 times smaller than possible with current semiconductor manufacturing technology. The technique is an important step toward the fabrication of individual chips capable of storing up to 16 million bits of information.

A new technique that provides a 10-fold improvement in the accuracy of testing circuit delays on very-large-scale integration (VLSI) chips has been developed by an engineer at IBM's East Fishkill, N.Y., laboratory. Circuit delays are the time intervals that it takes to turn on and off a particular circuit on an integrated circuit chip. The new technique enables engineers to measure within trillionths of a second the speeds of integrated circuits.

A compact scanning tunneling microscope developed by scientists at IBM's Zurich research laboratory in Switzerland lets researchers view

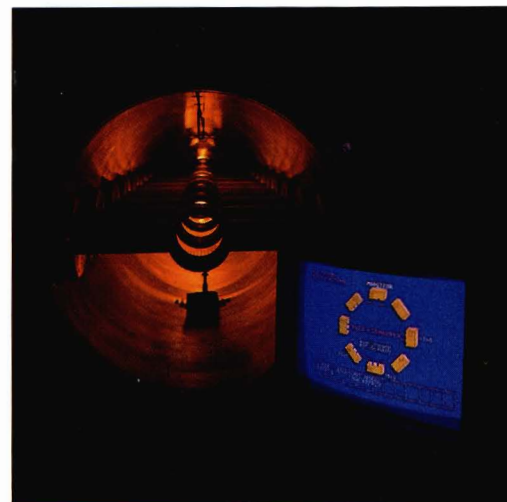
individual atoms on the surface of a sample material. The unit creates a profile of the surface under study by measuring and adjusting to variations in a current being passed between the sample and a probe traveling just above its surface. The latest development in a microscopy technique originally invented by the IBM scientists in 1981, the compact tunneling microscope has an added advantage in that it can be aimed at particular segments of a sample with the aid of a conventional microscope.

Yorktown researchers are working with scientists from New York University's Courant Institute of Mathematical Science in New York City to design an experimental, highly parallel computer to serve as a research tool for advanced computer studies. The experimental machine, known as RP3, will consist of up to 512 processors, linked in parallel and connected to as many as two billion characters of main memory. Initial focus of the project is the viability of using large-scale parallelism—many processors working on a single task—to address a variety of complex problems, including computer-aided design, expert systems and other advanced artificial intelligence projects.

Over the next five years, IBM will provide more than \$30 million in products and support to a supercomputer facility established at Cornell

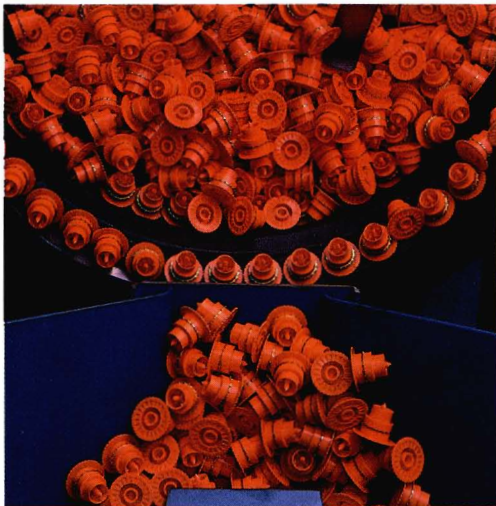
University in Ithaca, N.Y. Supercomputers are specially configured systems used to investigate complex problems that could take years to complete using conventional methods. Jointly sponsored by the university, the National Science Foundation (NSF), New York State, Floating Point Systems and IBM, the Cornell project is one of five supercomputer efforts initiated by the NSF to ensure that the American research community has access to advanced scientific computer technology.

Benoit Mandelbrot, IBM Fellow and originator of fractal geometry, was awarded the Barnard Medal of Meritorious Service to Science by Columbia University. The award is presented once every five years on the recommendation of the National Academy of Sciences. A major development in 20th-century science, fractal



*Scientists of the CERN European Laboratory for Particle Physics in Switzerland are installing an IBM Token-Ring Network to control accelerators used in atomic particle studies.*





*Automated manufacturing equipment is helping IBM's Boigny, France, plant reduce the cost and improve the quality of print ribbons produced at the plant.*

geometry is based on the principle that natural forms tend to repeat themselves. It is being applied across a spectrum of scientific disciplines.

#### Joint ventures

IBM Japan and Nippon Telegraph and Telephone Corporation, Japan's domestic telephone company, established a joint venture company in Japan to market telecommunications products and services. The firm has been named Nippon Information and Communication Corporation. Among planned products is a telecommunications system that will provide customers access to remotely located computers via telephone lines for exchange of text, graphics and computerized images.

In June, IBM, Aetna Life & Casualty and MCI Communications Corporation announced an agreement under which MCI would acquire substantially all the assets and operations of Satellite Business Systems. SBS had been owned jointly by IBM and Aetna Life & Casualty.

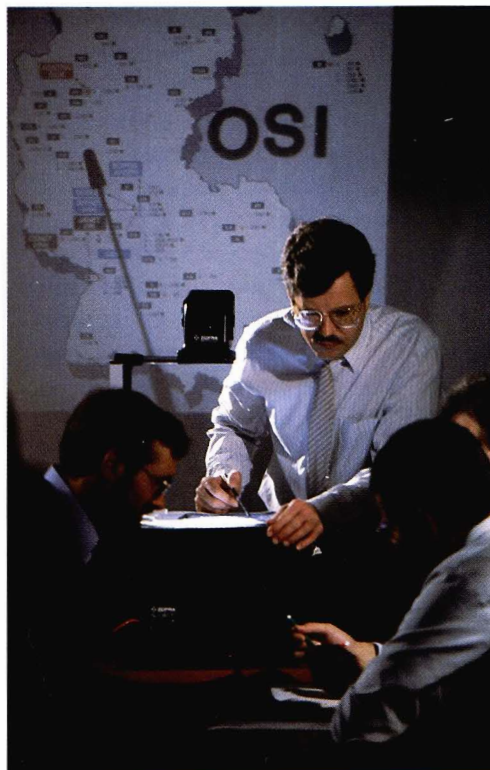
In September, IBM Italy and the ELSAG-Stet Group completed the formation of a joint venture

company called SEIAF. The joint venture will market products for flexible and integrated automation of manufacturing processes. The joint venture firm also will address approaches for connecting and integrating various areas of factory automation.

#### European Networking Center

IBM Europe has established a European Networking Center in Heidelberg, Germany, to carry out advanced systems communications projects. The center will permit IBM engineers, working with other European scientists, to perform studies in telecommunications and networking with particular focus on Open Systems Interconnection (OSI) applications.

Based on a reference model for computers developed by the International Organization of Standardization, OSI is designed to permit systems operating under different architectures to exchange data. IBM has been a major contributor to the development of OSI and has implemented OSI standards in several recent product offerings.



#### Reorganization

IBM announced a major reorganization of its U.S. marketing divisions during the fall of 1985. The new structure, which began operations on January 1, 1986, is designed to provide customers quality support and service while making efficient use of the company's resources.

Under the realignment, divisions that marketed IBM's products to traditional customer accounts were reorganized into two geographic marketing divisions that will market the company's product line to customers within their respective geographic areas.

Field service operations were realigned to be symmetrical with the new marketing organizations. The division which directs the company's marketing efforts through alternate channels realigned its value-added remarketing and authorized dealer operations into a single sales organization.

The company continued its efforts to decentralize decision-making and improve efficiency, realigning one of its major business groups into two new groups. One is responsible for developing and manufacturing large processors, storage systems and associated programming; the other, logic, memory and other semiconductor devices and packaging.

#### New facilities

In line with IBM's goals of growing with the industry and being the low-cost producer, the company continued to invest in new manufacturing and development facilities.

One of the newest facilities, a state-of-the-art production plant in Charlotte, N.C., is designed specifically for volume production of high-quality, low-cost products. The facility, which recently began manufacturing the IBM Proprinter, makes use of automation throughout its manufacturing operations. A series of special control programs directs the production process, which was

*Staff at IBM's European Networking Center in Heidelberg, Germany, reviews early results of an experimental networking study.*



designed to eliminate the need to maintain a parts inventory.

During the year, IBM invested \$6.1 billion in new plant, property and equipment. More than 5 million square feet of additional plant and laboratory space were completed. Another 4.8 million square feet of space were under construction.

Projects completed during 1985 included a semiconductor manufacturing building in East Fishkill, N.Y.; manufacturing buildings in Kingston, N.Y., and Rochester, Minn.; a laboratory facility in Yamato, Japan; and expansions of the Greenock, Scotland, plant and the Zurich Research Laboratory.

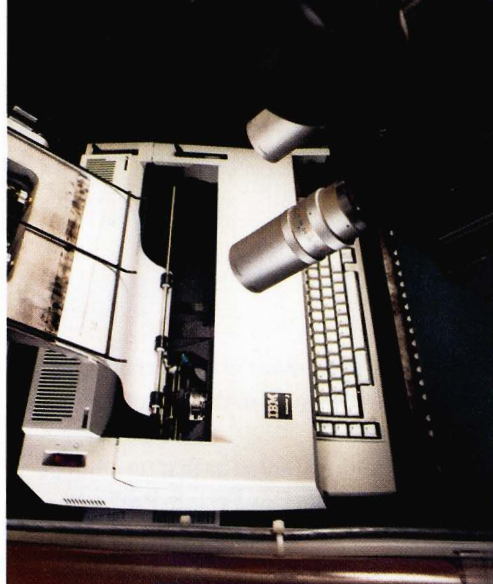
#### Employee suggestions

The IBM Suggestion Plan again had a positive impact on the company's productivity in 1985 as cost-saving ideas submitted under the plan yielded savings of more than \$125 million. Approximately 30,000 employees whose ideas were implemented under the Suggestion Plan also shared the benefits, earning more than \$18 million in cash awards.

#### Affirmative action

IBM continued its commitment to affirmative action in employment and advancement in 1985. Of the more than 10,250 new employees hired in the U.S. last year, over 45 percent were women and over 22 percent were minorities. About 5,200 women and 3,600 minority employees held management positions at year end, and of these almost 500 women and 500 minorities were in the top 20 percent of U.S. management jobs.

The company also continued its support to minority-owned businesses, purchasing more than \$125 million in products and services from some 850 minority-owned firms in 1985. IBM also made purchases totaling over \$70 million from more than 700 firms owned primarily by women, and over \$17 million from more than 70 companies employing handicapped workers.



*Cameras magnify print samples at IBM's typewriter and printer manufacturing plant in Lexington, Ky. Character images are compared with those stored in a computer system, ensuring the detection of flaws in print quality.*

#### Education

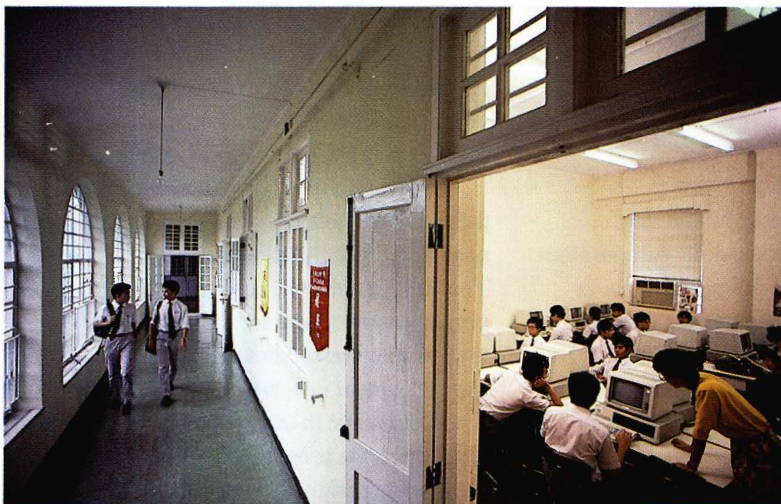
IBM increased its support for education, and particularly for programs designed to help universities keep pace with evolving technologies. The company also increased its support to educational institutions with large minority and disadvantaged enrollments, and to efforts aimed at increasing computer literacy among school-children.

Donations of cash and equipment were awarded to 13 universities in the U.S. for programs to enhance graduate-level education in the management of information systems. Under the program, each university will receive a cash grant and IBM equipment and software to

support curricula, faculty development and research into methods for making more efficient use of information systems in industry.

Planning grants were awarded to another 36 U.S. universities to assist them in developing proposals for research and graduate-level curricula in the materials and processing sciences. This spring, up to 12 schools will be selected to receive grants of cash and IBM equipment to support their proposed research and instructional programs.

More than 100 IBM employees were granted Faculty Loan leaves last fall to teach or give full-time administrative assistance to colleges, universities and high schools with large minority, handicapped or disadvantaged enrollments,



*A school in Hong Kong uses a Personal Computer cluster network provided by IBM to enable students and teachers to share instruction programs and equipment. The networking software supporting the cluster was developed by the University of Waterloo in Canada.*



or with programs geared to those students. In the 14 years since the Faculty Loan Program was initiated, more than 600 employees have been granted leaves to serve institutions requesting assistance.

IBM Europe has established a new scientific computing facility at the company's scientific



*IBM Australia contributed computer equipment and software to the University of Queensland in Brisbane, Australia, for teaching and research in advanced control systems. Here, a lecturer instructs students using one of the university's process control installations.*

center in Rome. The center provides the European academic and scientific communities the free use of advanced computing tools for experimental work in computation-intensive science and engineering research.

A major grant from IBM Canada and supporting funding from the government of Alberta are enabling the University of Alberta to establish a new educational computer network serving students and teachers in Edmonton, Calgary and Lethbridge. Under the agreement, IBM is providing software and equipment, including more than 160 IBM Personal Computers.

IBM Australia has contributed equipment, software and training to the Department of Chemical Engineering at the University of

Queensland in Brisbane in support of university programs and research in the field of advanced control systems.

IBM Europe awarded its first IBM Europe Science and Technology Prize to Professor Fritz Schaefer of the Max Planck Institute for Biophysical Chemistry in Goettingen, Germany for his pioneering work in laser research. The prize is designed to recognize an individual outside the company for significant and innovative contributions to science and technology in Europe.

#### IBM and the community

IBM's commitment to responsible corporate citizenship resulted in the strengthening of programs benefiting people around the globe. In all, the company's contributions of cash, equipment and other resources to social, cultural and educational programs worldwide amounted to more than \$188 million in 1985.

IBM continued its efforts in support of job training centers, adding 10 new centers in the U.S. Since IBM began its affiliation with community job training centers in 1968, more than 14,000 people have gained information processing and office skills through 57 IBM-supported centers. Similar programs throughout Europe have proven equally successful.

An IBM-initiated program helped create jobs for about 400 disadvantaged youths in several U.S. metropolitan areas last summer. The Summer Youth Employment Program provided grants to 20 community-based organizations in 18 cities with sizable youth unemployment to help develop jobs for high school students. In addition to the employment experience, the program offered an educational component designed to encourage participants to complete their high-school education.

When Mexico City was rocked by two devastating earthquakes in September, IBM personnel assisted in providing disaster relief. IBM Mexico concentrated its efforts on locating and assisting employees affected by the quakes and providing support to customers whose information processing operations had

been disrupted. With assistance from IBM staff in the U.S., IBM Mexico also helped coordinate two airlifts of medical supplies and rescue equipment.

IBM announced it will help underwrite a new television mathematics series being developed by the Children's Television Workshop, creators of the highly acclaimed "Sesame Street." The series, aimed at 8 to 12 year-olds, is designed to promote interest in mathematics. It is scheduled to debut in January 1987.

The company also was corporate underwriter for a major science series that premiered on the Public Broadcasting Service in January. The program, "Planet Earth," is a seven-part series on geophysics. IBM distributed related materials to schools across the U.S. to enable students to benefit from the series' educational content.

*Visitors view a major Renoir retrospective at the Boston Museum of Fine Art. Sponsored by IBM, the exhibit was also shown in Paris and London.*





# Financial Report

International Business Machines Corporation  
and Subsidiary Companies

## Report of Management

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.

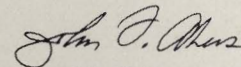
IBM maintains an effective system of internal accounting control. It consists, in part, of organizational arrangements with clearly defined lines of responsibility and delegation of authority. We believe this system provides reasonable assurance that transactions are executed in accordance with management 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 system 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 continue to 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

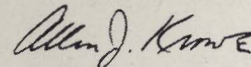
IBM Business Conduct Guidelines. These guidelines, translated into numerous languages, are distributed to employees throughout the world, and reemphasized through internal programs to assure that they are understood and followed.

Price Waterhouse, independent accountants, are retained to examine IBM's financial statements. Their accompanying report is based on an examination conducted in accordance with generally accepted auditing standards, including a review of internal accounting controls 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 accounting controls and financial reporting matters.



John F. Akers President and  
Chief Executive Officer



Allen J. Krowe Senior Vice President,  
Finance & Planning

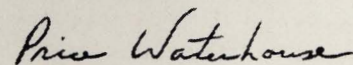
## Report of Independent Accountants

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

January 28, 1986

In our opinion, the accompanying consolidated financial statements, appearing on pages 26, 28, 30, and 33 through 43, present fairly the financial position of International Business Machines Corporation and its subsidiary companies at December 31, 1985, and 1984, and the results of their operations and changes in funds for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements

were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.



Price Waterhouse  
153 East 53rd Street  
New York, N.Y. 10022



# Consolidated Statement of Earnings

for the year ended December 31:

(Dollars in millions except per share amounts)	1985	1984	1983
Gross Income:			
Sales . . . . .	\$34,404	\$ 29,753	\$ 23,274
Services . . . . .	11,536	9,605	7,676
Rentals . . . . .	<u>4,116</u>	<u>6,579</u>	<u>9,230</u>
	\$50,056	\$ 45,937	\$ 40,180
Cost of sales . . . . .	14,911	12,374	9,748
Cost of services . . . . .	4,689	4,347	3,506
Cost of rentals . . . . .	1,503	2,198	3,141
Selling, general and administrative expenses . . . . .	13,000	11,587	10,614
Research, development and engineering expenses . . . . .	4,723	4,200	3,582
Interest expense . . . . .	<u>443</u>	<u>408</u>	<u>390</u>
	<u>39,269</u>	<u>35,114</u>	<u>30,981</u>
	10,787	10,823	9,199
Other income, principally interest. . . . .	<u>832</u>	<u>800</u>	<u>741</u>
Earnings before income taxes . . . . .	11,619	11,623	9,940
Provision for income taxes. . . . .	<u>5,064</u>	<u>5,041</u>	<u>4,455</u>
Net Earnings . . . . .	\$ <u>6,555</u>	\$ <u>6,582</u>	\$ <u>5,485</u>
Per share. . . . .	\$10.67	\$ 10.77	\$ 9.04
Average number of shares outstanding:			
1985—614,084,568			
1984—611,426,324			
1983—606,769,848			

The notes on pages 34 through 43 are an integral part of this statement.



# Management Discussion

## Results of Operations

The past year was a difficult one for the information-handling industry in North America. An uncertain economy and sluggish capital spending by our customers in the U.S. caused an adverse impact on IBM's performance for the full year 1985. Despite this, IBM achieved record worldwide shipments, introduced major new products and, in addition, had excellent financial results from its operations outside the U.S.

Worldwide gross income in 1985 totaled \$50.1 billion, an increase of 9.0 percent over 1984. Non-U.S. operations showed strong business growth, with gross income increasing by 16.0 percent to \$21.5 billion. Revenue growth for U.S. operations was a modest 4.2 percent, with 1985 gross income reaching \$28.5 billion.

Early in 1985 our customers paused to evaluate the advisability of installing IBM 308X processors or waiting for the availability of the new IBM 3090 processors. Volume shipments of the 3090 model 200 began in the third quarter. The high quality of this product, brought about by engineering and manufacturing excellence, contributed to the company's ability to deliver it earlier than expected.

Moderation in the strength of the dollar began to be reflected in the company's financial results in the last two quarters of the year. Although full-year results were still affected unfavorably by currency fluctuations, the effect in the second half of the year was positive.

Worldwide net earnings were essentially flat year-to-year, reflecting the company's resilient response to the adverse North American economic conditions. Worldwide net earnings of \$6,555 million were 0.4 percent below the 1984 record of \$6,582 million.

Gross income from sales was \$34.4 billion, an increase of 15.6 percent over 1984. Sales gross income includes sales to customers who have exercised their option to purchase installed rental equipment. Sales gross income, excluding sales of installed equipment, increased 24.6 percent over 1984, reflecting the purchase of products shipped to our customers during 1985.

Conversely, gross income from rentals declined 37.4 percent to \$4.1 billion. Rental gross income was 8.2 percent of total gross income in 1985, down from 14.3 percent a year ago.

Gross income from services continued to grow in 1985 and increased as a percentage of total gross income. Revenue from services reached \$11.5 billion in 1985, a 20.1 percent increase over the preceding year. The major increase came from program products which increased 30.3 percent to \$4.2 billion. Maintenance services increased 15.9 percent over 1984 to \$6.1 billion.

Information on industry segments and classes of similar products or services is presented on page 43. Sales of peripheral equipment showed a significant improvement over 1984, increasing 28.0 percent. This improvement, evident in both the U.S. and non-U.S. operations, was primarily the result of strong growth in shipments of magnetic tape subsystems and direct access storage devices. Total processor sales showed only modest worldwide growth and declined in the U.S. Sales of office systems/workstations increased by 15.1 percent, mostly in non-U.S. operations.

Worldwide gross profit was \$29.0 billion, an increase of 7.2 percent over 1984.

Efficiencies derived from the major investments over the past several years in plant capacity and new machinery and equipment continue to result in improved manufacturing cost. Despite this continuing improvement in productivity, gross profit margins declined 1.0 percentage point to 57.8 percent. There are two basic reasons for this decline.

Gross profit margins on low-priced, high-volume products are less than on high-end processors. As relatively more of our revenues are derived from sales of these low-priced, high-volume products, the total gross profit margin is reduced.

In addition, gross profit margins from rentals and from installed rental equipment converted to purchase are higher than gross profit margins on sales of new equipment. Consequently, as IBM's business shifts more to outright sales and away from rental and conversion income, a second downward pressure is brought

to bear on gross profit margins. This transition is largely behind us now, and the downward pressure on the margin from this will be less severe in the future.

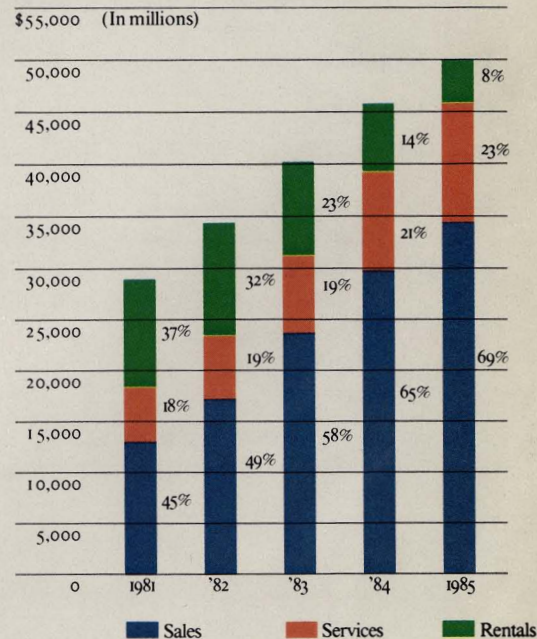
In 1985 gross profit from services increased 30.2 percent to \$6.8 billion. Program products were the primary contributor to this increase.

Selling, general and administrative expense as a ratio to gross income increased slightly in 1985 to 26.0 percent from 25.2 percent in 1984. Rigorous expense and resource controls were implemented throughout the business in 1985; these will continue in 1986 as the company maintains a focus on efficiency and productivity. Investments in research, development and engineering have resulted in a strong and competitive product line. This investment amounted to \$4.7 billion in 1985, an increase of 12.5 percent over 1984.

Other income, which is principally interest, increased 4.0 percent to \$832 million.

IBM's overall business health is sound, and the company is well positioned to share in the continued growth of the information-handling industry.

### IBM Consolidated Gross Income:





(Dollars in millions)		1985	1984
<i>Assets</i>			
<b>Current Assets:</b>			
Cash . . . . .	\$ 896	\$ 600	
Marketable securities, at cost, which approximates market . . . . .	4,726	3,762	
Notes and accounts receivable—trade, net of allowances . . . . .	9,757	7,393	
Other accounts receivable . . . . .	809	718	
Inventories . . . . .	8,579	6,598	
Prepaid expenses and other current assets . . . . .	<u>1,303</u>	<u>1,304</u>	
	\$ 26,070		\$ 20,375
<b>Rental Machines and Parts . . . . .</b>	<b>4,637</b>	<b>6,375</b>	
Less: Accumulated depreciation . . . . .	<u>2,804</u>	<u>3,425</u>	
	1,833		2,950
<b>Plant and Other Property . . . . .</b>	<b>29,846</b>	<b>23,048</b>	
Less: Accumulated depreciation . . . . .	<u>11,999</u>	<u>9,635</u>	
	17,847		13,413
<b>Investments and Other Assets . . . . .</b>	<b>6,884</b>	<b>6,070</b>	
	<u>\$ 52,634</u>	<u>\$ 42,808</u>	
<i>Liabilities and Stockholders' Equity</i>			
<b>Current Liabilities:</b>			
Taxes . . . . .	\$ 3,089	\$ 2,668	
Loans payable . . . . .	1,293	834	
Accounts payable . . . . .	1,823	1,618	
Compensation and benefits . . . . .	2,460	2,223	
Deferred income . . . . .	391	340	
Other accrued expenses and liabilities . . . . .	<u>2,377</u>	<u>1,957</u>	
	\$ 11,433		\$ 9,640
<b>Long-Term Debt . . . . .</b>	<b>3,955</b>	<b>3,269</b>	
<b>Other Liabilities . . . . .</b>	<b>1,606</b>	<b>1,353</b>	
<b>Deferred Income Taxes . . . . .</b>	<b>3,650</b>	<b>2,057</b>	
<b>Stockholders' Equity:</b>			
Capital stock, par value \$ 1.25 per share . . . . .	6,267	5,998	
Shares authorized: 750,000,000			
Issued: 1985—615,741,687; 1984—613,076,500			
Retained earnings . . . . .	27,234	23,486	
Translation adjustments . . . . .	<u>(1,466)</u>	<u>(2,948)</u>	
	32,035	26,536	
Less: Treasury stock, at cost . . . . .	<u>45</u>	<u>47</u>	
Shares: 1985—323,425; 1984—390,961			
	31,990	26,489	
	<u>\$ 52,634</u>	<u>\$ 42,808</u>	

The notes on pages 34 through 43 are an integral part of this statement.



# Management Discussion

## Financial Condition

During 1985, IBM maintained its strong financial position while continuing to make significant investments in research, development and engineering, and plant and other property. Over the last five years, these investments totaled \$38.3 billion.

In 1985, \$4.7 billion were directed to research, development and engineering. These expenditures sustained IBM's efforts to maintain its technical leadership, ensured a continuing flow of competitive products to the marketplace, and provided the company with the ability to pursue new growth opportunities.

Investments in plant and other property in 1985 amounted to \$6.1 billion, an increase of 32.5 percent over 1984. These investments were made to ensure that IBM continues to reduce unit manufacturing costs, maintains industry leadership in quality and achieves its goal of being the industry's low-cost producer. A significant part of that investment includes IBM products used internally that have helped the company to improve productivity and efficiency in all areas of its business. Manufacturing capacity has also been added and modernized to provide efficient facilities for producing the growing shipment volumes of IBM's expanding product line.

In addition, IBM has continued its investment in program products. Part of this investment, \$785 million in 1985, was capitalized and will be amortized over the revenue producing lives of the products.

IBM's investment in finance subsidiaries and sales-type leases reflects the company's growing participation in financing products purchased by its customers. In 1985, customers financed approximately \$5 billion in purchase value of IBM equipment through the IBM Credit Corporation and similar IBM activities around the world.

Two additional actions were taken in 1985 that affected IBM's investments and other assets. The company sold its \$503 million of U.S. fixed-income securities, and increased its investment in Satellite Business Systems (SBS).

Investments were also made in joint ventures such as International MarketNet, Trintex and Nippon Information and Communication

Corporation. Each of these joint ventures is designed to help capitalize on specific market opportunities.

As part of the ROLM Corporation acquisition, ROLM's Mil-Spec division was sold on June 28, 1985, to Loral Corporation.

IBM's working capital increased by \$3.9 billion during the year. This increase was caused by a \$2.4 billion growth in notes and accounts receivable, \$2.0 billion in inventories, and \$1.3 billion in cash and marketable securities. These increases were offset by a rise in current liabilities of \$1.8 billion. The growth in accounts receivable was primarily caused by the substantial increase in shipments to customers during the fourth quarter. Inventory growth occurred in work in process, as continued stocking was required to satisfy demand for volume increases throughout the product line. In addition, shelf stock for high-volume products was increased as demand and the distribution system for these products expanded.

During 1985, \$12.8 billion, or 82 percent of total funds provided, were generated from operations. These funds, coupled with an increase in long-term debt, were used to finance IBM's investments in the future. The company added \$1,614 million to long-term debt from various new issues during 1985. Long-term obligations from prior years were reduced by \$928 million, resulting in a net increase of \$686 million in long-term debt. IBM's credit rating remains strong, and its long-term debt-to-equity ratio is 12.4 percent.

In 1985, the company continued open-market acquisition of shares to meet most requirements of IBM's stockholder and employee stock plans.

Deferred income taxes increased by \$1.6 billion during 1985. This is attributable to tax timing differences related to sales-type leases, installment sales, depreciation, and the deferral of investment tax credits. In addition, one-time events that occurred in 1985 in conjunction with the acquisition of ROLM and SBS also served to reduce the company's current tax liability.

The accounting method for translating the majority of non-U.S. net assets into U.S. dollars requires such items to be translated at current

exchange rates. The cumulative effect of this currency translation is included in the equity section of the consolidated statement of financial position as "translation adjustments."

The moderation in the strength of the U.S. dollar during 1985 caused a significant reduction in the "translation adjustments," from \$2,948 million at year-end 1984 to \$1,466 million at year-end 1985. This year-to-year change of \$1,482 million is the result of valuing non-U.S. net assets at the relatively higher foreign currency exchange rates at year-end 1985, and is not a result of the operational performance of the company. The effect of the year-to-year change is to increase stockholders' equity.

Dividends of \$2,703 million were paid during the year, up \$196 million from 1984, or 7.8 percent.

During the year, management stressed improvements in all key areas of operations as well as asset management, while investing in areas promising the best possible growth for the future. Competition continues to be keen in all areas of the information-handling industry. Remaining competitive in product cost requires investment in new equipment and modern facilities as well as a low-cost, high-quality manufacturing process. Sustaining a broad, competitive product line requires expenditures in research, development and engineering, along with proper management controls to ensure an adequate return. These factors have been stressed in all IBM operating units with positive results.

IBM continues to manage its costs, expenses and other resources carefully. Product costs and expenses in 1985 reflect increases in productivity over the prior year, and this direction is expected to continue throughout 1986. Management remains optimistic about the future of IBM and the overall computer industry. The company's continuing investments in its business, coupled with the skills and loyalty of its employees, have positioned it for future growth.



# Consolidated Statement of Funds Flow

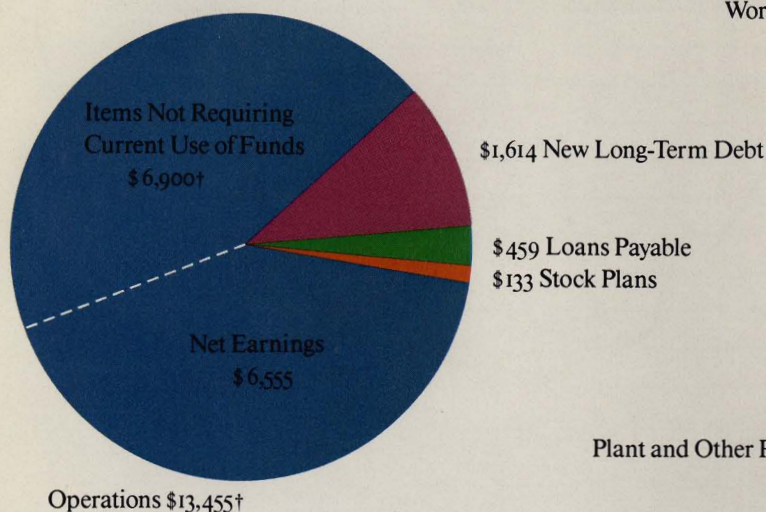
for the year ended December 31:

(Dollars in millions)	1985	1984	1983
<i>Funds (Cash and Marketable Securities) at January 1</i> . . . . .	\$ 4,362	\$ 5,536	\$ 3,300
<b>Provided from (used for) Operations:</b>			
<b>Sources:</b>			
Net earnings . . . . .	\$ 6,555	\$ 6,582	\$ 5,485
Items not requiring the current use of funds:			
Depreciation charged to costs and expenses . . . . .	2,894	2,987	3,362
Net book value of rental machines and other property retired or sold . . . . .	867	1,483	2,108
Amortization of program products . . . . .	425	486	311
Other (principally deferred income taxes) . . . . .	1,880	1,004	749
	<u>12,621</u>	<u>12,542</u>	<u>12,015</u>
Depreciation of manufacturing facilities capitalized . . . . .	157	228	265
	<u>12,778</u>	<u>12,770</u>	<u>12,280</u>
<b>Uses:</b>			
Investment in rental machines . . . . .	313	858	1,412
Investment in plant and other property . . . . .	6,117	4,615	3,518
	<u>6,430</u>	<u>5,473</u>	<u>4,930</u>
Investment in program products . . . . .	785	803	588
Increase in investments and other assets . . . . .	454	1,764	1,887
Net change in working capital (excluding cash, marketable securities and loans payable) . . . . .	3,101	4,043	855
	<u>10,770</u>	<u>12,083</u>	<u>8,260</u>
Translation effects . . . . .	677	(324)	(147)
Net provided from operations . . . . .	2,685	363	3,873
<b>Provided from External Financing:</b>			
Net change in long-term debt . . . . .	686	595	(177)
Net change in loans payable . . . . .	459	302	3
Net provided from external financing . . . . .	1,145	897	(174)
<b>Provided from Employee and Stockholder Plans</b> . . . . .	133	73	788
	<u>8,325</u>	<u>6,869</u>	<u>7,787</u>
<b>Less: Cash Dividends Paid</b> . . . . .	2,703	2,507	2,251
<i>Funds (Cash and Marketable Securities) at December 31</i> . . . . .	\$ 5,622	\$ 4,362	\$ 5,536

The notes on pages 34 through 43 are an integral part of this statement.

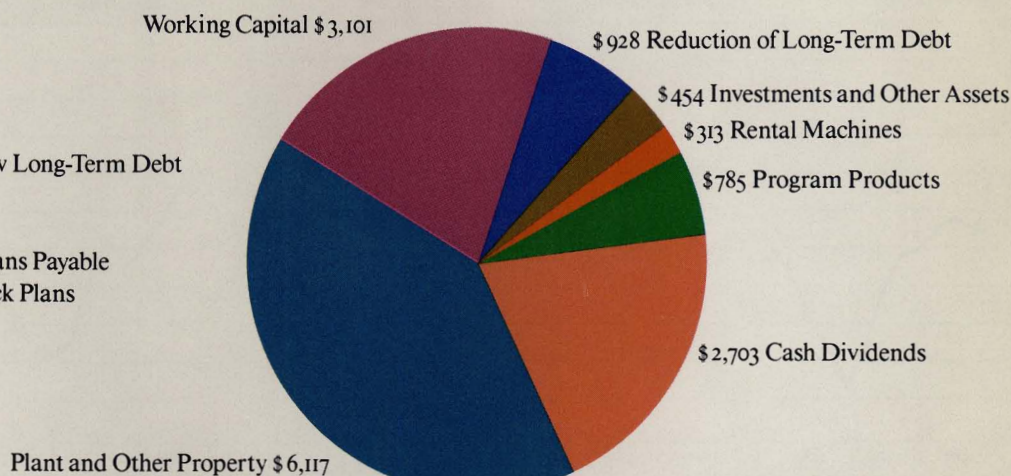


### Summary of Sources of Funds (Dollars in millions)



†Includes Translation Effects of \$ 677

### Summary of Uses of Funds (Dollars in millions)

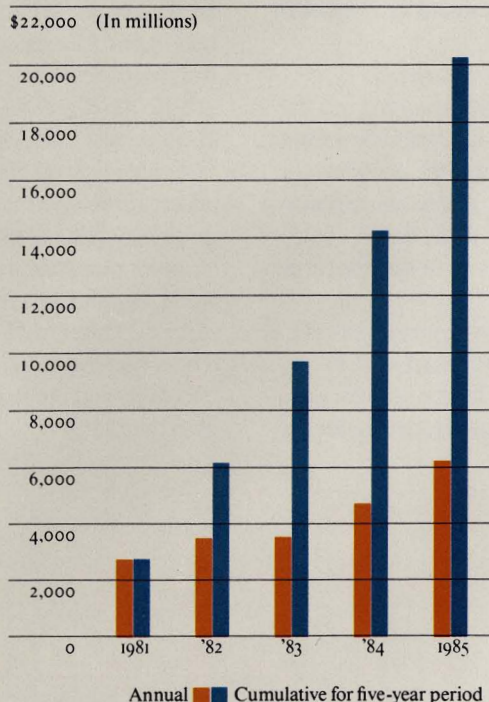


### Expenditures for Plant and Other Property

Over the past five years, the company has invested over \$20 billion in land, buildings, machinery and equipment, and internally installed IBM manufactured equipment required to meet customer demand, maintain technological leadership and improve productivity. These recent additions represent 68 percent of the gross asset value of plant and other property as of December 31, 1985.

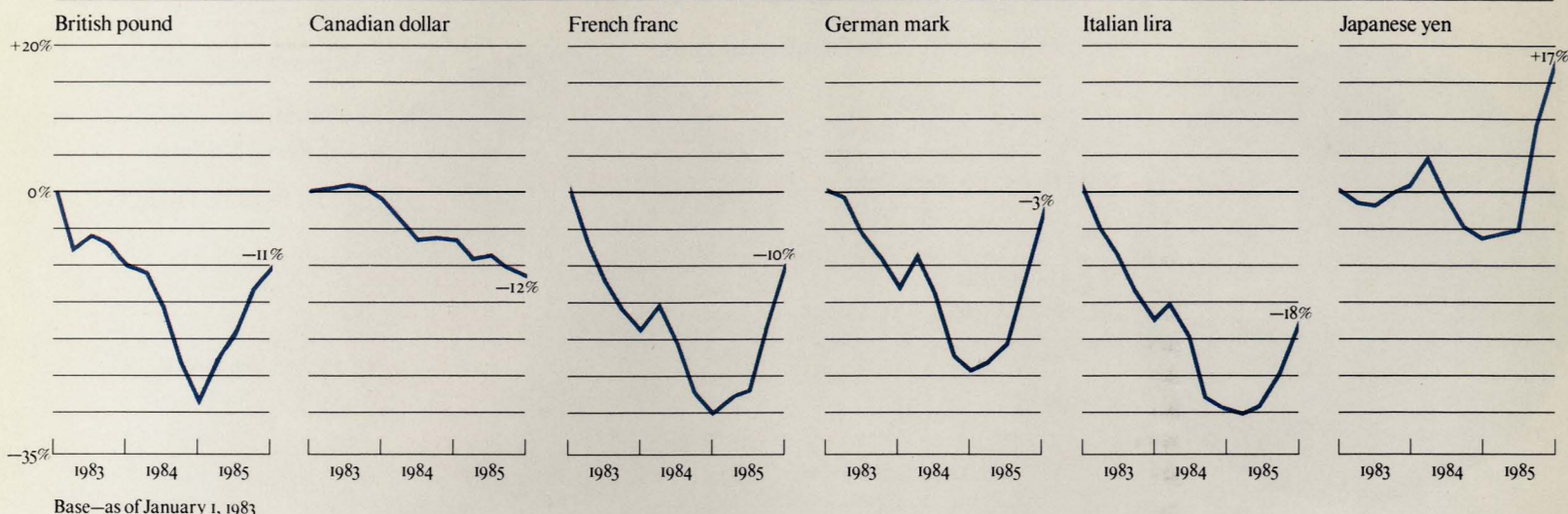
Continuous upgrading of our facilities is essential to achieve our objectives. Large investments will continue to be required in future years.

### Investment (Additions) in Plant and Other Property





## Percentage Change in Value of Foreign Currencies Compared to U.S. Dollar



In 1985, U.S. gross income increased by 4.2 percent, and non-U.S. gross income increased by 16.0 percent as reported in U.S. dollars. It is estimated that had currency rates remained constant with those of 1984, gross income would have been \$400 million greater than that reported in 1985, and gross income from non-U.S. operations would have grown by 18.2 percent.

As the dollar strengthens, net assets, revenue, costs and expenses, recorded in local currencies, are translated to fewer U.S. dollars than they would have been at the previous year's exchange rates. The graphs above illustrate the movement, in relation to the dollar, of the six major currencies in which IBM conducts most of its non-U.S. business.

The dollar, which had continued to strengthen during 1983 and 1984, began to weaken in 1985. However, for the full year 1985, IBM's gross income was still adversely affected by currency rates.

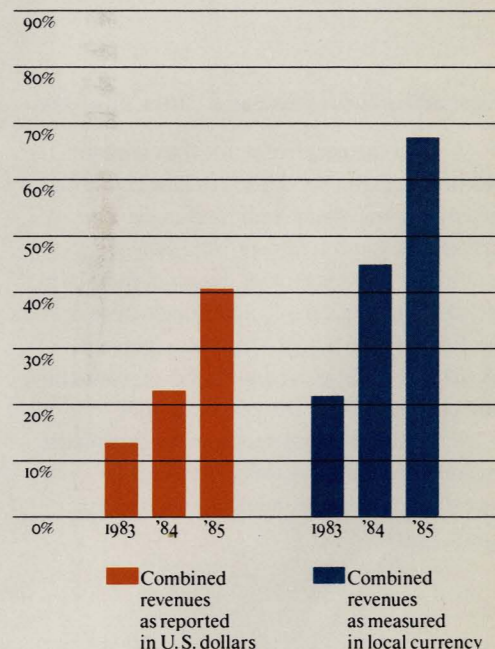
The graph to the right depicts the aggregate revenue growth from 1982 through 1985 for the same six countries, as reported in U.S. dollars. The graph also shows the local currency revenue growth rates calculated using 1982 U.S. dollar exchange rates. Management believes that this composite growth rate, as measured in local currency, is illustrative of the health of IBM's non-U.S. business and reflects the strong worldwide demand for its products.

To the degree that profits from these non-U.S. operations are not repatriated in the form of dividends or other payments, the currency effects are deferred to future periods, since these resources continue to be invested in the country.

IBM manufactures products throughout the world, and there is little dependence on U.S. exports in most of the major non-U.S. operations. The company has been able to compete effectively and profitably outside the U.S. as well as in the U.S.

## Six Major Countries—Combined Gross Income by Year

100% (Percent change over 1982)





# Consolidated Statement of Stockholders' Equity

for the year ended December 31:

(Dollars in millions)		Capital Stock	Retained Earnings	Translation Adjustments	Treasury Stock	Total
1983	Stockholders' Equity, January 1, 1983 . . . . .	\$ 5,008	\$ 16,259	\$ (1,307)	\$ —	\$ 19,960
	Net earnings . . . . .		5,485			5,485
	Cash dividends declared . . . . .		(2,251)			(2,251)
	Capital stock issued under employee and stockholder plans (8,318,513 shares) . . . . .	741				741
	Treasury stock (221,508 shares) acquired and sold under employee plans . . . . .		(4)			(4)
	Tax reductions—employee plans . . . . .	51				51
	Translation adjustments . . . . .			(763)		(763)
	Stockholders' Equity, December 31, 1983 . . . . .	<u>5,800</u>	<u>19,489</u>	<u>(2,070)</u>	<u>—</u>	<u>23,219</u>
1984	Net earnings . . . . .		6,582			6,582
	Cash dividends declared . . . . .		(2,507)			(2,507)
	Capital stock issued under employee plans (2,351,859 shares) . . . . .	154				154
	Purchases (6,711,522 shares) and sales (6,320,561 shares) of treasury stock under employee and stockholder plans—net . . . . .		(78)		(47)	(125)
	Tax reductions—employee plans . . . . .	44				44
	Translation adjustments . . . . .			(878)		(878)
	Stockholders' Equity, December 31, 1984 . . . . .	<u>5,998</u>	<u>23,486</u>	<u>(2,948)</u>	<u>(47)</u>	<u>26,489</u>
1985	Net earnings . . . . .		6,555			6,555
	Cash dividends declared . . . . .		(2,703)			(2,703)
	Capital stock issued under employee plans (2,664,869 shares) . . . . .	173				173
	Purchases (6,346,223 shares) and sales (6,413,759 shares) of treasury stock under employee and stockholder plans—net . . . . .		(104)		2	(102)
	Other (principally tax reductions— employee plans) . . . . .	96				96
	Translation adjustments . . . . .			1,482		1,482
	Stockholders' Equity, December 31, 1985 . . . . .	<u>\$ 6,267</u>	<u>\$ 27,234</u>	<u>\$ (1,466)</u>	<u>\$ (45)</u>	<u>\$ 31,990</u>

The notes on pages 34 through 43 are an integral part of this statement.



**Significant Accounting Policies**

<i>Principles of Consolidation:</i>	The consolidated financial statements include the accounts of International Business Machines Corporation and its U.S. and non-U.S. subsidiary companies, other than the wholly owned IBM Credit Corporation and non-U.S. finance subsidiaries, for which the equity method is used. Investments in joint ventures, and other companies in which IBM has a 20 to 50 percent ownership, are accounted for by the equity method. Investments of less than 20 percent are accounted for by the cost method.
<i>Translation of Non-U.S. Currency Amounts:</i>	For non-U.S. subsidiaries which operate in a local currency environment, assets and liabilities 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. For non-U.S. subsidiaries and branches which operate in U.S. dollars or whose economic environment is highly inflationary, inventories and plant, rental machines and other property are translated at approximate 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 remeasured at historical rates. All other income and expense items are translated at average rates of exchange prevailing during the year. Gains and losses which result from remeasurement are included in earnings.
<i>Gross Income:</i>	Gross income is recognized from sales or sales-type leases when the product is shipped, or in certain cases upon customer acceptance, from rentals under operating leases in the month in which they accrue, and from services over the contractual period or as the services are performed. Rental plans include maintenance service and contain discontinuance and purchase option provisions. Rental terms are predominantly monthly or for a two-year period. IBM equipment offered under term leases by IBM's finance subsidiaries is accounted for by IBM as outright sales.
<i>Program Products:</i>	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 generally capitalized as program products assets. The assets are amortized based on the estimated revenue distribution over their revenue-producing lives, but not in excess of six years. Ongoing costs to support or service licensed programs are expensed.
<i>Depreciation:</i>	Plant, rental machines and other property are carried at cost and depreciated over their estimated useful lives. Depreciation of assets acquired subsequent to December 31, 1983 is computed using the straight-line method. Depreciation of assets acquired prior to January 1, 1984 is computed using the sum-of-the-years digits method for rental machines, and either accelerated methods or the straight-line method for plant and other property.
<i>Goodwill:</i>	The excess of the cost over the fair value of the net assets of purchased businesses is recorded as goodwill and amortized on a straight-line basis over 20 years. Goodwill related to equity investments is included in the investment and amortized on a straight-line basis over 20 years.
<i>Retirement Plans and Other Postretirement Benefits:</i>	Current service costs of retirement plans are accrued currently. Prior service costs resulting from improvements in the plans are amortized generally over 15 years. Postretirement health care and life insurance benefits are fully accrued when the employee retires.
<i>Selling Expenses:</i>	Selling expenses are charged against income as they are incurred.
<i>Income Taxes:</i>	Income tax expense is based on reported earnings before income taxes. It thus includes the effects of timing differences between reported and taxable earnings that arise because certain transactions are included in taxable earnings in other years. Investment tax credits are deferred and amortized as a reduction of income tax expense over the average useful life of the applicable classes of property.
<i>Inventories:</i>	Raw materials, operating supplies, finished goods and work in process are included at the lower of average cost or market.



# Non-U.S. Operations

(Dollars in millions)

1985

1984

1983

## At end of year:

### Net assets employed

Current assets	\$ 12,395	\$ 8,583	\$ 8,115
Current liabilities	<u>6,629</u>	<u>4,636</u>	<u>4,585</u>
Working capital	5,766	3,947	3,530
Plant, rental machines and other property, net	6,451	4,902	5,622
Investments and other assets	<u>2,569</u>	<u>1,690</u>	<u>1,062</u>
	<u>14,786</u>	<u>10,539</u>	<u>10,214</u>
Long-term debt	645	222	466
Other liabilities	1,448	1,125	1,249
Deferred income taxes	<u>805</u>	<u>346</u>	<u>27</u>
	<u>2,898</u>	<u>1,693</u>	<u>1,742</u>
Net assets employed	<u>\$ 11,888</u>	<u>\$ 8,846</u>	<u>\$ 8,472</u>

Number of employees	<u>163,294</u>	<u>156,042</u>	<u>150,944</u>
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## For the year:

Gross income from sales, services and rentals	<u>\$ 21,545</u>	<u>\$ 18,566</u>	<u>\$ 17,053</u>
Earnings before income taxes	\$ 5,546	\$ 4,640	\$ 3,841
Provision for income taxes	<u>2,468</u>	<u>2,053</u>	<u>1,677</u>
Net earnings	<u>\$ 3,078</u>	<u>\$ 2,587</u>	<u>\$ 2,164</u>
Investment in plant, rental machines and other property	<u>\$ 2,333</u>	<u>\$ 1,807</u>	<u>\$ 1,987</u>

Non-U. S. subsidiaries which operate in a local currency environment account for approximately 85% of the company's non-U. S. gross income. The remaining 15% of the company's non-U. S. gross income is from subsidiaries and branches which operate in U. S. dollars or whose economic environment is highly inflationary.

For the years 1985, 1984 and 1983, non-U. S. financial results have been impacted by the strength of the U. S. dollar relative to the currencies of many countries. As the dollar strengthens, net assets and net earnings recorded in local currencies translate into fewer U. S. dollars than

they would have at the previous year's rates. The dollar, which had continued to strengthen during 1983 and 1984, began to weaken in 1985. However, for the full year 1985, IBM's gross income and net earnings were still adversely affected by currency rates. The translation adjustments, resulting from the translation of net assets, amounted to \$1,466 million at December 31, 1985, \$2,948 million at December 31, 1984, and \$2,070 million at December 31, 1983. The reduction of the translation adjustments since the end of 1984 is a reflection of the weakening of the dollar during 1985. The graphs on page 32

illustrate the movement, in relation to the dollar, of the six major currencies in which IBM conducts most of its non-U. S. business.

Undistributed earnings of non-U. S. subsidiaries included in consolidated retained earnings amounted to \$11,147 million at December 31, 1985, \$9,837 million at December 31, 1984 and \$8,510 million at December 31, 1983. These earnings, which reflect full provision for non-U. S. income taxes, are indefinitely reinvested in non-U. S. operations. Accordingly, no provision has been made for taxes that might be payable upon remittance of such earnings.



**Marketable Securities**

(Dollars in millions) **December 31, 1985** **December 31, 1984**

U.S. Government securities . . . . .	\$ 917	\$ 616
Time deposits and other bank obligations . . . . .	2,183	1,837
Non-U.S. government securities and other fixed-term obligations . . . . .	<u>1,626</u>	<u>1,309</u>
Total . . . . .	<u>\$ 4,726</u>	<u>\$ 3,762</u>
Market value . . . . .	<u>\$ 4,729</u>	<u>\$ 3,774</u>

**Inventories**

(Dollars in millions) **December 31, 1985** **December 31, 1984**

Current inventories:		
Finished goods . . . . .	\$ 2,576	\$ 1,619
Work in process . . . . .	5,714	4,676
Raw materials and operating supplies . . . . .	<u>289</u>	<u>303</u>
Total current inventories . . . . .	<u>8,579</u>	<u>6,598</u>
Work in process and field service parts included in:		
Rental machines and parts . . . . .	720	1,221
Plant, laboratory and office equipment . . . . .	<u>1,037</u>	<u>746</u>
Total inventories . . . . .	<u>\$ 10,336</u>	<u>\$ 8,565</u>

**Plant and Other Property**

(Dollars in millions) **December 31, 1985** **December 31, 1984**

Land and land improvements . . . . .	\$ 1,049	\$ 823
Buildings . . . . .	8,474	6,673
Plant, laboratory and office equipment . . . . .	<u>20,323</u>	<u>15,552</u>
	<u>29,846</u>	<u>23,048</u>
Less: Accumulated depreciation . . . . .	<u>11,999</u>	<u>9,635</u>
Total . . . . .	<u>\$ 17,847</u>	<u>\$ 13,413</u>



**Investments and Other Assets**

(Dollars in millions) December 31, 1985 December 31, 1984

Program products, less accumulated amortization (1985, \$1,765; 1984, \$1,491) . . . . .	\$ 1,964	\$ 1,604
Investments in finance subsidiaries . . . . .	1,095	1,220
Goodwill, less accumulated amortization (1985, \$49; 1984, \$4) . . . . .	852	882
Investment in Intel Corporation† . . . . .	641	655
Net investment in sales-type leases . . . . .	1,172	594
U. S. fixed income securities, at cost (market value: 1984, \$510). . . . .	—	503
Other investments and sundry assets . . . . .	1,160	612
<b>Total . . . . .</b>	<b>\$ 6,884</b>	<b>\$ 6,070</b>

†Includes goodwill of \$375 million at December 31, 1985 and \$404 million at December 31, 1984 (net of accumulated amortization of \$48 million and \$27 million, respectively).

**Long-Term Debt**

(Dollars in millions) December 31, 1985 December 31, 1984

<b>U. S. Operations:</b>		
7½% convertible subordinated debentures due 2004‡ . . . . .	\$ 1,285	\$ 1,285
10½% debentures due 2015 (with sinking fund payments 1996-2014). . . . .	500	—
10¼% notes due 1995 . . . . .	500	—
9¾% debentures due 2004 (with sinking fund payments to 2003). . . . .	442	450
9½% notes due 1986 . . . . .	—	500
<b>Other, payable in:</b>		
(Average interest rate at December 31, 1985, in parentheses)		
U. S. dollars, due 1986-2012 (11.6%) . . . . .	372	666
Swiss francs, due 1986-1987 (4.3%) . . . . .	243	247
German marks, due 1986-1988 (8.7%) . . . . .	187	210
European currency units, due 1990 (8.25%) . . . . .	133	—
	<u>3,662</u>	<u>3,358</u>
<b>Non-U. S. Operations:</b>		
<b>Various obligations, payable in:</b>		
(Average interest rate at December 31, 1985, in parentheses)		
French francs, due 1986-1997 (11.3%) . . . . .	246	62
Japanese yen, due 1986-2015 (7.0%) . . . . .	202	125
U. S. dollars, due 1986-1992 (8.5%) . . . . .	171	123
Other currencies, due 1986-1999 (15.7%) . . . . .	76	84
	<u>695</u>	<u>394</u>
	4,357	3,752
<b>Less: Net unamortized discount, related principally to the 7½%, 9¾% and 10½% debentures . . . . .</b>	<b>12</b>	<b>10</b>
	<u>4,345</u>	<u>3,742</u>
<b>Less: Current maturities . . . . .</b>	<b>390</b>	<b>473</b>
<b>Total . . . . .</b>	<b>\$ 3,955</b>	<b>\$ 3,269</b>

Annual maturity and sinking fund requirements in millions of dollars on long-term debt outstanding at December 31, 1985, are as follows:

1986, \$390; 1987, \$274; 1988, \$239; 1989, \$53; 1990, \$332; 1991 and beyond, \$3,069.

‡The 7½% convertible subordinated debentures are unsecured subordinated obligations of IBM, which are convertible into IBM capital stock at a conversion price of \$153.6563 per share. They will be redeemable, at the option of the company, starting in November 1988 at a price of 104.725% of the principal amount, and at decreasing prices thereafter. Sinking fund payments starting in 1994 are intended to retire 75% of the debentures prior to maturity. During 1985, conversions of debentures resulted in the issuance of 318 shares of IBM capital stock.



Taxes	(Dollars in millions)	1985	1984	1983
Earnings before income taxes:				
U.S. operations . . . . .		\$ 6,073	\$ 6,983	\$ 6,099
Non-U.S. operations . . . . .		<u>5,546</u>	<u>4,640</u>	<u>3,841</u>
		<u>\$ 11,619</u>	<u>\$ 11,623</u>	<u>\$ 9,940</u>
Provision for income taxes:				
U.S. operations . . . . .		\$ 2,596	\$ 2,988	\$ 2,778
Non-U.S. operations . . . . .		<u>2,468</u>	<u>2,053</u>	<u>1,677</u>
		<u>5,064</u>	<u>5,041</u>	<u>4,455</u>
Social Security, real estate, personal property and other taxes. . . . .		<u>1,753</u>	<u>1,636</u>	<u>1,550</u>
Total . . . . .		<u>\$ 6,817</u>	<u>\$ 6,677</u>	<u>\$ 6,005</u>
The components of the provision for income taxes are as follows:				
U.S. Federal:				
Current . . . . .		\$ 594	\$ 1,406	\$ 1,624
Net tax effects of timing differences . . . . .		957	702	188
Net deferred investment tax credits . . . . .		<u>144</u>	<u>80</u>	<u>47</u>
		<u>1,695</u>	<u>2,188</u>	<u>1,859</u>
Non-U.S.:				
Current . . . . .		2,886	2,102	2,250
Net tax effects of timing differences . . . . .		<u>246</u>	<u>465</u>	<u>32</u>
		<u>3,132</u>	<u>2,567</u>	<u>2,282</u>
U.S. State and local:				
Current . . . . .		128	187	265
Net tax effects of timing differences . . . . .		<u>109</u>	<u>99</u>	<u>49</u>
		<u>237</u>	<u>286</u>	<u>314</u>
Total provision . . . . .		<u>\$ 5,064</u>	<u>\$ 5,041</u>	<u>\$ 4,455</u>

The consolidated effective income tax rate was 43.6% in 1985, 43.4% in 1984, and 44.8% in 1983. The consolidated net tax effects of timing differences amounted to \$1,312 million and \$1,266 million in 1985 and 1984, respectively. Amounts relating to sales-type leases and installment sales were \$ 643 million in 1985 and \$ 623 million in 1984. Depreciation timing differences accounted for an additional \$ 358 million in 1985. Of the remaining timing differences, no individual item is material.



### Accounting Change—Program Products

On January 1, 1985, the company changed the method of amortization of program product assets from the straight-line method to a method based on the estimated revenue distribution over the products' revenue-producing lives. This change was applied as of January 1, 1985 to the remaining net book value of the existing assets, as well as to new assets.

In the opinion of management, this change will result in a better matching of costs with revenue because it is reflective of the increasing diversity of product offerings and of their terms and conditions. This change did not have a material effect on 1985 earnings.

### Research, Development and Engineering

Research, development and engineering expenses amounted to \$4,723 million in 1985, \$4,200 million in 1984 and \$3,582 million in 1983.

Included in these amounts were expenditures of \$3,457 million in 1985, \$3,148 million in 1984 and \$2,514 million in 1983 for a broad program of research and development covering basic scientific research in a variety of fields and the application of scientific advances to the development of new and improved products and their uses. In addition, expenditures for product related engineering amounted to \$1,266 million, \$1,052 million and \$1,068 million for the same three years.

### Rental Expense and Lease Commitments

Rental expense amounted to \$963 million in 1985, \$713 million in 1984 and \$567 million in 1983. Minimum rental commitments, in millions of dollars, under noncancelable leases for 1986 and thereafter are as follows: 1986, \$886; 1987, \$752; 1988, \$545; 1989, \$383; 1990, \$303; and after 1990, \$1,293. These leases are principally for the rental of office premises.

### Finance Subsidiaries

The company's wholly owned unconsolidated finance subsidiaries consist of IBM Credit Corporation and several non-U. S. finance subsidiaries. ROLM Credit Corporation was merged with IBM Credit Corporation in July 1985. IBM Credit Corporation offers lease financing of selected IBM products, finances receivables resulting from installment sales by IBM of its products, and finances selected non-IBM equipment in the U.S. The non-U.S. finance subsidiaries offer leases in several European countries, and in some cases finance installment receivables. IBM's investment in these subsidiaries is accounted for by the equity method and earnings are included in other income in

IBM's consolidated statement of earnings.

Summarized below is combined financial information for these finance subsidiaries, of which IBM Credit Corporation accounts for more than 90% of the net earnings. IBM has agreed to cause the IBM Credit Corporation to have a positive net worth at all times. IBM Credit Corporation has \$750 million of lines of credit available, in addition to \$500 million shared with the IBM Corporation. Additional information is available in the 1985 Annual Report of the IBM Credit Corporation. Copies may be obtained by writing to:

IBM Stockholder Relations Department  
590 Madison Avenue  
New York, N.Y. 10022

### Financial position at December 31:

(Dollars in millions)	1985	1984	(Dollars in millions)	1985	1984
<b>Assets:</b>			<b>Liabilities and Stockholder's Equity:</b>		
Cash and marketable securities . . . . .	\$ 306	\$ 112	Short-term debt . . . . .	\$ 1,509	\$ 1,031
Installment payment agreement receivables-net . . . . .	1,868	1,619	Deferred taxes and accruals . . . . .	461	209
Net investment in leases . . . . .	3,101	1,577	Due to IBM and affiliates:		
Receivable from IBM and affiliates . . . . .	347	74	Current . . . . .	538	293
Other . . . . .	196	117	Noncurrent . . . . .	184	502
<b>Total Assets . . . . .</b>	<b>\$ 5,818</b>	<b>\$ 3,499</b>	Long-term debt . . . . .	2,406	965
			Stockholder's equity . . . . .	720	499
			<b>Total Liabilities and Stockholder's Equity . . . . .</b>	<b>\$ 5,818</b>	<b>\$ 3,499</b>

### Earnings for the years ended December 31:

(Dollars in millions)	1985	1984	1983
Finance and other income . . . . .	\$ 539	\$ 305	\$ 164
Interest and other expenses . . . . .	404	230	118
Provision for income taxes . . . . .	24	7	4
<b>Net earnings . . . . .</b>	<b>\$ 111</b>	<b>\$ 68</b>	<b>\$ 42</b>

### Total purchases from IBM:

(Dollars in millions)	1985	1984	1983
IBM products for term lease customers . . . . .	\$ 1,723	\$ 1,212	\$ 369
Installment payment receivables . . . . .	\$ 1,112	\$ 1,143	\$ 852



### Interest Cost

Interest on borrowings of the company and its consolidated subsidiaries amounted to \$532 million in 1985, \$456 million in 1984 and \$429 million in 1983. Of these amounts, \$89 million in 1985, \$48 million in 1984 and \$39 million in 1983 were capitalized, resulting in interest expense of \$443 million, \$408 million and \$390 million for the same three years.

### Satellite Business Systems

MCI Communications Corporation and IBM have signed an agreement under which MCI will acquire substantially all of the assets and operations of Satellite Business Systems in exchange for approximately 47 million shares of MCI common stock, which IBM agrees to retain for a minimum of three years. At December 31, 1985, the value of the SBS assets to be exchanged was \$418 million. Completion of the transaction is subject to approval by the Federal Communications Commission and review under provisions of the Hart/Scott/Rodino Act. In addition, IBM has agreed that it will, under certain conditions, invest an additional \$400 million in MCI between September 1, 1986 and December 31, 1988.

IBM and Aetna Life & Casualty had previously reached agreement for IBM to acquire Aetna's interest in SBS, effective June 30, 1985. In addition to certain cash payments and other considerations, Aetna may receive a future payment from IBM which is dependent on the market value of MCI common stock at the time the MCI transaction is concluded, up to a maximum of \$98.6 million. Had this transaction taken place on December 31, 1985, the contingent payment would have been approximately \$30 million.

IBM's investment in SBS is accounted for by the equity method, and is included in investments and other assets in the consolidated statement of financial position.

### Retirement Plans

The company and its subsidiaries have retirement plans covering substantially all employees. The total cost of all plans for 1985, 1984 and 1983 was \$868 million, \$1,096 million and \$1,180 million, respectively.

U.S. regular and part-time employees are covered by noncontributory plans which are funded by company contributions to an irrevocable trust fund, which is held for the sole benefit of employees. Monthly retirement benefits generally represent the greater of a fixed amount per year of service, or a percent of career compensation. For plan purposes, annual compensation for each year of service before January 1, 1984, is defined as the average annual compensation paid for the years 1974 through 1983. Actual compensation is used thereafter. Benefits become vested upon completion of 10 years of service.

The annual cost of the U.S. plans is determined using an actuarial cost method known as the Frozen Initial Liability method. Under this method, annual pension cost comprises both current cost and the amortization of prior service costs which generally result from plan amendments. Current cost is determined by relating the present value of future benefits (excluding benefits related to prior service costs), less fund assets, to the present value of future compensation and applying the resulting percentage to current compensation. Prior service costs are determined and frozen at the

time of a plan amendment, and amortized over 15 years in equal annual amounts.

The principal actuarial assumptions used to determine cost are: rate of return on fund assets, future compensation levels, retirement ages, employee turnover and mortality rates. Variances between actual and assumed plan experience (actuarial gains or losses) are amortized over the remaining employee service period and are included in the determination of current cost.

It is the company's policy to fund accrued costs to the extent such costs are tax deductible. Pertinent cost and contribution data for U.S. retirement plans is presented below:

(Dollars in millions)	1985	1984	1983
Pension cost:			
Current cost . . . . .	\$ 391	\$ 490	\$ 551
Amortization of prior service costs . . . . .	<u>63</u>	<u>160</u>	<u>151</u>
Total cost. . . . .	<u>\$ 454</u>	<u>\$ 650</u>	<u>\$ 702</u>
Pension cost as a % of compensation . . . . .	<u>5.0%</u>	<u>8.2%</u>	<u>9.7%</u>
Unamortized prior service costs at December 31. . . . .	\$ <u>381</u>	\$ <u>413</u>	\$ <u>532</u>
Contributions . . . . .	\$ <u>520</u>	\$ <u>650</u>	\$ <u>644</u>

The decrease in pension costs in both 1985 and 1984 resulted principally from favorable returns on plan investments. Consistent with this experience, the rate of return assumption was increased in both years. Additionally, 1985 cost also decreased as a result of changing the prior service cost amortization period from 10 to 15 years.

The following table provides information on the status of the U.S. retirement plans. The actuarial present value of plan benefits provides



an estimate of that portion of the total prospective benefit obligation applicable to employee service to date and assumes the same rates of return on fund assets as were used to determine pension cost. In 1985, these rates were 8.0% for benefits payable in the following 10 years, and 6.0% for benefits payable thereafter. In 1984, these rates were 7.5% and 5.5% for the respective periods.

At December 31 (Dollars in millions)		
	1985	1984
Actuarial present value of plan benefits:		
Earned to date:		
Vested . . . . .	\$ 7,064	\$ 7,016
Nonvested . . . . .	319	280
	<u>\$ 7,383</u>	<u>\$ 7,296</u>
Including effect of projected future compensation levels . . . . .	\$ 10,463	\$ 10,296
Plan net assets (estimated market value) . . . . .	<u>\$ 14,842</u>	<u>\$ 11,444</u>
Number of individuals receiving benefits . . .	<u>22,650</u>	<u>20,937</u>

A comparison of plan net assets to these estimates provides an indication of the company's progress toward meeting its future commitment to pay benefits when due. However, it must be recognized that the market value of plan net assets available for benefits will fluctuate.

Non-U. S. subsidiaries have plans under which funds are deposited under various fiduciary-type arrangements, annuities are purchased under group contracts, or reserves are provided. At December 31, 1985 and December 31, 1984, it is estimated that the market value of fund assets and reserves of individual non-U.S. subsidiaries exceeded or approximated the actuarial present value of plan benefits earned to date.

### Postretirement Benefits

The company and its U. S. subsidiaries have medical, dental and life insurance plans for retirees, the estimated costs of which are fully accrued and funded with an independent trustee at the time an employee retires. These costs amounted to \$12 million, \$222 million and \$129 million in 1985, 1984 and 1983, respectively. Costs in 1985 were lower than in 1984 primarily because significantly fewer employees retired in 1985. Favorable investment fund performance also contributed to the reduction in costs.

Certain of the company's non-U. S. subsidiaries have similar plans for retirees. However, many retirees outside the U. S. are covered by government sponsored and administered programs. As a result, the costs of company sponsored programs outside the U. S. are not significant.

### Other Liabilities

Other liabilities consist principally of indemnity and retirement plan reserves for non-U. S. employees.

### Stock Purchase Plan

The 1981 Employees Stock Purchase Plan enables employees who are not participants in a stock option plan to purchase IBM's capital stock through payroll deductions of up to 10% of eligible compensation. The price an employee pays for a share of stock is 85% of the average market price on the date the employee has accumulated enough money to buy a share. During 1985, employees purchased 5,095,810 shares, all of which were treasury shares, for which \$560 million was paid to IBM. At December 31, 1985, 13,566,470 reserved unissued shares remain available for purchase under the Plan.

### Stock Option Plans

The stock option plans provide for granting officers and other key employees options to purchase IBM's capital stock at 100% of the market price on the day of grant. Options have

a maximum duration of 10 years and may be exercised in up to four annual installments, commencing one year from date of grant.

The plans are administered by the Executive Compensation Committee of the Board of Directors. The Committee may, at its discretion, grant Stock Appreciation Rights (SARs) to holders of options. Such rights offer optionees the alternative of electing not to exercise the related stock option, but to receive instead an amount in cash, stock, or a combination of cash and stock equivalent to the difference between the option price and the average market price of IBM stock on the date of exercising the right.

The plans also provide, subject to Committee approval, that payment by the optionee upon exercise of an option may be made using IBM stock as well as cash.

The following table summarizes stock option transactions during 1985:

	Number of Shares	
	Under Option	Available for Option
Balance at		
January 1, 1985 . . . .	14,104,664	3,454,935
Options granted . . . .	2,970,001	(2,970,001)
Options terminated . . .	(149,569)	99,318
Options cancelled—		
SARs exercised . . . .	(329,405)	—
Options exercised . . . .	(2,680,043)	—
Balance at		
December 31, 1985 . .	<u>13,915,648</u>	<u>584,252</u>
Exercisable at		
December 31, 1985 . .	<u>8,758,604</u>	

The options exercised during 1985 were at an average option price of \$63.13 per share. The 13,915,648 shares under option at December 31, 1985, are at option prices ranging from \$40.28 to \$130.82 per share.



## Segment Information

IBM operates primarily in the single industry segment encompassing information-handling systems, equipment and services. This segment represents more than 90% of consolidated gross income, operating profit and identifiable assets. The schedule on the next page shows gross

income by industry segments and by classes of similar products or services within the information-handling segment.

Financial information by geographic area for the years 1985, 1984 and 1983 is summarized below to provide a better understanding of IBM's

operations. Material interdependencies and overlaps exist among IBM's operating units and, therefore, the information may not be indicative of the financial results of, or investments in, the reported areas were they independent organizations.

Geographic Areas	(Dollars in millions)	1985	1984	1983
United States				
Gross income—Customers . . . . .		\$ 28,511	\$ 27,371	\$ 23,127
Interarea transfers . . . . .		3,487	3,074	2,275
Total . . . . .		<u>\$ 31,998</u>	<u>\$ 30,445</u>	<u>\$ 25,402</u>
Net earnings . . . . .		3,450	3,981	3,296
Assets at December 31 . . . . .		31,886	28,394	23,322
Europe/Middle East/Africa				
Gross income—Customers . . . . .		\$ 14,065	\$ 11,996	\$ 11,324
Interarea transfers . . . . .		520	363	235
Total . . . . .		<u>\$ 14,585</u>	<u>\$ 12,359</u>	<u>\$ 11,559</u>
Net earnings . . . . .		2,104	1,873	1,580
Assets at December 31 . . . . .		14,341	9,864	9,958
Americas/Far East				
Gross income—Customers . . . . .		\$ 7,480	\$ 6,570	\$ 5,729
Interarea transfers . . . . .		1,173	1,124	728
Total . . . . .		<u>\$ 8,653</u>	<u>\$ 7,694</u>	<u>\$ 6,457</u>
Net earnings . . . . .		980	719	562
Assets at December 31 . . . . .		7,392	5,600	5,142
Eliminations				
Gross income . . . . .		\$ (5,180)	\$ (4,561)	\$ (3,238)
Net earnings . . . . .		21	9	47
Assets . . . . .		(985)	(1,050)	(961)
Consolidated				
Gross income . . . . .		<u>\$ 50,056</u>	<u>\$ 45,937</u>	<u>\$ 40,180</u>
Net earnings . . . . .		<u>\$ 6,555</u>	<u>\$ 6,582</u>	<u>\$ 5,485</u>
Assets at December 31 . . . . .		<u>\$ 52,634</u>	<u>\$ 42,808</u>	<u>\$ 37,461</u>

Non-U. S. subsidiaries which operate in a local currency environment account for approximately 85% of the company's non-U. S. gross income. The remaining 15% is from subsidiaries and branches, predominantly in the Americas/Far East area, which operate in U. S. dollars or whose economic environment is highly inflationary.

In the Europe/Middle East/Africa area, European operations accounted for approximately 95% of gross income in 1985, 1984 and 1983.

Interarea transfers, consisting principally of completed machines, subassemblies and parts, are generally priced at cost plus an appropriate service charge, applied consistently throughout the

world. The cost and service charges that relate to asset transfers are capitalized and depreciated or amortized by the importing area. Interarea accounts receivable, the unamortized portion of service charges, and the net change during the year in unamortized service charges have been eliminated in consolidation.



# Gross Income by Industry Segments and Classes of Similar Products or Services

(Dollars in millions)	Consolidated			U.S. Only		
	1985	1984†	1983†	1985	1984†	1983†
Information-Handling:						
Processors:						
Sales . . . . .	\$ 11,647	\$ 11,014	\$ 9,002	\$ 5,649	\$ 6,066	\$ 4,910
Rentals . . . . .	488	905	1,651	145	346	685
	<u>12,135</u>	<u>11,919</u>	<u>10,653</u>	<u>5,794</u>	<u>6,412</u>	<u>5,595</u>
Peripherals:						
Sales . . . . .	10,325	8,068	6,418	6,110	5,015	3,841
Rentals . . . . .	2,351	3,584	4,717	1,227	1,940	2,547
	<u>12,676</u>	<u>11,652</u>	<u>11,135</u>	<u>7,337</u>	<u>6,955</u>	<u>6,388</u>
Office Systems/Workstations:						
Sales . . . . .	9,557	8,300	5,659	5,656	5,415	3,578
Rentals . . . . .	976	1,655	2,256	489	889	1,254
	<u>10,533</u>	<u>9,955</u>	<u>7,915</u>	<u>6,145</u>	<u>6,304</u>	<u>4,832</u>
Program Products . . . . .	4,165	3,197	2,302	2,176	1,708	1,288
Maintenance Services . . . . .	6,103	5,266	4,577	3,666	3,106	2,633
Other:						
Sales . . . . .	1,363	1,180	1,105	895	762	693
Services . . . . .	650	620	648	198	167	135
Rentals . . . . .	301	435	606	178	252	331
	<u>2,314</u>	<u>2,235</u>	<u>2,359</u>	<u>1,271</u>	<u>1,181</u>	<u>1,159</u>
	<u>47,926</u>	<u>44,224</u>	<u>38,941</u>	<u>26,389</u>	<u>25,666</u>	<u>21,895</u>
Federal Systems:						
Sales . . . . .	1,439	1,123	1,028	1,439	1,123	1,028
Services . . . . .	618	522	148	618	522	148
	<u>2,057</u>	<u>1,645</u>	<u>1,176</u>	<u>2,057</u>	<u>1,645</u>	<u>1,176</u>
Other Business:						
Sales . . . . .	73	68	63	65	60	56
Total . . . . .	<u>\$ 50,056</u>	<u>\$ 45,937</u>	<u>\$ 40,180</u>	<u>\$ 28,511</u>	<u>\$ 27,371</u>	<u>\$ 23,127</u>

†Reclassified to conform with 1985 presentation.

While IBM operates primarily in a single industry segment and manages its worldwide business as such, gross income has been categorized into major classes of product.

For purposes of classifying similar products of the Information-Handling industry segment, user programmable equipment having the capability of manipulating data arithmetically or logically and making calculations, in a manner directly addressable by the user through the operation of a stored program, has been classified as Processors, except that small business computers and intelligent workstations are included under Office Systems/Workstations. Typewriters have also been classified under

Office Systems/Workstations. Peripherals include printers, copiers, storage and telecommunication devices. Peripheral functions embedded in processors are classified with Processors. Program Products include both applications and systems software. Maintenance Services consist of separately billed charges for maintenance. Other consists principally of supplies and unit record equipment.

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 (e.g., printer), to be functionally integrated with a display, telecommunication device and a processor to form an office system. 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.

Federal Systems consists of specialized information-handling products and services primarily for the United States defense, space and other agencies.

Other Business consists of training and testing materials for school, home and industrial use.



## Five-Year Comparison of Selected Financial Data

(Dollars in millions except per share amounts)		1985	1984	1983	1982	1981
<b>For the year:</b>						
Gross income from sales, services and rentals . . . . .		\$ 50,056	\$ 45,937	\$ 40,180	\$ 34,364	\$ 29,070
Net earnings . . . . .		6,555	6,582	5,485	4,409	3,610
Per share . . . . .		10.67	10.77	9.04	7.39	6.14
Cash dividends paid . . . . .		2,703	2,507	2,251	2,053	2,023
Per share . . . . .		4.40	4.10	3.71	3.44	3.44
Investment in rental machines . . . . .		313	858	1,412	3,293	4,146
Investment in plant and other property . . . . .		6,117	4,615	3,518	3,392	2,699
Return on stockholders' equity . . . . .		22.4%	26.5%	25.4%	23.4%	21.1%
<b>At end of year:</b>						
Total assets . . . . .		\$ 52,634	\$ 42,808	\$ 37,461	\$ 32,541	\$ 29,107
Net investment in rental machines . . . . .		1,833	2,950	4,866	7,599	8,220
Net investment in plant and other property . . . . .		17,847	13,413	11,276	9,964	8,577
Working capital . . . . .		14,637	10,735	8,168	5,080	3,195
Long-term debt . . . . .		3,955	3,269	2,674	2,851	2,669
Stockholders' equity . . . . .		31,990	26,489	23,219	19,960	17,676

## Selected Quarterly Data

(Dollars in millions except per share and stock prices)		Gross Income	Gross Profit	Net Earnings	Per Share		Stock Prices	
					Earnings	Dividends	High	Low
1985	First Quarter . . . . .	\$ 9,769	\$ 5,591	\$ 986	\$ 1.61	\$ 1.10	\$ 138.25	\$ 119.00
	Second Quarter . . . . .	11,434	6,497	1,414	2.30	1.10	133.25	117.38
	Third Quarter . . . . .	11,698	6,726	1,474	2.40	1.10	132.75	120.00
	Fourth Quarter . . . . .	17,155	10,139	2,681	4.36	1.10	158.75	122.88
	Total . . . . .	\$ 50,056	\$ 28,953	\$ 6,555	\$ 10.67	\$ 4.40		
1984	First Quarter . . . . .	\$ 9,585	\$ 5,630	\$ 1,202	\$ 1.97	\$ .95	\$ 125.00	\$ 106.50
	Second Quarter . . . . .	11,199	6,666	1,623	2.65	.95	117.25	99.00
	Third Quarter . . . . .	10,657	6,312	1,585	2.60	1.10	128.50	104.00
	Fourth Quarter . . . . .	14,496	8,410	2,172	3.55	1.10	127.75	116.00
	Total . . . . .	\$ 45,937	\$ 27,018	\$ 6,582	\$ 10.77	\$ 4.10		

There were 798,152 stockholders of record at December 31, 1985. During 1985, stockholders received \$2,703 million in cash dividends.

The regular quarterly cash dividend payable March 10, 1986, will be at the rate of \$1.10 per share. This dividend will be IBM's 284th consecutive quarterly cash dividend.

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



# Supplemental Financial Information

## Information on the Effects of Changing Prices

Although inflation-adjusted information is an imprecise estimate, there are circumstances in which it can serve to emphasize the debilitating effects of inflation. It points out the importance of keeping inflation under control and sustaining public policy initiatives to encourage capital investment.

Rates of inflation continued to moderate in the United States and in many other countries throughout 1985. Despite this current positive trend, the cumulative effect of inflation over the past several years has generally eroded industry's ability to fund the replacement and expansion of productive capacity. This has not been the case with IBM.

The following supplemental information, which has been prepared in accordance with standards established by the Financial Accounting Standards Board, is intended to assist users of financial statements in understanding the impact of changing prices on the company's operations.

The data presented below reflect the effects

on earnings and stockholders' equity resulting from using estimated changes in specific prices to restate the value of inventories and other properties at currently prevailing prices (current cost).

The estimates are based upon latest production costs, published price indexes, current suppliers' prices and appraised valuations. Cost of sales and depreciation expense are restated to reflect the change in the related asset values.

### Discussion of Financial Results

IBM's 1985 financial results, when adjusted for changing prices, show a reduction of \$246 million from reported net earnings and an increase in stockholders' equity of \$2,648 million. The decrease in earnings results principally from increased depreciation expense of \$270 million on plant, rental machines and other property that have been valued at \$22,487 million to approximate current cost. Current inventories have been valued at \$8,480 million on a current cost basis.

Companies which retain monetary assets or liabilities, such as cash or debt, incur gains and losses in purchasing power during periods of inflation. IBM's net monetary asset position resulted in a purchasing power loss of \$124 million in 1985.

The effects of translation on the changes in specific prices of IBM's net assets have been estimated without any attempt to adjust the data for general rate of inflation differences among various countries. The translation adjustments reflect changes in the valuation of assets denominated in currencies other than the U.S. dollar which result from exchange rate fluctuations.

In dollars of average 1985 purchasing power, the increase in current costs that might have been expected from general inflation exceeded IBM's specific price level changes by \$838 million. Management views this positively, in that technology and productivity improvements substantially offset inflation. Similar patterns are reflected in the prior years.

## Comparison of Selected Financial Data Adjusted for Changes in Specific Prices (Current Cost)

(Dollars in millions except per share amounts)	As Reported in Financial Statements	In Average 1985 Dollars				
	1985	1985	1984	1983	1982	1981
Gross income from sales, services and rentals . . .	\$ 50,056	\$ 50,056	\$ 47,576	\$ 43,385	\$ 38,298	\$ 34,384
Cost of sales, services and rentals . . . . .	21,103	21,156	19,762	17,916	15,355	14,151
Expenses and other income . . . . .	17,334	17,527	16,084	15,118	14,038	13,001
Provision for income taxes . . . . .	5,064	5,064	5,221	4,811	4,251	3,371
Net earnings . . . . .	\$ 6,555	\$ 6,309	\$ 6,509	\$ 5,540	\$ 4,654	\$ 3,861
Loss from decline in purchasing power of net monetary assets . . . . .		\$ 124	\$ 130	\$ 83	\$ 1	\$ 74
Translation adjustments . . . . .	\$ 1,482	\$ 1,597	\$ (1,075)	\$ (976)	\$ (866)	\$ (1,178)
Change in specific prices— net of general inflation . . . . .		\$ (838)	\$ (707)	\$ (78)	\$ (342)	\$ (1,373)
Stockholders' equity (net assets) at December 31 . .	\$ 31,990	\$ 34,638	\$ 30,241	\$ 28,156	\$ 25,272	\$ 23,360
Per share information:						
Earnings per share . . . . .	\$ 10.67	\$ 10.27	\$ 10.65	\$ 9.13	\$ 7.81	\$ 6.57
Cash dividends per share . . . . .	\$ 4.40	\$ 4.40	\$ 4.25	\$ 4.01	\$ 3.83	\$ 4.07
Market price at December 31 . . . . .		\$ 155.50	\$ 127.52	\$ 131.73	\$ 107.28	\$ 67.28
Average Consumer Price Index for all Urban Consumers (1967=100.0) . . . . .		322.2	311.1	298.4	289.1	272.4

The actual market price of IBM stock at December 31, for years 1981 to 1985 was \$56.88, \$96.25, \$122.00, \$123.13 and \$155.50, respectively.



# Directors and Officers

<b>IBM Corporation Board of Directors:</b>	John F. Akers ..... President and Chief Executive Officer, IBM	<b>Board Committees:</b>	<b>Executive</b> Frank T. Cary, Chairman John F. Akers Stephen D. Bechtel, Jr. Amory Houghton, Jr. William H. Moore John R. Opel Paul J. Rizzo Irving S. Shapiro
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	J. Richard Munro ..... President and Chief Executive Officer, Time, Inc., New York, N.Y.—publishing		
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	Cyrus R. Vance ..... Partner, Simpson Thacher & Bartlett, New York, N.Y.—attorneys at law		
	*Elected 1/28/86		
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	William McChesney Martin, Jr. .... Retired Chairman, Federal Reserve Board, Washington, D.C.		
	Dean R. McKay ..... Retired Senior Vice President, IBM		
	Maersk Mc-Kinney Moller ..... Chief Executive Officer, A. P. Moller, Copenhagen, Denmark—owners of the Maersk Fleet		
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	Thomas J. Watson, Jr. .... Chairman Emeritus, IBM		
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	*Elected 1/28/86		†Resigned 1/14/86



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# IBM Organization

*IBM is organized into the following groups, divisions and wholly owned subsidiaries:*

## **Information Systems and Communications Group**

*Communication Products Division*—Has worldwide development and U. S. manufacturing responsibility for communications systems and networks, display products, designated general-purpose and industry systems and related programming. The division serves as the worldwide architectural and systems focal point for Systems Network Architecture activities.

*Entry Systems Division*—Has worldwide development and U. S. manufacturing responsibility for IBM's general purpose, low-cost, personal-use computer systems, graphics workstations and related software.

## **Information Systems and Products Group**

*Information Products Division*—Has worldwide development and related programming and U. S. manufacturing responsibility for typewriters, copiers and systems for the banking industry, and for peripheral equipment, including printers, copier systems and associated supplies.

*System Products Division*—Has worldwide development and U. S. manufacturing responsibility for small- and intermediate-sized general purpose systems and related programming, as well as for low-end direct access storage devices.

## **Information Systems and Storage Group**

*Data Systems Division*—Has worldwide development and associated programming responsibility for large, complex systems, with primary emphasis on high-performance products, plus U. S. manufacturing responsibility for those systems.

*General Products Division*—Has worldwide development and U. S. manufacturing responsibility for storage systems, including tape units, disk products and mass storage systems, program products and product-related programming.

## **Information Systems Technology Group**

*General Technology Division*—Has worldwide development, product assurance and U. S. manufacturing responsibility for logic, memory and special semiconductor devices and multi-layer

ceramics. The division also procures components for the IBM World Trade Americas/Far East Corporation and U. S. operating units.

*Systems Technology Division*—Has worldwide development, product assurance and U. S. manufacturing responsibility for circuit packaging used in IBM computing systems. Also develops and manufactures intermediate processors and printers and develops programming systems.

## **Information Systems Group**

*National Distribution Division*—Has marketing responsibility within the U. S. for selected systems and high-volume products delivered through alternate channels of distribution such as IBM Product Centers, value-added remarketers and authorized dealers. In addition, the division has responsibility for marketing IBM supplies and accessories within the U. S.

*National Service Division*—Provides service for assigned products, manages service business within the U. S. and its territories, and supports IBM's marketing efforts.

*North-Central Marketing Division*—Markets within the U. S. and its territories the full standard line of IBM products to customers within its geographic area.

*South-West Marketing Division*—Markets within the U. S. and its territories the full standard line of IBM products to customers within its geographic area.

## **Other Divisions**

*Federal Systems Division*—Provides specialized information-handling and control systems and the accompanying software for seaborne, spaceborne, airborne and ground-based applications for the Federal government. This includes systems integration and development of software for large complex systems both for the Federal government and commercial customers.

*Real Estate and Construction Division*—Manages the selection and acquisition of sites, the design and construction of buildings, and the purchase or lease of facilities for all IBM operations in the U. S. The division has responsibility for assessing real estate projects outside the U. S.,

as well as for IBM's worldwide energy and environmental programs. It also provides facility services to selected headquarters locations.

*Research Division*—Brings scientific understanding to bear on areas of company interest through basic research and development of technologies of potential long-range importance.

## **Subsidiaries**

*IBM Credit Corporation*—Offers lease financing of IBM products, either directly or through partnerships, and finances installment receivables resulting from sales by IBM of its information processing systems and equipment to customers in the U. S. Provides consumer financing of IBM products through IBM credit card. It also finances purchases of non-IBM equipment.

*IBM Instruments, Inc.*—Has responsibility for IBM's efforts in the analytical instruments field, including marketing and servicing selected products in the U. S.

*ROLM Corporation*—Has worldwide development, manufacturing and marketing responsibility for fully integrated computerized business communications systems, including private branch exchanges, voice messaging systems, circuit-switched data systems, desktop products, and related applications.

*Science Research Associates, Inc.*—Has worldwide development, publication and/or marketing responsibility for a wide range of educational and testing materials and services for use in schools, colleges and businesses.

*IBM World Trade Americas / Far East Corporation*—With a territory extending across four continents, this subsidiary is responsible for IBM operations in 46 countries, including Australia, Brazil, Canada, China and Japan.

*IBM World Trade Europe / Middle East / Africa Corporation*—Through its subsidiary, IBM Europe, located in Paris, it is responsible for IBM operations in 85 countries.

*IBM World Trade Corporation*—Provides designated support to IBM World Trade organizational units.



# Stockholder Information

*The following information is provided as a convenient reference for IBM stockholders:*

## **The 1986 Annual Meeting**

of stockholders will be held in the Albert Thomas Convention and Exhibit Center, Houston, Texas, on Monday, April 28, at 10 a.m.

**Notice of Annual Meeting, Proxy Statement and Proxy Voting Card** are mailed to each stockholder in March. The Proxy Statement describes the items of business to be voted on at the Annual Meeting and provides biographies of the Board's nominees for director and their principal affiliations with other companies or organizations, as well as other information about the company.

**The Report of the IBM Annual Meeting**, mailed to each stockholder in June, summarizes the activities at the Annual Meeting, including a report on the company, questions and answers of general interest, and the results of voting on items of business.

## **IBM Stock Transfer**

is handled by the IBM Stockholder Relations Department, 590 Madison Avenue, New York, N.Y. 10022. The department maintains stockholder records and can answer questions regarding stockholders' accounts. Stockholders wishing to transfer stock or to change the name on a stock certificate should contact the department for instructions.

Stock certificates are valuable and should be safeguarded, since replacement takes time and requires payment of a surety bond premium by the stockholder. If a stock certificate is lost, stolen or destroyed, Stockholder Relations should be notified. Registered mail should be used whenever stock is mailed.

## **IBM Stock is Traded**

on the New York Stock Exchange, other exchanges in the United States and exchanges in Austria, Belgium, Canada, England, France, Germany, Japan, Switzerland and the Netherlands.

## **Stock Transfer Offices:**

IBM Stockholder Relations Department  
590 Madison Avenue, New York, N.Y. 10022  
IBM Stockholder Relations Department  
One IBM Plaza, Chicago, Ill. 60611

## **Co-Transfer Agents:**

Trust Général du Canada  
1100 University Street, Montreal, Quebec,  
Canada H3B 2G7  
National Trust Company  
21 King Street East, Toronto, Ontario,  
Canada M5C 1B3

## **Registrars:**

Morgan Guaranty Trust Company of New York  
30 West Broadway, New York, N.Y. 10007  
The First National Bank of Chicago  
One First National Plaza, Chicago, Ill. 60670  
Montreal Trust Company  
One Place Ville Marie,  
Montreal, Quebec, Canada H3B 3L6  
15 King Street West, Toronto, Ontario,  
Canada M5H 1B4

*The following information may be obtained without charge from the IBM Stockholder Relations Department, 590 Madison Avenue, New York, N.Y. 10022:*

## **The Form 10-K Annual Report**

to the Securities and Exchange Commission provides further details on IBM's business, including a list of subsidiaries, summarized in the Annual Report. Form 10-K is available in April.

## **The Form 10-Q Quarterly Report**

to the Securities and Exchange Commission is available in May, August and November.

**A Transcript of the Annual Meeting** is available in June.

**An IBM Dividend Reinvestment Plan Booklet** explains how stockholders may automatically reinvest dividends toward the purchase of additional shares of IBM stock, as well as make optional additional investments for that purpose.

## **IBM Business Conduct Guidelines**

is a booklet sent to IBM employees worldwide describing the ethical and business principles that the company sets for the conduct of its business.

## **Equal Opportunity, Affirmative Action and Community Programs**

in IBM are outlined in a document that describes programs in the United States for women, minorities and handicapped persons, and reviews IBM's Affirmative Action efforts in the community.

## **IBM Programs in the Community, Education and the Arts**

is a brochure that describes support programs for education, community service, hospitals, the arts and other areas, with examples of employee involvement in communities.

## **IBM Operations in South Africa**

are summarized in a report of the company's business in that country. This report describes the personnel principles and practices to which IBM adheres in doing business in South Africa.

## **IBM Annual Report Translations and Recordings**

are available. The report is translated into French, German and Japanese. An audio cassette recording in English is available for the blind.

## **A Service for Deaf Stockholders**

provided by the IBM Stockholder Relations Department enables deaf stockholders who have access to a teletypewriter to communicate with the department's New York City office. Stockholders who wish to use the service should call  
(212) 407-4552.

## **For Information:**

Regarding stockholders' accounts, call  
(212) 735-7000.  
General questions about IBM, call  
(800) 426-3333.  
Outside the continental U.S., call  
(617) 895-2874.

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