

INTERNATIONAL BUSINESS MACHINES CORP  
Form 10-Q  
April 29, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10 - Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**FOR THE QUARTER ENDED MARCH 31, 2014**

**1-2360**

(Commission file number)

**INTERNATIONAL BUSINESS MACHINES CORPORATION**

(Exact name of registrant as specified in its charter)

**New York**

**13-0871985**

(State of incorporation)

(IRS employer identification number)

**Armonk, New York**

**10504**

(Address of principal executive offices)

(Zip Code)

**914-499-1900**

(Registrant's telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.    Yes ☒    No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).    Yes ☒    No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The registrant had 1,012,183,432 shares of common stock outstanding at March 31, 2014.





**Index**

**Page**

**Part I - Financial Information:**

**Item 1. Consolidated Financial Statements:**

Consolidated Statement of Earnings for the three months ended March 31, 2014 and 2013

3

Consolidated Statement of Comprehensive Income for the three months ended March 31, 2014 and 2013

4

Consolidated Statement of Financial Position at March 31, 2014 and December 31, 2013

5

Consolidated Statement of Cash Flows for the three months ended March 31, 2014 and 2013

7

Consolidated Statement of Changes in Equity for the three months ended March 31, 2014 and 2013

Notes to Consolidated Financial Statements

**Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition**



**Item 4. Controls and Procedures**

67

**Part II - Other Information:**

**Item 1. Legal Proceedings**

67

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds and Issuer Repurchases of Equity Securities**

67

**Item 6. Exhibits**

68



**Part I - Financial Information**

**Item 1. Consolidated Financial Statements:**

**INTERNATIONAL BUSINESS MACHINES CORPORATION  
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF EARNINGS  
(UNAUDITED)**

**Three Months Ended March 31,**

**(Dollars in millions except per share amounts)**

**2014**

**2013**

**Revenue:**

Services

\$

13,982

\$

	14,274
Sales	
	7,984
	8,629
Financing	
	517
	505
<b>Total revenue</b>	
	22,484
	23,408
<b>Cost:</b>	

Services

9,101

9,526

Sales

2,561

2,931

Financing

278





	6,289
	5,577
Research, development and engineering	
	1,501
	1,644
Intellectual property and custom development income	
	(207)
	(183)
Other (income) and expense	

(126)

(60)

Interest expense

105

94

**Total expense and other (income)**

7,563

7,072

**Income before income taxes**

2,980

3,606

Provision for income taxes

596

574

**Net income**

\$

2,384

\$

3,032

**Earnings per share of common stock:**

Assuming dilution

\$	2.29
----	------

\$	2.70
----	------

Basic

\$	2.30
----	------

\$	2.72
----	------

**Weighted-average number of common shares outstanding: (millions)**

Assuming dilution

1,041.8

1,124.0

Basic

1,035.2

1,113.7

**Cash dividend per common share**

\$

0.95

\$

0.85

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

**INTERNATIONAL BUSINESS MACHINES CORPORATION  
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
(UNAUDITED)**

**Three Months Ended March 31,**

**(Dollars in millions)**



**2014**

**2013**

**Net income**

\$

2,384

\$

3,032

**Other comprehensive income/(loss), before tax:**

**Foreign currency translation adjustments**

(61)

(405)

**Net changes related to available-for-sale securities:**

Unrealized gains/(losses) arising during the period

0

(3)

Reclassification of (gains)/losses to net income

4

1

Subsequent changes in previously impaired securities arising during the period

—

1

**Total net changes related to available-for-sale securities**

4

(1)

**Unrealized gains/(losses) on cash flow hedges:**

Unrealized gains/(losses) arising during the period

88

360

Reclassification of (gains)/losses to net income

(1)

(56)

**Total unrealized gains/(losses) on cash flow hedges**

87

305

28

**Retirement-related benefit plans:**

Prior service costs/(credits)

1

33

Net (losses)/gains arising during the period

32

(15)

29

Curtailments and settlements

4

—

Amortization of prior service (credits)/cost

(29)

(30)

Amortization of net (gains)/losses

649

886

**Total retirement-related benefit plans**

656

875

**Other comprehensive income/(loss), before tax**

687

773

**Income tax (expense)/benefit related to items of other comprehensive income**

(241)

(480)

**Other comprehensive income/(loss)**

446

293

**Total comprehensive income/(loss)**

\$

2,830

\$

3,325

(Amounts may not add due to rounding)



(The accompanying notes are an integral part of the financial statements)

**INTERNATIONAL BUSINESS MACHINES CORPORATION  
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION  
(UNAUDITED)**

**ASSETS**

**At March 31,**

**At December 31,**

**(Dollars in millions)**

**2014**

**2013**

**Assets:**

Current assets:

Cash and cash equivalents

\$	9,409
----	-------

\$	10,716
----	--------

Marketable securities

295

350

Notes and accounts receivable - trade (net of allowances of \$305

in 2014 and \$291 in 2013)

9,682

10,465

Short-term financing receivables (net of allowances of \$317 in 2014

and \$308 in 2013)

18,329

19,787

Other accounts receivable (net of allowances of \$36 in 2014 and

\$36 in 2013)

1,650

1,584

Inventories, at lower of average cost or market:

Finished goods

472

444

Work in process and raw materials

1,984

1,866

Total inventories

2,456

2,310

Deferred taxes

1,708

	1,651
Prepaid expenses and other current assets	
	4,430
	4,488
Total current assets	
	47,959
	51,350



Property, plant and equipment

40,478

40,475

Less: Accumulated depreciation

26,795

26,654

Property, plant and equipment — net

13,683

13,821

Long-term financing receivables (net of allowances of \$93 in 2014

and \$80 in 2013)

11,918

12,755

Prepaid pension assets

6,110

	5,551
Deferred taxes	
	3,034
	3,051
Goodwill	
	31,214
	31,184
Intangible assets — net	
	3,698
	3,871

Investments and sundry assets

5,030

4,639

**Total assets**

\$

122,646

\$

126,223

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

**INTERNATIONAL BUSINESS MACHINES CORPORATION  
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION – (CONTINUED)  
(UNAUDITED)**

**LIABILITIES AND EQUITY**

**(Dollars in millions)**

**At March 31,**

**At December 31,**

**2014**

**2013**

**Liabilities:**

Current liabilities:

Taxes

\$

2,245

\$

4,633

Short-term debt

9,312

6,862

Accounts payable

	6,865
	7,461
Compensation and benefits	
	3,664
	3,893
Deferred income	
	13,681
	12,557
Other accrued expenses and liabilities	



	5,292
	4,748
Total current liabilities	
	41,058
	40,154
Long-term debt	
	34,668
	32,856
Retirement and nonpension postretirement benefit obligations	

	16,031
	16,242
Deferred income	
	4,042
	4,108
Other liabilities	
	10,106
	9,934
<b>Total liabilities</b>	
	105,906

103,294

**Equity:**

IBM stockholders' equity:

Common stock, par value \$0.20 per share, and additional paid-in capital

51,943

51,594

Shares authorized: 4,687,500,000

Shares issued: 2014 - 2,210,627,775

2013 - 2,207,522,548

Retained earnings

131,431

130,042

Treasury stock - at cost

(145,612)

(137,242)

Shares: 2014 - 1,198,444,343

2013 - 1,153,131,611

Accumulated other comprehensive income/(loss)

(21,156)

(21,602)

Total IBM stockholders' equity

16,607

22,792

Noncontrolling interests

	133
	137
<b>Total equity</b>	
	16,740
	22,929
<b>Total liabilities and equity</b>	
\$	
	122,646
\$	
	126,223

(Amounts may not add due to rounding.)



(The accompanying notes are an integral part of the financial statements.)

**INTERNATIONAL BUSINESS MACHINES CORPORATION  
AND SUBSIDIARY COMPANIES**

**CONSOLIDATED STATEMENT OF CASH FLOWS  
(UNAUDITED)**

**Three Months Ended March 31,**

**(Dollars in millions)**

**2014**

**2013**

**Cash flows from operating activities:**

Net income

\$

2,384

\$

3,032

Adjustments to reconcile net income to cash provided by operating activities

## Depreciation

802

822

## Amortization of intangibles

339

	331
Stock-based compensation	
	124
	144
Net (gain)/loss on asset sales and other	
	(161)
	(62)
Changes in operating assets and liabilities, net of acquisitions/divestitures	
	(162)

(244)

**Net cash provided by operating activities**

3,326

4,023

**Cash flows from investing activities:**

Payments for property, plant and equipment

(849)

(714)

Proceeds from disposition of property, plant and equipment

74

123

Investment in software

(112)

(139)

Acquisition of businesses, net of cash acquired

(264)

(58)

Divestitures of businesses, net of cash transferred

391

10

Non-operating finance receivables — net

665

732

Purchases of marketable securities and other investments

(477)

(2,136)

Proceeds from disposition of marketable securities and other investments

608

1,169

**Net cash provided by/(used in) investing activities**

35

(1,012)



**Cash flows from financing activities:**

Proceeds from new debt

4,875

2,685

Payments to settle debt

(1,507)

(857)

Short-term borrowings/(repayments) less than 90 days — net

	845
	(1,359)
Common stock repurchases	
	(8,166)
	(2,593)
Common stock transactions — other	
	270
	356
Cash dividends paid	
	(990)

(948)

**Net cash used in financing activities**

(4,673)

(2,716)

Effect of exchange rate changes on cash and cash equivalents

5

(121)

Net change in cash and cash equivalents

(1,307)

173

Cash and cash equivalents at January 1

10,716

10,412

**Cash and cash equivalents at March 31**

\$

9,409

\$

10,585

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)

**INTERNATIONAL BUSINESS MACHINES CORPORATION  
AND SUBSIDIARY COMPANIES  
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
(UNAUDITED)**

**Common**

**Stock and**

**Accumulated**

**Additional**

**Other**

**Total IBM**

**Non-**



**Paid-in**

**Retained**

**Treasury**

**Comprehensive**

**Stockholders'**

**Controlling**

**Total**

**(Dollars in millions)**

**Capital**

**Earnings**

**Stock**

**Income/(Loss)**

**Equity**

**Interests**

**Equity**

**Equity - January 1, 2014**

\$	
	51,594
\$	
	130,042
\$	
	(137,242)
\$	
	(21,602)
\$	
	22,792
\$	
	137
\$	
	22,929
Net income plus other	

comprehensive income/(loss)

Net income

2,384

2,384

2,384

Other comprehensive income/(loss)

446

446

Total comprehensive income/(loss)

\$

2,830

\$

2,830

Cash dividends paid –

common stock

(990)

(990)

(990)

Common stock issued under



employee plans (3,105,227 shares)

333

333

Purchases (488,203 shares) and

sales (328,673 shares) of treasury

stock under employee plans – net

(5)

(46)

(51)

(51)

Other treasury shares purchased,

not retired (45,153,202 shares)

(8,324)

(8,324)

(8,324)

Changes in other equity

16

86

16

16

Changes in noncontrolling interests

(4)

(4)

**Equity - March 31, 2014**

\$

51,943

\$

131,431

\$

(145,612)

\$

(21,156)



\$	16,607
\$	133
\$	16,740

**Common**

**Stock and**

**Accumulated**

**Additional**

**Other**

**Total IBM**

**Non-**

**Paid-in**

**Retained**

**Treasury**

**Comprehensive**

**Stockholders'**

**Controlling**

**Total**

**(Dollars in millions)**

**Capital**

**Earnings**

**Stock**

**Income/(Loss)**

**Equity**

**Interests**

**Equity**

**Equity - January 1, 2013**

\$	50,110
\$	117,641
\$	(123,131)
\$	(25,759)
\$	18,860
\$	124
	92

\$

18,984

Net income plus other

comprehensive income/(loss)

Net income

3,032

3,032

3,032

Other comprehensive income/(loss)

293

293

293

Total comprehensive income/(loss)



\$	3,325
\$	3,325
Cash dividends paid –	

common stock

(948)

(948)

Common stock issued under

employee plans (3,726,163 shares)

361

361

361

Purchases (629,550 shares) and

sales (648,990 shares) of treasury

stock under employee plans – net

(12)

(53)

(65)

(65)

Other treasury shares purchased,

not retired (12,318,883 shares)

(2,493)

(2,493)

(2,493)

Changes in other equity



52

52

52

Changes in noncontrolling interests

(1)

(1)

**Equity - March 31, 2013**

\$

50,522

\$

119,713

\$

(125,677)

\$

(25,466)

\$

19,092

\$

122

\$

19,214

(Amounts may not add due to rounding.)

(The accompanying notes are an integral part of the financial statements.)



## Notes to Consolidated Financial Statements:

**1. Basis of Presentation:** The accompanying Consolidated Financial Statements and footnotes of the International Business Machines Corporation (IBM or the company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial statements and footnotes are unaudited. In the opinion of the company's management, these statements include all adjustments, which are only of a normal recurring nature, necessary to present a fair statement of the company's results of operations, financial position and cash flows.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amount of assets, liabilities, revenue, costs, expenses and other comprehensive income/(loss) that are reported in the Consolidated Financial Statements and accompanying disclosures. These estimates are based on management's best knowledge of current events, historical experience, actions that the company may undertake in the future and on various other assumptions that are believed to be reasonable under the circumstances. As a result, actual results may be different from these estimates. See the company's 2013 Annual Report on pages 67 to 70 for a discussion of the company's critical accounting estimates.

Interim results are not necessarily indicative of financial results for a full year. The information included in this Form 10-Q should be read in conjunction with the company's 2013 Annual Report.

Noncontrolling interest amounts in income of \$(0.5) million and \$1.4 million, net of tax, for the three months ended March 31, 2014 and 2013, respectively, are included in the Consolidated Statement of Earnings within the other (income) and expense line item.

Within the financial statements and tables presented, certain columns and rows may not add due to the use of rounded numbers for disclosure purposes. Percentages presented are calculated from the underlying whole-dollar amounts. Certain prior year amounts have been reclassified to conform to the current year presentation. This is annotated where applicable.

**2. Accounting Changes:** In April 2014, the Financial Accounting Standards Board (FASB) issued guidance that changes the criteria for reporting a discontinued operation. According to the new guidance, only disposals of a component that represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results is a discontinued operation. The new guidance also requires expanded disclosures about discontinued operations and disposals of a significant part of an entity that does not qualify for discontinued operations reporting. The guidance is effective beginning January 1, 2015 with early adoption permitted, but only for disposals (or classifications as held for sale) that have not been reported in previously-issued financial statements. The impact to the company will be dependent on any transaction that is within the scope of the new guidance.

In July 2013, the FASB issued guidance regarding the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. Under certain circumstances, unrecognized tax benefits should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The guidance was effective January 1, 2014, and was adopted by the company in the first quarter. The guidance is a change in financial statement presentation only and had no material impact in the consolidated financial results.

In March 2013, the FASB issued guidance on when foreign currency translation adjustments should be released to net income. When a parent entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity, the parent is required to release any related cumulative translation adjustment into net income. Accordingly, the cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. The guidance was effective January 1, 2014 and did not have a material impact in the Consolidated Statement of Financial Position.

In February 2013, the FASB issued guidance for the recognition, measurement and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date. Examples include debt arrangements, other contractual obligations and settled litigation matters. The guidance requires an entity to measure such obligations as the sum of the amount that the reporting entity agreed to pay on the basis of its arrangement among its co-obligors plus additional amounts the reporting entity expects to pay on behalf of its co-obligors. The guidance was effective January 1, 2014 and did not have a material impact in the consolidated financial results.





**Notes to Consolidated Financial Statements – (continued)**

### **3. Financial Instruments:**

#### **Fair Value Measurements**

Accounting guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Under this guidance, the company is required to classify certain assets and liabilities based on the following fair value hierarchy:

- Level 1—Quoted prices (unadjusted) in active markets for identical assets or liabilities that can be accessed at the measurement date;
- Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3—Unobservable inputs for the asset or liability.

The guidance requires the use of observable market data if such data is available without undue cost and effort.

When available, the company uses unadjusted quoted market prices in active markets to measure the fair value and classifies such items within Level 1. If quoted market prices are not available, fair value is based upon internally developed models that use current market-based or independently sourced market parameters such as interest rates and currency rates. Items valued using internally generated models are classified according to the lowest level input or value driver that is significant to the valuation.

The determination of fair value considers various factors including interest rate yield curves and time value underlying the financial instruments. For derivatives and debt securities, the company uses a discounted cash flow analysis using discount rates commensurate with the duration of the instrument.

In determining the fair value of financial instruments, the company considers certain market valuation adjustments to the “base valuations” calculated using the methodologies described below for several parameters that market participants would consider in determining fair value:

- Counterparty credit risk adjustments are applied to financial instruments, taking into account the actual credit risk of a counterparty as observed in the credit default swap market to determine the true fair value of such an instrument.

- Credit risk adjustments are applied to reflect the company's own credit risk when valuing all liabilities measured at fair value. The methodology is consistent with that applied in developing counterparty credit risk adjustments, but incorporates the company's own credit risk as observed in the credit default swap market.

As an example, the fair value of derivatives is derived utilizing a discounted cash flow model that uses observable market inputs such as known notional value amounts, yield curves, spot and forward exchange rates as well as discount rates. These inputs relate to liquid, heavily traded currencies with active markets which are available for the full term of the derivative.

Certain financial assets are measured at fair value on a nonrecurring basis. These assets include equity method investments that are recognized at fair value at the measurement date to the extent that they are deemed to be other-than-temporarily impaired. Certain assets that are measured at fair value on a recurring basis can be subject to nonrecurring fair value measurements. These assets include available-for-sale equity investments that are deemed to be other-than-temporarily impaired. In the event of an other-than-temporary impairment of a financial investment, fair value is measured using a model described above.

Non-financial assets such as property, plant and equipment, land, goodwill and intangible assets are also subject to nonrecurring fair value measurements if they are deemed to be impaired. The impairment models used for nonfinancial assets depend on the type of asset. See Note A, "Significant Accounting Policies - Impairment," on page 88 in the company's 2013 Annual Report for additional information. There were no material impairments of non-financial assets for the three months ended March 31, 2014 and 2013, respectively.

Accounting guidance permits the measurement of eligible financial assets, financial liabilities and firm commitments at fair value, on an instrument-by-instrument basis, that are otherwise not permitted to be accounted for at fair value under other accounting standards. This election is irrevocable. The company has not applied the fair value option to any eligible assets or liabilities.

The following tables present the company's financial assets and financial liabilities that are measured at fair value on a recurring basis at March 31, 2014 and December 31, 2013.

**Notes to Consolidated Financial Statements – (continued)**

**(Dollars in millions)**

**At March 31, 2014**

**Level 1**

**Level 2**

**Level 3**

**Total**

**Assets:**

Cash equivalents (1)

Time deposits and certificates of deposit

\$	—
\$	4,619
\$	—
\$	4,619

Commercial paper

—

559

—

559

Money market funds

988

—

—

120



988

U.S. government securities

—

599

—

599

Canadian government securities

—

226

—

226

Other securities

—

40

—

40

122

Total

988

6,044

---

7,032

(6)

Debt securities - current (2)

---

295

---

295

(6)

Debt securities - noncurrent (3)

1

8

—

9

Trading securities investments (3)

—

77

—

77

Available-for-sale equity investments (3)

4

—

—

4

Derivative assets (4)

Interest rate contracts

---

363

---

Foreign exchange contracts

—

297

—

297

Equity contracts

—

17

—

17

Total

—

678

—

678

(7)

**Total assets**

\$



993

\$

7,102

\$

—

\$

8,095

(7)

**Liabilities:**

Derivative liabilities (5)

Foreign exchange contracts

\$

—

\$

427

\$

—

130

\$

427

Equity contracts

—

2

—

2

Interest rate contracts

—

	12
	—
	12
<b>Total liabilities</b>	
\$	—
\$	
	441
\$	—
\$	
(7)	441

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.

(2) Commercial paper and certificates of deposit reported as marketable securities in the Consolidated Statement of Financial Position.

(3) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

(4) The gross balances of derivative assets contained within prepaid expenses and other current assets, and investments

and sundry assets in the Consolidated Statement of Financial Position at March 31, 2014 were \$202 million and

\$476 million, respectively.

(5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at March 31, 2014 were \$370 million and \$71 million, respectively.

(6) Available-for-sale securities with carrying values that approximate fair value.

(7) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by \$221 million each.

**Notes to Consolidated Financial Statements – (continued)**

**(Dollars in millions)**

**At December 31, 2013**

**Level 1**

**Level 2**

**Level 3**

**Total**

**Assets:**

Cash equivalents (1)

Time deposits and certificates of deposit

\$	—
\$	4,754
\$	—
\$	4,754



Commercial paper

—

1,507

—

1,507

Money market funds

1,728

—

—

	1,728
Other securities	—
	8
	—
	8
Total	1,728
	138

	6,269
	—
	7,997
(6)	
Debt securities - current (2)	
	—
	350
	—
	350
(6)	
Debt securities - noncurrent (3)	
	139

1

7

—

9

Available-for-sale equity investments (3)

18

—

—

Derivative assets (4)

Interest rate contracts

	—
	308
Foreign exchange contracts	
	—
	375
	—
	375
Equity contracts	
	142

—

36

—

36

Total

—

719

—

719

(7)

**Total assets**

\$

1,747

\$

7,345

\$

—

\$

9,092

(7)

**Liabilities:**



Derivative liabilities (5)

Interest rate contracts

\$

\$ 13

\$ —

\$ 13

Foreign exchange contracts —

484

—

484

Equity contracts

—

4

—

4

**Total liabilities**

\$

—

\$

501

\$

—

\$

501

(7)

(1) Included within cash and cash equivalents in the Consolidated Statement of Financial Position.

(2) Commercial paper and certificates of deposit reported as marketable securities in the Consolidated Statement of Financial Position.

(3) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

(4) The gross balances of derivative assets contained within prepaid expenses and other current assets, and investments

and sundry assets in the Consolidated Statement of Financial Position at December 31, 2013 were \$318 million and

\$401 million, respectively.

- (5) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at December 31, 2013 were \$375 million and \$126 million, respectively.
- (6) Available-for-sale securities with carrying values that approximate fair value.
- (7) If derivative exposures covered by a qualifying master netting agreement had been netted in the Consolidated Statement of Financial Position, the total derivative asset and liability positions would have been reduced by \$251 million each.

There were no transfers between Levels 1 and 2 for the three months ended March 31, 2014 and the year ended December 31, 2013.

#### **Financial Assets and Liabilities Not Measured at Fair Value**

##### **Short-Term Receivables and Payables**

Notes and other accounts receivable and other investments are financial assets with carrying values that approximate fair value. Accounts payable, other accrued expenses and short-term debt (excluding the current portion of long-term debt) are financial liabilities with carrying values that approximate fair value. If measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy.

##### **Loans and Long-term Receivables**

Fair values are based on discounted future cash flows using current interest rates offered for similar loans to clients with similar credit ratings for the same remaining maturities. At March 31, 2014 and December 31, 2013, the difference between the carrying amount and estimated fair value for loans and long-term receivables was immaterial. If measured at fair value in the financial statements, these financial instruments would be classified as Level 3 in the fair value hierarchy.

**Notes to Consolidated Financial Statements – (continued)**

**Long-term Debt**

Fair value of publicly-traded long-term debt is based on quoted market prices for the identical liability when traded as an asset in an active market. For other long-term debt for which a quoted market price is not available, an expected present value technique that uses rates currently available to the company for debt with similar terms and remaining maturities is used to estimate fair value. The carrying amount of long-term debt was \$34,668 million and \$32,856 million, and the estimated fair value was \$36,808 million and \$34,555 million at March 31, 2014 and December 31, 2013, respectively. If measured at fair value in the financial statements, long-term debt (including the current portion) would be classified as Level 2 in the fair value hierarchy.

**Debt and Marketable Equity Securities**

The company's cash equivalents and current debt securities are considered available-for-sale and recorded at fair value, which is not materially different from carrying value, in the Consolidated Statement of Financial Position.

During the quarter, the company acquired equity investments in conjunction with the sale of the customer care business which are classified as trading securities. At March 31, 2014, unrealized gains related to trading securities of \$6 million were recorded in other (income) and expense in the Consolidated Statement of Earnings.

The following tables summarize the company's noncurrent debt and marketable equity securities which are also considered available-for-sale and recorded at fair value in the Consolidated Statement of Financial Position.

**Gross**

**Gross**

**(Dollars in millions)**

**Adjusted**

**Unrealized**

**Unrealized**

**Fair**

**At March 31, 2014:**

**Cost**

**Gains**

**Losses**

**Value**

Debt securities – noncurrent(1)

\$	8
\$	2
\$	—
\$	9
Available-for-sale equity investments(1)	
\$	2
\$	2
\$	
0	
\$	4



(1) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

**Gross**

**Gross**

(Dollars in millions)

**Adjusted**

**Unrealized**

**Unrealized**

**Fair**

**At December 31, 2013:**

**Cost**

**Gains**

**Losses**

**Value**

Debt securities – noncurrent(1)

\$

	\$	1
	\$	—
	\$	9
Available-for-sale equity investments(1)		
	\$	20
	\$	2
	\$	4
	\$	18

(1) Included within investments and sundry assets in the Consolidated Statement of Financial Position.

Based on an evaluation of available evidence as of March 31, 2014 and December 31, 2013, the company believes that unrealized losses on debt and available-for-sale equity investments were temporary and did not represent a need for an other-than-temporary impairment.

Sales of debt and available-for-sale equity investments during the period were as follows:

**(Dollars in millions)**

**For the three months ended March 31:**

**2014**

**2013**

Proceeds

\$

14

\$

18

Gross realized gains (before taxes)

—

3

Gross realized losses (before taxes)

4

4

**(Dollars in millions)**

**For the three months ended March 31:**

**2014**

**2013**

Net unrealized gains/(losses) arising during the period

\$

0

\$

\$ (1)

Net unrealized (gains)/losses reclassified to net income\*

3

0

\* There were no writedowns for the three months ended March 31, 2014 and 2013.

The contractual maturities of substantially all available-for-sale debt securities are less than one year at March 31, 2014.

**Notes to Consolidated Financial Statements – (continued)****Derivative Financial Instruments**

The company operates in multiple functional currencies and is a significant lender and borrower in the global markets. In the normal course of business, the company is exposed to the impact of interest rate changes and foreign currency fluctuations, and to a lesser extent equity and commodity price changes and client credit risk. The company limits these risks by following established risk management policies and procedures, including the use of derivatives, and, where cost effective, financing with debt in the currencies in which assets are denominated. For interest rate exposures, derivatives are used to better align rate movements between the interest rates associated with the company's lease and other financial assets and the interest rates associated with its financing debt. Derivatives are also used to manage the related cost of debt. For foreign currency exposures, derivatives are used to better manage the cash flow volatility arising from foreign exchange rate fluctuations.

As a result of the use of derivative instruments, the company is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, the company has a policy of only entering into contracts with carefully selected major financial institutions based upon their overall credit profile. The company's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. The right of set-off that exists under certain of these arrangements enables the legal entities of the company subject to the arrangement to net amounts due to and from the counterparty reducing the maximum loss from credit risk in the event of counterparty default.

The company is also a party to collateral security arrangements with most of its major derivative counterparties. These arrangements require the company to hold or post collateral (cash or U.S. Treasury securities) when the derivative fair values exceed contractually established thresholds. Posting thresholds can be fixed or can vary based on credit default swap pricing or credit ratings received from the major credit agencies. The aggregate fair value of all derivative instruments under these collateralized arrangements that were in a liability position at March 31, 2014 and December 31, 2013 was \$201 million and \$216 million, respectively, for which no collateral was posted at March 31, 2014 and December 31, 2013. Full collateralization of these agreements would be required in the event that the company's credit rating falls below investment grade or if its credit default swap spread exceeds 250 basis points, as applicable, pursuant to the terms of the collateral security arrangements. The aggregate fair value of derivative instruments in net asset positions as of March 31, 2014 and December 31, 2013 was \$678 million and \$719 million, respectively. This amount represents the maximum exposure to loss at the reporting date as a result of the counterparties failing to perform as contracted. This exposure was reduced by \$221 million and \$251 million at March 31, 2014 and December 31, 2013, respectively, of liabilities included in master netting arrangements with those counterparties. Additionally, at March 31, 2014 and December 31, 2013, this exposure was reduced by \$23 million and \$29 million of cash collateral, respectively, received by the company. At March 31, 2014 and December 31, 2013, the net exposure related to derivative assets recorded in the Consolidated Statement of Financial Position was \$434 million and \$439 million, respectively. At March 31, 2014 and December 31, 2013, the net amount related to derivative liabilities recorded in the Consolidated Statement of Financial Position was \$220 million and \$250 million, respectively.



In the Consolidated Statement of Financial Position, the company does not offset derivative assets against liabilities in master netting arrangements nor does it offset receivables or payables recognized upon payment or receipt of cash collateral against the fair values of the related derivative instruments. No amount was recognized in other receivables at March 31, 2014 or December 31, 2013 for the right to reclaim cash collateral. The amount recognized in accounts payable for the obligation to return cash collateral totaled \$23 million and \$29 million at March 31, 2014 and December 31, 2013, respectively. The company restricts the use of cash collateral received to rehypothecation, and therefore reports it in prepaid expenses and other current assets in the Consolidated Statement of Financial Position. No amount was rehypothecated at March 31, 2014 or at December 31, 2013. At March 31, 2014 and December 31, 2013, no amounts of non-cash collateral were held.

The company may employ derivative instruments to hedge the volatility in stockholders' equity resulting from changes in currency exchange rates of significant foreign subsidiaries of the company with respect to the U.S. dollar. These instruments, designated as net investment hedges, expose the company to liquidity risk as the derivatives have an immediate cash flow impact upon maturity which is not offset by a cash flow from the translation of the underlying hedged equity. The company monitors this cash loss potential on an ongoing basis and may discontinue some of these hedging relationships by de-designating or terminating the derivative instrument in order to manage the liquidity risk. Although not designated as accounting hedges, the company may utilize derivatives to offset the changes in the fair value of the de-designated instruments from the date of de-designation until maturity.

In its hedging programs, the company uses forward contracts, futures contracts, interest-rate swaps and cross-currency swaps, depending upon the underlying exposure. The company is not a party to leveraged derivative instruments.

## **Notes to Consolidated Financial Statements – (continued)**

A brief description of the major hedging programs, categorized by underlying risk, follows.

### **Interest Rate Risk**

#### **Fixed and Variable Rate Borrowings**

The company issues debt in the global capital markets, principally to fund its financing lease and loan portfolios. Access to cost-effective financing can result in interest rate mismatches with the underlying assets. To manage these mismatches and to reduce overall interest cost, the company uses interest-rate swaps to convert specific fixed-rate debt issuances into variable-rate debt (i.e., fair value hedges) and to convert specific variable-rate debt issuances into fixed-rate debt (i.e., cash flow hedges). At March 31, 2014 and December 31, 2013, the total notional amount of the company's interest rate swaps was \$5.9 billion and \$3.1 billion, respectively. The weighted-average remaining maturity of these instruments at March 31, 2014 and December 31, 2013 was approximately 9.5 years and 10.6 years, respectively.

#### **Forecasted Debt Issuance**

The company is exposed to interest rate volatility on future debt issuances. To manage this risk, the company may use forward starting interest-rate swaps to lock in the rate on the interest payments related to the forecasted debt issuance. These swaps are accounted for as cash flow hedges. The company did not have any derivative instruments relating to this program outstanding at March 31, 2014 and December 31, 2013.

At March 31, 2014 and December 31, 2013, net gains of approximately \$1 million (before taxes), respectively, were recorded in accumulated other comprehensive income/(loss) in connection with cash flow hedges of the company's borrowings. Within these amounts, gains of less than \$1 million, respectively, are expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying transactions.

### **Foreign Exchange Risk**

### **Long-Term Investments in Foreign Subsidiaries (Net Investment)**

A large portion of the company's foreign currency denominated debt portfolio is designated as a hedge of net investment in foreign subsidiaries to reduce the volatility in stockholders' equity caused by changes in foreign currency exchange rates in the functional currency of major foreign subsidiaries with respect to the U.S. dollar. The company also uses cross-currency swaps and foreign exchange forward contracts for this risk management purpose. At March 31, 2014 and December 31, 2013, the total notional amount of derivative instruments designated as net investment hedges was \$3.4 billion and \$3.0 billion, respectively. The weighted-average remaining maturity of these instruments at March 31, 2014 and December 31, 2013 was approximately 0.4 years for both periods.

### **Anticipated Royalties and Cost Transactions**

The company's operations generate significant nonfunctional currency, third-party vendor payments and intercompany payments for royalties and goods and services among the company's non-U.S. subsidiaries and with the parent company. In anticipation of these foreign currency cash flows and in view of the volatility of the currency markets, the company selectively employs foreign exchange forward contracts to manage its currency risk. These forward contracts are accounted for as cash flow hedges. The maximum length of time over which the company is hedging its exposure to the variability in future cash flows is four years. At March 31, 2014 and December 31, 2013, the total notional amount of forward contracts designated as cash flow hedges of forecasted royalty and cost transactions was \$10.2 billion with a weighted-average remaining maturity of 0.7 years for both periods.

At March 31, 2014 and December 31, 2013, in connection with cash flow hedges of anticipated royalties and cost transactions, the company recorded net losses of \$169 million and \$252 million (before taxes), respectively, in accumulated other comprehensive income/(loss). Within these amounts, \$155 million and \$166 million of losses, respectively, are expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying anticipated transactions.

## **Notes to Consolidated Financial Statements – (continued)**

### **Foreign Currency Denominated Borrowings**

The company is exposed to exchange rate volatility on foreign currency denominated debt. To manage this risk, the company employs cross-currency swaps to convert fixed-rate foreign currency denominated debt to fixed-rate debt denominated in the functional currency of the borrowing entity. These swaps are accounted for as cash flow hedges. Currently, the maximum length of time over which the company has hedged its exposure to variability in future cash flows is approximately seven years. At March 31, 2014 and December 31, 2013, the total notional amount of cross currency swaps designated as cash flow hedges of foreign currency denominated debt was \$1.2 billion for both periods.

At March 31, 2014 and December 31, 2013, in connection with cash flow hedges of foreign currency denominated borrowings, the company recorded net losses of \$6 million (before taxes) and \$9 million (before taxes), respectively, in accumulated other comprehensive income/(loss). Within these amounts, \$3 million of losses in both periods is expected to be reclassified to net income within the next 12 months, providing an offsetting economic impact against the underlying exposure.

### **Subsidiary Cash and Foreign Currency Asset/Liability Management**

The company uses its Global Treasury Centers to manage the cash of its subsidiaries. These centers principally use currency swaps to convert cash flows in a cost-effective manner. In addition, the company uses foreign exchange forward contracts to economically hedge, on a net basis, the foreign currency exposure of a portion of the company's nonfunctional currency assets and liabilities. The terms of these forward and swap contracts are generally less than one year. The changes in the fair values of these contracts and of the underlying hedged exposures are generally offsetting and are recorded in other (income) and expense in the Consolidated Statement of Earnings. At March 31, 2014 and December 31, 2013, the total notional amount of derivative instruments in economic hedges of foreign currency exposure was \$16.3 billion and \$14.7 billion, respectively.

### **Equity Risk Management**

The company is exposed to market price changes in certain broad market indices and in the company's own stock primarily related to certain obligations to employees. Changes in the overall value of these employee compensation obligations are recorded in selling, general and administrative (SG&A) expense in the Consolidated Statement of Earnings. Although not designated as accounting hedges, the company utilizes derivatives, including equity swaps and futures, to economically hedge the exposures related to its employee compensation obligations. The derivatives are linked to the total return on certain broad market indices or the total return on the company's common stock, and are recorded at fair value with gains or losses also reported in SG&A expense in the Consolidated Statement of Earnings.

At March 31, 2014 and December 31, 2013, the total notional amount of derivative instruments in economic hedges of these compensation obligations was \$1.2 billion and \$1.3 billion, respectively.

## Other Risks

The company may hold warrants to purchase shares of common stock in connection with various investments that are deemed derivatives because they contain net share or net cash settlement provisions. The company records the changes in the fair value of these warrants in other (income) and expense in the Consolidated Statement of Earnings. The company did not have any warrants qualifying as derivatives outstanding at March 31, 2014 and December 31, 2013.

The company is exposed to a potential loss if a client fails to pay amounts due under contractual terms. The company may utilize credit default swaps to economically hedge its credit exposures. The swaps are recorded at fair value with gains and losses reported in other (income) and expense in the Consolidated Statement of Earnings. The company did not have any derivative instruments relating to this program outstanding at March 31, 2014 and December 31, 2013.

The following tables provide a quantitative summary of the derivative and non-derivative instrument- related risk management activity as of March 31, 2014 and December 31, 2013 as well as for the three months ended March 31, 2014 and 2013, respectively:

**Notes to Consolidated Financial Statements – (continued)**

**Fair Values of Derivative Instruments in the Consolidated Statement of Financial Position**

**As of March 31, 2014 and December 31, 2013**

**(Dollars in millions)**

**Fair Value of Derivative Assets**

**Fair Value of Derivative Liabilities**

**Balance Sheet**

**Balance Sheet**

**Classification**

**3/31/2014**

**12/31/2013**

**Classification**

**3/31/2014**

**12/31/2013**

**Designated as hedging**

**instruments:**



**Interest rate contracts:**

Prepaid expenses and

Other accrued

other current assets

\$	—
\$	—
expenses and liabilities	
\$	—
\$	0
Investments and sundry	

assets

363

308

Other liabilities

12

13

**Foreign exchange**

Prepaid expenses and

Other accrued

**contracts:**

other current assets

110

187

expenses and liabilities

270

331

172

Investments and sundry

assets

54

26

Other liabilities

173

55

112

**Fair value of derivative**

174

**Fair value of derivative**

<b>assets</b>	
\$	528
\$	522
<b>liabilities</b>	
\$	337
\$	175

**Not designated as**



**hedging instruments:**

**Foreign exchange**

Prepaid expenses and

Other accrued

**contracts:**

other current assets

\$

74

\$

94

expenses and liabilities

\$

98

178

\$

40

Investments and sundry

assets

59

179

Other liabilities

4

**Equity contracts:**

1

Prepaid expenses and

Other accrued

other current assets

17

36

expenses and liabilities

2

4

**Fair value of derivative**

**Fair value of derivative**

**assets**

\$ 151

\$ 197

**liabilities**

\$ 104

\$ 45

**Total debt designated as**

**hedging instruments:**

Short-term debt

N/A

N/A



\$		—
\$		190
Long-term debt		
		N/A
		N/A
		6,116
		6,111
		185



**Total**

\$	678
\$	719
\$	6,557
\$	6,802

N/A-not applicable



**Notes to Consolidated Financial Statements – (continued)**

**The Effect of Derivative Instruments in the Consolidated Statement of Earnings**

**For the three months ended March 31, 2014 and 2013**

**(Dollars in millions)**

**Gain (Loss) Recognized in Earnings**

**Consolidated**

**Statement of**

**Recognized on**

**Attributable to Risk**

**Earnings Line Item**

**Derivatives(1)**

**Being Hedged(2)**

**For the three months ended March 31:**

**2014**



**2013**

**2014**

**2013**

**Derivative instruments in fair value hedges:**

Interest rate contracts

Cost of financing

\$ 48

\$ (20)

\$ (23)

\$ 46

Interest expense

33

(13)

(15)

**Derivative instruments not designated as**

**hedging instruments(1):**

Foreign exchange contracts

Other (income)

and expense

(34)

(439)

N/A

N/A

Equity contracts

SG&A expense

21

85

N/A

197

N/A

Total

\$

68

\$

198

(387)

\$

(38)

\$

76

**Gain (Loss) Recognized in Earnings and Other Comprehensive Income**

**Consolidated**

**(Ineffectiveness) and**

**Effective Portion**

**Statement of**

**Effective Portion Reclassified**



**Amounts Excluded from**

**Recognized in OCI**

**Earnings Line Item**

**from AOCI**

**Effectiveness Testing(3)**

**For the three months**

**ended March 31:**

**2014**

**2013**

**2014**

**2013**

**2014**

**2013**

**Derivative instruments**

**in cash flow hedges:**

Interest rate contracts

\$ \_\_\_\_\_

\$ \_\_\_\_\_

Interest expense

\$ \_\_\_\_\_

\$ \_\_\_\_\_

\$ \_\_\_\_\_

\$

Other (income)

Foreign exchange

88

360

and expense

29

37

(0)

1

contracts

206

Cost of sales

(26)

9

—

—

SG&A expense

(2)

10

—

—

**Instruments in net**



**investment hedges(4):**

Foreign exchange

contracts

(26)

219

Interest expense

—

—

0

(1)

Total

\$

62

\$

579

212

\$	1
\$	56
\$	(0)
\$	0

N/A-not applicable

Note: OCI represents Other comprehensive income/(loss) in the Consolidated Statement of Comprehensive Income and AOCI represents Accumulated other comprehensive income/(loss) in the Consolidated Statement of Changes in Equity.

- (1) The amount includes changes in clean fair values of the derivative instruments in fair value hedging relationships and the periodic accrual for coupon payments required under these derivative contracts.
- (2) The amount includes basis adjustments to the carrying value of the hedged item recorded during the period and amortization of basis adjustments recorded on de-designated hedging relationships during the period.
- (3) The amount of gain (loss) recognized in income represents ineffectiveness on hedge relationships.
- (4) Instruments in net investment hedges include derivative and non-derivative instruments.

For the three months ending March 31, 2014 and 2013, there were no significant gains or losses recognized in earnings representing hedge ineffectiveness or excluded from the assessment of hedge effectiveness (for fair value hedges), or associated with an underlying exposure that did not or was not expected to occur (for cash flow hedges);

nor are there any anticipated in the normal course of business.

**Notes to Consolidated Financial Statements – (continued)**

Refer to the company's 2013 Annual Report, Note A, "Significant Accounting Policies – Derivative Financial Instruments," on pages 90 to 91 for additional information.

**4. Financing Receivables:** The following table presents financing receivables, net of allowances for credit losses, including residual values.

**At March 31,**

**At December 31,**

**(Dollars in millions)**

**2014**

**2013**

Current:

Net investment in sales-type and direct financing leases

\$	4,096
\$	4,004
Commercial financing receivables	
	7,024
	8,541
Client loan receivables	
	5,797
	5,854
Installment payment receivables	
	1,412
	216





Client loan receivables

6,147

6,360

Installment payment receivables

619

695

Total

\$

11,918

\$

12,755

218

Net investment in sales-type and direct financing leases relates principally to the company's systems products and are for terms ranging generally from two to six years. Net investment in sales-type and direct financing leases includes unguaranteed residual values of \$698 million and \$737 million at March 31, 2014 and December 31, 2013, respectively, and is reflected net of unearned income of \$634 million and \$672 million, and net of the allowance for credit losses of \$131 million and \$123 million at those dates, respectively.

Commercial financing receivables, net of allowance for credit losses of \$16 million and \$23 million at March 31, 2014 and December 31, 2013, respectively, relate primarily to inventory and accounts receivable financing for dealers and remarketers of IBM and OEM products. Payment terms for inventory and accounts receivable financing generally range from 30 to 90 days.

Client loan receivables, net of allowance for credit losses of \$222 million and \$201 million at March 31, 2014 and December 31, 2013, respectively, are loans that are provided primarily to clients to finance the purchase of software and services. Separate contractual relationships on these financing arrangements are for terms ranging generally from one to seven years.

Installment payment receivables, net of allowance for credit losses of \$41 million and \$41 million at March 31, 2014 and December 31, 2013, respectively, are loans that are provided primarily to clients to finance hardware, software and services ranging generally from one to three years.

Client loan receivables and installment payment receivables financing contracts are priced independently at competitive market rates. The company has a history of enforcing the terms of these separate financing agreements.

The company utilizes certain of its financing receivables as collateral for nonrecourse borrowings. Financing receivables pledged as collateral for borrowings were \$756 million and \$769 million at March 31, 2014 and December 31, 2013, respectively.

The company did not have any financing receivables held for sale as of March 31, 2014 and December 31, 2013.

### **Financing Receivables by Portfolio Segment**

The following tables present financing receivables on a gross basis, excluding the allowance for credit losses and residual value, by portfolio segment and by class, excluding current commercial financing receivables and other miscellaneous current financing receivables at March 31, 2014 and December 31, 2013. The company determines its allowance for credit losses based on two portfolio segments: lease receivables and loan receivables, and further

segments the

**Notes to Consolidated Financial Statements – (continued)**

portfolio into two classes: major markets and growth markets. For additional information on the company's accounting policies for the allowance for credit losses, see the company's 2013 Annual Report on pages 92 and 93.

**(Dollars in millions)**

**Major**

**Growth**

**At March 31, 2014**

**Markets**

Markets

Total

Financing receivables:

Lease receivables

\$	6,356
\$	2,235
\$	8,591
	222

Loan receivables

	9,980
	4,259
	14,239
Ending balance	
\$	
	16,336
\$	
	6,494
\$	
	22,831
Collectively evaluated for impairment	
\$	
	16,223
\$	
	223

6,270

\$

22,494

Individually evaluated for impairment

\$

113

\$

224

\$

337

Allowance for credit losses:

Beginning balance at January 1, 2014

224



Lease receivables

\$ 42

\$ 80

\$ 123

Loan receivables

95

	147
	242
Total	
\$	137
\$	228
\$	365
Write-offs	
	(5)
	(3)
	(8)
	226

Provision

3

36

39

Other

(0)

(1)

(1)

Ending balance at March 31, 2014

\$

134

227

\$	260
\$	394
Lease receivables	
\$	41
\$	90
\$	131
Loan receivables	
\$	93
\$	171
\$	228

Collectively evaluated for impairment

\$	41
----	----

\$	47
----	----

\$	89
----	----

Individually evaluated for impairment

\$	93
----	----

\$ 213

\$ 306

(Dollars in millions)

Major

Growth

At December 31, 2013

Markets

Markets

Total

Financing receivables:

Lease receivables

\$

6,796

\$

2,200

\$

8,996

Loan receivables

10,529

4,012

14,542

Ending balance

232



\$	17,325
\$	6,212
\$	23,537
Collectively evaluated for impairment	
\$	17,206
\$	6,013
\$	23,219
Individually evaluated for impairment	
\$	119
\$	199
	233

\$

318

Allowance for credit losses:

Beginning balance at January 1, 2013

Lease receivables

\$

234

	59
\$	
	55
\$	
	114
Loan receivables	
	121
	84
	204
Total	
\$	
	180
\$	
	138
	235

\$	318
Write-offs	(23)
	(10)
	(33)
Provision	(21)
	105
	84
Other	236

	1
	(6)
	(5)
Ending balance at December 31, 2013	
\$	
	137
\$	
	228
\$	
	365
Lease receivables	
\$	
	42
\$	
	237

80

\$

123

Loan receivables

\$

95

\$

147

\$

242

Collectively evaluated for impairment

\$	45
----	----

\$	48
----	----

\$	93
----	----

Individually evaluated for impairment

\$	93
----	----

\$	179
----	-----

\$	272
----	-----

When determining the allowances, financing receivables are evaluated either on an individual or a collective basis. For individually evaluated receivables, the company determines the expected cash flow for the receivable and calculates an estimate of the potential loss and the probability of loss. For those accounts in which the loss is probable, the company records a specific reserve. In addition, the company records an unallocated reserve that is determined by applying a reserve rate to its different portfolios, excluding accounts that have been specifically reserved. This reserve rate is based upon credit rating, probability of default, term, characteristics (lease/loan) and loss history.



**Notes to Consolidated Financial Statements – (continued)**

**Financing Receivables on Non-Accrual Status**

Certain receivables for which the company has recorded a specific reserve may also be placed on non-accrual status. Non-accrual assets are those receivables with specific reserves and other accounts for which it is likely that the company will be unable to collect all amounts due according to original terms of the lease or loan agreement. Income recognition is discontinued on these receivables.

The following table presents the recorded investment in financing receivables which were on non-accrual status at March 31, 2014 and December 31, 2013.

**At March 31,**

**At December 31,**

**(Dollars in millions)**

**2014**

**2013**

Major markets

\$ 24

\$ 25

Growth markets

62

34

Total lease receivables

\$ 85

\$ 59

Major markets

\$ 41

\$ 40

Growth markets

116

92

Total loan receivables

\$ 157

\$ 132

Total receivables

\$ 242

\$ 191

**Impaired Loans**

The company considers any loan with an individually evaluated reserve as an impaired loan. Depending on the level of impairment, loans will also be placed on non-accrual status.

The following tables present impaired client loan receivables.

**At March 31, 2014**

**At December 31, 2013**

**Recorded**

**Related**

**Recorded**

**Related**

**(Dollars in millions)**

**Investment**

**Allowance**

**Investment**

**Allowance**

Major markets

\$

\$	63
\$	79
\$	67
Growth markets	
	147
	136
	122
	116
Total	
\$	222
	246

\$

199

\$

201

\$

183

**Interest**

**Average**

**Interest**

**Income**

(Dollars in millions)

**Recorded**

**Income**

**Recognized on**

**For the three months ended March 31, 2014:**

**Investment**

**Recognized**

**Cash Basis**

Major markets

\$



77

\$

0

\$

0

Growth markets

134

0

0

Total

\$

211

\$

0

\$

249

**Interest**

**Average**

**Interest**

Income

(Dollars in millions)

Recorded

Income

Recognized on

For the three months ended March 31, 2013:

Investment

Recognized

Cash Basis

Major markets

\$	79
----	----

\$	0
----	---

\$	0
----	---

Growth markets

	79
	0
	0
Total	
\$	
	158
\$	
	0
\$	
	0

### **Credit Quality Indicators**

The company's credit quality indicators, which are based on rating agency data, publicly available information and information provided by customers, are reviewed periodically based on the relative level of risk. The resulting indicators are a numerical rating system that maps to Standard & Poor's Ratings Services credit ratings as shown below. Standard & Poor's does not provide credit ratings to the company on its customers.

**Notes to Consolidated Financial Statements – (continued)**

The following tables present the gross recorded investment for each class of receivables, by credit quality indicator, at March 31, 2014 and December 31, 2013. Receivables with a credit quality indicator ranging from AAA to BBB- are considered investment grade. All others are considered non-investment grade. The credit quality indicators do not reflect mitigation actions that the company may take to transfer credit risk to third parties.

**Lease Receivables**

**Loan Receivables**

**(Dollars in millions)**

**Major**

**Growth**

**Major**

**Growth**

**At March 31, 2014:**

**Markets**

**Markets**

Markets

Markets

Credit Rating:

AAA – AA-

\$

648

\$

63

255

\$	1,017
\$	119
A+ – A-	1,243
	168
	1,952
	320
BBB+ – BBB-	2,172
	256



1,025

3,411

1,953

BB+ – BB

1,349

333

2,119

634

BB- – B+

519

257

350

814

666

B – B-

354

218

555

414

CCC+ – D

258

	71
	80
	111
	152
Total	
\$	
	6,356
\$	
	2,235
\$	
	9,980
\$	
	4,259
	259

At March 31, 2014, the industries which made up Global Financing's receivables portfolio consisted of: Financial (39 percent), Government (15 percent), Manufacturing (13 percent), Retail (9 percent), Services (8 percent), Communications (6 percent), Healthcare (5 percent) and Other (4 percent).

**Lease Receivables**

**Loan Receivables**

**(Dollars in millions)**

**Major**

**Growth**

**Major**

**Growth**

**At December 31, 2013:**

**Markets**

**Markets**

**Markets**

**Markets**

Credit Rating:

AAA – AA-

\$	743
\$	68
\$	1,151
\$	261

125

A+ – A-

1,513

168

2,344

307

BBB+ – BBB-

2,111

957

3,271

262

1,745

BB+ – BB

1,393

350

2,158

638

BB- – B+

595

368

263

	922
	672
B – B-	
	365
	214
	565
	391
CCC+ – D	
	76
	264



	74
	118
	134
Total	
\$	
	6,796
\$	
	2,200
\$	
	10,529
\$	
	4,012

At December 31, 2013, the industries which made up Global Financing's receivables portfolio consisted of: Financial (39 percent), Government (14 percent), Manufacturing (14 percent), Retail (8 percent), Services (8 percent), Healthcare (6 percent), Communications (6 percent) and Other (4 percent).

#### **Past Due Financing Receivables**

The company views receivables as past due when payment has not been received after 90 days, measured from the billing date.

**Notes to Consolidated Financial Statements – (continued)**

**Recorded**

**Total**

**Total**

**Investment**

**(Dollars in millions)**

**Past Due**

**Financing**

**> 90 Days**

**At March 31, 2014:**

**> 90 days\***

**Current**

**Receivables**

**and Accruing**

Major markets

\$ 8

\$ 6,348

\$ 6,356

\$ 8

Growth markets

17

2,218

	2,235
	10
Total lease receivables	
\$	
	25
\$	
	8,566
\$	
	8,591
\$	
	18

Major markets

\$	11
\$	9,969
\$	9,980
\$	11

Growth markets

31

4,228

271

	4,259
	6
Total loan receivables	
\$	
	43
\$	
	14,197
\$	
	14,239
\$	
	18



Total	
\$	68
\$	22,763
\$	22,831
\$	35

\* Does not include accounts that are fully reserved.

**Recorded**

**Total**

**Total**

**Investment**

**(Dollars in millions)**

**Past Due**

**Financing**

**> 90 Days**

**At December 31, 2013:**

**> 90 days\***

**Current**

**Receivables**

**and Accruing**

Major markets

\$

\$

6,789

\$

6,796

\$

5

## Growth markets

19

2,181

2,200

11

Total lease receivables

\$

25

277

\$	8,970
----	-------

\$	8,996
----	-------

\$	16
----	----

Major markets

\$	9
----	---

\$

10,520

\$

10,529

\$

6

## Growth markets

34

3,979

4,012

18

Total loan receivables

\$

43

279

\$

14,499

\$

14,542

\$

25

Total

\$

68

280



\$	23,469
\$	23,537
\$	41

\* Does not include accounts that are fully reserved.

#### **Troubled Debt Restructurings**

The company did not have any troubled debt restructurings during the three months ended March 31, 2014 and for the year ended December 31, 2013.

**5. Stock-Based Compensation:** Stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized over the employee requisite service period. The following table presents total stock-based compensation cost included in the Consolidated Statement of Earnings:

(Dollars in millions)

For the three months ended March 31:

	2014	
	2013	
Cost		
\$		31
\$		31
Selling, general and administrative		
		88
		283

	99
Research, development and engineering	
	14
	14
Other (income) and expense*	
	(9)
	—
Pre-tax stock-based compensation cost	
	124
	144
Income tax benefits	
	284

	(41)
	(50)
Total stock-based compensation cost	
\$	
	83
\$	
	94

\* Reflects the one-time effects related to the divestiture of the customer care business.



**Notes to Consolidated Financial Statements – (continued)**

The decrease in pre-tax stock-based compensation cost for the three months ended March 31, 2014, as compared to the corresponding period in the prior year, was due to decreases related to restricted stock units (\$9 million), performance share units (\$7 million) and the company's assumption of stock-based awards previously issued by acquired entities (\$4 million).

As of March 31, 2014, the total unrecognized compensation cost of \$853 million related to non-vested awards is expected to be recognized over a weighted-average period of approximately 2.4 years.

There was no significant capitalized stock-based compensation cost at March 31, 2014 and 2013.

**6. Segments:** The table on page 25 reflects the results of operations of the company's segments consistent with the management and measurement system utilized within the company. Performance measurement is based on pre-tax income. These results are used, in part, by senior management, both in evaluating the performance of, and in allocating resources to, each of the segments.

**Notes to Consolidated Financial Statements – (continued)**

**SEGMENT INFORMATION**





### **Global Services**

**Global**

**Global**

**Technology**

**Business**

**Systems and**

**Global**

**Total**

**(Dollars in millions)**

**Services**

**Services**

**Software**

**Technology**

**Financing**

**Segments**

**For the three months**

ended March 31, 2014:

External revenue

\$

9,330

\$

	4,483
\$	
	5,661
\$	
	2,391
\$	
	512
\$	
	22,376
Internal revenue	
	241
	141
	932
	295

	168
	617
	2,099
Total revenue	
\$	9,570
\$	4,624
\$	6,593
\$	2,559
\$	1,129
\$	296



24,476

Pre-tax income

\$

1,345

\$

628

\$

1,918

\$

(660)

\$

596

\$

3,828

Revenue year-to-year change

(2.9)

297

%	
	(0.9)
%	
	3.0
%	
	(20.7)
%	
	8.6
%	
	(2.8)
%	
Pre-tax income year-to-year	

change

(15.1)

%

(10.6)

%

(4.7)

%

(63.1)

%

	10.7
%	
	(13.7)
%	
Pre-tax income margin	
	14.1
%	
	13.6
%	
	29.1
%	
	(25.8)
%	
	52.8
%	
	15.6
%	
	300

nm - not meaningful



**For the three months**

**ended March 31, 2013:**

External revenue



\$	9,605
\$	4,484
\$	5,572
\$	3,106
\$	499
\$	23,266
Internal revenue	
	248
	180
	305

	831
	120
	541
	1,919
Total revenue	
\$	9,852
\$	4,664
\$	6,403
\$	3,226
	306

\$		1,040
\$		25,185
Pre-tax income		
\$		1,585
\$		703
\$		2,014
\$		(405)
\$		538
\$		4,435
		307

Pre-tax income margin

%

16.1

	15.1
%	
	31.5
%	
	(12.5)
%	
	51.8
%	
	17.6
%	



**Reconciliations to IBM as Reported:**

**(Dollars in millions)**

**For the three months ended March 31:**

**2014**

**2013**

Revenue:

Total reportable segments

\$

24,476

\$

25,185



Eliminations of internal transactions

(2,099)

(1,919)

Other revenue adjustments

107

142

Total IBM Consolidated

\$

22,484

\$

23,408

313

Pre-tax income:

Total reportable segments

\$

3,828

\$

4,435

Amortization of acquired intangible assets

(194)

(183)

Acquisition-related charges

(8)

(11)

Non-operating retirement-related (costs)/income

(123)

315

(283)

Eliminations of internal transactions

(524)

(339)

Unallocated corporate amounts

0

(13)

Total IBM Consolidated

\$

316

2,980

\$

3,606



**Notes to Consolidated Financial Statements – (continued)**

**7. Equity Activity:**

**Reclassifications and Taxes Related to Items of Other Comprehensive Income**



**(Dollars in millions)**

**Before Tax**

**Tax (Expense)/**

**Net of Tax**

**For the three months ended March 31, 2014:**

**Amount**

**Benefit**

**Amount**

**Other comprehensive income/(loss):**

**Foreign currency translation adjustments**

\$	(61)
----	------

\$	10
----	----

\$	(51)
----	------

**Net changes related to available-for-sale securities:**

Unrealized gains/(losses) arising during the period

\$

0

\$

(0)

\$

0

Reclassification of (gains)/losses to other (income) and expense

(2)

3

Subsequent changes in previously impaired securities arising during

the period

—

—

—

**Total net changes related to available-for-sale securities**

\$	4
	\$
	(2)
	\$
	3

**Unrealized gains/(losses) on cash flow hedges:**

Unrealized gains/(losses) arising during the period

\$

88

\$

(33)

\$

54

Reclassification of (gains)/losses to:

Cost of sales

26

(10)

16

SG&A expense

2

0

2

Other (income) and expense

(29)

11

(18)

Interest expense

0

(0)

0

**Total unrealized gains/(losses) on cash flow hedges**

\$

87

\$

328



(32)

\$

55

**Retirement-related benefit plans(1):**

Prior service costs/(credits)

\$

1

\$

(0)

\$

329

0

Net (losses)/gains arising during the period

32

(11)

21

Curtailments and settlements

4

(1)

3

330

Amortization of prior service (credits)/costs

(29)

10

(20)

Amortization of net (gains)/losses

649

(214)

434

**Total retirement-related benefit plans**

331

\$	656
\$	(217)
\$	439
<b>Other comprehensive income/(loss)</b>	
\$	687
\$	(241)
\$	446

(1) These AOCI components are included in the computation of net periodic pension cost. (See note 8, "Retirement-Related Benefits,"

for additional information.)

**Notes to Consolidated Financial Statements – (continued)**

**Reclassifications and Taxes Related to Items of Other Comprehensive Income**

**(Dollars in millions)**

**Before Tax**

**Tax (Expense)/**

**Net of Tax**

**For the three months ended March 31, 2013:**

**Amount**

**Benefit**

**Amount**

**Other comprehensive income/(loss):**

**Foreign currency translation adjustments**

\$	(405)
----	-------

\$	(84)
----	------

\$	(489)
----	-------

**Net changes related to available-for-sale securities:**



Unrealized gains/(losses) arising during the period

\$ (3)

\$ 1

\$ (2)

Reclassification of (gains)/losses to other (income) and expense

(0)

0

Subsequent changes in previously impaired securities arising during

the period

1

(0)

1

**Total net changes related to available-for-sale securities**

\$

(1)

\$

0

\$

(0)

**Unrealized gains/(losses) on cash flow hedges:**

Unrealized gains/(losses) arising during the period

\$

360

\$

(128)

\$

232

Reclassification of (gains)/losses to:

Cost of sales

(9)

3

(6)

SG&A expense

(10)

3

(7)

Other (income) and expense

(37)

14

(23)

Interest expense

0

—

0

**Total unrealized gains/(losses) on cash flow hedges**

\$

305

342

\$	(108)
----	-------

\$	197
----	-----

**Retirement-related benefit plans(1):**

Prior service costs/(credits)	
\$	33

	\$
	(11)

\$

22

Net (losses)/gains arising during the period

(15)

5

(10)

Curtailments and settlements

—

—

—



Amortization of prior service (credits)/costs

(30)

10

(20)

Amortization of net (gains)/losses

886

(293)

594

**Total retirement-related benefit plans**

345

\$	875
----	-----

\$	(289)
----	-------

\$	586
----	-----

**Other comprehensive income/(loss)**

\$	773
----	-----

\$	(480)
----	-------

\$	293
----	-----

(1) These AOCI components are included in the computation of net periodic pension cost. (See note 8, "Retirement-Related Benefits,"

for additional information.)

**Notes to Consolidated Financial Statements – (continued)**

**Accumulated Other Comprehensive Income/(Loss) (net of tax)**

**Net Change**

**Net Unrealized**

**Net Unrealized**

**Foreign**

**Retirement-**

**Gains/(Losses)**

**Accumulated**

**Gains/(Losses)**

**Currency**

**Related**

**on Available-**

**Other**

**on Cash Flow**

**Translation**

**Benefit**

**For-Sale**

**Comprehensive**

**(Dollars in Millions)**

**Hedges**

**Adjustments\***

**Plans**

**Securities**

**Income/(Loss)**

January 1, 2014

\$	(165)
\$	332
\$	(21,767)
\$	351

(1)

\$

(21,602)

Other comprehensive income before

reclassifications

54

352



(51)

21

0

24

Amount reclassified from accumulated

other comprehensive income

1

0

417

3

421

Total change for the period

55

(51)

354

439

3

446

March 31, 2014

\$

(111)

\$

281

\$

(21,328)

\$

2

\$

(21,156)

**Net Change**

**Net Unrealized**

**Net Unrealized**

**Foreign**

**Retirement-**

**Gains/(Losses)**

**Accumulated**

**Gains/(Losses)**

**Currency**

**Related**

**on Available-**

**Other**

**on Cash Flow**

**Translation**

**Benefit**

**For-Sale**

**Comprehensive**

**(Dollars in Millions)**

**Hedges**

**Adjustments\***

**Plans**

**Securities**

**Income/(Loss)**

January 1, 2013

\$	(90)
\$	1,733
\$	(27,406)
\$	4
\$	(25,759)
Other comprehensive income before	

reclassifications

232

(489)

12

(1)

(245)

Amount reclassified from accumulated



other comprehensive income

(35)

0

574

0

361

	539
Total change for the period	
	197
	(489)
	586
	(0)
	293
March 31, 2013	
\$	
	107
\$	
	1,243
\$	
	362

(26,820)

\$

4

\$

(25,466)

\* Foreign currency translation adjustments are presented gross except for any associated hedges which are presented net of tax.

**8. Retirement-Related Benefits:** The company offers defined benefit pension plans, defined contribution pension plans, as well as nonpension postretirement plans primarily consisting of retiree medical benefits. The following table provides the total retirement-related benefit plans' impact on income before income taxes:

**Yr. to Yr.**

**(Dollars in millions)**

**Percent**

**For the three months ended March 31:**

**2014**

**2013**

**Change**

Retirement-related plans – cost

Defined benefit and contribution pension plans – cost

\$

474

\$

674

365

	(29.6)
%	
Nonpension postretirement plans – cost	
	67
	80
	(16.0)
Total	
\$	
	541
\$	
	754
	366

(28.2)

%





**Notes to Consolidated Financial Statements – (continued)**

The following tables provide the components of the cost/(income) for the company's pension plans:

Cost/(Income) of Pension Plans

(Dollars in millions)

U.S. Plans

Non-U.S. Plans

For the three months ended March 31:

2014

2013

2014

2013

Service cost

\$ —

\$ —

\$ 116

\$ 131

Interest cost

	555
	496
	390
	382
Expected return on plan assets	
	(1,024)
	(995)
	(572)
	(554)
Amortization of prior service costs/(credits)	
	372

2

2

(29)

(31)

Recognized actuarial losses

269

451

360

404

373

Curtailments and settlements

—

—

4

0

Multi-employer plans/other costs

—

—

79

Total net periodic pension (income)/cost of defined

benefit plans

(198)

(46)

375

	348
	363
Cost of defined contribution plans	
	191
	206
	133
	151
Total defined benefit and contribution plans cost recognized	
	376



in the Consolidated Statement of Earnings

\$	(7)
\$	160
\$	481
\$	514

On March 24, 2014, the Supreme Court of Spain issued a ruling against IBM Spain in litigation involving its defined benefit and defined contributions plans. See page 35 for additional information. As a result of the ruling, the company recorded an additional pre-tax retirement-related obligation of \$55 million in the first quarter of 2014 in selling, general and administrative expense in the Consolidated Statement of Earnings. This charge is not reflected in operating (non-GAAP) expense. This obligation is reflected in "Non-U.S. Plans - Multi-employer plans/other costs" in the table above. To date, the rulings in this case are declaratory only and there have been no quantifications of any individual remedies.

In March 2014, the company initiated a change to the investment strategy of its U.S. defined benefit plan. The 2014 target asset allocation was modified, primarily by reducing equity securities from 42 percent to 32 percent, and increasing debt securities from 47 percent to 57 percent of total plan assets, respectively. The asset allocation change was substantially completed by March 31, 2014. This change is designed to reduce the potential negative impact that equity markets might have on the funded status of the U.S. defined benefit plan. The change is expected to reduce the 2015 expected long-term rate of return on assets to approximately 7.75 percent. See note S, "Retirement-Related Benefits," on page 135 in the company's 2013 Annual Report for additional information regarding the company's investment strategy.

In 2014, the company expects to contribute to its non-U.S. defined benefit and multi-employer plans approximately \$600 million, which will be mainly contributed to the defined benefit pension plans in Japan, the UK, Switzerland and the Netherlands. This amount represents the legally mandated minimum contributions. Total net contributions to the non-U.S. plans in the first three months of 2014 were \$126 million.

The following table provides the components of the cost/(income) for the company's nonpension postretirement plans:

Cost of Nonpension Postretirement Plans

**U.S. Plan**

**Non-U.S. Plans**

**(Dollars in millions)**

**2014**

**2013**

**2014**

**2013**

**For the three months ended March 31:**

Service cost

\$ 7

\$ 9

\$ 2

\$ 3

Interest cost

45

42

381

	16
	16
Expected return on plan assets	
	0
	(0)
	(2)
	(2)
Amortization of prior service costs/(credits)	
	(2)

—

	(1)
	(1)
Recognized actuarial losses	
	0
	8
	3
	6
Total nonpension postretirement plan cost recognized in	

Consolidated Statement of Earnings

\$	50
\$	58
\$	17
\$	22





**Notes to Consolidated Financial Statements – (continued)**

In connection with the Medicare Prescription Drug Improvement and Modernization Act of 2003 (the ‘Act’), the company qualified to receive a subsidy through 2013. Due to benefit plan changes effective January 1, 2014, the company no longer qualifies for the subsidy as of that date. The company is expected to receive additional subsidies after 2013 to true up the final subsidy amount due to IBM under the Act. The company received a \$5.4 million subsidy in the first quarter of 2014 and a \$6.1 million subsidy in the first quarter of 2013. For further information related to the Act, see page 141 in the company’s 2013 Annual Report.

**9. Acquisitions/Divestitures:**

Acquisitions: During the three months ended March 31, 2014, the company completed two acquisitions at an aggregate cost of \$286 million.

The Software segment completed acquisitions of two privately held companies in the first quarter: Aspera, Inc. (Aspera) and Cloudant, Inc. (Cloudant). Both acquisitions were for 100 percent of the acquired companies.

The table below reflects the purchase price related to these acquisitions and the resulting purchase price allocations as of March 31, 2014:

**Amortization**

**Total**

**(Dollars in millions)**

**Life (in yrs.)**

**Acquisitions**

Current assets

\$

21

Fixed assets/noncurrent assets

387

Intangible assets:

Goodwill

N/A

239

Completed technology

7

33

Client relationships

389

7

1

Patents/trademarks

5-7

8

Total assets acquired

319

Current liabilities

(11)

Noncurrent liabilities

391

(22)

Total liabilities assumed

(33)

Total purchase price

\$

286

392



N/A - not applicable

Each acquisition further complemented and enhanced the company's portfolio of product and services offerings.

Aspera's technology makes cloud computing faster, more predictable and more cost effective for big data transfers such as enterprise storage, sharing virtual images or accessing the cloud for increased computing capacity. The acquisition of Cloudant will extend the company's mobile and cloud platforms by enabling developers to easily and quickly create next generation mobile and web-based applications. Purchase price consideration for these acquisitions as reflected in the table above, was paid primarily in cash. All acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents.

The acquisitions were accounted for as business combinations using the acquisition method, and accordingly, the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired entity was recorded at their estimated fair values at the date of acquisition. The primary items that generated the goodwill are the value of the synergies between the acquired companies and IBM and the acquired assembled work-force, neither of which qualify as an amortizable intangible asset. The overall weighted-average life of the identified amortizable intangible

assets acquired is 6.8 years. These identified intangible assets will be amortized on a straight-line basis over their useful lives. Goodwill of \$239 million has been assigned to the Software segment. It is expected that none of the goodwill will be deductible for tax purposes.

On April 10, 2014, the company announced that it had entered into a definitive agreement to acquire Silverpop, a privately held company based in Atlanta, GA. Silverpop is a provider of cloud-based capabilities that deliver personalized customer engagements in highly scalable environments. The acquisition is expected to close in the second quarter of 2014.

**Notes to Consolidated Financial Statements – (continued)**

Divestitures:

On January 23, 2014, IBM and Lenovo Group Limited (Lenovo) announced a definitive agreement in which Lenovo will acquire the company's x86 server portfolio for \$2.3 billion, consisting of approximately \$2 billion in cash, with the balance in Lenovo stock. The stock will represent less than 5 percent equity ownership in Lenovo. The company will sell to Lenovo its System x, BladeCenter and Flex System blade servers and switches, x86-based Flex integrated systems, NeXtScale and iDataPlex servers and associated software, blade networking and maintenance operations.

IBM and Lenovo plan to enter into a strategic relationship which will include a global OEM and reseller agreement for sales of IBM's industry-leading entry and midrange Storwize disk storage systems, tape storage systems, General Parallel File System software, SmartCloud Entry offering, and elements of IBM's system software, including Systems Director and Platform Computing solutions. Following the closing of the transaction, Lenovo will assume related customer service and maintenance operations. IBM will continue to provide maintenance delivery on Lenovo's behalf for an extended period of time.

The transaction will be completed as soon as is practical, subject to the satisfaction of regulatory requirements, customary closing conditions and any other required approvals. At March 31, 2014, the company is engaged in the regulatory review process and in the activities necessary to separate the tangible assets in order to close the transaction. The transaction is expected to be completed in phases, with the initial closing expected in the second half of 2014. Subsequent local closings will occur subject to similar conditions, agreements and the information and consultation process in applicable countries.

The company expects to recognize a total pre-tax gain on the sale of approximately \$1 billion. This gain will be recognized consistent with the closing schedule for the transaction. The exact amount of the gain and the breakdown by closing date is not yet determinable. The variables that can impact the final gain include the valuation of the final balance sheet transferred, the valuation of other related agreements and transaction-related expenses.

The company's worldwide x86 business is reported in the Systems and Technology segment, and the associated maintenance operations are part of the Global Technology Services segment. In 2013, this combined business delivered approximately \$4.6 billion of revenue, was essentially breakeven on a pre-tax income basis and had approximately \$100 million in tangible assets.

On September 10, 2013, IBM and SYNEX announced a definitive agreement in which SYNEX will acquire the company's worldwide customer care business process outsourcing services business for \$501 million, consisting of approximately \$430 million in cash, net of balance sheet adjustments, and \$71 million in SYNEX stock, which

represents less than 5 percent equity ownership in SYNnex. As part of the transaction, SYNnex entered into a multi-year agreement with the company, and Concentrix, SYNnex's outsourcing business, has become an IBM strategic business partner for global customer care business process outsourcing services.

The transaction is being completed in phases – the initial closing was completed on January 31, 2014, with subsequent closings expected to be completed in the second quarter of 2014, subject to customary closing conditions, local agreements and the information and consultation process in applicable countries. The company expects to recognize a total pre-tax gain on the sale of between \$200 million and \$225 million. The gain recognized in the first quarter of 2014 was \$98 million. The company's worldwide customer care business process outsourcing services and industry process services was reported in the Global Technology Services segment. In 2013, the divested business delivered approximately \$1.3 billion of revenue, approximately \$0.1 billion of pre-tax income and had approximately \$50 million in tangible assets.

On April 17, 2012, the company announced that it had signed a definitive agreement with Toshiba TEC for the sale of its Retail Store Solutions business. As part of the transaction, the company agreed to transfer the maintenance business to Toshiba TEC within three years of the original closing of the transaction.

In first quarter 2014, the company completed the first phase of the transfer of the maintenance workforce to Toshiba. Subsequent wave closings are scheduled to be completed through the first quarter of 2015 along with associated parts and inventory transfer. The first phase transfer and an assessment of the ongoing contractual terms of the overall transaction resulted in the recognition of an additional pre-tax gain of \$34 million in the first quarter of 2014.

The company expects to close the final phase of the divestiture in the first quarter of 2015. Overall, the company expects to recognize a cumulative total pre-tax gain on the sale of approximately \$508 million.

**Notes to Consolidated Financial Statements – (continued)**

**10. Intangible Assets Including Goodwill:** The following table details the company's intangible asset balances by major asset class:

**At March 31, 2014**

**(Dollars in millions)**

**Gross Carrying**

**Accumulated**

**Net Carrying**

**Intangible asset class**

**Amount**

**Amortization**

**Amount**

Capitalized software

\$

1,471

\$

(696)

\$

775

Client relationships

2,149

(1,050)

1,099

Completed technology

399

	2,935
	(1,312)
	1,623
In-process R&D	
	2
	—
	2
Patents/trademarks	
	366
	(169)
	400



	198
Other*	
	7
	(5)
	2
Total	
\$	
	6,929
\$	
	(3,231)
\$	
	3,698

**At December 31, 2013**

**(Dollars in millions)**

**Gross Carrying**

**Accumulated**

**Net Carrying**

**Intangible asset class**

**Amount**

**Amortization**

**Amount**

Capitalized software

\$

	1,494
\$	
	(699)
\$	
	794
Client relationships	
	2,148
	(977)
	1,171
Completed technology	
	2,910
	(1,224)
	403

	1,687
In-process R&D	
	13
	—
	13
Patents/trademarks	
	358
	(154)
	204
Other*	
	7
	404

	(5)
	2
Total	
\$	
	6,930
\$	
	(3,059)
\$	
	3,871

\* Other intangibles are primarily acquired proprietary and nonproprietary business processes, methodologies and systems.

The net carrying amount of intangible assets decreased \$173 million during the first quarter of 2014, primarily due to amortization, partially offset by intangible asset additions resulting from acquisitions. The aggregate intangible amortization expense for acquired intangibles (excluding capitalized software) was \$339 million and \$331 million for the quarters ended March 31, 2014 and 2013, respectively. In addition, in the first three months of 2014, the company retired \$164 million of fully amortized intangible assets, impacting both the gross carrying amount and accumulated amortization by this amount.

The amortization expense for each of the five succeeding years relating to intangible assets currently recorded in the Consolidated Statement of Financial Position is estimated to be the following at March 31, 2014:

**Capitalized**

**Acquired**

(Dollars in millions)

**Software**

**Intangibles**

**Total**

2014 (for Q2-Q4)

\$

377

\$

619

\$

997

407

2015

294

642

936

2016

96

601

697

2017

408



