INTERNATIONAL BUSINESS MACHINES CORP
Form 10-Q
October 30, 2012
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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 SEPTEMBER 30, 2012

1-2360

(Commission file number)

INTERNATIONAL BUSINESS MACHINES CORPORATION

(Exact name of registrant as specified in its charter)

New York (State of incorporation)	**13-0871985** (IRS employer identification number)
Armonk, New York (Address of principal executive offices)	**10504** (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 l3 or l5(d) of the Securities Exchange Act of 1934 during the preceding l2 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 x No o

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 x No o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The registrant has 1,129,932,457 shares of common stock outstanding at September 30, 2012.

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PART I - Financial Information

ITEM 1. Consolidated Financial Statements:

INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF EARNINGS

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in millions except per share amounts)	**2012**	**2011**	**2012**	**2011**
Revenue:				
Services	$ 14,626	$ 15,299	$ 44,279	$ 45,241
Sales	9,642	10,331	29,424	30,612
Financing	479	527	1,500	1,577
Total revenue	24,747	26,157	75,203	77,430
Cost:				
Services	9,515	10,138	29,285	30,569
Sales	3,242	3,570	10,003	10,657
Financing	258	276	784	787
Total cost	13,016	13,984	40,072	42,014
Gross profit	11,732	12,173	35,131	35,416
Expense and other income:				
Selling, general and administrative	5,908	5,662	17,632	17,518
Research, development and engineering	1,534	1,546	4,722	4,703
Intellectual property and custom development income	(303)	(298)	(847)	(855)
Other (income) and expense	(606)	128	(796)	23
Interest expense	124	107	350	298
Total expense and other income	6,657	7,146	21,060	21,687
Income before income taxes	5,074	5,027	14,071	13,729
Provision for income taxes	1,251	1,188	3,300	3,364
Net income	$ 3,824	$ 3,839	$ 10,771	$ 10,365
Earnings per share of common stock:				
Assuming dilution	$ 3.33	$ 3.19	$ 9.27	$ 8.48
Basic	$ 3.36	$ 3.23	$ 9.38	$ 8.60
Weighted-average number of common shares outstanding: (millions)				
Assuming dilution	1,149.3	1,204.9	1,161.8	1,222.1
Basic	1,137.2	1,188.6	1,148.4	1,205.2

Cash dividend per common share	$ 0.85	$ 0.75	$ 2.45	$ 2.15

(Amounts may not add due to rounding.)

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

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(UNAUDITED)

(Dollars in millions)	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income	$ 3,824	$ 3,839	$ 10,771	$ 10,365
Other comprehensive income/(loss), before tax				
Foreign currency translation adjustments	501	(1,500)	164	(674)
Net changes related to available-for-sale securities:				
Unrealized gains/(losses) arising during the period	11	(6)	13	(20)
Reclassification of (gains)/losses to net income	(27)	0	(43)	(231)
Subsequent changes in previously impaired securities arising during the period	(7)	(8)	20	3
Total net changes related to available-for-sale securities	(24)	(14)	(10)	(248)
Unrealized gains/(losses) on cash flow hedges:				
Unrealized gains/(losses) arising during the period	(54)	295	65	(159)
Reclassification of (gains)/losses to net income	(112)	167	(246)	494
Total unrealized gains/(losses) on cash flow hedges	(165)	461	(181)	335
Retirement-related benefit plans:				
Prior service costs/(credits)	0	(0)	0	(32)
Net (losses)/gains arising during the period	1	(0)	66	605
Curtailments and settlements	(2)	0	(1)	13
Amortization of prior service (credits)/costs	(37)	(40)	(112)	(117)
Amortization of net (gains)/losses	613	463	1,846	1,395
Total retirement-related benefit plans	575	423	1,799	1,864
Other comprehensive income/(loss), before tax	887	(630)	1,771	1,276
Income tax (expense)/benefit related to items of other comprehensive income	(109)	(361)	(606)	(632)
Other comprehensive income/(loss)	778	(989)	1,165	645
Total comprehensive income/(loss)	$ 4,601	$ 2,850	$ 11,936	$ 11,010

(Amounts may not add due to rounding.)

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

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(UNAUDITED)

ASSETS

(Dollars in millions)	**At September 30, 2012**	**At December 31, 2011**
Assets:		
Current assets:		
Cash and cash equivalents	$ 11,909	$ 11,922
Marketable securities	345	0
Notes and accounts receivable trade (net of allowances of $250 in 2012 and $256 in 2011)	9,772	11,179
Short-term financing receivables (net of allowances of $277 in 2012 and $311 in 2011)	14,925	16,901
Other accounts receivable (net of allowances of $20 in 2012 and $11 in 2011)	2,066	1,481
Inventories, at lower of average cost or market:		
Finished goods	649	589
Work in process and raw materials	1,937	2,007
Total inventories	2,586	2,595
Deferred taxes	1,522	1,601
Prepaid expenses and other current assets	5,016	5,249
Total current assets	48,141	50,928
Property, plant and equipment	40,716	40,124
Less: Accumulated depreciation	26,688	26,241
Property, plant and equipment net	14,027	13,883
Long-term financing receivables (net of allowances of $65 in 2012 and $38 in 2011)	10,791	10,776
Prepaid pension assets	3,424	2,843
Deferred taxes	2,555	3,503
Goodwill	28,270	26,213
Intangible assets net	3,565	3,392
Investments and sundry assets	5,006	4,895
Total assets	$ 115,778	$ 116,433

(Amounts may not add due to rounding.)

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

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)

(UNAUDITED)

LIABILITIES AND EQUITY

(Dollars in millions)	**At September 30, 2012**	**At December 31, 2011**
Liabilities:		
Current liabilities:		
Taxes	$ 2,147	$ 3,313
Short-term debt	9,334	8,463
Accounts payable	7,085	8,517
Compensation and benefits	4,730	5,099
Deferred income	11,230	12,197
Other accrued expenses and liabilities	4,973	4,535
Total current liabilities	39,499	42,123
Long-term debt	24,333	22,857
Retirement and nonpension postretirement benefit obligations	16,682	18,374
Deferred income	4,263	3,847
Other liabilities	9,335	8,996
Total liabilities	94,112	96,197
Equity:		
IBM stockholders equity:		
Common stock, par value $0.20 per share, and additional paid-in capital	49,603	48,129
Shares authorized: 4,687,500,000		
Shares issued: 2012 - 2,194,791,952		
2011 - 2,182,469,838		
Retained earnings	112,773	104,857
Treasury stock - at cost	(120,115)	(110,963)
Shares: 2012 - 1,064,859,496		
2011 - 1,019,287,274		
Accumulated other comprehensive income/(loss)	(20,720)	(21,885)
Total IBM stockholders equity	21,541	20,138
Noncontrolling interests	126	97
Total equity	21,666	20,236
Total liabilities and equity	$ 115,778	$ 116,433

(Amounts may not add due to rounding.)

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

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended September 30,	
(Dollars in millions)	**2012**	**2011**
Cash flows from operating activities:		
Net income	$ 10,771	$ 10,365
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation	2,572	2,701
Amortization of intangibles	952	926
Stock-based compensation	510	498
Net (gain)/loss on asset sales and other	(697)	(252)
Changes in operating assets and liabilities, net of acquisitions/divestitures	(868)	(1,488)
Net cash provided by operating activities	13,240	12,750
Cash flows from investing activities:		
Payments for property, plant and equipment	(3,082)	(3,060)
Proceeds from disposition of property, plant and equipment	233	480
Investment in software	(476)	(421)
Acquisition of businesses, net of cash acquired	(2,266)	(223)
Divestitures of businesses, net of cash transferred	587	4
Non-operating finance receivables net	718	534
Purchases of marketable securities and other investments	(2,596)	(1,156)
Proceeds from disposition of marketable securities and other investments	1,971	2,950
Net cash used in investing activities	(4,912)	(891)
Cash flows from financing activities:		
Proceeds from new debt	9,589	6,652
Payments to settle debt	(4,991)	(5,625)
Short-term borrowings/(repayments) less than 90 days net	(2,177)	116
Common stock repurchases	(8,988)	(11,465)
Common stock transactions other	1,198	2,029
Cash dividends paid	(2,816)	(2,593)
Net cash used in financing activities	(8,185)	(10,886)
Effect of exchange rate changes on cash and cash equivalents	(156)	(330)
Net change in cash and cash equivalents	(13)	643
Cash and cash equivalents at January 1	11,922	10,661
Cash and cash equivalents at September 30	$ 11,909	$ 11,303

(Amounts may not add due to rounding.)

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

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INTERNATIONAL BUSINESS MACHINES CORPORATION

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

(UNAUDITED)

(Dollars in millions)	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Non-Controlling Interests	Total Equity
Equity - January 1, 2012	$ 48,129	$ 104,857	$ (110,963)	$ (21,885)	$ 20,138	$ 97	$ 20,236
Net income plus other comprehensive income/(loss)							
Net income		10,771			10,771		10,771
Other comprehensive income/(loss)				1,165	1,165		1,165
Total comprehensive income/(loss)					$ 11,936		$ 11,936
Cash dividends declared common stock		(2,816)			(2,816)		(2,816)
Common stock issued under employee plans (12,322,115 shares)	1,149				1,149		1,149
Purchases (2,092,008 shares) and sales (2,358,099 shares) of treasury stock under employee plans net		(40)	(145)		(185)		(185)
Other treasury shares purchased, not retired (45,838,313 shares)			(9,007)		(9,007)		(9,007)
Changes in other equity	324				324		324
Changes in noncontrolling interests						29	29
Equity - September 30, 2012	$ 49,603	$ 112,773	$ (120,115)	$ (20,720)	$ 21,541	$ 126	$ 21,666

(Dollars in millions)	Common Stock and Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income/(Loss)	Total IBM Stockholders Equity	Non-Controlling Interests	Total Equity
Equity - January 1, 2011	$ 45,418	$ 92,532	$ (96,161)	$ (18,743)	$ 23,046	$ 126	$ 23,172
Net income plus other comprehensive income/(loss)							
Net income		10,365			10,365		10,365
Other comprehensive income/(loss)				645	645		645
Total comprehensive income/(loss)					$ 11,010		$ 11,010
Cash dividends declared common stock		(2,593)			(2,593)		(2,593)

Common stock issued under employee plans (17,318,927 shares)	1,900				1,900		1,900
Purchases (1,451,421 shares) and sales (4,102,531 shares) of treasury stock under employee plans net		(38)	192		154		154
Other treasury shares purchased, not retired (69,345,414 shares)			(11,465)		(11,465)		(11,465)
Changes in other equity	240				240		240
Changes in noncontrolling interests						(40)	(40)
Equity - September 30, 2011	$ 47,558	$ 100,266	$ (107,434)	$ (18,099)	$ 22,291	$ 87	$ 22,378

(Amounts may not add due to rounding.)

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

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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 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 assets, liabilities, revenue, costs, expenses and accumulated other comprehensive income/(loss) that are reported in the Consolidated Financial Statements and accompanying disclosures. Actual results may be different. See the company s 2011 Annual Report on pages 58 to 61 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 2011 Annual Report.

Noncontrolling interest amounts in income of $3.0 million and $0.9 million, net of tax, for the three months ended September 30, 2012 and 2011, respectively, and $8.6 million and $5.7 million, net of tax, for the nine months ended September 30, 2012 and 2011, respectively, are included in the Consolidated Statement of Earnings within the other (income) and expense line item. Additionally, changes to noncontrolling interests which are presented in the Consolidated Statement of Changes in Equity on page 8 were $29 million and $(40) million for the nine months ended September 30, 2012 and 2011, respectively.

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 May 2011, the Financial Accounting Standards Board (FASB) issued amended guidance and disclosure requirements for fair value measurements. These amendments did not have a material impact on the consolidated financial results. These changes became effective January 1, 2012 on a prospective basis. See Note 3, Financial Instruments on pages 9 through 14 for fair value disclosures.

In July 2012, the FASB issued amended guidance that simplifies how entities test indefinite-lived intangible assets other than goodwill for impairment. After an assessment of certain qualitative factors, if it is determined to be more likely than not that an indefinite-lived asset is impaired, entities must perform the quantitative impairment test. Otherwise, the quantitative test is optional. The amended guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The adoption of this guidance is not expected to have a material impact on the company s financial results.

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.

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Notes to Consolidated Financial Statements (continued)

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 asse