INTERNATIONAL BUSINESS MACHINES CORP
Form 10-Q
July 29, 2008
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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 JUNE 30, 2008

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 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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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 1,354,840,130 shares of common stock outstanding at June 30, 2008.

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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)

(Dollars in millions except per share amounts)	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Revenue:				
Services	$ 15,203	$ 13,072	$ 29,777	$ 25,495
Sales	10,976	10,097	20,263	19,083
Financing	642	602	1,282	1,223
Total revenue	26,820	23,772	51,322	45,801
Cost:				
Services	10,709	9,450	21,057	18,501
Sales	4,225	4,059	7,899	7,867
Financing	286	325	600	629
Total cost	15,221	13,834	29,556	26,997
Gross profit	11,599	9,938	21,766	18,804
Expense and other income:				
Selling, general and administrative	6,289	5,631	11,909	10,720
Research, development and engineering	1,660	1,534	3,229	3,044
Intellectual property and custom development income	(285)	(246)	(559)	(451)
Other (income) and expense	(24)	(253)	(149)	(432)
Interest expense	145	130	323	203
Total expense and other income	7,786	6,796	14,754	13,083
Income from continuing operations before income taxes	3,814	3,142	7,012	5,721
Provision for income taxes	1,049	881	1,928	1,616
Income from continuing operations	2,765	2,261	5,084	4,105

(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 EARNINGS (continued)
(UNAUDITED)

(Dollars in millions except per share amounts)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Discontinued Operations				
Loss from discontinued operations, net of tax		(1)		(0)
Net income	$ 2,765	$ 2,260	$ 5,084	$ 4,105
Earnings/(loss) per share of common stock:				
Assuming dilution:				
Continuing operations	$ 1.98	$ 1.55	$ 3.63	$ 2.75
Discontinued operations		(0.00)		(0.00)
Total	$ 1.98	$ 1.55	$ 3.63	$ 2.75
Basic:				
Continuing operations	$ 2.02	$ 1.57	$ 3.70	$ 2.80
Discontinued operations		(0.00)		(0.00)
Total	$ 2.02	$ 1.57	$ 3.70	$ 2.80
Weighted-average number of common shares outstanding: (millions)				
Assuming dilution	1,395.8	1,460.8	1,400.1	1,491.8
Basic	1,366.3	1,437.2	1,374.6	1,468.3
Cash dividends per common share	$ 0.50	$ 0.40	$ 0.90	$ 0.70

(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 June 30, 2008	At December 31, 2007
Assets:		
Current assets:		
Cash and cash equivalents	$ 9,626	$ 14,991
Marketable securities	221	1,155
Notes and accounts receivable trade (net of allowances of $254 in 2008 and $241 in 2007)	10,952	11,428
Short-term financing receivables (net of allowances of $323 in 2008 and $296 in 2007)	15,242	16,289
Other accounts receivable (net of allowances of $15 in 2008 and $13 in 2007)	1,034	1,072
Inventories, at lower of average cost or market:		
Finished goods	667	668
Work in process and raw materials	2,248	1,996
Total inventories	2,916	2,664
Deferred taxes	1,949	1,687
Prepaid expenses and other current assets	4,371	3,891
Total current assets	46,312	53,177
Plant, rental machines and other property	40,320	38,584
Less: Accumulated depreciation	24,934	23,503
Plant, rental machines and other property net	15,386	15,081
Long-term financing receivables (net of allowances of $65 in 2008 and $58 in 2007)	11,473	11,603
Prepaid pension assets	19,027	17,417
Intangible assets net	3,277	2,107
Goodwill	19,624	14,285
Investments and sundry assets	5,829	6,761
Total assets	$ 120,928	$ 120,431

(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)

LIABILITIES AND STOCKHOLDERS EQUITY

(Dollars in millions except per share amounts)		At June 30, 2008		At December 31, 2007
Liabilities and Stockholders Equity:				
Current liabilities:				
Taxes	$	2,831	$	3,673
Short-term debt		12,710		12,235
Accounts payable		7,531		8,054
Compensation and benefits		4,288		4,645
Deferred income		10,815		9,802
Other accrued expenses and liabilities		6,508		5,901
Total current liabilities		44,683		44,310
Long-term debt		21,522		23,039
Retirement and nonpension postretirement benefit obligations		14,243		13,582
Deferred income		3,171		3,060
Other liabilities		9,044		7,970
Total liabilities		92,663		91,962
Stockholders equity:				
Common stock - par value $0.20 per share and additional paid-in capital		37,882		35,188
Shares authorized: 4,687,500,000				
Shares issued: 2008 - 2,086,162,676 2007 - 2,057,607,421				
Retained earnings		64,456		60,640
Treasury stock - at cost		(71,068)		(63,945)
Shares: 2008 - 731,322,546 2007 - 672,373,283				
Accumulated gains and (losses) not affecting retained earnings		(3,006)		(3,414)
Total stockholders equity		28,264		28,470
Total liabilities and stockholders equity	$	120,928	$	120,431

(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
FOR THE SIX MONTHS ENDED JUNE 30,
(UNAUDITED)

(Dollars in millions)	2008	2007
Cash flow from operating activities from continuing operations:		
Net Income	$ 5,084	$ 4,105
Loss from discontinued operations		(0)
Adjustments to reconcile income from continuing operations to cash provided from operating activities:		
Depreciation	2,096	1,943
Amortization of intangibles	654	581
Stock-based compensation	340	361
Net gain on asset sales and other	(75)	(257)
Changes in operating assets and liabilities, net of acquisitions/divestitures	353	(274)
Net cash provided by operating activities from continuing operations	8,453	6,459
Cash flow from investing activities from continuing operations:		
Payments for plant, rental machines and other property, net of proceeds from dispositions	(1,999)	(1,803)
Investment in software	(381)	(439)
Acquisition of businesses, net of cash acquired	(5,891)	(241)
Divestiture of businesses, net of cash transferred	29	310
Purchases of marketable securities and other investments	(8,284)	(16,998)
Proceeds from sale of marketable securities and other investments	9,617	16,602
Net cash used in investing activities from continuing operations	(6,909)	(2,569)
Cash flow from financing activities from continuing operations:		
Proceeds from new debt	6,813	14,066
Payments to settle debt	(5,924)	(1,962)
Short-term (repayments)/borrowings less than 90 days net	(2,273)	171
Common stock repurchases	(7,164)	(18,205)
Common stock transactions other	2,704	1,967
Cash dividends paid	(1,239)	(1,044)
Net cash used in financing activities from continuing operations	(7,083)	(5,008)
Effect of exchange rate changes on cash and cash equivalents	175	112
Net cash used in discontinued operations - operating activities		(6)
Net change in cash and cash equivalents	(5,365)	(1,012)
Cash and cash equivalents at January 1	14,991	8,022
Cash and cash equivalents at June 30	$ 9,626	$ 7,010

(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 thereto are unaudited. In the opinion of the management of the International Business Machines Corporation (the company), 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 accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the amounts of assets, liabilities, revenue, costs, expenses and gains and losses not affecting retained earnings that are reported in the Consolidated Financial Statements and accompanying disclosures. Actual results may be different. See the company s 2007 Annual Report for a discussion of the company s critical accounting estimates.

Interim results are not necessarily indicative of results for a full year. The information included in this Form 10-Q should be read in conjunction with the company s 2007 Annual Report.

Within the financial tables in this Form 10-Q, 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.

2. Accounting Changes: In June 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) Emerging Issues Task Force 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, which will become effective in 2009 via retrospective application. Under the FSP, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and, therefore, are included in computing earnings per share (EPS) pursuant to the two-class method. The two-class method determines earnings per share for each class of common stock and participating securities according to dividends or dividend equivalents and their respective participation rights in undistributed earnings. Restricted Stock Units (RSUs) granted to employees prior to December 31, 2007 are considered participating securities as they receive non-forfeitable dividend equivalents at the same rate as common stock. RSUs granted after December 31, 2007 do not receive dividend equivalents and are not considered participating securities. The company will adopt the FSP in fiscal year 2009. Upon implementation, the company does not expect a material impact on diluted and basic EPS. The implementation of the FSP is expected to decrease diluted EPS by $0.01 for the first and second quarters of 2008, by $0.02 for the six months ended June 30, 2008, and by $0.03 for the year ended December 31, 2007. Basic EPS is expected to decrease by $0.01 in each of the first and second quarters of 2008, by $0.02 for the six months ended June 30, 2008 and by $0.05 for the year ended December 31, 2007.

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133. SFAS No. 161 expands the current disclosure requirements of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, such that entities must now provide enhanced disclosures on a quarterly basis regarding how and why the entity uses derivatives; how derivatives and related hedged items are accounted for under SFAS No. 133 and how derivatives and related hedged items affect the entity s financial position, performance and cash flow. Pursuant to the transition provisions of the Statement, the company will adopt SFAS No. 161 in fiscal year 2009 and will present the required disclosures in the prescribed format on a prospective basis. This Statement will not impact the consolidated financial results as it is disclosure-only in nature.

In February 2008, the FASB issued FSP Financial Accounting Standard (FAS) 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13, and FSP FAS 157-2, Effective Date of FASB Statement No. 157. FSP FAS 157-1 removes leasing from the scope of SFAS No. 157, Fair Value Measurements. FSP FAS 157-2 delays the effective date of SFAS No. 157 from 2008 to 2009 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). See SFAS No. 157 discussion on page 9.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, which will become effective in 2009 via prospective application to business combinations. This Statement requires that the acquisition method of accounting be applied to a broader set of business combinations, amends the definition of a business combination, provides a definition of a business, requires an acquirer to recognize an acquired business at its fair value at the acquisition date and requires the assets and liabilities assumed in a business combination to be measured and recognized at their fair values as of the acquisition date (with limited exceptions). The company will adopt this Statement in fiscal year 2009 and its effects on future periods will depend on the nature and significance of business combinations subject to this statement.

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Notes to Consolidated Financial Statements (continued)

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51. This Statement requires that the noncontrolling interest in the equity of a subsidiary be accounted for and reported as equity, provides revised guidance on the treatment of net income and losses attributable to the noncontrolling interest and changes in ownership interests in a subsidiary and requires additional disclosures that identify and distinguish between the interests of the controlling and noncontrolling owners. Pursuant to the transition provisions of SFAS No. 160, the company will adopt the Statement in fiscal year 2009 via retrospective application of the presentation and disclosure requirements. The company does not expect the adoption of this Statement to have a material effect on the Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115, which became effective January 1, 2008. SFAS No. 159 permits entities to measure 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 generally accepted accounting principles. The fair value measurement election is irrevocable and subsequent changes in fair value must be recorded in earnings. The company adopted this Statement as of January 1, 2008 and the adoption of this Statement did not have a material effect on the Consolidated Financial Statements.

In September 2006, the FASB finalized SFAS No. 157 which became effective January 1, 2008 except as amended by FSP FAS 157-1 and FSP FAS 157-2 as previously described. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements; however, it does not require any new fair value measurements. The provisions of SFAS No. 157 were applied prospectively to fair value measurements and disclosures for financial assets and financial liabilities and nonfinancial assets and nonfinancial liabilities recognized or disclosed at fair value in the financial statements on at least an annual basis beginning in the first quarter of 2008. The adoption of this Statement did not have a material effect on the Consolidated Financial Statements for fair value measurements made during the six months ended June 30, 2008. While the company does not expect the adoption of this Statement to have a material impact on its Consolidated Financial Statements in subsequent reporting periods, the company continues to monitor any additional implementation guidance that is issued that addresses the fair value measurements for certain financial assets, such as private market pension plan assets, and nonfinancial assets and nonfinancial liabilities not disclosed at fair value in the financial statements on at least an annual basis. See Note 6 on pages 12 to 14 for additional information regarding the adoption of this Statement.

3. Stockholders Equity: The following table summarizes Net income plus gains and (losses) not affecting retained earnings (net of tax), a component of Stockholders equity in the Consolidated Statement of Financial Position:

(Dollars in millions)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net income	$ 2,765	$ 2,260	$ 5,084	$ 4,105
Gains and (losses) not affecting retained earnings (net of tax):				
Foreign currency translation adjustments	(2)	259	457	349
Prior service costs, net gains/(losses) and transition assets/(obligations)	151	262	277	470
Net unrealized (losses)/gains on marketable securities (1)	(19)	65	(176)	47
Net unrealized gains/(losses) on cash flow hedge derivatives	147	23	(149)	38

Total net gains and (losses) not affecting retained earnings	276	609	408	904
Net income plus gains and (losses) not affecting retained earnings	$ 3,041	$ 2,869	$ 5,492	$ 5,009

(1) Sale of Lenovo stock and mark-to-market adjustments of remaining Lenovo stock accounted for a $18 million loss and a $89 million gain for second quarter of 2008 and 2007, and a loss of $169 million and a gain of $52 million in the first six months of 2008 and 2007, respectively.

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Notes to Consolidated Financial Statements (continued)

4. 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:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions)	**2008**	**2007**	**2008**	**2007**
Cost	$ 30	$ 45	$ 59	$ 91
Selling, general and administrative	125	123	252	235
Research, development and engineering	15	17	29	37
Other (income) and expense		(1)		(1)
Pre-tax stock-based compensation cost	170	184	340	361
Income tax benefits	(63)	(76)	(110)	(143)
Total stock-based compensation cost	$ 106	$ 107	$ 230	$ 219

The reduction in pre-tax stock-based compensation cost for the three months ended June 30, 2008, as compared to the corresponding period in the prior year, was principally the result of a reduction in the level of stock option grants ($55 million), partially offset by an increase related to restricted and performance-based stock units ($36 million). The reduction in pre-tax stock-based compensation cost for the six months ended June 30, 2008, as compared to the corresponding period in the prior year, was principally the result of a reduction in the level of stock option grants ($119 million), partially offset by an increase related to restricted and performance-based stock units ($93 million). The effects on pre-tax stock-based compensation cost related to the formation of a joint venture based on the company s Printing Systems Division are included in Other (income) and expense above and in the Consolidated Statement of Earnings for the three and six-month periods ended June 30, 2007.

As of June 30, 2008, the total unrecognized compensation cost of $1,342 million related to non-vested awards is expected to be recognized over a weighted-average period of approximately three years.

There were no significant capitalized stock-based compensation costs at June 30, 2008 and 2007.

For Restricted Stock Units (RSUs) awarded after December 31, 2007, dividend equivalents will not be paid. The fair value of such RSUs is determined and fixed on the grant date based on the company s stock price adjusted for the exclusion of dividend equivalents.

5. 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 tables provide the total retirement-related benefit plans impact on income from continuing operations before income taxes.

For the three months ended June 30:	**2008**	**2007**

(Dollars in millions)			**Yr. to Yr. Percent Change**
Retirement-related plans cost:			
Defined benefit and contribution pension plans cost	$ 290	$ 534	(45.8)%
Nonpension postretirement plans cost	91	94	(3.6)
Total	$ 381	$ 628	(39.4)%

For the six months ended June 30: **(Dollars in millions)**	**2008**	**2007**	**Yr. to Yr. Percent Change**
Retirement-related plans cost:			
Defined benefit and contribution pension plans cost	$ 651	$ 1,074	(39.4)%
Nonpension postretirement plans cost	185	197	(6.1)
Total	$ 836	$ 1,271	(34.2)%

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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

For the three months ended June 30: (Dollars in millions)	U.S. Plans 2008	U.S. Plans 2007	Non-U.S. Plans 2008	Non-U.S. Plans 2007
Service cost	$	$ 185	$ 138	$ 145
Interest cost	666	647	518	433
Expected return on plan assets	(994)	(926)	(705)	(613)
Amortization of transition assets				
Amortization of prior service cost		15	(34)	(31)
Recognized actuarial losses	63	171	156	222
Net periodic pension (income)/cost U.S. Plan and material non-U.S. Plans	(265)*	92*	73**	156**
Cost of other defined benefit plans	27	32	59	42
Total net periodic pension (income)/cost for all defined benefit plans	(238)	124	132	198
Cost of defined contribution plans	252	97	143	115
Total retirement plan cost recognized in the Consolidated Statement of Earnings	$ 15	$ 221	$ 275	$ 313

* Represents the qualified portion of the IBM Personal Pension Plan.

** Represents the qualified and non-qualified portion of material non-U.S. Plans.

For the six months ended June 30: (Dollars in millions)	U.S. Plans 2008	U.S. Plans 2007	Non-U.S. Plans 2008	Non-U.S. Plans 2007+
Service cost	$	$ 373	$ 276	$ 291
Interest cost	1,337	1,293	1,024	857
Expected return on plan assets	(1,989)	(1,852)	(1,395)	(1,217)
Amortization of transition assets				(1)
Amortization of prior service cost		30	(68)	(62)
Recognized actuarial losses	133	340	310	442
Net periodic pension (income)/cost U.S. Plan and material non-U.S. Plans	(519)*	184*	147**	310**
Cost of other defined benefit plans	50	62	116	79
Total net periodic pension (income)/cost for all defined benefit plans	(469)	246	263	389
Cost of defined contribution plans	573	213	283	226
Total retirement plan cost recognized in the Consolidated Statement of Earnings	$ 105	$ 459	$ 546	$ 615

+ Reclassified to conform with 2008 presentation.

* Represents the qualified portion of the IBM Personal Pension Plan.

** Represents the qualified and non-qualified portion of material non-U.S. Plans.

In 2008, the company expects to contribute to its non-U.S. defined benefit plans approximately $660 million, which is the legally mandated minimum contribution for its non-U.S. plans. Total contributions to the non-U.S. plans in the first half of 2008 were $295 million.

On April 29, 2008, the IBM Board of Directors approved a pension adjustment for certain U.S. retirees and beneficiaries. Effective September 1, 2008, this adjustment provides a pension increase to approximately 42,000 IBM retirees who retired before January 1, 1997. The impact of this adjustment will be included in the IBM Personal Pension Plan remeasurement at December 31, 2008, therefore, there will be no impact to 2008 net periodic pension cost.

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Notes to Consolidated Financial Statements (continued)

The following table provides the components of the cost for the company s nonpension postretirement plans.

Cost of Nonpension Postretirement Plans

(Dollars in millions)	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Service cost	$ 13	$ 17	$ 28	$ 34
Interest cost	77	76	156	155
Amortization of prior service cost	(15)	(15)	(31)	(30)
Expected return on plan assets			(4)	
Recognized actuarial losses	2	4	5	12
Net periodic post retirement plan cost U.S. Plan	77	82	153	171
Cost of non-U.S. Plans	14	12	32	26
Total nonpension postretirement plan cost recognized in the Consolidated Statement of Earnings	$ 91	$ 94	$ 185	$ 197

The company received a $17.1 million subsidy in the second quarter and $20.2 million for the first half of 2008 in connection with the Medicare Prescription Drug Improvement and Modernization Act of 2003. A portion of this amount is used by the company to reduce its obligation and expense related to the plan, and the remainder is contributed to the plan to reduce contributions required by the participants. For further information related to the Medicare Prescription Drug Act, see page 115 in the company s 2007 Annual Report.

6. Fair Value: As highlighted in Note 2 on page 8, the company adopted the provisions of SFAS No. 157 as amended by FSP FAS 157-1 and FSP FAS 157-2 on January 1, 2008. Pursuant to the provisions of FSP FAS 157-2, the company will not apply the provisions of SFAS No. 157 until January 1, 2009 for the following major categories of nonfinancial assets and liabilities from the Consolidated Statement of Financial Position: Plant, rental machines and other property-net; Goodwill; Intangible assets-net; and, the Asset retirement obligation liabilities within Other accrued expenses and liabilities and Other liabilities. The company recorded no change to its opening balance of Retained earnings as of January 1, 2008 as it did not have any financial instruments requiring retrospective application per the provisions of SFAS No. 157.

Fair Value Hierarchy

SFAS No. 157 specifies a hierarchy of valuation techniques based upon whether the inputs to those valuation techniques reflect assumptions other market participants would use based upon market data obtained from independent sources (observable inputs) or reflect the company s own assumptions of market participant valuation (unobservable inputs). In accordance with SFAS No. 157, these two types of inputs have created the following fair value hierarchy:

- Level 1 Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly;
- Level 3 Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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Notes to Consolidated Financial Statements (continued)

SFAS No. 157 requires the use of observable market data if such data is available without undue cost and effort.

Measurement of Fair Value

The company measures fair value as an exit price using the procedures described below for all assets and liabilities measured at fair value. When available, the company uses unadjusted quoted market prices to measure 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, where possible, 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. Thus, an item may be classified in Level 3 even though there may be inputs that are readily observable. If quoted market prices are not available, the valuation model used generally depends on the specific asset or liability being valued. The determination of fair value considers various factors including interest rate yield curves and time value underlying the financial instruments. For derivatives and marketable debt securities, the company uses a discounted cash flow analysis using discount rates commensurate with the duration of the instrument. In the event of an other-than-temporary impairment of a nonpublic equity method investment, the company uses the net asset value of its investment in the investee adjusted using discounted cash flows for the company s estimate of the price that it would receive to sell the investment to a market participant that would consider all factors that would impact the investment s fair value. In determining the fair value of financial instruments, the company considers 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, where the base valuation uses market parameters based on an AA (or equivalent) credit rating. Due to the fact that not all counterparties have a AA (or equivalent) credit rating, it is necessary to take into account the actual credit rating of a counterparty 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.

Items Measured at Fair Value on a Recurring Basis

The following table presents the company s assets and liabilities that are measured at fair value on a recurring basis at June 30, 2008 consistent with the fair value hierarchy provisions of SFAS No. 157.

(Dollars in millions)	Level 1	Level 2	Level 3	Netting (1)	Total
Assets:					
Cash and cash equivalents	$ 2,919	$ 4,044	$	$	$ 6,964
Marketable securities		120			120

Derivative assets (2)	31	1,009		(541)	499
Investments and sundry assets	437	1			438
Total Assets	**$ 3,387**	**$ 5,175**	**$**	**$ (541)**	**$ 8,021**
Liabilities:					
Derivative liabilities (3)	$	$ 1,782	$	$ (541)	$ 1,241
Total Liabilities	**$**	**$ 1,782**	**$**	**$ (541)**	**$ 1,241**

(1) Represents netting of derivative exposures covered by a qualifying master netting agreement in accordance with FASB Interpretation No. 39, Offsetting of Amounts Relating to Certain Contracts, and credit risk adjustments, if material.

(2) 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 June 30, 2008 are $793 million and $247 million, respectively.

(3) The gross balances of derivative liabilities contained within other accrued expenses and liabilities, and other liabilities in the Consolidated Statement of Financial Position at June 30, 2008 are $1,300 million and $481 million, respectively.

At June 30, 2008, the company did not have any assets or liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

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Notes to Consolidated Financial Statements (continued)

Items Measured at Fair Value on a Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis and therefore are not included in the table above. These assets include equity method investments that are recognized at fair value at the end of the period 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 and are included in the table above can also be subject to nonrecurring fair value measurements. These assets include public cost method investments that are deemed to be other-than-temporarily impaired. The company did not record any other-than-temporary impairment charges for these assets during the first six months of 2008.

7. Accelerated Share Repurchase: In May 2007, IBM International Group (IIG), a wholly-owned foreign subsidiary of the company repurchased 118.8 million shares of common stock for $12.5 billion under accelerated share repurchase (ASR) agreements with three banks.

Pursuant to the ASR agreements, executed on May 25, 2007, IIG paid an initial purchase price of $105.18 per share for the repurchase. The initial purchase price was subject to adjustment based on the volume weighted average price of IBM common stock over a settlement period of three months for each of the banks. The adjustment also reflected certain other amounts including the banks carrying costs, compensation for ordinary dividends declared by the company during the settlement period and interest benefits for receiving the $12.5 billion payment in advance of the anticipated purchases by each bank of shares in the open market during its settlement period. The adjustment amount could be settled in cash, registered shares or unregistered shares at IIG s option. Under the ASR, IIG had a separate settlement with each of the three banks. The first settlement occurred on September 6, 2007, resulting in a settlement payment to the bank of $151.8 million. The second settlement occurred on December 5, 2007, resulting in a settlement payment to the bank of $253.1 million. The third settlement occurred on March 4, 2008, resulting in a settlement payment to the company of $54.2 million. The settlement amounts were paid in cash at the election of IIG in accordance with the provisions of the ASR and were recorded as adjustments to Stockholders equity in the Consolidated Statement of Financial Position on the settlement dates. The adjusted average price paid per share during the ASR period was $108.13, resulting in a total purchase price of $12,851 million versus the original $12,500 million. The $351 million difference was settled in cash.

8. Acquisitions: During the six months ended June 30, 2008, the company completed 13 acquisitions at an aggregate cost of $6,447 million. The Cognos, Inc. and Telelogic AB acquisitions are shown separately given their significant purchase prices.

Cognos, Inc. (Cognos) On January 31, 2008, the company acquired 100 percent of the outstanding common shares of Cognos for consideration of $5,021 million consisting of $4,998 million of cash and $24 million of equity instruments. Through this acquisition, IBM and Cognos will become a leading provider of technology and services for business intelligence and performance management, delivering the industry s most complete, open standards-based platform with the broadest range of expertise to help companies expand the value of their information, optimize their business processes and maximize performance across their enterprises. The company acquired Cognos to accelerate its Information on Demand strategy, a cross-company initiative that combines the company s strength in information integration, content and data management and business consulting services to unlock the business value of information. Cognos was integrated into the Software segment upon acquisition, and goodwill, as reflected in the table on page 15 has been entirely assigned to the Software segment. It is expected that 20-30 percent of the goodwill will be deductible for tax purposes. The overall weighted average useful life of the intangible assets acquired, excluding goodwill, is

6.5 years.

Telelogic, AB (Telelogic) On April 3, 2008, IBM acquired 100 percent of the outstanding common shares of Telelogic for cash consideration of $885 million. Telelogic is a leading global provider of solutions for automating and supporting best practices across the enterprise from powerful modeling of business processes and enterprise architectures to requirements-driven development of advanced systems and software. Telelogic s solutions enable organizations to align product, systems and software development lifecycles with business objectives and customer needs to dramatically improve quality and predictability, while significantly reducing time-to-market and overall costs. Clients will benefit from the combined technologies and services of both companies, providing them a wider range of software and system development capabilities used to build complex systems. Telelogic was integrated into the Software segment upon acquisition, and goodwill, as reflected in the table on page 15 has been entirely assigned to the Software segment. None of the goodwill will be deductible for tax purposes. The overall weighted average useful life of the intangible assets acquired, excluding goodwill, is 7.0 years.

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Notes to Consolidated Financial Statements (continued)

Other Acquisitions The company acquired 11 additional companies at an aggregate cost of $541 million that are presented in the table below as Other Acquisitions.

The Software segment completed seven other acquisitions, all privately held companies: in the first quarter; AptSoft Corporation, Solid Information Technology, Net Integration Technologies Inc., and Encentuate, Inc; in the second quarter; Infodyne, Beijing Super Info and FilesX.

Global Technology Services (GTS) completed one acquisition in the first quarter: Arsenal Digital Solutions, a privately held company. Arsenal provides global clients with security rich information protection services designed to handle increasing data retention requirements.

Global Business Services (GBS) completed one acquisition in the first quarter: u9consult, a privately held company. u9consult complements the company s existing capabilities in value chain consulting.

Systems and Technology completed two acquisitions in the second quarter: Diligent Technologies Corporation and Platform Solutions, Inc (PSI), both privately held companies. Diligent will be an important component of IBM s New Enterprise Data Center model, which helps clients improve IT efficiency and facilitates the rapid deployment of new IT services for future business growth. PSI s technologies and skills, along with its intellectual capital, will be integrated into the company s mainframe product engineering cycles and future product plans. In the second quarter, $24 million of the purchase price of PSI was attributed to the settlement of a preexisting lawsuit between IBM and PSI and recorded in SG&A expense. See note 14 on page 18 for additional information regarding this litigation. Also, the company recorded a $24 million In-Process Research and Development (IPR&D) charge related to this acquisition in the second quarter.

Purchase price consideration for the Other Acquisitions was paid all in cash. All acquisitions are reported in the Consolidated Statement of Cash Flows net of acquired cash and cash equivalents.

The table below reflects the purchase price related to these acquisitions and the resulting purchase price allocations as of June 30, 2008.

(Dollars in millions)	Amortization Life (yrs.)	Cognos*	Telelogic	Other Acquisitions
Current assets		$ 507	$ 238	$ 26
Fixed assets/non current		126	7	17
Intangible assets:				

Goodwill	N/A	4,177	658	433
Completed technology	3 7	534	108	47
Client relationships	3 7	47	127	11
IPR&D	N/A			24
Other	3 7	543	15	18
Total assets acquired		5,934	1,153	575
Current liabilities		(784)	(213)	(47)
Non current liabilities		(128)	(54)	(12)
Total liabilities assumed		(912)	(267)	(59)
Settlement of preexisting litigation				24
Total purchase price		$ 5,021	$ 885	$ 541

* Purchase price allocation at June 30, 2008 reflects immaterial adjustments from the March 31, 2008 balances.

The acquisitions were accounted for as purchase transactions, and accordingly, the assets and liabilities of the acquired entities were 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 workforce, neither of which qualify as an amortizable intangible asset. For the Other Acquisitions, the overall weighted-average life of the identified amortizable intangible assets acquired is 5.0 years. With the exception of goodwill, these identified intangible assets will be amortized on a straight-line basis over their useful lives. Goodwill of $433 million has been assigned to the Software ($119 million), Global Technology Services ($84 million) and Systems and Technology ($231 million) segments. Substantially, all of the goodwill related to Other Acquisitions is not deductible for tax purposes.

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Notes to Consolidated Financial Statements (continued)

9. Printing Systems Divestiture: In January 2007, the company announced an agreement with Ricoh Company Limited (Ricoh), a publicly traded company, to form a joint venture company based on IBM s Printing System Division (a division of the Systems and Technology segment). The company initially created a wholly-owned subsidiary, InfoPrint Solutions Company, LLC (InfoPrint), by contributing specific assets and liabilities from its printer business. The Printing System Division generated approximately $1 billion of revenue in 2006. The InfoPrint portfolio includes solutions for production printing for enterprises and commercial printers as well as solutions for office workgroup environments and industrial segments. On June 1, 2007 (closing date), the company divested 51 percent of its interest in InfoPrint to Ricoh. The company will divest its remaining ownership to Ricoh quarterly over a three year period from the closing date. At June 30, 2008, the company s ownership in InfoPrint was 32.6 percent. See IBM s 2007 Annual Report, Note C, Acquisitions/Divestitures , for additional information.

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

(Dollars in millions) Intangible asset class	Gross Carrying Amount	At June 30, 2008 Accumulated Amortization	Net Carrying Amount
Capitalized software	$ 1,920	$ (841)	$ 1,079
Client-related	1,664	(573)	1,091
Completed technology	1,161	(239)	922
Patents/Trademarks	195	(55)	140
Other(1)	176	(129)	46
Total	$ 5,115	$ (1,837)	$ 3,277

(Dollars in millions) Intangible asset class	Gross Carrying Amount	At December 31, 2007 Accumulated Amortization	Net Carrying Amount
Capitalized software	$ 1,926	$ (826)	$ 1,100
Client-related	1,054	(495)	559
Completed technology	536	(194)	342
Strategic alliances	103	(103)	
Patents/Trademarks	128	(61)	67
Other(1)	154	(115)	39
Total	$ 3,901	$ (1,794)	$ 2,107

(1) Other intangibles are primarily acquired proprietary and non-proprietary business processes, methodologies and systems and impacts from currency translation.

The net carrying amount of intangible assets increased $1,170 million during the first half of 2008, primarily due to acquired intangible assets and capitalized software additions, partially offset by amortization. The aggregate intangible amortization expense was $337 million and $654 million for the second quarter and first six months of 2008, respectively, versus $289 million and $580 million for the second quarter and first six months ended June 30, 2007, respectively. In addition, in the first half of 2008, the company retired $619 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 June 30, 2008:

(Dollars in millions)	**Capitalized Software**	**Acquired Intangibles**	**Total**
2008 (for Q3-Q4)	$ 373	$ 316	$ 689
2009	497	498	994
2010	186	402	588
2011	22	353	375
2012		271	271

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Notes to Consolidated Financial Statements (continued)

The changes in the goodwill balances by reportable segment, for the six months ended June 30, 2008, are as follows:

(Dollars in millions) Segment	Balance 12/31/07	Goodwill Additions	Purchase Price Adjustments	Divestitures	Foreign Currency Translation And Other Adjustments	Balance 6/30/08
Global Business Services	$ 4,041	$	$ (1)	$	$ 29	$ 4,069
Global Technology Services	2,914	84	(2)		166	3,161
Systems and Technology	484	231	20		1	735
Software	6,846	4,954	(61)		(80)	11,658
Global Financing						
Total	$ 14,285	$ 5,268	$ (44)	$	$ 116	$ 19,624

There were no goodwill impairment losses recorded during the first six months of 2008.

11. Financing Receivables: The following table presents financing receivables, net of allowances for doubtful accounts, including residual values.

(Dollars in millions)	At June 30, 2008	At December 31, 2007
Current:		
Net investment in sales-type leases	$ 4,469	$ 4,746
Commercial financing receivables	5,232	6,263
Client loans receivables	4,877	4,652
Installment payment receivables	665	629
Total	$ 15,242	$ 16,289
Noncurrent:		
Net investment in sales-type leases	$ 6,192	$ 6,085
Commercial financing receivables	125	113
Client loans receivables	4,719	4,931
Installment payment receivables	438	474
Total	$ 11,473	$ 11,603

Net investment in sales-type leases is for leases that relate principally to the company s equipment and are for terms ranging from two to seven years. Net investment in sales-type leases includes unguaranteed residual values of $947 million and $915 million at June 30, 2008 and December 31, 2007, respectively, and is reflected net of unearned income of $1,069 million and $1,016 million and of allowance for uncollectible accounts of $141 million and $127 million at those dates, respectively.

Commercial financing receivables relate primarily to inventory and accounts receivable financing for dealers and remarketers of IBM and non-IBM products. Payment terms for inventory and accounts receivable financing generally range from 30 to 90 days.

Client loans receivables relate to loans that are provided by Global Financing primarily to the company s clients to finance the purchase of the company s software and services. Separate contractual relationships on these financing arrangements are for terms ranging from two to seven years. Each financing contract is 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 non-recourse borrowings. Financing receivables pledged as collateral for borrowings were $341 million and $258 million at June 30, 2008 and December 31, 2007, respectively.

The company did not have any financing receivables held for sale as of June 30, 2008 and December 31, 2007.

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Notes to Consolidated Financial Statements (continued)

12. Segments: The tables on pages 63 and 64 of this Form 10-Q reflect the results of the company s reportable segments consistent with the management system used by the company s chief operating decision maker. These results are not necessarily a depiction that is in conformity with GAAP. For example, employee retirement plan costs are developed using actuarial assumptions on a country-by-country basis and allocated to the segments based on headcount. Different results could occur if actuarial assumptions that are unique to each segment were used. Segment performance measurement is based on income before income taxes (pre-tax income). These results are used, in part, by management, both in evaluating the performance of, and in allocating resources to, each of the segments.

13. Restructuring-Related Liabilities: The following table provides a rollforward of the current and noncurrent liability balances for actions taken in the following periods: (1) the second-quarter of 2005; (2) the fourth-quarter 2002 actions associated with the acquisition of the PricewaterhouseCoopers consulting business; (3) the second-quarter of 2002 actions associated with the Microelectronics Division and the rebalancing of both the company s workforce and leased space resources; (4) the 2002 actions associated with the hard disk drive (HDD) business for reductions in workforce, manufacturing capacity and space; (5) actions taken in 1999; and (6) actions that took place prior to 1994. See the company s 2007 Annual Report, Note Q on pages 99 and 100 for additional information on the actions taken in 2005.

(Dollars in millions)	Liability as of 12/31/2007	Payments	Other adjustments*	Liability as of 6/30/2008
Current:				
Workforce	$ 130	$ (69)	$ 46	$ 107
Space	30	(17)	18	31
Other	7		1	8
Total Current	$ 167	$ (86)	$ 65	$ 146
Noncurrent:				
Workforce	$ 557	$	$ 18	$ 575
Space	74		(14)	60
Total Noncurrent	$ 631	$	$ 4	$ 635

* The other adjustments column in the table above principally includes the reclassification of noncurrent to current, foreign currency translation adjustments and interest accretion.

14. Contingencies: The company is involved in a variety of claims, demands, suits, investigations and proceedings that arise from time to time in the ordinary course of its business, including actions with respect to contracts, intellectual property (IP), product liability, employment, benefits, securities, foreign operations and environmental matters. These actions may be commenced by a number of different parties, including competitors, partners, clients, current or former employees, government and regulatory agencies, stockholders and representatives of the locations in which the company does business.

The following is a summary of some of the more significant legal matters involving the company.

The company is a defendant in an action filed on March 6, 2003 in state court in Salt Lake City, Utah by The SCO Group (SCO v. IBM). The company removed the case to Federal Court in Utah. Plaintiff is an alleged successor in interest to some of AT&T s Unix IP rights, and alleges copyright infringement, unfair competition, interference with contract and breach of contract with regard to the company s distribution of AIX and Dynix and contribution of code to Linux. The company has asserted counterclaims, including breach of contract, violation of the Lanham Act, unfair competition, intentional torts, unfair and deceptive trade practices, breach of the General Public License that governs open source distributions, promissory estoppel and copyright infringement. In October 2005, the company withdrew its patent counterclaims in an effort to simplify and focus the issues in the case and to expedite their resolution. Motions for summary judgment were heard in March 2007, and the court has not yet issued its decision. On August 10, 2007, the court in another suit, The SCO Group, Inc. v. Novell, Inc., issued a decision and order determining, among other things, that Novell is the owner of UNIX and UnixWare copyrights, and obligating SCO to recognize Novell s waiver of SCO s claims against IBM and Sequent for breach of UNIX license agreements. At the request of the court in SCO v. IBM, on August 31, 2007, each of the parties filed a status report with the court concerning the effect of the August 10th Novell ruling on the SCO v. IBM case, including the pending motions. On September 14, 2007, plaintiff filed for bankruptcy protection, and all proceedings in this case were stayed.

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Notes to Consolidated Financial Statements (continued)

On November 29, 2006, the company filed a lawsuit against Platform Solutions, Inc. (PSI) in the United States District Court for the Southern District of New York. IBM filed its amended complaint on August 17, 2007 and asserted claims for patent infringement, trade secret misappropriation, copyright infringement, tortious interference and breach of contract in connection with PSI s development and marketing of a computer system that PSI says is compatible with IBM s S/390 and System z architectures. IBM also sought a declaratory judgment that its refusal to license its patents to PSI and certain of its software for use on PSI systems does not violate the antitrust laws. IBM seeks damages and injunctive relief. On September 21, 2007, PSI answered the amended complaint and asserted counterclaims against IBM for alleged monopolization and attempted monopolization, tying, violations of New York and California statutes proscribing unfair competition, tortious interference with the acquisition of PSI by a third party and promissory estoppel. PSI also sought declaratory judgments of noninfringement of IBM s patents and patent invalidity. In October 2007, PSI filed a complaint with the European Commission claiming that the company s alleged refusal to do business with PSI violated European competition law. The company responded to this complaint in December. On January 11, 2008, the court in the New York lawsuit permitted T3 Technologies, a reseller of PSI computer systems, to intervene as a counterclaim-plaintiff, and the court also permitted the company to file a second amended complaint adding patent infringement claims against T3. On June 30, 2008, IBM acquired PSI. As a result of this transaction, IBM and PSI dismissed all claims against each other. Litigation between the company and T3 continues.

In October 2003, a purported collective action lawsuit was filed against IBM in the United States District Court for the Northern District of California by 10 former IBM employees alleging, on behalf of themselves and allegedly similarly situated former employees, that the company engaged in a pattern and practice of discriminating against employees on the basis of age when it terminated employees, both in connection with reductions in force and individualized determinations (Syverson v. IBM). Initially, the District Court dismissed the lawsuit on the basis of release agreements signed by all the plaintiffs. On appeal, the Ninth Circuit reversed the trial court s finding that the release barred these claims, and in January 2007, after denial of IBM s petition for rehearing, the matter was returned to the trial court for further proceedings. On October 3, 2007, the court dismissed with prejudice plaintiffs claim for relief under the Older Workers Benefit Protection Act, and dismissed with leave to amend plaintiffs claim asserting disparate impact age discrimination with respect to individualized terminations. On November 6, 2007, plaintiffs filed a Third Amended Complaint, amending the disparate impact claim. IBM filed its answer on November 26, 2007, and discovery is proceeding.

In July 2005, two lawsuits were filed in the United States District Court for the Southern District of New York related to the company s disclosures concerning first-quarter 2005 earnings and the expensing of equity compensation. Pursuant to an Order from the Court dated March 28, 2006, the two lawsuits were consolidated into a single action captioned In re International Business Machines Corp. Securities Litigation. Plaintiffs filed a corrected consolidated amended complaint dated May 19, 2006, in which they named the company and IBM s Senior Vice President and Chief Financial Officer as defendants and alleged that defendants made certain misrepresentations and omissions in violation of Section 10(b), and Rule 10b-5 thereunder, and Section 20(a) of the Securities Exchange Act of 1934. On September 20, 2006, the Court denied a Motion to Dismiss that was filed by IBM. On March 12, 2007, the plaintiffs class was certified; class notifications were mailed on or about May 30, 2007. On May 30, 2008, the Court granted preliminary approval of a settlement of this action and set September 8, 2008 as the date for a fairness hearing.

In January 2004, the Seoul District Prosecutors Office in South Korea announced it had brought criminal bid-rigging charges against several companies, including IBM Korea and LG IBM (a joint venture between IBM Korea and LG Electronics, which has since been dissolved, effective January, 2005) and had also charged employees of some of those entities with, among other things, bribery of certain officials of government-controlled entities in Korea and bid rigging. IBM Korea and LG IBM cooperated fully with authorities in these matters. A number of individuals, including former IBM Korea and LG IBM employees, were subsequently found guilty and sentenced. IBM Korea and LG IBM were also required to pay fines. Debarment orders were imposed at different times, covering a period of no more than a year from the date of issuance, which barred IBM Korea from doing business directly with certain government-controlled entities in Korea. All debarment orders have since expired and when they were in force did not prohibit IBM Korea from selling products and services to business partners who sold to government-controlled entities in Korea. In addition, the U.S. Department of Justice and the SEC have both contacted the company in connection with this matter. In March 2008, the company received a request from the SEC for additional information.

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Notes to Consolidated Financial Statements (continued)

On March 27, 2008, the company was temporarily suspended from participating in new business with U.S. Federal government agencies. The notice of temporary suspension was issued by the Environmental Protection Agency (EPA) and related to an investigation by the EPA of possible violations of the Procurement Integrity provisions of the Office of Federal Procurement Policy Act regarding a specific bid for business with the EPA originally submitted in March 2006. In addition, the U.S. Attorney s Office for the Eastern District of Virginia served the company and certain employees with grand jury subpoenas related to the bid, requesting testimony and documents regarding interactions between employees of the EPA and certain company employees. On April 4, 2008, the company announced an agreement with the EPA that terminated the temporary suspension order. The company is cooperating with the EPA and with the U.S. Attorney s Office for the Eastern District of Virginia.

The company is a defendant in a civil lawsuit brought in Tokyo District Court by Tokyo Leasing Co., Ltd., which seeks to recover losses that it allegedly suffered after IXI Co., Ltd. initiated civil rehabilitation (bankruptcy) proceedings in Japan and apparently failed to pay Tokyo Leasing amounts for which Tokyo Leasing now seeks to hold IBM and others liable. The claims in this suit include tort and breach of contract.

The company is a defendant in numerous actions filed after January 1, 2008 in Supreme Court for the State of New York, county of Broome, on behalf of hundreds of plaintiffs. The complaints allege numerous and different causes of action, including for negligence and recklessness, private nuisance and trespass. Plaintiffs in these cases seek medical monitoring and claim damages in unspecified amounts for a variety of personal injuries and property damages allegedly arising out of the presence of groundwater contamination and vapor intrusion of groundwater contaminants into certain structures in which plaintiffs reside or resided, or conducted business, allegedly resulting from the release of chemicals into the environment by the company at its former manufacturing and development facility in Endicott. These complaints also seek punitive damages in an unspecified amount.

The company is party to, or otherwise involved in, proceedings brought by U.S. federal or state environmental agencies under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), known as Superfund, or laws similar to CERCLA. Such statutes require potentially responsible parties to participate in remediation activities regardless of fault or ownership of sites. The company is also conducting environmental investigations, assessments or remediations at or in the vicinity of several current or former operating sites globally pursuant to permits, administrative orders or agreements with country, state or local environmental agencies, and is involved in lawsuits and claims concerning certain current or former operating sites.

The company is also subject to ongoing tax examinations and governmental assessments in various jurisdictions. Along with many other U.S. companies doing business in Brazil, the company is involved in various challenges with Brazilian authorities regarding non-income tax assessments and non-income tax litigation matters. These matters principally relate to claims for taxes on the importation of computer software. The total amounts related to these matters are approximately $2.6 billion, including amounts currently in litigation and other amounts. In addition, the company has received an income tax assessment from Mexican authorities relating to the deductibility of certain warranty payments. In response, the company has filed an appeal in the Mexican Federal Fiscal court. The total potential amount related to this matter for all applicable years is approximately $550 million. The company believes it will prevail on these matters and that these amounts are not meaningful indicators of liability.

In accordance with SFAS No. 5, Accounting for Contingencies, (SFAS No. 5), the company records a provision with respect to a claim, suit, investigation or proceeding when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Claims and proceedings are reviewed at least quarterly and provisions are taken or adjusted to reflect the impact and status of settlements, rulings, advice of counsel and other information pertinent to a particular matter. Any recorded liabilities including any changes to such liabilities for the quarter ended June 30, 2008, were not material to the Consolidated Financial Statements. Based on its experience, the company believes that the damage amounts claimed in the matters previously referred to are not a meaningful indicator of the potential liability. Claims, suits, investigations and proceedings are inherently uncertain and it is not possible to predict the ultimate outcome of the matters previously discussed. While the company will continue to defend itself vigorously in all such matters, it is possible that the company s business, financial condition, results of operations or cash flows could be affected in any particular period by the resolution of one or more of these matters.

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Notes to Consolidated Financial Statements (continued)

Whether any losses, damages or remedies finally determined in any such claim, suit, investigation or proceeding could reasonably have a material effect on the company s business, financial condition, results of operations or cash flows will depend on a number of variables, including the timing and amount of such losses or damages; the structure and type of any such remedies; the significance of the impact any such losses, damages or remedies may have on the Consolidated Financial Statements; and the unique facts and circumstances of the particular matter which may give rise to additional factors.

15. Commitments: The company s extended lines of credit to third-party entities include unused amounts of $4,944 million and $3,702 million at June 30, 2008 and December 31, 2007, respectively. A portion of these amounts was available to the company s business partners to support their working capital needs. In addition, the company has committed to provide future financing to its clients in connection with client purchase agreements for approximately $4,288 million and $3,654 million at June 30, 2008 and December 31, 2007, respectively.

The company has applied the disclosure provisions of FIN 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, to its agreements that contain guarantee or indemnification clauses. These disclosure provisions expand those required by SFAS No. 5, by requiring a guarantor to disclose certain types of guarantees, even if the likelihood of requiring the guarantor s performance is remote. The following is a description of arrangements in which the company is the guarantor.

The company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts entered into by the company, under which the company customarily agrees to hold the party harmless against losses arising from a breach of representations and covenants related to such matters as title to the assets sold, certain intellectual property (IP) rights, specified environmental matters, third-party performance of non-financial contractual obligations and certain income taxes. In each of these circumstances, payment by the company is conditioned on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the company to challenge the other party s claims. Further, the company s obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the company may have recourse against third parties for certain payments made by the company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements, due to the conditional nature of the company s obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the company under these agreements have not had a material effect on the company s business, financial condition or results of operations.

In addition, the company guarantees certain loans and financial commitments. The maximum potential future payment under these financial guarantees was $24 million and $23 million at June 30, 2008 and December 31, 2007, respectively. The fair value of the guarantees recognized in the Consolidated Statement of Financial Position is not material.

The company offers warranties for its hardware products that range up to three years, with the majority being either one or three years. Estimated costs for warranty terms standard to the deliverable are recognized when revenue is recorded for the related deliverable. Revenue from extended warranty contracts, for which the company is obligated to perform, is recorded as deferred income and subsequently recognized on a straight-line basis over the delivery period. Changes in the company s deferred income for extended warranty contracts and warranty liability for standard warranties, which are included in other accrued expenses and liabilities and other liabilities on the Consolidated Statement of Financial Position, are presented in the following tables:

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Notes to Consolidated Financial Statements (continued)

Standard Warranty Liability

(Dollars in millions)	**2008**	**2007**
Balance at January 1	$ 412	$ 582
Current period accruals	199	228
Accrual adjustments to reflect actual experience	18	(25)
Charges incurred	(253)	(327)
Balance at June 30	$ 376	$ 458

The decrease in the balance was primarily driven by a reduction in estimated future cost as a result of the divestiture of the Personal Computing business to Lenovo Group Limited (Lenovo) in April 2005.

Extended Warranty Liability

(Dollars in millions)	**2008**	**2007**
Aggregate deferred revenue at January 1	$ 409	$ 131
Revenue deferred for new extended warranty contracts	157	120
Amortization of deferred revenue	(50)	(29)
Other (a)	8	1
Aggregate deferred revenue at June 30	$ 523	$ 223
Current	$ 199	$ 102
Non current	325	121
Aggregate deferred revenue at June 30	$ 523	$ 223

(a) Other primarily consists of foreign currency translation adjustments.

16. Subsequent Events: On July 29, 2008, the company announced that the Board of Directors approved a quarterly dividend of $0.50 per common share. The dividend is payable September 10, 2008 to stockholders of record on August 8, 2008.

On July 28, 2008, the company issued $1.0 billion of 3-year floating rate notes.

On July 28, 2008, the company announced an agreement to acquire ILOG, a publicly held company, for approximately $340 million. The closing of this acquisition is conditioned upon satisfactory completion of all regulatory reviews.

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Item 2.

MANAGEMENT S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008*

Snapshot

(Dollars in millions except per share amounts) Three months ended June 30:	2008	2007	Yr. To Yr. Percent/ Margin Change
Revenue	$ 26,820	$ 23,772	12.8%**
Gross profit margin	43.2%	41.8%	1.4pts.
Total expense and other income	$ 7,786	$ 6,796	14.6%
Total expense and other income to revenue ratio	29.0%	28.6%	0.4pts.
Provision for income taxes	$ 1,049	$ 881	19.1%
Income from continuing operations	$ 2,765	$ 2,261	22.3%
Net income	$ 2,765	$ 2,260	22.3%
Net income margin	10.3%	9.5%	0.8pts.
Earnings per share from continuing operations:			
Assuming dilution	$ 1.98	$ 1.55	27.7%
Basic	$ 2.02	$ 1.57	28.7%
Weighted average shares outstanding:			
Assuming dilution	1,395.8	1,460.8	(4.5)%
Basic	1,366.3	1,437.2	(4.9)%

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* The following Results of Continuing Operations discussion does not include the hard disk drive (HDD) business that the company sold to Hitachi, Ltd. on December 31, 2002. The HDD business was accounted for as a discontinued operation under generally accepted accounting principles. There were no losses from Discontinued Operations in the second quarter and first six months of 2008 and a $1 million loss in the second quarter of 2007 and no loss for the first six months of 2007.

** 5.6 percent adjusted for currency

Within the Management Discussion, selected references to adjusted for currency or at constant currency are made so that the financial results can be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons of the company s business performance.

In the second quarter, total revenue increased 12.8 percent as reported, 5.6 percent adjusted for currency, versus the second quarter of 2007. Pre-tax income from continuing operations was $3,814 million, up 21.4 percent compared to the prior year. Diluted earnings per share from continuing operations was $1.98, an increase of 27.7 percent year to year.

The company has been executing a strategy that aligns investments to growth opportunities. In the emerging markets, the company continues to invest to capture opportunities created from the build out of the infrastructures in these high-growth economies. In the more established markets, the company has been managing its business for productivity and the company is delivering solutions that provide value to its clients. In this environment, clients are looking for ways to save cost, conserve capital and manage risk. The company s second quarter financial results reflect the strength of the company s unique business model, built for both emerging and established markets and for delivering breakthrough technologies and business know-how to its clients.

Revenue growth was consistent across all geographies when adjusted for currency. Americas revenue increased 8.2 percent (6 percent adjusted for currency), Europe increased 19.9 percent (7 percent adjusted for currency) and Asia Pacific increased 15.8 percent (6 percent adjusted for currency). In the established countries, which the company manages through its major markets organization, the company s value proposition and its new technologies drove strong growth. U.S. revenue growth was 5 percent, and Canada accelerated to an 11 percent growth rate, adjusted for currency. In Europe, revenue adjusted for currency, increased 7 percent in Germany, 6 percent in France, while Italy grew 5 percent and the U.K. increased 4 percent. Japan revenue, adjusted for currency, decreased year to year, however the revenue growth rate improved modestly from last quarter.

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Management Discussion (continued)

The company focuses on the emerging markets through its new growth markets organization. These countries represented 18 percent of the company s geographic revenue in the quarter and grew 21 percent (14 percent adjusted for currency). A subset of these countries, Brazil, Russia, India and China, together grew 31 percent (20 percent adjusted for currency). The increase was driven by strong growth in India, which was up 35 percent (37 percent adjusted for currency).

On a segment basis, the increase in revenue was driven by strong double digit growth in Global Services. Global Technology Services revenue increased 15.3 percent, while Global Business Services revenue improved by 17.7 percent versus the second quarter of 2007. Software revenue increased 16.7 percent led by branded middleware, including contributions from the Cognos and Telelogic acquisitions. In addition, Systems and Technology revenue increased 2.2 percent, primarily driven by the new z10 mainframe, growth in converged System p servers and Storage, partially offset by weaker performance in Microelectronics OEM, legacy System i, System x and the impact of the prior year printer divestiture. Total Systems revenue growth was 9.9 percent in the second quarter. Global Financing revenue increased 6.1 percent reflecting an improvement in financing revenue offset by a decline in used equipment sales.

The gross profit margin was 43.2 percent, an increase of 1.4 points, primarily due to improved margins in Global Technology Services (0.7 points of the increase), improved revenue mix in Systems and Technology (0.3 points of the increase), improved margins in Global Business Services (0.3 points of the increase) and improved revenue mix in Software (0.3 points of the increase).

Total expense and other income increased 14.6 percent (7 percent adjusted for currency) for the second quarter of 2008 versus the second quarter of 2007. Overall, the increase was driven by approximately 8 points due to the effects of currency and 6 points due to acquisitions.

The company s effective tax rate for the second quarter of 2008 was 27.5 percent versus 28.0 percent in the second quarter of 2007.

The company generated $4,251 million in cash flow provided by operating activities, an increase of $807 million, compared to the second quarter of 2007, primarily driven by increased net income ($504 million) and changes in operating assets and liabilities ($219 million). Net cash used in investing activities of $1,131 million was $980 million higher than the second quarter of 2007, primarily due to the Telelogic acquisition. Net cash used in financing activities of $4,287 million was $995 million higher, primarily due to an increase in net payments associated with debt ($11,646 million), partially offset by lower payments to repurchase common stock ($10,071 million) in the second quarter of 2008 versus the second quarter of 2007.

In the second-quarter 2008, total Global Services signings increased 12 percent year to year to $14,689 million ($12,152 million adjusted for currency, up 4 percent). Short-term signings were $6,962 million, an increase of 18 percent year to year (9 percent adjusted for currency). Long-term signings were $7,728 million, an increase of 7 percent (flat adjusted for currency). The estimated Global Services backlog, at constant currency, was $117 billion at June 30, 2008, down $1 billion versus the March 31, 2008 balance and up $1 billion versus the June 30, 2007 balance.

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Management Discussion (continued)

(Dollars in millions except per share amounts) Six months ended June 30:	2008	2007	Yr. To Yr. Percent/ Margin Change
Revenue	$ 51,322	$ 45,801	12.1%**
Gross profit margin	42.4%	41.1%	1.4pts.
Total expense and other income	$ 14,754	$ 13,083	12.8%
Total expense and other income to revenue ratio	28.7%	28.6%	0.2pts.
Provision for income taxes	$ 1,928	$ 1,616	19.4%
Income from continuing operations	$ 5,084	$ 4,105	23.8%
Net income	$ 5,084	$ 4,105	23.9%
Net income margin	9.9%	9.0%	0.9pts.
Earnings per share from continuing operations:			
Assuming dilution	$ 3.63	$ 2.75	32.0%
Basic	$ 3.70	$ 2.80	32.1%
Weighted average shares outstanding:			
Assuming dilution	1,400.1	1,491.8	(6.2)%
Basic	1,374.6	1,468.3	(6.4)%

	6/30/08	12/31/07	
Assets	$ 120,928	$ 120,431	0.4%
Liabilities	$ 92,663	$ 91,962	0.8%
Equity	$ 28,264	$ 28,470	(0.7)%

** 4.8 percent adjusted for currency

For the first six months of 2008, total revenue increased 12.1 percent as reported, 4.8 percent adjusted for currency, versus the prior year. Pre-tax income from continuing operations was $7,012 million, a 22.6 percent increase compared to the first half of 2007. Diluted earnings per share from continuing operations was $3.63, reflecting a 32.0 percent improvement year to year.

Americas revenue increased 8.4 percent (6 percent adjusted for currency), Europe increased 17.9 percent (6 percent adjusted for currency) and Asia Pacific increased 15.0 (5 percent adjusted for currency) in the first half. In the established countries, U.S. revenue growth was 6 percent and Canada increased 5 percent, adjusted for currency. In Europe, revenue adjusted for currency, increased 3 percent in Germany, 3 percent in France, 3 percent in Italy and the U.K. increased 4 percent. Japan revenue decreased 2 percent adjusted for currency year to year.

Across the geographies, aggregate revenue from the growth market countries increased 19.8 percent (13 percent adjusted for currency) in the first six months of 2008 and represented approximately 17 percent of the company s geographic revenue. Revenue in the key growth countries of Brazil, Russia, India and China together grew 28.6 percent (17 percent adjusted for currency) in the first half of 2008 versus the first half of 2007.

The increase in first half revenue was driven by strong double digit growth in the Global Services segments. Global Technology Services revenue increased 16.2 percent, while Global Business Services revenue improved by 17.6 percent. Software revenue increased 15.4 percent, led by branded middleware and contributions from acquisitions. Systems and Technology revenue decreased 2.0 percent primarily driven by weaker performance in Microelectronics OEM, legacy System i, System x and the prior year printer divestiture, partially offset by increased revenue for the new z10 mainframe and growth in converged System p servers and Storage. Total Systems revenue growth was 6.4 percent in the first half. Global Financing revenue increased 4.5 percent reflecting an improvement in financing revenue offset by a decline in used equipment sales.

The gross profit margin was 42.4 percent, an increase of 1.4 points, primarily due to improved margins in Global Technology Services (0.8 points of the increase), improved margins and revenue mix in Systems and Technology (0.5 points of the increase), improved margins in Global Business Services (0.3 point of the increase) and improved revenue mix in Software (0.3 points of the increase).

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Management Discussion (continued)

Total expense and other income increased 12.8 percent (6 percent adjusted for currency) for the first half of 2008 versus the first half of 2007. Overall, the increase was driven by approximately 7 points due to the effects of currency, 5 points due to acquisitions and 1 point from additional interest expense associated with the 2007 accelerated share repurchase.

The effective tax rate for the first six months of 2008 was 27.5 percent versus 28.2 percent for the comparable period in 2007.

The company generated $8,453 million in cash flow provided by operating activities, an increase of $1,993 million, compared to the first half of 2007, primarily driven by increased net income ($979 million) and changes in operating assets and liabilities ($627 million). Net cash used in investing activities of $6,909 million was $4,340 million higher than the first half of 2007, primarily due to the Cognos and Telelogic acquisitions. Net cash used in financing activities of $7,083 million was $2,075 million higher, primarily due to an increase in net payments associated with debt ($13,658 million), partially offset by lower payments to repurchase common stock ($11,041 million) in the first half of 2008 versus the first half of 2007.

Total assets increased $497 million (decreased $2,065 million adjusted for currency) from December 31, 2007, primarily driven by increased goodwill ($5,339 million) and intangible assets ($1,170 million) due primarily to the Cognos and Telelogic acquisitions, increased prepaid pension assets ($1,610 million) and prepaid expenses ($481 million), partially offset by lower cash and marketable securities ($6,299 million), also due to the Cognos and Telelogic acquisitions, lower financing receivables ($1,176 million) and lower investments and sundry assets ($932 million). The company had $9,847 million in cash and marketable securities at June 30, 2008.

Total liabilities increased $702 million (decreased $1,348 million adjusted for currency) from December 31, 2007, primarily due to deferred income ($1,124 million), retirement and nonpension postretirement benefit obligations ($661 million), other accruals ($636 million), deferred tax liabilities ($620 million) and income tax reserves ($457 million) , partially offset by lower debt ($1,042 million), taxes ($842 million), accounts payable ($523 million) and compensation and benefits ($357 million).

Stockholders equity of $28,264 million decreased $205 million from December 31, 2007, primarily due to increased treasury stock ($7,123 million) as a result of common stock repurchases, partially offset by higher retained earnings ($3,816 million) due to net income and common stock ($2,694 million) driven by stock option activity.

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Management Discussion (continued)

Second Quarter and First Six Months in Review

Results of Continuing Operations

Segment Details

The following is an analysis of the second quarter and first six months of 2008 versus second quarter and first six months of 2007 reportable segment external revenue and gross margin results.

(Dollars in millions) For the three months ended June 30:	2008	2007	Yr. to Yr. Percent/Margin Change	Yr. to Yr. Percent Change Adjusting for Currency
Revenue:				
Global Technology Services	$ 10,100	$ 8,756	15.3%	7.5%
Gross margin	31.6%	29.8%	1.8pts.	
Global Business Services	5,107	4,338	17.7%	9.3%
Gross margin	25.8%	24.3%	1.5pts.	
Systems and Technology	5,212	5,102	2.2%	(2.7)%
Gross margin	38.6%	37.3%	1.3pts.	
Software	5,574	4,777	16.7%	9.1%
Gross margin	84.6%	84.9%	(0.3)pts.	
Global Financing	634	597	6.1%	(1.7)%
Gross margin	55.3%	46.0%	9.3pts.	
Other	193	201	(4.0)%	(5.8)%
Gross margin	5.6%	19.8%	(14.2)pts.	
Total revenue	$ 26,820	$ 23,772	12.8%	5.6%
Gross profit	$ 11,599	$ 9,938	16.7%	
Gross margin	43.2%	41.8%	1.4pts.	

(Dollars in millions) For the six months ended June 30:	2008	2007	Yr. to Yr. Percent/Margin Change	Yr. to Yr. Percent Change Adjusting for Currency
Revenue:				
Global Technology Services	$ 19,777	$ 17,013	16.2%	8.2%
Gross margin	31.5%	29.5%	2.0pts.	
Global Business Services	10,018	8,521	17.6%	9.1%

Gross margin	25.4%	24.1%	1.4pts.	
Systems and Technology	9,431	9,622	(2.0)%	(6.8)%
Gross margin	37.9%	36.1%	1.8pts.	
Software	10,421	9,028	15.4%	8.0%
Gross margin	84.3%	84.3%	0.0pts.	
Global Financing	1,266	1,211	4.5%	(2.6)%
Gross margin	53.1%	48.5%	4.6pts.	
Other	409	404	1.1%	0.1%
Gross margin	(7.8)%	15.9%	(23.7)pts.	
Total revenue	$ 51,322	$ 45,801	12.1%	4.8%
Gross profit	$ 21,766	$ 18,804	15.8%	
Gross margin	42.4%	41.1%	1.4pts.	

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Management Discussion (continued)

The following table presents each reportable segment s external revenue as a percentage of total external segment revenue.

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Global Technology Services	37.9%	37.1%	38.8%	37.5%
Global Business Services	19.2	18.4	19.7	18.8
Total Global Services	57.1	55.6	58.5	56.2
Systems and Technology	19.6	21.6	18.5	21.2
Global Financing	2.4	2.5	2.5	2.7
Total Systems and Technology/Global Financing	22.0	24.2	21.0	23.9
Software	20.9	20.3	20.5	19.9
Total	100.0%	100.0%	100.0%	100.0%

Global Services

(Dollars in millions) For the three months ended June 30:	2008	2007	Yr. to Yr. Percent Change
Global Services Revenue:	$ 15,206	$ 13,094	16.1%
Global Technology Services	$ 10,100	$ 8,756	15.3%
Strategic Outsourcing	5,183	4,569	13.4
Integrated Technology Services	2,378	2,059	15.5
Maintenance	1,876	1,613	16.3
Business Transformation Outsourcing	666	515	29.2
Global Business Services	$ 5,107	$ 4,338	17.7%

(Dollars in millions) For the six months ended June 30:	2008	2007	Yr. to Yr. Percent Change
Global Services Revenue:	$ 29,794	$ 25,535	16.7%
Global Technology Services	$ 19,777	$ 17,013	16.2%
Strategic Outsourcing	10,194	8,903	14.5
Integrated Technology Services	4,565	3,958	15.3
Maintenance	3,700	3,147	17.6
Business Transformation Outsourcing	1,320	1,005	31.4
Global Business Services	$ 10,018	$ 8,521	17.6%

The company s Global Services segments, Global Technology Services and Global Business Services, had combined revenue of $15,206 million, an increase of 16.1 percent (8 percent adjusted for currency) in the second quarter and $29,794 million, an increase of 16.7 percent (8 percent adjusted for currency) in the first six months of 2008, respectively, when compared to same periods of 2007. Performance was broad based with double-digit growth in all lines of businesses and across all geographies. This is the fourth consecutive quarter of Global Services revenue growth in excess of the company s longer term objective. Global Services is benefiting from both its infrastructure offerings and offerings that drive cost savings and time to value for clients. The growth markets are focused on the longer-term infrastructure build outs, while the more established major markets are focused on cost savings and value creation. In the second-quarter 2008, total Global Services signings increased 12 percent year to year to $14,689 million ($12,152 million adjusted for currency, up 4 percent). Short-term signings were $6,962 million, an increase of 18 percent year to year (9 percent adjusted for currency). Long-term signings were $7,728 million, an increase of 7 percent (flat adjusted for currency). In the growth markets, adjusted for currency, second quarter signings increased 25 percent, and long-term signings grew 70 percent. In the major markets, short-term signings increased 7 percent and long-term signings were down 10 percent, respectively, adjusted for currency. The Global Services segments delivered combined pre-tax profit of $1,631 million in the second quarter and $3,199 million in the first six months of 2008, an improvement of 28.1 percent and 31.9 percent, respectively, versus the same periods of 2007.

Global Technology Services (GTS) revenue increased 15.3 percent (8 percent adjusted for currency) and 16.2 percent (8 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the second quarter and

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Management Discussion (continued)

first half of 2007. All lines of business delivered double-digit revenue growth. Total signings in GTS increased 14 percent (9 percent adjusted for currency) in the second quarter of 2008, with long-term signings increasing 13 percent (9 percent adjusted for currency) and short-term signings increasing 16 percent (9 percent adjusted for currency).

Strategic Outsourcing (SO) revenue was up 13.4 percent (5 percent adjusted for currency) in the second quarter and 14.5 percent (6 percent adjusted for currency) in the first six months of 2008, respectively, versus the same periods in 2007. Revenue increased in all geographies driven by prior year s signings and continued growth in base accounts. SO signings in the second quarter of 2008 increased 7 percent (2 percent adjusted for currency) when compared to the second quarter of 2007.

Integrated Technology Services (ITS) revenue increased 15.5 percent (8 percent adjusted for currency) in the second quarter and 15.3 percent (8 percent adjusted for currency) in the first six months of 2008 when compared to the same periods in 2007. Revenue growth continues to be driven by the key infrastructure offerings. ITS signings in the second quarter increased 16 percent (9 percent adjusted for currency) year to year. Signings were strong in key infrastructure offerings such as Green Data Center and Converged Communications.

Maintenance revenue increased 16.3 percent (8 percent adjusted for currency) and 17.6 percent (10 percent adjusted for currency) in the second quarter and first six months of 2008, respectively versus the same periods in the prior year. The company continues to benefit from providing maintenance services on non-IBM IT equipment, including services provided to Ricoh InfoPrint Solutions. This work transitioned to Ricoh in June 2008.

Business Transformation Outsourcing (BTO) revenue increased 29.2 percent (26 percent adjusted for currency) in the second quarter and was up 31.4 percent (27 percent adjusted for currency) for the first six months of 2008, with double-digit revenue growth in all geographies. The business process outsourcing Daksh business delivered double-digit revenue growth again this quarter. BTO signings, which can vary significantly period-to-period, increased 45 percent (44 percent adjusted for currency) in the second quarter.

Global Business Services (GBS) revenue increased 17.7 percent (9 percent adjusted for currency) and 17.6 percent (9 percent adjusted for currency) in the second quarter and first half of 2008, respectively, versus the prior year periods. All geographies and industry sectors delivered double-digit revenue growth. The Application Management Services and Core Consulting businesses both delivered strong revenue performance again this quarter. Total signings in GBS increased 9 percent (decreased 2 percent adjusted for currency) in the second quarter of 2008. Short-term signings increased 19 percent (9 percent adjusted for currency) as clients continue to be focused on projects with shorter-term paybacks and ones that preserve cash, drive cost savings and help them meet regulatory requirements. Long-term signings decreased 9 percent (20 percent adjusted for currency) compared to a strong second quarter of 2007, which grew 70 percent versus the prior year.

(Dollars in millions) **For the three months ended June 30:**	**2008**	**2007**	**Yr. To Yr. Percent/ Margin Change**
Global Services gross profit:			
Global Technology Services:			

Gross profit	$ 3,189	$ 2,607	22.3%
Gross profit margin	31.6%	29.8%	1.8pts.
Global Business Services:			
Gross profit	1,318	1,054	25.1%
Gross profit margin	25.8%	24.3%	1.5pts.

(Dollars in millions) For the six months ended June 30:	2008	2007	Yr. To Yr. Percent/ Margin Change
Global Services gross profit:			
Global Technology Services			
Gross profit	$ 6,221	$ 5,014	24.1%
Gross profit margin	31.5%	29.5%	2.0pts.
Global Business Services			
Gross profit	2,547	2,051	24.2%
Gross profit margin	25.4%	24.1%	1.4pts.

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Management Discussion (continued)

GTS gross profit increased 22.3 percent in the second quarter and 24.1 percent in the first half of 2008 compared to the same periods of 2007, with gross profit margins improving 1.8 points and 2.0 points, respectively, year to year. Segment pre-tax profit increased 26.2 percent to $994 million, with a pre-tax margin of 9.5 percent in the second quarter of 2008, up 0.9 points versus second-quarter 2007. The first half 2008 segment pre-tax profit increased 34.9 percent to $1,982 million, with a pre-tax margin of 9.6 percent, an improvement of 1.4 points year to year. The margin expansion was driven by an improved cost structure resulting from improved productivity and prior year restructuring, a mix to higher value products in ITS and year-to-year savings in retirement-related costs.

GBS gross profit increased 25.1 percent in the second quarter and 24.2 percent for the first six months of 2008 compared to the same periods in 2007 with gross profit margins improving 1.5 points and 1.4 points, respectively, year to year. Segment pre-tax profit increased 31.2 percent to $637 million, with a pre-tax margin of 11.9 percent in the second quarter of 2008, up 1.5 points year to year. The first-half 2008 segment pre-tax profit increased 27.3 percent to $1,216 million, with a pre-tax margin of 11.5 percent, an increase of 1.1 points versus the first six months of 2007. The margin improvements were driven primarily by increased utilization, effective contract management and lower retirement-related costs.

Global Services Signings

In addition to reporting Global Services signings at constant currency, the company presents signings as reported, or at actual rates. The company believes that presenting signings at both actual rates and adjusted for currency provides investors with a more complete view of its services business. In addition, reporting signings at actual rates provides better comparability to other companies in the industry who report signings using actual rates.

(At Actual Currency Rates)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions)	**2008**	**2007**	**2008**	**2007**
GTS Signings:				
Long term	$ 5,916	$ 5,220	$ 11,078	$ 10,468
Short term	2,701	2,334	5,019	4,425
Total	$ 8,618	$ 7,554	$ 16,098	$ 14,893
GBS Signings:				
Long term	$ 1,812	$ 1,988	$ 2,796	$ 2,906
Short term	4,260	3,568	8,407	7,213
Total	$ 6,072	$ 5,557	$ 11,203	$ 10,119

(At Constant Currency Rates)

(Dollars in millions)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
GTS Signings:				
Long term	$ 4,842	$ 4,452	$ 9,197	$ 9,376
Short term	2,275	2,082	4,272	4,003
Total	$ 7,117	$ 6,534	$ 13,468	$ 13,379
GBS Signings:				
Long term	$ 1,520	$ 1,910	$ 2,415	$ 2,815
Short term	3,515	3,213	7,098	6,548
Total	$ 5,035	$ 5,124	$ 9,514	$ 9,364

Global Services signings are management s initial estimate of the value of a client s commitment under a Global Services contract. Signings are used by management to assess period performance of Global Services management. There are no third-party standards or requirements governing the calculation of signings. The calculation used by management includes an approximation of currency and involves estimates and judgments to gauge the extent of a client s commitment, including the type and duration of the agreement, and the presence of termination charges or wind-down costs. For example, for long-term contracts that require significant up-front investment by the company, the portions of these contracts that are a signing

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Management Discussion (continued)

are those periods in which there is a significant economic impact on the client if the commitment is not achieved, usually through a termination charge or the client incurring significant wind-down costs as a result of the termination. For short-term contracts that do not require significant upfront investments, a signing is usually equal to the full contract value. Long-term contracts represent SO and BTO contracts as well as GBS contracts with the U.S. Federal government and its agencies and Application Management Services (AMS) for custom and legacy applications. Short-term contracts represent the remaining GBS offerings of Consulting and Systems Integration, AMS for packaged applications and ITS contracts.

Signings include SO, BTO, ITS and GBS contracts. Contract extensions and increases in scope are treated as signings only to the extent of the incremental new value. Maintenance is not included in signings as maintenance contracts tend to be more steady state, where revenues equal renewals.

Backlog includes SO, BTO, ITS, GBS and Maintenance. Backlog is intended to be a statement of overall work under contract and therefore does include Maintenance. Backlog estimates are subject to change and are affected by several factors, including terminations, changes in the scope of contracts, periodic revalidations, adjustments for revenue not materialized and currency assumptions used to approximate constant currency.

Contract portfolios purchased in an acquisition are treated as positive backlog adjustments provided those contracts meet the company s requirements for initial signings. A new signing will be recognized if a new services agreement is signed incidental or coincidental to an acquisition or divestiture.

Systems and Technology

(Dollars in millions) For the three months ended June 30:	2008	2007	Yr. to Yr. Percent Change
Systems and Technology Revenue:	$ 5,212	$ 5,102	2.2%
System z			32.1
System p			28.7
System i			(46.9)
System x			(7.7)
Storage			11.8
Retail Store Solutions			0.2
Total Systems			9.9
Microelectronics OEM			(19.3)
Printing Systems			nm

nm - not meaningful

(Dollars in millions) **For the six months ended June 30:**	**2008**	**2007**	**Yr. to Yr. Percent Change**
Systems and Technology Revenue:	$ 9,431	$ 9,622	(2.0)%
System z			22.6
System p			15.8
System i			(35.6)
System x			(4.9)
Storage			10.8
Retail Store Solutions			(1.3)
Total Systems			6.4
Microelectronics OEM			(19.4)
Printing Systems			nm

nm - not meaningful

Systems and Technology revenue increased 2.2 percent (down 3 percent adjusted for currency) and declined 2.0 percent (7 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the same periods in 2007. On June 1, 2007, the company completed the divestiture of its printing business. Systems and Technology revenue, excluding the divested printing business, increased 5.5 percent (essentially flat adjusted for currency) and 2.2 percent (down

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Management Discussion (continued)

3 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the comparable periods in 2007. See Note 9 on page 16 for additional information regarding this divestiture. Total Systems revenue increased 9.9 percent (4 percent adjusted for currency) and 6.4 percent (down 1 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, compared to the prior year periods.

System z revenue increased 32.1 percent and 22.6 percent (23 percent and 14 percent adjusted for currency) in the second quarter and first six months of 2008 versus the second quarter and first six months of 2007, respectively. MIPS (millions of instructions per second) shipments increased 34 percent and 25 percent in the second quarter and first half of 2008 versus the second quarter and first half of 2007, respectively, reflecting strength in both traditional and specialty workloads. These increases were primarily driven by the new System z10 enterprise class server announced at the end of February. Customers are leveraging the z10 to reduce their technology and energy costs as they simplify their data centers. Revenue growth was particularly strong in the Americas and Europe, as well as in the Financial Services sector.

Converged System p revenue increased 28.7 percent and 15.8 percent (23 percent and 10 percent adjusted for currency) in the second quarter and first six months of 2008 versus the second quarter and first six months of 2007, respectively. The revenue growth was primarily driven by strong performance in midrange servers which increased 68 percent in the second quarter of 2008 versus the second quarter of 2007, following almost a 60 percent increase in the first quarter of 2008 versus the first quarter of 2007. High-end servers increased 21 percent in the second quarter, driven by the new POWER6 595 high-end server, which was announced early in the quarter. With POWER6 performance now available across the entire product line, this platform is well positioned to sustain its technical and market leadership.

The company s legacy System i revenue decreased 46.9 percent and 35.6 percent (50 percent and 40 percent adjusted for currency) in the second quarter and first six months of 2008 versus the same periods in 2007, respectively, as the company transitions the System i customer base to the converged POWER platform within System p.

System x revenue decreased 7.7 percent and 4.9 percent (13 percent and 10 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the second quarter and first six months of 2007. System x server revenue declined 5 percent and 2 percent in the second quarter and first six months of 2008 versus the comparable periods of 2007, respectively. High-end server revenue increased 23 percent and 18 percent for the second quarter and first six months of 2008 versus the same periods in 2007, respectively, offset by continued softness in low-end server revenue. Blades revenue increased 14 percent and 21 percent in the second quarter and first half of 2008 versus the second quarter and first half of 2007, respectively.

Storage revenue increased 11.8 percent and 10.8 percent (6 percent and 5 percent adjusted for currency) in the second quarter and first six months of 2008 versus the comparable periods in 2007. Total disk revenue increased 20 percent and 13 percent in the second quarter of 2008 and the first six months of 2008 versus the second quarter and first six months of 2007, respectively. These increases were driven by growth in Enterprise Disk (18 percent and 17 percent for the periods) on continued strength of the DS8000 product and increased midrange and low-end disk revenue. Tape revenue declined 2 percent in the second quarter of 2008 and increased 6 percent for the first six months of 2008 versus the comparable periods of 2007, respectively. The decline in the second quarter was due to a pause by clients in advance of the new high-end product which was announced in mid July.

Microelectronics OEM revenue decreased 19.3 percent and 19.4 percent (20 percent and 20 percent adjusted for currency), respectively, for the second quarter and first six months of 2008 versus the comparable periods of 2007, respectively. The primary mission of this business is to provide leadership technology for the systems business, as demonstrated during the first half of 2008 in the new z10 mainframe and POWER6 systems.

Retail Stores Solutions revenue increased 0.2 percent and declined 1.3 percent (down 4 percent and 6 percent adjusted for currency) in the second quarter and first six months of 2008 versus the same periods in 2007, respectively, while Printing Systems revenue decreased as a result of the divestiture of the business in the second quarter of 2007.

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Management Discussion (continued)

(Dollars in millions) For the three months ended June 30:	2008	2007	Yr. to Yr. Percent/ Margin Change
Systems and Technology:			
Gross profit	$ 2,013	$ 1,905	5.6%
Gross profit margin	38.6%	37.3%	1.3pts.

(Dollars in millions) For the six months ended June 30:	2008	2007	Yr. to Yr. Percent/ Margin Change
System and Technology:			
Gross profit	$ 3,575	$ 3,477	2.8%
Gross profit margin	37.9%	36.1%	1.8pts.

The increases in gross profit for the second quarter and first six months of 2008 versus the same periods of 2007 were primarily due to the increases in revenue in converged System p and System z.

Overall, gross margin in the second quarter increased 1.3 points versus the prior year. Converged System p performance contributed 1.6 points to the overall margin improvement, while the divestiture of the printing business contributed 0.6 points. These increases were offset by lower margins in Microelectronics OEM and legacy System i, which impacted the overall margin by 0.8 points and 0.2 points, respectively. First half gross margin increased 1.8 points compared to the first half of 2007. Converged System p, the divestiture of the printing business, Storage, Retail Stores Solutions and System x contributed 1.4 points, 0.6 points, 0.4 points, 0.2 points and 0.2 points, respectively, to this improvement, partially offset by lower margins in Microelectronics OEM and legacy System i, which impacted the overall margin by 1.0 points and 0.2 points, respectively.

Systems and Technology s pre-tax income increased 20.7 percent in the second quarter, and 27.5 percent for the first six months when compared to the prior year. Pre-tax margin increased 1.2 points and 1.3 points in the second quarter and first six months, respectively, versus the prior year periods reflecting the ongoing shift to higher value as clients virtualize their IT environments.

Software

(Dollars in millions) For the three months ended June 30:	2008	2007+	Yr. to Yr. Percent Change
Software Revenue:	$ 5,574	$ 4,777	16.7%
Middleware:	$ 4,311	$ 3,674	17.3%
Key Branded Middleware:	3,062	2,524	21.3
WebSphere Family			9.3
Information Management			29.5

Lotus			20.9
Tivoli			9.3
Rational			37.0
Other middleware	1,250	1,150	8.7
Operating systems	592	568	4.2
Product Lifecycle Management	267	259	3.2
Other	405	277	46.1

+ Reclassified to conform with 2008 presentation.

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Management Discussion (continued)

(Dollars in millions) For the six months ended June 30:		2008		2007	Yr. to Yr. Percent Change
Software Revenue:	$	10,421	$	9,028	15.4%
Middleware:	$	8,062	$	6,920	16.5%
Key Branded Middleware:		5,648		4,690	20.4
WebSphere Family					13.8
Information Management					28.4
Lotus					18.8
Tivoli					9.4
Rational					21.0
Other middleware		2,414		2,230	8.3
Operating systems		1,121		1,090	2.9
Product Lifecycle Management		515		510	1.1
Other		723		509	42.0

Software segment revenue increased 16.7 percent (9 percent adjusted for currency) to $5,574 million and 15.4 percent (8 percent adjusted for currency) to $10,421 million in the second quarter and first six months of 2008, respectively, versus the same periods in 2007, reflecting continued strong demand for the Key Branded Middleware products and contribution from acquisitions.

Revenue from Key Branded Middleware increased 21.3 percent (13 percent adjusted for currency) in the second quarter of 2008 and 20.4 percent (13 percent adjusted for currency) in the first six months of 2008, when compared to the same periods in 2007 and represented 55 percent (54 percent for first six months) of total quarterly software segment revenue. The company continues to invest in these products and expects the majority of its software revenue growth to come from this portion of the portfolio. Demand for the branded middleware products in the second quarter continued to reflect customers investments in software to improve their cost effectiveness and business performance, manage regulatory requirements and improve the productivity of their workforce.

Revenue from the WebSphere Family of products increased 9.3 percent (2 percent adjusted for currency) and 13.8 percent (6 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the same periods in 2007, led by double-digit growth in WebSphere Application Servers. Revenue from WebSphere products continues to increase as customers use the power of the Web to lower their cost and expand their reach. The company acquired InfoDyne Corporation in the quarter. InfoDyne complements the company s broad set of software products for the financial markets.

Information Management revenue increased 29.5 percent and 28.4 percent (21 percent and 20 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the second quarter and first six months of 2007. Revenue performance was driven by contribution from the Cognos acquisition as well as growth of over 30 percent in the distributed relational database product set. Information Management products provide information On Demand to help customers improve their business performance.

Lotus revenue increased 20.9 percent (12 percent adjusted for currency) and 18.8 percent (10 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the same periods in 2007 as customers continue to invest to improve the personal productivity of their workforce. This was the 15th consecutive quarter of revenue growth from Lotus software.

Tivoli revenue increased 9.3 percent and 9.4 percent (3 percent and 3 percent adjusted for currency) in the second quarter and first six months of 2008 versus the second quarter and first six months of 2007, led by double digit growth in Tivoli Security and Storage Management products. This was the 15th consecutive quarter of strong revenue growth in Storage Management software. These products provide clients with solutions that address complex regulatory requirements.

Rational revenue increased 37.0 percent and 21.0 percent (28 percent and 13 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, versus the comparable prior year periods. The Telelogic AB acquisition was completed in the quarter and contributed to the revenue growth in the brand. The Rational software tooling portfolio helps customers increase workforce productivity. With the addition of Telelogic, the company has the software tooling to support both applications and embedded systems development.

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Management Discussion (continued)

Operating systems product revenue increased 4.2 percent (decreased 2 percent adjusted for currency) and 2.9 percent (decreased 3 percent adjusted for currency) in the second quarter and first six months of 2008, respectively, when compared to the same period of 2007. Revenue growth in both the quarter and first six months was led by System z and converged System p operating systems software.

Other software segment revenue increased 46.1 percent (36 percent adjusted for currency) in the second quarter and 42.0 percent (33 percent adjusted for currency) in the first half of 2008 when compared to the same periods of 2007, reflecting continued growth in software-related services, such as consulting and education.

(Dollars in millions) **For the three months ended June 30:**	**2008**	**2007**	**Yr. to Yr. Percent/ Margin Change**
Software:			
Gross profit	$ 4,717	$ 4,057	16.3%
Gross profit margin	84.6%	84.9%	(0.3)pts.

(Dollars in millions) **For the six months ended June 30:**	**2008**	**2007**	**Yr. to Yr. Percent/ Margin Change**
Software:			
Gross profit	$ 8,783	$ 7,609	15.4%
Gross profit margin	84.3%	84.3%	0.0pts.

Software segment gross profit increased 16.3 percent to $4,717 million for the second quarter and 15.4 percent to $8,783 million for the first six months of 2008, driven primarily by revenue growth. Gross profit margin was 84.6 percent in the second quarter, down 0.3 points year to year and was 84.3 percent in the first six months, flat year to year. The software gross profit margin decline in the second quarter was driven primarily by the integration of the Cognos and Telelogic acquisitions.

The Software segment contributed $1,492 million of pre-tax profit in the second quarter of 2008, an increase of 19.4 percent, and $2,759 million in the first six months, an increase of 20.7 percent, when compared to the same periods of 2007. The segment pre-tax profit margin was 23.7 percent and 23.4 percent in the second quarter and first six months of 2008, up 0.2 points and 0.9 points, respectively, versus the prior year periods. Revenue growth and productivity, partially offset by increased costs of acquisitions, drove the pre-tax margin improvements.

Global Financing

See page 50 for a discussion of Global Financing s revenue and gross profit.

Geographic Revenue

In addition to the revenue presentation by reportable segment, the company also measures revenue performance on a geographic basis. The following geographic, regional and country-specific revenue performance excludes OEM revenue, which is presented separately.

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Management Discussion (continued)

(Dollars in millions) For the three months ended June 30:		2008		2007	Yr. to Yr. Percent Change
Total Revenue	$	26,820	$	23,772	12.8%
Geographies:	$	26,114	$	22,919	13.9%
Americas		10,926		10,095	8.2
Europe/Middle East/Africa		9,844		8,209	19.9
Asia Pacific		5,343		4,615	15.8
OEM	$	706	$	852	(17.2)%

(Dollars in millions) For the six months ended June 30:		2008		2007	Yr. to Yr. Percent Change
Total Revenue	$	51,322	$	45,801	12.1%
Geographies:	$	49,919	$	44,120	13.1%
Americas		20,849		19,242	8.4
Europe/Middle East/Africa		18,619		15,791	17.9
Asia Pacific		10,451		9,087	15.0
OEM	$	1,403	$	1,680	(16.5)%

Revenue increased consistently in all geographies when adjusted for currency in the second quarter of 2008 compared to the second quarter of 2007, and growth rates accelerated sequentially from the first-quarter 2008. Adjusted for currency, revenue growth was led by Europe and the growth market countries.

Americas revenue increased 8.2 percent (6 percent adjusted for currency) in the second quarter. The U.S. had another good quarter with revenue increasing 5.0 percent compared to the second quarter of 2007. Latin America revenue increased 29.6 percent (15 percent adjusted for currency) and Canada revenue increased 19.7 percent (11 percent adjusted for currency).

Europe/Middle East/Africa (EMEA) revenue increased 19.9 percent (7 percent adjusted for currency) in the second quarter of 2008 when compared to the second quarter of 2007. Adjusted for currency, the rate of growth improved over the past several quarters. In the major countries, Germany revenue increased 24.7 percent (7 percent adjusted for currency), France revenue increased 23.2 percent (increased 6 percent adjusted for currency), Italy revenue increased 21.3 percent (5 percent adjusted for currency), the U.K. revenue increased 3.2 percent (4 percent adjusted for currency) and Spain revenue increased 27.5 percent (10 percent adjusted for currency).

Asia Pacific revenue increased 15.8 percent (6 percent adjusted for currency) in the second quarter of 2008 versus the prior year second quarter. Growth was led by the India, Greater China, Australia/New Zealand, Korea and ASEAN regions, where the economies and IT markets continue to expand, with combined revenue growth of 18.2 percent (13 percent adjusted for currency). Japan revenue increased 13.1 percent, as reported, in the quarter, but declined 2 percent adjusted for currency.

Across the geographies, aggregate revenue from the countries comprising the company s new growth markets organization increased 20.8 percent (14 percent adjusted for currency) in the second quarter of 2008 and represented approximately 18 percent of the company s geographic revenue in the quarter. Revenue performance in these markets accelerated sequentially from the first quarter as the company continues to invest to capture the opportunities created from the build-out of the infrastructures in these high growth economies. These rapidly growing markets are expected to continue to drive the company s revenue and profit in the second half of 2008. The BRIC countries of Brazil, Russia, India and China together grew 30.5 percent (20 percent adjusted for currency), led by growth in India of 35.4 percent (37 percent adjusted for currency). Brazil revenue increased 39.8 percent (17 percent adjusted for currency), China revenue increased 26.2 percent (19 percent adjusted for currency) while Russia revenue increased 2.8 percent (3 percent adjusted for currency) compared to a very strong second quarter, 2007.

OEM revenue decreased 17.2 percent (18 percent adjusted for currency) in the quarter driven by reduced demand in the Microelectronics OEM business.

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Management Discussion (continued)

Americas revenue for the first six months of 2008 was $20.8 billion, an increase of 8.4 percent (6 percent adjusted for currency) when compared to the same period of 2007. The U.S. increased 5.7 percent, Canada increased 18.1 percent (5 percent adjusted for currency) and Latin America increased 24.6 percent (11 percent adjusted for currency).

EMEA revenue was $18.6 billion, up 17.9 percent (6 percent adjusted for currency) in the first six months of 2008 versus the same period in 2007. Revenue increased in all major countries with Spain up 25.6 percent (9 percent adjusted for currency), Italy 18.6 percent (3 percent adjusted for currency), France 18.6 percent (3 percent adjusted for currency), Germany 18.4 percent (3 percent adjusted for currency) and the UK 4.0 percent (4 percent adjusted for currency).

Asia Pacific revenue increased 15.0 percent (5 percent adjusted for currency) to $10.5 billion in the first six months of 2008 when compared to the first six months of 2007. Revenue increased in all geographic regions and was led by performance in China (increased 22.1 percent as reported, 15 percent adjusted for currency), India (increased 39.0 percent as reported, 34 percent adjusted for currency) and Australia/New Zealand (increased 16.8 percent as reported, 3 percent adjusted for currency). Japan revenue increased 11.9 percent as reported, but decreased 2 percent adjusted for currency.

Across the geographies, aggregate revenue from the growth market countries increased 19.8 percent (13 percent adjusted for currency) in the first six months of 2008 and represented approximately 17 percent of the company s geographic revenue. Revenue in the key countries of Brazil, Russia, India and China together grew 28.6 percent (17 percent adjusted for currency) in the first half of 2008 versus the first half of 2007. Brazil revenue increased 33.5 percent (11 percent adjusted for currency), Russia 16.3 percent (16 percent adjusted for currency), India 39.0 percent (34 percent adjusted for currency) and China 22.1 percent (15 percent adjusted for currency).

Expense

The company continued to execute its investment strategy in the second quarter and first half of 2008, aligning investments to growth opportunities on a global basis. The total expense and other income to revenue ratio was 29.0 percent and 28.7 percent for the second quarter and first six months of 2008 versus 28.6 percent and 28.6 percent for the second quarter and first six months of 2007, respectively. Total expense and other income increased 14.6 percent and 12.8 percent in the second quarter and first half of 2008, respectively. Overall, these increases were primarily driven by approximately 8 points and 7 points due to the effects of currency and approximately 6 points and 5 points due to acquisitions for the second quarter and first six months of 2008 versus the comparable periods in 2007, respectively.

For additional information regarding Total expense and other income, see the following analyses by category.

Selling, general and administrative expense

(Dollars in millions)	Yr. To Yr. Percent