

Management Discussion

International Business Machines Corporation and Subsidiary Companies

GAAP Reconciliation

The tables below provide a reconciliation of the company's income statement results as reported under GAAP to its operating earnings presentation which is a non-GAAP measure. The company's calculation of operating (non-GAAP) earnings, as presented, may differ from similarly titled measures reported by other companies. Please refer to the "Operating (non-GAAP) Earnings" section for management's rationale for presenting operating earnings information.

(\$ in millions except per share amounts)

For the year ended December 31, 2019:	GAAP	Acquisition-Related Adjustments	Retirement-Related Adjustments	U.S. Tax Reform Charges	Operating (non-GAAP)
Gross profit	\$36,488	\$ 547	\$ —	\$ —	\$37,035
Gross profit margin	47.3%	0.7 pts.	— pts.	— pts.	48.0%
SG&A	\$20,604	\$(1,044)	\$ —	\$ —	\$19,560
RD&E	5,989	(53)	—	—	5,936
Other (income) and expense	(968)	152	(615)	—	(1,431)
Interest expense	1,344	(228)	—	—	1,116
Total expense and other (income)	26,322	(1,173)	(615)	—	24,533
Pre-tax income from continuing operations	10,166	1,721	615	—	12,503
Pre-tax margin from continuing operations	13.2%	2.2 pts.	0.8 pts.	— pts.	16.2%
Provision for income taxes*	\$ 731	\$ 378	\$ 103	\$(146)	\$ 1,067
Effective tax rate	7.2%	2.0 pts.	0.5 pts.	(1.2) pts.	8.5%
Income from continuing operations	\$ 9,435	\$ 1,343	\$ 512	\$ 146	\$11,436
Income margin from continuing operations	12.2%	1.7 pts.	0.7 pts.	0.2 pts.	14.8%
Diluted earnings per share from continuing operations	\$ 10.57	\$ 1.50	\$0.58	\$0.16	\$ 12.81

* The tax impact on operating (non-GAAP) pre-tax income is calculated under the same accounting principles applied to the GAAP pre-tax income which employs an annual effective tax rate method to the results.

(\$ in millions except per share amounts)

For the year ended December 31, 2018 :	GAAP	Acquisition-Related Adjustments	Retirement-Related Adjustments	U.S. Tax Reform Charges	Operating (non-GAAP)
Gross profit	\$36,936	\$ 372	\$ —	\$ —	\$37,307
Gross profit margin	46.4%	0.5 pts.	— pts.	— pts.	46.9%
SG&A	\$19,366	\$(451)	\$ —	\$ —	\$18,915
RD&E	5,379	—	—	—	5,379
Other (income) and expense	1,152	(2)	(1,572)	—	(422)
Interest expense	723	—	—	—	723
Total expense and other (income)	25,594	(453)	(1,572)	—	23,569
Pre-tax income from continuing operations	11,342	824	1,572	—	13,739
Pre-tax margin from continuing operations	14.3%	1.0 pts.	2.0 pts.	— pts.	17.3%
Provision for income taxes*	\$ 2,619	\$ 176	\$ 324	\$(2,037)	\$ 1,082
Effective tax rate	23.1%	(0.1) pts.	(0.3) pts.	(14.8) pts.	7.9%
Income from continuing operations	\$ 8,723	\$ 649	\$ 1,248	\$ 2,037	\$12,657
Income margin from continuing operations	11.0%	0.8 pts.	1.6 pts.	2.6 pts.	15.9%
Diluted earnings per share from continuing operations	\$ 9.51	\$0.71	\$ 1.36	\$ 2.23	\$ 13.81

* The tax impact on operating (non-GAAP) pre-tax income is calculated under the same accounting principles applied to the GAAP pre-tax income which employs an annual effective tax rate method to the results.