

Systems revenue of \$8,034 million decreased 2.0 percent year to year as reported (2 percent adjusted for currency) driven by strong IBM Z performance in 2017 and continued price pressures impacting Storage Systems in a competitive environment. Both hardware platforms were down year to year for the full year, as reported and adjusted for currency. This performance was partially offset by strong growth in Power Systems (which grew as reported and adjusted for currency in 2018) with strong performance in POWER9-based systems and Linux throughout the year. Within Systems, cloud revenue of \$3.1 billion decreased 10 percent as reported and adjusted for currency compared to the prior year reflecting IBM Z product cycle dynamics.

(\$ in millions)

For the year ended December 31:	2018	2017	Yr.-to-Yr. Percent/ Margin Change
<b>Systems</b>			
External Systems Hardware gross profit	\$2,590	\$2,893	(10.5)%
External Systems Hardware gross profit margin	40.7%	44.6%	(3.8)pts.
External Operating Systems Software gross profit	\$1,412	\$1,469	(3.9)%
External Operating Systems Software gross profit margin	84.5%	86.4%	(1.9)pts.
External total gross profit	\$4,002	\$4,362	(8.2)%
External total gross profit margin	49.8%	53.2%	(3.4)pts.
Pre-tax income	\$ 904	\$1,128	(19.9)%
Pre-tax margin	10.2%	12.6%	(2.4)pts.

The Systems gross profit margin decrease year to year was driven by the mix away from IBM Z and margin declines in Power Systems and Storage Systems. The pre-tax income decline was driven by the strong performance in IBM Z in the prior year and the continued investment in innovation across the Systems portfolio.

### Global Financing

(\$ in millions)

For the year ended December 31:	2018	2017	Yr.-to-Yr. Percent Change
<b>Results of Operations</b>			
External revenue	\$1,590	\$1,696	(6.3)%
Internal revenue	1,610	1,471	9.5
Total revenue	\$3,200	\$3,168	1.0%
Pre-tax income	\$1,361	\$1,278	6.5%

The increase in Global Financing total revenue was driven by an increase in internal revenue, partially offset by a decrease in external revenue. Internal revenue grew 9.5 percent driven by increases in internal financing (up 17.6 percent) and internal used equipment sales (up 6.8 percent). External revenue declined 6.3 percent due to a decrease in external used equipment sales (down 30.8 percent), partially offset by an increase in external financing (up 4.9 percent). The increase in Global Financing pre-tax income was primarily driven by an increase in gross profit and a decrease in total expense.

### GAAP Reconciliation

The table below provides a reconciliation of our consolidated gross profit and gross margin as reported under GAAP to our operating earnings presentation which is a non-GAAP measure. Management's calculation of operating (non-GAAP) earnings, as presented, may differ from similarly titled measures reported by other companies. Refer to the "Operating (non-GAAP) Earnings" section for management's rationale for presenting operating earnings information.

(\$ in millions)

For the year ended December 31:	GAAP	Acquisition- Related Adjustments	Operating (non-GAAP)
<b>2018</b>			
Gross profit	\$36,936	\$372	\$37,307
Gross profit margin	46.4%	0.5 pts.	46.9%
<b>2017</b>			
Gross profit	\$36,943	\$449	\$37,392
Gross profit margin	46.7%	0.6 pts.	47.2%

### OTHER INFORMATION

#### Looking Forward

IBM is focused on chapter 2 of clients' digital reinventions, which includes scaling AI and shifting mission-critical workloads to the cloud. To address the cloud opportunity, enterprises need to be able to move and manage data, services and workflows across multiple clouds and on-premises. They also need to be able to address security concerns, data protection and protocols, availability and cloud management. This is best addressed with a hybrid, multi-cloud, open approach, based on a foundation of Linux, with containers and Kubernetes. On July 9, 2019, we closed the acquisition of Red Hat, which significantly changed the cloud landscape and will accelerate our high value business model. Together, IBM and Red Hat offer the leading hybrid, multi-cloud platform built on open source technologies.

The combination of IBM and Red Hat is already off to a strong start. In August, we introduced Cloud Paks, cloud-native software that brings together IBM middleware, AI, management and security and Red Hat's OpenShift platform. As we look forward, the largest hybrid cloud opportunity is in services: advising clients on architectural choices, moving workloads, building new applications and managing those applications. With GBS and GTS expertise in digital reinventions and managing mission-critical workloads, we are well positioned to help our