

# INTERNATIONAL BUSINESS MACHINES CORP

## FORM 10-K (Annual Report)

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**Note T.****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. See note A, "Significant Accounting Policies," on page 76 for additional information.

The following table presents total stock-based compensation cost included in the Consolidated Statement of Earnings.

(\$ in millions)

For the year ended December 31:	2009	2008	2007
Cost	\$ 94	\$ 116	\$ 166
Selling, general and administrative	417	484	480
Research, development and engineering	47	58	68
Other (income) and expense*	—	—	(1)
Pre-tax stock-based compensation cost	558	659	713
Income tax benefits	(221)	(224)	(248)
<b>Total stock-based compensation cost</b>	<b>\$ 337</b>	<b>\$ 435</b>	<b>\$ 464</b>

\* Reflects the one-time effects of the divestiture of the Printing Systems business in the second quarter of 2007.

Total unrecognized compensation cost related to non-vested awards at December 31, 2009 and 2008 was \$1,082 million and \$1,076 million, respectively, and is expected to be recognized over a weighted-average period of approximately 2.5 years.

There was no significant capitalized stock-based compensation cost at December 31, 2009, 2008 and 2007.

**Incentive Awards**

Stock-based incentive awards are provided to employees under the terms of the company's long-term performance plans (the "Plans"). The Plans are administered by the Executive Compensation and Management Resources Committee of the Board of Directors (the "Committee"). Awards available under the Plans principally include stock options, restricted stock units, performance share units or any combination thereof. The nonmanagement members of the IBM Board of Directors also received stock options under a director stock option plan through December 31, 2006. The director stock option plan was terminated effective January 1, 2007.

The amount of shares originally authorized to be issued under the company's existing Plans was 274.1 million at December 31, 2009 and 2008. In addition, certain incentive awards granted under previous Plans, if and when those awards were canceled, could be reissued under the company's existing Plans. As such, 66.4 million and 47.6 million additional awards were considered authorized to be issued under the company's existing Plans as of December 31, 2009 and 2008, respectively. There were 1.9 million and 23.8 million option awards outstanding (which were included in the total options outstanding at December 31, 2009 and 2008, respectively) under previous Plans that, if and when canceled, would increase the number of authorized shares. There were 140.4 million and 130.1 million unused shares available to be granted under the Plans as of December 31, 2009 and 2008, respectively.

Under the company's long-standing practices and policies, all awards are approved prior to or on the date of grant. The exercise price of at-the-money stock options is the average of the high and low market price on the date of grant. The options

approval process specifies the individual receiving the grant, the number of options or the value of the award, the exercise price or formula for determining the exercise price and the date of grant. All awards for senior management are approved by the Committee. All awards for employees other than senior management are approved by senior management pursuant to a series of delegations that were approved by the Committee, and the grants made pursuant to these delegations are reviewed periodically with the Committee. Awards that are given as part of annual total compensation for senior management and other employees are made on specific cycle dates scheduled in advance. With respect to awards given in connection with promotions or new hires, the company's policy requires approval of such awards prior to the grant date, which is typically the date of the promotion or the date of hire. The exercise price of these options is the average of the high and low market price on the date of grant.

### Stock Options

Stock Options are awards which allow the employee to purchase shares of the company's stock at a fixed price. Stock options are granted at an exercise price equal to the company stock price on the date of grant. These awards, which generally vest 25 percent per year, are fully vested four years from the date of grant and have a contractual term of ten years. The company also had a stock-based program under the Plans for its senior executives, designed to drive improved performance and increase the ownership executives have in the company. These executives had the opportunity to receive at-the-money stock options by agreeing to defer a certain percentage of their annual incentive compensation into IBM equity, where it is held for three years or until retirement. In 2005, this program was expanded to cover all executives of the company. Options under this program become fully vested three years from the date of grant and have a contractual term of ten years. The plan element permitting executives to defer annual incentive compensation into IBM equity and receive at-the-money stock options was terminated at December 31, 2006.

The company estimates the fair value of stock options using the Black-Scholes valuation model. Key inputs and assumptions used to estimate the fair value of stock options include the grant price of the award, the expected option term, volatility of the company's stock, the risk-free rate and the company's dividend yield. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by the company.

The fair value of each stock option grant was estimated at the date of grant using a Black-Scholes option pricing model. The following table presents the weighted-average assumptions used in the valuation and the resulting weighted-average fair value per option granted.

For the year ended December 31:	2009 *	2008 *	2007
Option term (years)**	—	—	5
Volatility +	—	—	23.1%
Risk-free interest rate (zero coupon U.S. treasury note)	—	—	4.5%
Dividend yield	—	—	1.4%
Weighted-average fair value per option granted	—	—	\$ 26

\* During the years ended December 31, 2009 and 2008, the company did not grant stock options.

\*\* The option term is the number of years that the company estimates, based upon history, that options will be outstanding prior to exercise or forfeiture.

+ The company's estimates of expected volatility are principally based on daily price changes of the company's stock over the expected option term, as well as the additional requirements included in accounting guidance on share-based payments.

The following table summarizes option activity under the Plans during the years ended December 31, 2009, 2008 and 2007.

	2009		2008		2007	
	Wtd. Avg. Exercise Price	No. of Shares Under Option	Wtd. Avg. Exercise Price	No. of Shares Under Option	Wtd. Avg. Exercise Price	No. of Shares Under Option
Balance at January 1	\$ 102	119,307,170	\$ 100	157,661,257	\$ 95	207,663,223
Options granted	—	—	—	—	103	1,087,381
Options exercised	120	(28,100,192)	91	(36,282,000)	77	(46,961,380)
Options canceled/expired	127	(17,996,521)	109	(2,072,087)	106	(4,127,967)
<b>Balance at December 31</b>	<b>\$ 98</b>	<b>73,210,457</b>	<b>\$ 102</b>	<b>119,307,170</b>	<b>\$ 100</b>	<b>157,661,257</b>
<b>Exercisable at December 31</b>	<b>\$ 98</b>	<b>72,217,126</b>	<b>\$ 102</b>	<b>114,445,381</b>	<b>\$ 100</b>	<b>144,092,169</b>

The shares under option at December 31, 2009 were in the following exercise price ranges:

Options Outstanding				
Exercise Price Range	Wtg. Avg. Exercise Price	Number of Shares Under Option	Aggregate Intrinsic Value	Wtd. Avg. Remaining Contractual Life (in years)
\$61-\$85	\$ 77	17,468,272	\$ 940,917,103	3.2
\$86-\$105	98	32,894,001	1,067,822,966	3.4
\$106 and over	112	22,848,184	432,260,579	1.5
	<u>\$ 98</u>	<u>73,210,457</u>	<u>\$ 2,441,000,648</u>	<u>2.8</u>

  

Options Exercisable				
Exercise Price Range	Wtd. Avg. Exercise Price	Number of Shares Under Option	Aggregate Intrinsic Value	Wtd. Avg. Remaining Contractual Life (in years)
\$61-\$85	\$ 77	17,439,702	\$ 939,529,901	3.2
\$86-\$105	98	31,929,240	1,039,848,239	3.3
\$106 and over	112	22,848,184	432,260,579	1.5
	<u>\$ 98</u>	<u>72,217,126</u>	<u>\$ 2,411,638,719</u>	<u>2.7</u>

In connection with various acquisition transactions, there were an additional 1.1 million options outstanding at December 31, 2009, as a result of the company's assumption of options granted by the acquired entities. The weighted-average exercise price of these options was \$76 per share.

#### Exercises of Employee Stock Options

The total intrinsic value of options exercised during the years ended December 31, 2009, 2008 and 2007 was \$639 million, \$1,073 million and \$1,414 million, respectively. The total cash received from employees as a result of employee stock option exercises for the years ended December 31, 2009, 2008 and 2007 was approximately \$2,744 million, \$3,320 million and \$3,619 million, respectively. In connection with these exercises, the tax benefits realized by the company for the years ended December 31, 2009, 2008 and 2007 were \$243 million, \$356 million and \$481 million, respectively.

The company settles employee stock option exercises primarily with newly issued common shares and, occasionally, with treasury shares. Total treasury shares held at December 31, 2009 and 2008 were approximately 822 million and 758 million shares, respectively.

#### Stock Awards

In lieu of stock options, currently the company grants its employees stock awards. These awards are made in the form of Restricted Stock Units (RSUs), including Retention Restricted Stock Units (RRSUs), or Performance Share Units (PSUs). RSUs are stock awards granted to employees that entitle the holder to shares of common stock as the award vests, typically over a one- to five-year period. The fair value of the awards is determined and fixed on the grant date based on the company's stock price. For 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.

The tables on page 108 summarize RSU and PSU activity under the Plans during the years ended December 31, 2009, 2008 and 2007.

## RSUs

	2009		2008		2007	
	Wtd. Avg. Grant Price	Number of Units	Wtd. Avg. Grant Price	Number of Units	Wtd. Avg. Grant Price	Number of Units
Balance at January 1	\$ 100	12,397,515	\$ 94	11,887,746	\$ 84	10,217,258
RSUs granted	105	4,432,449	107	4,587,011	104	4,929,141
RSUs released	99	(2,748,613)	88	(3,526,580)	77	(2,747,110)
RSUs canceled/forfeited	101	(675,697)	98	(550,662)	88	(511,543)
<b>Balance at December 31</b>	<b>\$ 102</b>	<b>13,405,654</b>	<b>\$ 100</b>	<b>12,397,515</b>	<b>\$ 94</b>	<b>11,887,746</b>

## PSUs

	2009		2008		2007	
	Wtd. Avg. Grant Price	Number of Units	Wtd. Avg. Grant Price	Number of Units	Wtd. Avg. Grant Price	Number of Units
Balance at January 1	\$ 102	3,078,694	\$ 93	2,783,823	\$ 89	2,417,378
PSUs granted at target	101	1,568,129	119	1,058,381	103	1,156,708
Additional shares earned above target*	83	396,794	91	275,190	95	216,826
PSUs released	83	(1,440,099)	91	(860,705)	96	(926,386)
PSUs canceled/forfeited	111	(126,781)	102	(177,995)	90	(80,703)
<b>Balance at December 31**</b>	<b>\$ 107</b>	<b>3,476,737</b>	<b>\$ 102</b>	<b>3,078,694</b>	<b>\$ 93</b>	<b>2,783,823</b>

\* Represents additional shares issued to employees after vesting of PSUs because final performance metrics exceeded specified targets.

\*\* Represents the number of shares expected to be issued based on achievement of grant date performance targets. The actual number of shares issued depends on the company's performance against specified targets over the vesting period.

The remaining weighted-average contractual term of RSUs at December 31, 2009, 2008 and 2007 is the same as the period over which the remaining cost of the awards will be recognized, which is approximately three years. The fair value of RSUs granted during the years ended December 31, 2009, 2008 and 2007 was \$467 million, \$490 million and \$513 million, respectively. The total fair value of RSUs vested and released during the years ended December 31, 2009, 2008 and 2007 was \$272 million, \$311 million and \$213 million, respectively. As of December 31, 2009, 2008 and 2007, there was \$892 million, \$863 million and \$740 million, respectively, of unrecognized compensation cost related to non-vested RSUs. The company received no cash from employees as a result of employee vesting and release of RSUs for the years ended December 31, 2009, 2008 and 2007.

PSUs are stock awards where the number of shares ultimately received by the employee depends on the company's performance against specified targets and typically vest over a three-year period. The fair value of each PSU is determined on the grant date, based on the company's stock price, and assumes that performance targets will be achieved. Over the performance period, the number of shares of stock that will be issued is adjusted upward or downward based upon the probability of achievement of performance targets. The ultimate number of shares issued and the related compensation cost recognized as expense will be based on a comparison of the final performance metrics to the specified targets. The fair value of PSUs granted during the years ended December 31, 2009, 2008 and 2007 was \$159 million, \$126 million and \$116 million, respectively. Total fair value of PSUs vested and released during the years ended December 31, 2009, 2008 and 2007 was \$120 million, \$78 million and \$88 million, respectively.

In connection with vesting and release of RSUs and PSUs, the tax benefits realized by the company for the years ended December 31, 2009, 2008 and 2007 were \$156 million, \$165 million and \$133 million, respectively.

## IBM Employees Stock Purchase Plan

The company maintains a non-compensatory Employees Stock Purchase Plan (ESPP). The ESPP enables eligible participants to purchase full or fractional shares of IBM common stock at a five-percent discount off the average market price on the day of purchase through payroll deductions of up to 10 percent of eligible compensation. Eligible compensation includes any compensation received by the employee during the year. The ESPP provides for offering periods during which shares may be purchased and continues as long as shares remain available under the ESPP, unless terminated earlier at the discretion of the Board of Directors. Individual ESPP participants are restricted from purchasing more than \$25,000 of common stock in one calendar year or 1,000 shares in an offering period.

Employees purchased 3.2 million, 3.5 million and 4.0 million shares under the ESPP during the years ended December 31, 2009, 2008 and 2007, respectively. Cash dividends declared and paid by the company on its common stock also include cash dividends on the company stock purchased through the ESPP. Dividends are paid on full and fractional shares and can be reinvested in the ESPP. The company stock purchased through the ESPP is considered outstanding and is included in the weighted-average outstanding shares for purposes of computing basic and diluted earnings per share.

Approximately 9.6 million, 12.8 million and 16.3 million shares were available for purchase under the ESPP at December 31, 2009, 2008 and 2007, respectively.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 2-77235, 33-29022, 33-33458, 33-34406, 33-53777, 33-60225, 33-60227, 33-60237, 33-60815, 333-01411, 33-52931, 33-33590, 333-76914, 333-87708, 333-09055, 333-23315, 333-31305, 333-41813, 333-44981, 333-48435, 333-81157, 333-87751, 333-87859, 333-87925, 333-30424, 333-33692, 333-36510, 333-102872, 333-102870, 333-103471, 333-104806, 333-114190, 333-131934, 333-138326, 333-138327, 333-148964 and 333-151673) and the Registration Statements on Form S-3 (Nos. 33-49475(1), 33-31732, 333-03763, 333-27669, 333-32690, 333-101034, 333-145104 and 333-145104-01) of International Business Machines Corporation of our report dated February 23, 2010, relating to the financial statements and effectiveness of internal control over financial reporting, which appears in the 2009 Annual Report to Shareholders, which is incorporated in this Annual Report on Form 10-K. We also consent to the incorporation by reference of our report dated February 23, 2010, relating to the Financial Statement Schedule, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP  
New York, New York  
February 23, 2010