IBM 2Q 2025 Earnings

Conference Call Transcript

IBM Participants:

Arvind Krishna – Chairman, President and Chief Executive Officer
James Kavanaugh – SVP and Chief Financial Officer
Olympia McNerney – Global Head of Investor Relations

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MANAGEMENT DISCUSSION

Operator: Welcome, and thank you for standing by. At this time, all participants are in a listen-only mode. Today's conference is being recorded. If you have any objections, you may disconnect at this time. Now, I will turn the meeting over to Olympia McNerney, IBM's Global Head of Investor Relations. Olympia, you may begin.

Olympia McNerney: Thank you. I'd like to welcome you to IBM's second quarter 2025 earnings presentation. I'm Olympia McNerney, and I'm here today with Arvind Krishna, IBM's Chairman, President and Chief Executive Officer, and Jim Kavanaugh, IBM's Senior Vice President and Chief Financial Officer. We'll post today's prepared remarks on the IBM investor website within a couple of hours, and a replay will be available by this time tomorrow.

To provide additional information to our investors, our presentation includes certain non-GAAP measures. For example, all of our references to revenue and signings growth are at constant currency. We've provided reconciliation charts for these and other non-GAAP financial measures at the end of the presentation, which is posted to our investor website.

Finally, some comments made in this presentation may be considered forward looking under the Private Securities Litigation Reform Act of 1995. These statements involve factors that could cause our actual results to differ materially. Additional information about these factors is included in the company's SEC filings.

So with that, I'll turn the call over to Arvind.

Arvind Krishna: Thank you for joining us today. In the second quarter, we delivered solid results across revenue, profit, and cash, exceeding our expectations. Our performance this quarter was led by Software and Infrastructure, as demand remains high for technology that improves productivity, reduces costs, and fuels innovation. While the operating environment remains dynamic, these results reflect the strength of our portfolio and the resiliency of our business model.

Before I get deeper into the results, let me touch on the broader economic backdrop. I'll start by saying that we appreciate the administration's priority on economic growth and focused regulation, which will strengthen the US competitive position. We believe this will result in long-term value creation and enable technology to contribute to economic growth. Technology continues to serve as a key competitive advantage, allowing businesses to scale, drive efficiencies and fuel growth and we saw this play out in the quarter. While not a major factor overall, geopolitical tensions are prompting a few clients to move cautiously. US federal spending was also somewhat constrained in the first half, but we do not expect it to create long-term headwinds.

Let me now turn to our execution in the quarter. Our strategy remains focused: hybrid cloud and artificial intelligence. This strategy is built on five reinforcing elements – client trust, flexible and open platforms, sustained innovation, deep domain expertise, and a broad ecosystem. Together, they form a flywheel for growth, which again played out this quarter. In Software, we continue to see momentum, including 14% growth in Red Hat. HashiCorp is also off to a great start, accelerating performance in our first full quarter since closing, and seeing early wins with joint Ansible and Terraform product synergies. Infrastructure was up 11%, driven by a very strong start to z17. The new IBM Z is an embodiment of the hybrid cloud and AI capabilities we bring to clients. IBM Z continues to deliver on its core strengths: AI, security, and scalable capacity driving its enduring nature with clients. These results were balanced by Consulting performance which continues to be impacted by the demand environment.

AI remains a powerful driver of transformation for our clients and for IBM. We are transforming our enterprise operations using technology and embedding AI across more than 70 workflows, leveraging our own IBM software solutions across hybrid cloud, automation, and AI, to drive competitive advantage. What differentiates IBM is the breadth of our AI offerings—with an innovative technology stack and consulting business at scale, and our Client Zero lens. Our GenAI book of business now stands at over $7.5 billion, inception-to-date, with momentum accelerating quarter over quarter. We're seeing strong demand for our AI agents and assistants, RHEL AI, Granite models, as well as an accelerating need for our Consulting services to deploy AI. Just last week, IBM was recognized as an Emerging Leader in the first-ever Gartner® Emerging Market Quadrant™ for Gen AI Consulting & Implementation Services.

Our Client Zero experience has resonated with companies like UPS, Verizon, Mizuho, and Nestlé, who are using our AI tools to unlock data, drive automation, and reduce operational friction. As clients focus on scaling AI and delivering ROI, our progress on internal productivity is fueling and accelerating our client engagements. We're also expanding our partner ecosystem to deliver AI at scale. This quarter, we announced new or deepened collaborations with Oracle, Box, AWS, Salesforce, Microsoft, EY, Finastra, and WPP. Each is aimed at embedding watsonx into core business workflows.

At Think 2025, we introduced new capabilities across our portfolio. We launched new features for watsonx Orchestrate, which allows users to build custom AI agents in minutes with no coding required. There are now more than 150 pre-built, domain-specific agents in our catalog, spanning HR, sales, procurement, and IT. Our partners are building on this as well – integrating agents from Oracle, Salesforce, AWS, and others. And Orchestrate supports the full agent lifecycle, from building to managing and governing agents across business functions, regardless of which AI models they are built with. We expanded watsonx.data to enable our enterprise clients to get easy access and drive

value from their trusted, unstructured data. And our webMethods Hybrid Integration simplifies how clients connect workflows, APIs, and data across hybrid environments.

As agentic AI matures, we believe it will power over a billion new applications and a massive expansion in code, driving a critical need for automation. Our Automation portfolio is uniquely positioned to deliver these solutions to clients across hybrid cloud. SAP plans to deploy our high value automation portfolio including Red Hat Ansible Automation Platform and HashiCorp Terraform and Vault, highlighting the opportunity we have in product synergies.

Innovation also extends to Infrastructure. This quarter, we launched z17, our most advanced mainframe yet. It features the new Telum II processor delivering more than 450 billion AI inference operations per day with millisecond latency. That means AI models can run directly on transactional workloads with no external servers needed. The Spyre accelerator, which will be available in the fourth quarter, will enable watsonx Code Assistant for Z and watsonx Assistant for Z to run natively on z17. As more than 70% of IBM Z clients continue to expand or maintain capacity, our software stack is bringing even more innovation to IBM Z including watsonx Code Assistant for Z, watsonx.data, Concert and HashiCorp Vault. In July, we introduced Power11 to deliver the performance, resiliency, and scalability enterprises need to run mission-critical data-intensive workloads across hybrid environments. And we have announced Rise with SAP on Power11.

In Quantum, we achieved a major milestone with the deployment of IBM Quantum System Two in Japan, in partnership with RIKEN. This marks the first installation outside the United States and underscores our commitment to global leadership in quantum computing. To complement our organic innovation, M&A remains important. We closed the acquisition of DataStax this quarter, adding real-time, scalable data capabilities to support AI-driven applications.

In closing, we remain focused on consistent execution and long-term growth. While the environment remains dynamic, we have a disciplined strategy and a durable business model. Given our first half performance, we continue to expect accelerating revenue growth to 5% plus and are raising our expectations for free cash flow to above $13.5 billion for the year. We're confident in our ability to deliver sustainable, profitable growth. Jim, over to you.

James Kavanaugh: Thanks Arvind. In the second quarter, we delivered $17.0 billion in revenue, $4.7 billion of Adjusted EBITDA, $3.2 billion of operating pre-tax income and operating earnings per share of $2.80. And through the first half we generated $4.8 billion dollars of free cash flow, our highest first half free cash flow margin in many years. Our revenue growth, mix and productivity drove 200 basis points of Adjusted EBITDA margin expansion, 16% Adjusted EBITDA growth and 15% operating earnings per share growth. We exceeded our expectations on revenue, profitability, Adjusted EBITDA and earnings per share, highlighting the strength of our portfolio and resiliency of our business model.

Our revenue for the quarter grew over 5% at constant currency. Software grew 8% this quarter as we continue to benefit from our high-value, annual recurring revenue base which grew to $22.7 billion, up 10% since last year. Red Hat growth accelerated one point sequentially to 14%, fueled by another quarter of double-digit bookings and demand for our hybrid cloud solutions. We gained market share across each of our key solutions, led by OpenShift growing revenue more than 20%, with ARR now at $1.7 billion. Automation grew 14%, with HashiCorp off to a strong start. We accelerated bookings growth in the first full quarter since closing, fueled by IBM's global go-to-market reach and deepening product and technology synergies that are unlocking new customer value. Data was up 7% fueled by strength across our AI offerings. And Transaction Processing revenue declined two percent in the quarter, reflecting where we are in the new z17 cycle as clients prioritized hardware spend at the beginning of a new program, as you can see in our strong IBM Z results.

Infrastructure revenue grew 11% this quarter, with Hybrid Infrastructure up 19% and Infrastructure Support down 3%. Within Hybrid Infrastructure, IBM Z was up 67%, reflecting early strength in our z17 program as AI use cases are resonating strongly with clients. The success of our launch highlights the enduring nature of the IBM Z platform through the value of our continued innovation around AI workloads and the realization that hybrid cloud is the dominant architecture. Clients continue to invest in IBM Z because it remains the backbone for mission-critical workloads offering unmatched reliability, scalability, security and performance – while seamlessly integrating with hybrid cloud and AI strategies. Distributed Infrastructure revenue was down 17% with product cycle dynamics impacting Power, with the recent announcement of Power11 in July. Power11, our next-generation platform, features advancements across the processor, hardware architecture and virtualization software stack. While Storage was impacted by the new IBM Z cycle as clients prioritized hardware spend, our early strength in z17 and growth in installed MIPS capacity drives a long-term benefit given the 3-4x Z stack multiplier.

Consulting revenue was flat, stabilizing in the first half, and heading into the second half, our backlog remains healthy, up 4% over last year, despite the challenging pricing environment. In the quarter, Intelligent Operations revenue grew 2% while Strategy and Technology declined by 2%. The environment remains dynamic with clients prioritizing cost-efficient, high-impact technology investments, driving good revenue growth in areas like business application transformation, AI operations, and cloud platform engineering, and leading to momentum in our Consulting generative AI book of business, at over $1 billion in the quarter. This early momentum is important – engaging with clients as they architect their AI strategies is establishing Consulting as a strategic partner of choice and we are encouraged that through the first half, we are seeing a greater share of GenAI signings tied to new projects. Delayed decision-making, especially in discretionary projects, as well as prior year renewals impacted our in-period signings. However, we're seeing an improvement in strategic wins with new clients and expanding engagements with existing clients.

Now turning to profitability. During the quarter, the strength of our portfolio mix and productivity execution drove expansion of our operating gross profit margin of 230 basis points, Adjusted EBITDA margin of 200 basis points and operating pre-tax margin of 110 basis points, ahead of our expectations and well above our model. Our productivity initiatives create a flywheel that allows us to invest back in our business – both organically and inorganically, increase our financial flexibility, and deliver margin expansion – and we saw this play out again in the quarter. We remain laser focused on driving efficiency and cost savings by leveraging technology and embedding AI in our workflows as well as optimizing our supply chain and service delivery. This quarter, we continued to optimize our supply chain by shifting our Distributed Infrastructure manufacturing to an industry standard strategic partner. This is the next evolution of our supply chain transformation as we pivot to a simpler more efficient process, which helps us optimize cash conversion cycles.

Through the first half, we generated $4.8 billion of free cash flow, up about $300 million year-over-year, resulting in our highest first half free cash flow margin in reported history. The largest driver of this growth comes from Adjusted EBITDA, up $1 billion year-over-year. Partially offsetting this is working capital. Given global trade dynamics, we continued to prudently protect our supply chain, reflecting the confidence we have in our new innovation cycles across Infrastructure. And as we have been discussing, given the closing of the HashiCorp acquisition, foregone interest income was another headwind. Despite this, we are a few points ahead of our historical attainment levels through the first half.

Our strong liquidity position, solid investment grade balance sheet, and disciplined capital allocation policy remain a focus for us. We ended the quarter with cash of $15.5 billion, which is up over $700 million from the end of 2024 including spending $7.8 billion on acquisitions in the first half, driven largely by the closing of HashiCorp. Our debt balance ending the quarter was $64.2 billion, including $11.7 billion of debt for our financing business, with a receivables portfolio that is over 75% investment grade. In addition, we returned $3.1 billion to shareholders in the form of dividends in the first half.

Now, let me talk about what we are seeing going forward. We delivered strong performance in the first half across revenue, operating margin expansion, profitability and earnings per share and free cash flow. The strength of our portfolio, investment in innovation, and integrated value drive the durability of our revenue performance and underpin our confidence in accelerating revenue growth of 5% plus for the full year. And through the first half, given the strength in our underlying fundamentals with our Adjusted EBITDA up 14%, we are raising our free cash flow guidance to above $13.5 billion for 2025.

As discussed at our Investor Day, our mix shift towards Software is a key driver of our growth acceleration. Software is now about 45% of our business, with ARR growing 10%. Given the strength

of our portfolio, investment in innovation and contribution from acquisitions, we continue to expect Software revenue growth approaching double digits for the full year. Through the first half, we delivered above model growth of 15% in Automation, and in-line model growth of 14% in Red Hat and 7% in Data, and these trends should continue. And we continue to expect Red Hat to grow in the mid-teens. While Transaction Processing was flat in the first half, and below our model as clients prioritized spend on our high value innovation z17, the strength of the new cycle provides future monetization value across the Z stack. Given this dynamic, we now expect low-single digit growth in Transaction Processing for the year. With our strong start to z17, Infrastructure should contribute about one-and-a-half points to IBM's revenue growth this year. And in Consulting, while we are encouraged by our backlog growing mid-single digits and the continued progress in our GenAI book of business, given the current demand environment, we continue to be prudently cautious on Consulting's growth contribution to IBM this year.

As I mentioned earlier, we have been accelerating our productivity initiatives, which is fueling our flywheel for growth and margin expansion. We are early in this Client Zero journey on scaling AI internally to reinvent the way we work and are excited about the significant opportunities ahead of us. We exited 2024 at $3.5 billion of annual run rate savings achieved and we now believe we can achieve approximately $4.5 billion in annual run rate savings by the end of 2025. Through the first half of this year, our operating pre-tax margins have expanded by 90 basis points, ahead of our model, despite dilution from HashiCorp. Given this performance and increased productivity savings, we are raising our expectations for IBM's full year operating pre-tax margin to expand by about a point. And our tax rate expectation for the year remains in the mid-teens. As always, the timing of discrete items can cause the rate to vary within the year.

For the third quarter, we are comfortable with consensus estimates for both revenue and profitability.

Let me conclude by saying we are pleased with our first half performance, highlighting the resiliency of our business model, disciplined strategy and growth opportunities ahead of us. Arvind and I are now happy to take your questions. Olympia, let's get started.

Olympia McNerney: Thank you, Jim. Before we begin the Q&A, I'd like to mention a couple of items. First, supplemental information is provided at the end of the presentation. And then second, as always, I'd ask you to refrain from multi-part questions. Operator, let's please open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. And at this time, we'll begin the question-and-answer session of the conference. [Operator Instructions] And our first question comes from Wamsi Mohan with Bank of America. Please state your question.

Wamsi Mohan, Bank of America: Yes, thank you so much. I was hoping you could double click on the software trend. It looks like organic growth decelerated in the quarter to maybe between 3% to 4%. Could you confirm that? And that would imply that it would be the third quarter of software organic growth deceleration, but you just expressed confidence in your approaching 10% guide. So, between Transaction Processing deceleration, maybe Red Hat maintaining it, what are some of the other puts and takes that we should be expecting in the business? And how much should we expect organic software growth to be for the remainder of the year? Thank you so much.

James Kavanaugh: Okay, Wamsi, thank you for the question. Appreciate it. Let's get right to the heart of this. You dial back to how we opened up the year in January, and then we built on that at our Investor Day in early February. We talked about 2025, we were entering from a position of strength in Software.

Why? New innovation we're bringing to market, strong recurring revenue base, by the way, now $23 billion grown double digits, Red Hat momentum throughout the year and the opportunity around virtualization and others, GenAI book of business and the M&A growth synergies.
Halfway through the year right now, we actually feel even more confident about the year of approaching double digits. And let me just break this down compared to the Investor Day model around each of our categories.

One, hybrid cloud. We accelerated our Red Hat performance first quarter, second quarter by an incremental point, now growing about 14.5%. By the way, that's contributing about 3.5 points of IBM's Software revenue growth, all organic, by the way. And we continue to see mid-teens growth for the year and contributing about 3.5 points. Why? Double digit growth again in annualized bookings, opportunities around virtualization. By the way, through the first three quarters, we now eclipsed $300 million worth of total bookings around virtualization. And we see that pipeline even accelerating faster in the second half. And then you got AI and application, hybrid cloud containerization that's going to drive it. So, we feel pretty good about Red Hat.

Two, Automation. Our model on Automation is low double digits. We operated through the first half at 15% above model. Now, underneath that, we're contributing about 3.5 points of that software growth. We're off to a great start in HashiCorp, as we talked about in the prepared remarks.

We're very excited about the integrated value of that value proposition across IBM, plus Red Hat, plus HashiCorp. We 2x'ed the annual bookings in the first quarter underneath IBM. And oh, by the way, our pipeline in the second half is 3x last year across our entire Automation portfolio with regards to HashiCorp. So, we actually expect Automation to continue to accelerate throughout the year. And we

will be well above our model mid to high teens against that Investor Day model. That's going to contribute about an incremental point of growth.

Third, data. Data, we continue to execute well on GenAI momentum. Now inception to date, $1.5 billion worth of book of business on software. We're bringing new innovation to market that we showcased at Think. We're building strong pipeline in the second half that we're confident on. And we have the M&A synergies that are going to play forward, both in Automation and in data. So, we expect that to deliver on model.

Now you come to Transaction Processing. Transaction Processing flat through the first half. That's, by the way, below our model mid-single digit, right? That's about a 2-point impact through the first half to Software's growth. When you look at it, well, what are we seeing?
As we always talk about, Transaction Processing runs mission-critical software on top of our mainframe platform. We run that mainframe platform as a stack economic play, $3 to $4, a platform multiplier over the cycle. We're off to the strongest-ever first quarter start in the history of IBM around mainframe in a launch quarter. We shipped over 100% MIPS capacity into the marketplace on z17.

So, while that's having a near-term impact on Transaction Processing, you saw it down 2% in the quarter, clients reprioritized their spend to the hardware. Now that will impact near-term, but look at what happened on z16. Same thing happened in second quarter last year. And what happened? We accelerated that growth. That's that multiplier effect as we get more capacity in the marketplace. And we expect Transaction Processing now to be about low-single digit. It'll return to growth in the second half. So, between accelerating growth continued on Red Hat, the automation synergistic value on Hashi, Transaction Processing capitalizing on that multiplier effect of a very strong start on mainframe, we see that organic growth moving forward. And oh, by the way, we're comfortable with third quarter guidance. And third quarter guidance already accelerates organic growth.

Olympia McNerney: Great. Operator, let's take the next question.

Operator: Your next question comes from Amit Daryanani with Evercore ISI. Please state your question.

Amit Daryanani, Evercore ISI: Thanks a lot. Good afternoon, everyone. Arvind, I'm hoping you just spend a little bit of time talking about what are you hearing from your customers at this point, given what seems to be a very volatile macro tape? And maybe just talk about a few categories where you think customers want to spend more money, they're prioritizing versus think that they might be de-emphasizing a bit? And then, very specifically, I'd love to hear your thoughts around Red Hat. Given the strong trajectory you guys are seeing, how do you see virtualization starting to contribute to that

growth, especially given the acquisition of VMware by Broadcom and the price increase in implementing sales?

Arvind Krishna: I've been very, very, I've turned from being, I use the word cautious optimism at the end of the first quarter. I would now turn my way all the way to optimism around the macro environment. As we go around the globe, I'll first touch on geography and then touch on some sector or client examples.

I think Japan is re-industrializing and they are committed to economic growth for their nation. That implies that Japan is digitizing at rates we have not seen, and digitizing is through the use of technology.

If you go across South Asia, they're all booming. In real terms, South Asia is growing at north of 10%, because when you think about 6%, 7% GDP growth in India combined with 6% inflation, that means that actual rates, their economies are growing at 10% to 12%.
The Middle East, especially Saudi and UAE, they're booming in terms of plowing all of their profits back into their economies, and they're trying to create now diversified economies of which technology forms a strong piece.

People have talked a lot about Europe, but Europe has remained remarkably resilient as a technology consumer. I believe the reason for that is that when they look at their concerns around supply chains, they look at the issues around cyber, and they look at their labor demographics, technology offers them an actual answer against all of those headwinds. We come into North America and every company is now convinced that technology forms the basis of how do you scale revenue while not spending that much on CapEx and that much on labor expenses. So, as you've gone around the globe, those form the backdrops for why enterprise technology is going to remain a strong grower somewhere in the 5%, 6%, 7% range is from what we can see.

Then if I touch on it in a more client lens, if I think about a bank in Western Europe, they're strongly motivated to begin to use AI on how to improve their customer experience and how to improve their internal risk profiles. If I look at telecom here in the United States, they're looking deeply at how they can have a software-defined backbone for their very high throughput network backbones in order to give themselves more flexibility in how traffic gets routed and to be able to leverage the reach of advancement that comes in standard servers and software.

You asked me about Red Hat. So, Amit, if you'd allow me, I'll go a little bit broader than the virtualization question. First, Red Hat Linux, the core original product of Red Hat is growing in the high-single digits because of extreme demand around people deploying Red Hat in order to be able to

leverage AI as well, not just the standard server footprint, which normally I would tell you gives you 6%, 7%, but additional workloads is adding that couple of percent that you're asking about.

If we look at OpenShift, it's actually a platform answer. So, people are looking for what platform do we use for containers and what platform do we use for virtualization? There were three or four answers in each category. If I look at two of the three competitors on the containerization side, they've taken themselves out of the market in practical terms.

So, if people are wanting a container platform that goes across public clouds and on-premise, I will tell you that we are the leading answer for that and every analyst as an industry analyst will tell you that. If you look at virtualization, there are a few answers, but then there is a set of clients who would prefer a common answer across containerization virtualization, and then by default, we tend to win those. That has accelerated the OpenShift piece.

And last but not least, as we have brought HashiCorp in and the numbers show through in the HashiCorp product family, but the combination with Ansible is very powerful and is going to boost Ansible as well going forward. So, I hope this gives you a bit of color both in the macro and on Red Hat.

Olympia McNerney: Operator, let's take the next question.

Operator: Your next question comes from Ben Reitzes with Melius Research. Please state your question.

Ben Reitzes, Melius Research: Hey, guys. Thanks. I wanted to take kind of like the opposite tack of the first question and ask why not, what is causing you not to raise guidance if you feel better about the economy? And it looks like free cash flow is above your pace. It looks like you're already at 5%-plus constant currency. I know that includes an acquisition. And it looks like TPP and a bunch of others may accelerate.

So, just wondering, is it conservative to say that you're comfortable with the street for the 3Q when all that is looking actually better and you're already at your 5%-plus and already ahead of pace on free cash flow? Thanks a lot.

James Kavanaugh: Thanks, Ben. I appreciate the question overall. Let's just ground us in what we're actually saying both in the prepared remarks and here tonight. Coming off of a first half, which we feel very good and pleased about our performance, and I think it talks to how we have fundamentally changed and repositioned this company around a portfolio, a business model, and an execution engine that actually reflects itself in a diversified business model and a durable and resilient business model.

So, today, number one, we beat Street expectations and our own expectations in the quarter on revenue, on operating margin, on profitability, on earnings, on free cash flow. And what are we saying about the full year here now tonight?

Number one, since January, the average analyst estimates have taken up the IBM revenue by well in excess of $1 billion. We've been taking up the year already. We live in an actual world. Yes, FX is moving our way. But also in the quarter, our $400 million beat, about $375 million of that was pure business performance and constant currency. So, by definition, we have confidence entering the second quarter.

And I'll come back to revenue. But we're also then, number two, we are taking up the year on our productivity initiatives. We exited last year. We talked about $3.5 billion of productivity that we've been able to fundamentally drive out of this business. This is what Arvind keeps talking about, this productivity mindset, that we spent time with all of you at our Think Conference about reimagining and reinventing how we run our company. How do we leverage technology, digitization, embed AI across our workflows?

We are seeing extreme penetration around that. And that's given us guidance and confidence to raise that to $4.5 billion. That flows to operating margin. We're taking our operating margins up from 0.5 point to now roughly 1 point. We're taking our adjusted EBITDA up because it's all high-quality earnings profit. That adjusted EBITDA is now going to be low teens growth. By the way, dollarized that, that's over $2 billion year-to-year growth in adjusted EBITDA. And then we're flowing that all the way down through the cash flow. High quality, sustainable cash flow generation.

Now, with all that said, we got a half a year to go. Free cash flow, we got two-thirds of our free cash flow to go. Revenue, we still got $40 billion worth of revenue to go. We feel confident about the position we're in, the strength of our portfolio in software, double-digit annuity revenue, around $23 billion book of business. We feel good about infrastructure by the way, we took infrastructure up for the year. This is not a pull ahead, a mainframe cyclical demand in that quarter. We took the entire year up.

So, I would tell you, we feel very confident, even more confident than 90 days ago. And yes, we have upside and conservatism. Absolutely. But that's what you would expect of us.

Olympia McNerney: Operator, let's take the next question.

Operator: Your next question comes from Jim Schneider with Goldman Sachs Asset Management. Please state your question.

James Schneider, Goldman Sachs: Good afternoon. Thanks for taking my question. I was wondering, if you step back and look at the holistic software portfolio, there are a lot of questions on what we're doing for this year. But maybe going forward, heading into 2026, given the impact of some of businesses and positive tailwinds you talked about, do you think there's potential for improving both organic and overall software growth heading into 2026 from the current 10% levels this year? I mean, I wonder if you think that's possible.

And then maybe secondarily, if you could just address the Consulting business and what you're seeing right now in terms of the duration of the bookings you're seeing, and whether there's any kind of change in the time to commencement of some of the Consulting contracts you're signing. Thank you.

Arvind Krishna: Jim, thanks for the question, though I did, I think, count three parts in there. Let me address the first part on the software macro going into 2026, and then I'll give it over to our Jim, Jim Kavanaugh, for some of the details there and on Consulting.
Look, I think the question you're asking is one that we spend a lot of time on and one that I'm incredibly confident about. If I look at the underlying macros, all the parts we talked about Red Hat, I see them maintaining themselves into 2026. This is not unique to this quarter or a month, and so I would expect to see that same growth carry on there.

If I look at automation, that is really driven by the complexity of our clients' technology environments, and then them wanting to run them at extremely high resilience, they want to run them at much lower labor cost expense, and the amount of compute in their environments is increasing. So, they need technology. We label that automation to go run all that.

We can see that the desire to unlock value from all of the data, to unlock data for AI, as well as to deploy AI inside the enterprise, which is where we are focused, is going to only accelerate, not decrease. So, all those three parts of the portfolio, I would give you equal or higher growth rates going into 2026.

Now, you come to TP, and Jim addressed that. TP tends to be slightly lagging with the capacity that is being deployed on mainframes. So, as that capacity gets deployed, I would fully expect TP to return to its long-term model, which is in between low and mid-single digits.

So, if you put all that together, and then if you add what other M&A we might do, because since you raised that, let me just – you touched organic and inorganic. I'm very optimistic about the current M&A environment. Of course, all regulators will always watch for misbehavior and for areas where they see too much consolidation. That said, what we've seen over the last four months has made us optimistic that we are now in a rational regulation environment where M&A that makes sense will get approved in reasonable timeframes. So, with that, Jim, let me give it to you.

James Kavanaugh: Yeah, Jim, thank you for the question overall. Just let me put a bow on Arvind's point about software and bring it up a level to IBM, and then that will lead right into your consulting question, if I remember the question overall. But when you look at it, first of all, way too early. We have a lot of work to do. Team is extremely focused on discipline execution here and delivering and unlocking client value with all the new investments and innovation in the second half this year.

When you look at 2026 at a big picture, I'll reiterate what we said on Investor Day. We feel good about the Software portfolio, and Arvind just gave you some of the key KPIs underneath that about how we feel even more confident heading into 2026 with that. But the other big drivers are, one, GenAI, not only software, but we've now got north of a $7.5 billion book of business, and it's generating increased penetration across our portfolio, both Software and Consulting, which I'll talk on.

Two, our M&A growth synergies. We accelerated some opportunistically into this year. We're very excited about the portfolio that we've been able to acquire and the synergistic value of what that's going to bring to Automation. To Wamsi's question, that is going to fuel second half, and that's why second half pipeline is so strong in automation and data around that synergistic value of IBM, Red Hat, and Hashi together. So that synergistic play of M&A is going to play out in 2026.

Three, the integrated value of that multiplier effect of having a mainframe platform. We have taken up the year on infra on mainframe. We see a very strong start, and that $3 to $4 platform multiplier plays out in 2026 and 2027. And then finally, Consulting backlog, $32 billion, which leads me to your last question. And let me take a little bit of a moment to talk about this because there's been a lot of competitors that have come out already in the marketplace.

Our Consulting overall revenue was flat. We stabilized coming off a fourth quarter down 1%. I would tell you we're still operating, as we said in prepared remarks, in a very dynamic environment. Clients are re-prioritizing that spending. They're focused on cost efficiency and deploying GenAI to really drive not only the operating leverage in their own business, but to Arvind's point, leveraging technology for what it's done for a century, and that is create scale and create new businesses and new markets and opportunities. And we're capitalizing on that.

But even with that dynamic environment, I might surprise you right now, but we're actually seeing some good green shoots. One, I would put it in four buckets. Backlog, two, GenAI, three, our strategic partnerships, and four, the fundamentals of our business, read that productivity. Backlog, $32 billion at spot rates, which is what's going to play out over the history of that backlog, up over 8%. Stable erosion, and Jim, to your question, our duration is actually down six months from last year. So, we're seeing much more higher revenue realization, higher quality overall. And our trailing 12-month book to bill is 1.14 times.

Now, our signings in the quarter, before someone else asked the question, we were down 18%. That was entirely driven by last year's large early renewals. As we've talked about over the years, I've been very clear, all signings are not the same. Renewals, by definition, are low to no revenue realization. They're typically revenue and margin compression, and that's what's playing out here in the first half.

Underneath that, though, our net new business penetration was up 13% year-to-year. And in the first half, up 7 points. Read that 200-plus new clients we acquired already in our Consulting business year-over-year. And that's fueling, actually, an accelerated backlog in the second half on what that backlog runout looks like in the second half. But again, as you all know, that's only about 70% of the revenue in the second half. We still have to sell and bill new business starting in July through the rest of the year. But encouraging green shoots.

GenAI, $6 billion-plus. By the way, 17% of our backlog now, growing substantially, over 20% of our bookings. And for the first time in the second quarter, we eclipsed 10% of our revenue now coming out of GenAI at, by the way, over a 3-point margin differential. Strategic partnerships, great momentum in SAP, Microsoft, AWS, Palo Alto. By the way, we have a lot of headroom. And productivity and business model, our margins are up over 200 basis points through the first half.

So, while a lot of green shoots, I think to Ben's question, we're prudently cautious in this environment. And by the way, if those green shoots play out in the second half, it's upside to our guide.

Olympia McNerney: Great. Operator, let's take the next question.

Operator: Your next question comes from Erik Woodring with Morgan Stanley. Please state your question.

Erik Woodring, Morgan Stanley: Hey, guys. Thank you so much for taking my question. Arvind, I wanted to direct this to you. It kind of builds off of what Jim was just talking about. It's been, I think, only six quarters, you've reached a $7.5 billion cumulative AI book of business. Incredibly impressive in such a short period of time. And I'm just wondering if you could provide us with some color on how that's impacting customer spend in the non-AI parts of IBM?

And really what I'm trying to understand is how are customers prioritizing AI over non-AI? Is there cannibalization in other areas of client spend, or is it incremental to client spend? And how might that change as you look at these engagements out over the next, call it, one to three years? Does it become more incremental? I just would love some flavor on incrementalism versus cannibalization. Thank you.

Arvind Krishna: Thanks, Erik, for the question. I'm going to sort of maybe dive down to the components of what is called a full AI stack to answer your question. So, let's look at it across hardware, which includes semiconductors, then look at it in the enabling software layers, in software applications, which actually leverage AI to make themselves much better, and then finally into Consulting.

So, if you look at it first from the semiconductors and the infrastructure level, I would tell you that this is completely incremental. And you can see that in the market. When you look at CPU versus GPU, the CPU rates maintain. Yes, who they are provided by changes all the time, but the total volume of servers is not decreasing. So that tells you that is maintained.
What could happen, but I would put that in the very tiny percentages of maybe 1%, 2%, 3%, is that people will put a little bit more pricing pressure on the item they believe to be commodity versus the item they believe to be high innovation. But that is just the way technology has always played out. That is the way you're seeing it, and you can see that reflected in the market right now.

Next, when you get to the enabling software layers, that is purely incremental. There is no cannibalization there with alternate forms of technology. I will tell you that the cannibalization is going to come from the fourth part. People are looking at their own internal labor expenses, and people are looking at their third-party labor expenses, and they're looking to decrease those to make room for what they're doing around software.

When you look at AI coming into software products, whether it's ours, for example, in our case, in Apptio, in Hashi, in Turbonomic, so the known direct AI products, it actually makes those products better and compete better against others. So, it's not a cannibalization, because that would apply to ourselves. That is more a market share question, that it takes market share from those who are unable to do that. And you can also see that play out in the market with other players.

If I look at Consulting, yes, there is a big piece of the AI book of business which is coming because people are directing their dollars towards that kind of consulting as opposed to alternate forms of consulting. And that is why it's really important to be focused on what we call transformative projects, which includes AI, but also includes some of our partners, be it the cloud partners, or SAP, or Oracle, or Palo Alto, etcetera, because that kind of project is far more robust and less likely to be cannibalized. But some other parts of customer application development do tend to get cannibalized towards AI. So hopefully that gives you some color on both parts of your question, where are clients prioritizing, and also where it's incremental.

Olympia McNerney: Great. Operator, let's take the next question.

Operator: Your next question comes from Brian Essex with JPMorgan. Please state your question.

Brian Essex, JPMorgan Securities: Hi, good afternoon, and thank you for taking the question. I guess, Arvind, for you, I appreciate your public sector-related comments at the beginning of the call, and it seems like we're starting to see a more aggressive competitive stance regarding IT investment from the current administration. I guess, based on conversations you may have had, could you frame out how you think IBM is positioned to address the shift in spending priorities of the administration or public sector in general, and how much visibility do you have there? Thank you.

Arvind Krishna: Yeah. Thanks, Brian. Look, I'll use the word federal as opposed to public sector, because just because in some of our written documents, public includes healthcare and life sciences and others, so I'll use the word federal and government to be more precise in what this is.

From my conversations direct, as well as public statements from various members of the administration, they had a very strong focus in the first six months to focus on cost-cutting and efficiency to get to what they believed was the right size. They have been very, very clear. Their focus is now shifting to, number one, we need to modernize the agencies and how they leverage technology to provide a better service to citizens and to leverage technology to also reduce waste as opposed to just cost-cutting.

Two, I was very pleased to see the AI action plan that came out this morning. They are very clear that AI has to be used by government agencies against the goals I just laid out. Then, while these have not concluded, the conversations we've been having with a number of agencies on leveraging our capabilities across both software as well as consulting to help them go on their paths towards modernization, towards better services for citizens, towards reducing waste, towards more effective overall systems coming all the way into the 21st century, I'm actually quite enthused by their ability to begin to make progress in the next few months. So that's kind of what we're observing.

And so, the visibility, I will tell you, when they are willing to make time and they're willing to meet at the highest levels in the various agencies, that's a positive statement that they are serious about it and they do take us. And the visibility I get then is that I think we are a credible player because of our track record and having delivered for the government in the past many years.

Olympia McNerney: Operator, let's take one last question.

Operator: Thank you. And our last question comes from Matt Swanson with RBC. Please state your question.

Matt Swanson, RBC Capital Markets: All right. Yeah, thanks for taking my question. Arvind, I want to double-click, I think, on the $1.5 billion of software bookings in the GenAI space and specifically on

some of these watsonx products, the data, the governance, and orchestrate. So, I guess one would be, are you starting to see any of these really differentiate themselves in terms of customer demand?

And then specifically on the orchestrate layer, that seems to be a space that a lot of companies have started to talk about, whether it be model orchestration or agentic orchestration. If you can just talk a little more about your right to win in that space and how you're positioned?

Arvind Krishna: Matt, thanks for the question. First, I have been really pleased by both the uptake and the overall adoption of our GenAI products. We put most of them under the watsonx umbrella, so that's kind of where they show up in our internals.

First, there's a few that you did not mention that I think are very unique to us, both because of the knowledge we have, as well as the capabilities that our engineers bring to the table. The watsonx Code Assistant on Z, which helps people modernize their mainframe environment, helps you understand, and if you want to translate your COBOL code into Java, is really taken up and has got very wide adoption. We thought people would use it to just modernize COBOL to Java, but actually in the vast majority of the cases, people are also using it to understand the tens of millions of lines of code that they have, and then decide what makes sense to modernize versus what makes sense to keep, now that you can document it and know what it does.

The second one that is very exciting that we're bringing out in this third quarter is the watsonx Assistant for Z, which helps you have an AI administrator that manages your mainframe environment in addition to the people you have who manage it. So, these are, I think, somewhat unique to us. If I think about watsonx AI, people need an AI runtime, whether that's going to come from RHEL AI or watsonx AI as a place that they can get the models, and we are very focused on domain-specific smaller models as opposed to the very, very large models, and that becomes a carrier for those.

I think you're going to see a lot more of those under the RHEL AI and OpenShift AI umbrella, because that is where some of those capabilities are going to migrate. People need to get their data ready for AI, so that's where watsonx.data plays, and we believe with the upcoming integration of the data stacks capabilities into that, that will then become an even stronger offering.

The last part of your question, and not to avoid your asking, what gives us the right to win in orchestrate? Look, IBM has always been about being in a heterogeneous space, so it cannot be about just our own agents, of which we have about 70 to 80 of them. It cannot be about bespoke agents only, because we believe many of our clients are going to build bespoke agents that are unique to them. We also integrate in about 70 agents from third parties that come in there.

This is going to be won based on how easy is it? If it is only about your own agent, I actually think that those are our partners. Those are not people we compete with, and plenty are going to focus primarily on their own agents. Great.

Then there are going to be agents that come from different places, and people want their own bespoke agents. That is the client where we are going to win in orchestrate, and that is what our pipeline and our early discussions with clients show, and that is what distinguishes us from those who are kind of focused on primarily their own agents.

Arvind Krishna: So, look, to close the call out, we are off to a great start in the first half. Our portfolio strength, the resilience of our business model reinforces our confidence in our growth trajectory. I look forward to sharing our progress with you as you move through the rest of the year.

Olympia McNerney: Thank you, Arvind. Operator, let me turn it back to you to close out the call.

Operator: Thank you for participating on today's call. The conference has now ended. You may disconnect at this time.