Introduction

Thank you. I'd like to welcome you to IBM's second quarter 2026 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 and a replay of today's webcast on the IBM investor website within a couple of hours. The earnings presentation is already available.

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.

CEO Perspective

Thank you for joining us today. As you saw in our pre-announcement, our second-quarter performance fell short of expectations. Consistent with our commitment to transparency, we shared the results as soon as our financial close process was substantially complete. I won't revisit the details from the pre-announcement, as Jim will provide additional context. Instead, I'll focus on the positioning of our business, the growth opportunities we see ahead and actions we are taking to address execution in the quarter.

Our conviction in the strength of our business and our ability to grow and drive shareholder value remains unchanged. We recognize that the technology spending environment remains dynamic, and we must continue to evolve how we engage clients, bringing the full breadth of IBM's innovation to bear on their most important priorities. As clients determine how and where to deploy AI, we believe our portfolio is well positioned to help them realize value in a secure, cost-effective, and scalable way.

Over the last five years, we have transformed our business, improved the durability of our revenue growth, and strengthened our operating model. Those fundamentals remain intact. Software is nearly 45% of our total revenue and has been repositioned to higher-growth end markets across Hybrid Cloud, Data, Automation and mission critical transaction processing software running on mainframe. Our offerings help clients build and run applications and AI anywhere, unlock the value of their data, orchestrate and govern AI at scale, and operate more efficiently, securely, and resiliently. Our second quarter Software shortfall was limited to a capex-sensitive area of the portfolio. The vast majority of our Software

business — about 80% of that revenue — is recurring in nature and delivered healthy growth in the quarter, reflecting the demand for our offerings and giving us confidence in our growth opportunity.

Our AI strategy is the right one for IBM and aligns to what we are known for: hybrid, sovereignty, and trust. We have held the view for a while that the unprecedented investment in AI infrastructure and models will increase pressure on enterprises to generate meaningful returns from that spend. Value will increasingly shift toward the orchestration and data layers, so that clients can optimize outcomes, cost, and governance across multiple models and agents and keep control of their proprietary data. IBM's differentiation lies in our neutrality and enterprise-grade operational control: the ability to orchestrate agents across models, clouds, and on-premises environments while also providing built-in observability, evaluation, governance, identity management, and security. Watsonx Orchestrate is the control plane that helps clients build, manage, and govern agents, which combined with Red Hat gives clients a foundation to run inference and applications on any infrastructure. Bob is our entry point into the developer ecosystem, helping clients build enterprise-ready AI applications and agents while creating a natural pathway to adoption of watsonx Orchestrate and IBM's broader AI platform. Confluent delivers real-time, governed data to models and agents across that control plane. Concert provides enterprises with a unified view of application health, security, compliance, and operational performance. Clients remain in the early stages of AI adoption, making our combination of consulting expertise and technology a key differentiator. We're helping clients move to deployment, and that's translating into growing demand across Consulting, led by generative AI.

In Infrastructure, despite challenges this quarter, z17 is having the best refresh cycle in reported history. Transaction volumes, cyber requirements

and resilience continue to drive growth for the mainframe. While clients continually evaluate workload placement, we see no evidence of clients moving off the mainframe. z17 remains at nearly 130% program-to-program, well ahead of z16, which was our strongest on record. IBM Z runs over 70% of the world's transaction volume in terms of value. To give you perspective on our reach, there are over 140 million installed MIPS running mission critical transactions across every industry. Clients representing 85% of these installed MIPS are either maintaining or growing capacity. Earlier this month, we introduced a smaller LinuxONE system that allows clients to address data center space and cost constraints while offering the security, resiliency and real-time inferencing the Z platform can deliver. This innovation expands our addressable market.

Distributed Infrastructure just delivered its best quarter of revenue growth on record, growing 37%. We see this as an increasingly important growth vector for IBM, driven by AI adoption and the rapid growth of enterprise data. We have been investing across Power and Storage AI infrastructure to position ourselves for this market opportunity. Power continues to gain momentum as the value proposition of Power11 — resiliency, performance, and Linux modernization — resonates with clients. We are gaining share in Storage through differentiated offerings across Flash, Fusion, and tape, including AI-enabled capabilities that help clients scale and manage data for AI. Demand remains strong, driving a robust pipeline and positioning us well for the second half of the year.

We are acting decisively to capture new market opportunities as they arise. The Mythos release in early April has accelerated the discovery of security vulnerabilities for clients. This creates a multi-billion dollar TAM for IBM and Red Hat to help clients secure their open source software, through our new capability, Lightwell. IBM offers a differentiated value

proposition as a leader in open source through Red Hat and also recent acquisitions of Confluent and HashiCorp. Clients can subscribe to Lightwell for $1 million per year to access open source packages that have been remediated or validated. In the first two weeks of availability, we have already made more than 7,500 package versions available. Early adopters of Lightwell include organizations like Bank of America, BNY, Citi, Goldman Sachs, JPMorganChase, Mastercard, Morgan Stanley, Royal Bank of Canada, State Street, Visa, Wells Fargo and more.

Finally, quantum computing is no longer decades away, it is upon us, and we are investing aggressively. Recently, with the U.S. Department of Commerce, we announced a letter of intent to build Anderon, the world's first pure-play quantum foundry supported by $1 billion in CHIPS incentives provided by the Department of Commerce and a $1 billion cash contribution by IBM. Shortly after that, we disclosed plans to invest more than $10 billion in quantum over the next five years, spanning R&D, capex, manufacturing scale up, M&A and ecosystem expansion. This supports our roadmap to Starling in 2029 — the world's first large-scale, fault-tolerant quantum computer. Recently, IDC evaluated eleven quantum computing vendors and ranked IBM first overall, citing our ecosystem readiness for quantum advantage, our track record of delivering the roadmap on time, and our quantum-classical integration.

With the portfolio we have and the opportunities ahead, it comes down to execution. That is where we fell short in the second quarter. We have engaged with clients on the transactions that slipped and have a clear understanding of what needs to change. We are adapting to deliver greater business value to clients around our innovation, and greater economic value to better align with client priorities. At the same time, we are accelerating productivity actions across the company, spanning both spend reduction initiatives and actions designed to drive growth. These

include leveraging AI to improve software development productivity, increasing the effectiveness of our sales and marketing organization and accelerating our supply chain. Together, these actions help enhance our margin and free cash flow commitments, while improving our ability to capture the growth we see ahead.

For this growth, we are also accelerating changes to our go-to-market model. The goal is to expand coverage across thousands of additional clients where our portfolio is highly relevant and where we see significant wallet-share opportunities. While IBM has a strong presence within the Fortune 1000, there is a lot of opportunity beyond this. These changes are aligned with the areas of our business demonstrating strong momentum, including Red Hat, HashiCorp, Confluent, watsonx, and Storage. As AI adoption moves from experimentation to enterprise-scale deployment, we are also investing in more specialized technical and client-facing talent, including Forward Deployed Engineers.

Our conviction in the strength of our business and our ability to capture the growth opportunities ahead remains unchanged. We now expect revenue growth for the full year in a range of four-to-five percent. We continue to expect to grow free cash flow by about $1 billion this year, as we accelerate our productivity initiatives. With that, let me hand it over to Jim to go through the financials.

Financial Highlights

Thanks Arvind. In the second quarter, we delivered 1% revenue growth, 30 basis points of operating pre-tax margin expansion and 5% diluted operating earnings per share growth. And through the first half, we generated $4.8 billion of free cash flow. Let me go through what played out in our segments in more detail.

Software revenue grew 5% this quarter, with flat organic revenue growth. As Arvind discussed in our pre-announcement, in the final weeks of June, we saw a shift in client spending priorities. Many clients redirected spending toward servers, storage, and memory purchases to secure supply-constrained infrastructure ahead of expected price increases. As a result, tens of large deals failed to close on the timelines we expected, accounting for the majority of the shortfall.

To understand these dynamics, it is important to recognize that many clients purchase mainframe and the associated software stack through enterprise license agreements, which create a strong incumbency moat for IBM and are generally treated as capital investments. These agreements typically contain a high concentration of Transaction Processing software, although they may also include Data and Automation products. As clients prioritized other capex investments, the timing of these deals shifted, resulting in Transaction Processing revenue declining 9%, while Data grew 18% and Automation grew 3%. In contrast, we continued to see strong underlying demand in our subscription and consumption-based software. Because these are generally purchased as operating expenditures, they were largely unaffected by the capex dynamics that impacted some of our ELA transactions during the quarter.

Let me take a step back and discuss the composition of our software revenue. We offer customers flexible purchasing options that align technology investments with their business needs, making it easier to adopt and scale solutions across their businesses. About 80% of our annual Software revenue is recurring and is made up of subscription and consumption-based revenue like our Red Hat, HashiCorp and Confluent products. It also includes subscription-and-support revenue that provides customers with ongoing access to software enhancements and support. This revenue grew nicely in the quarter, and our ARR was $24.6 billion, up 8% since last year. The other 20% of Software revenue is transactional in nature and is predominantly related to the incumbency with mainframe and the associated enterprise license agreements with Transaction Processing and other software products in Data and Automation. ELAs are highly valuable to IBM because they establish long-term, strategic client commitments that expand adoption across our software products, creating a multiplier effect. Transactional revenue was down high single digits in the quarter given the shift in buying patterns we have discussed.

On the subscription side of the business, HashiCorp had another record bookings quarter and accelerated revenue growth through the first half of the year. And Confluent is off to a strong start and on track with our expectations after its first full quarter post-close. Red Hat growth accelerated one point sequentially to 11%, driven by improvement in the subscription piece of the business and stable growth in consumption-based services. OpenShift ARR is now $2.2 billion with strong growth, reflecting the demand for our containerization and virtualization products, where we now have about $680 million of contracts signed since early 2024. In RHEL, performance continued to be impacted by constrained hardware availability, similar to last quarter.

Infrastructure revenue declined 7% this quarter. While Z performance was below our expectations, through the first five quarters of z17 availability, revenue is well ahead of prior cycles at nearly 130% program to program. As Arvind said, we see no evidence of clients moving off mainframe. Clients continue to invest in IBM Z to modernize mission-critical workloads, with a focus on resiliency, security, and increasingly enabling AI on the platform. AI is driving incremental capacity growth and new workloads as clients look to run AI closer to their most sensitive data. We are seeing strong early adoption of our AI innovations, with nearly 50% of z17 customers investing in AI capabilities with Spyre Accelerator, and clients deploying watsonx Code Assistant for Z are growing MIPS capacity three times faster than those who are not. In a world where infrastructure costs are rising and efficiency matters more than ever, IBM Z offers a compelling economic advantage. Depending on the size and complexity of workloads, clients can realize a 2-to-15x total cost of ownership benefit versus moving these workloads off platform, reinforcing why the platform remains central to their operations and positioning us to capture additional value as AI workloads grow. And adding to Arvind's comments on the strength in Distributed Infrastructure, we exited the quarter with approximately $500 million of backlog, our highest on record, supporting continued momentum.

In Consulting, signings grew 6%, marking our second consecutive quarter of growth and reflecting continued client investment in business transformation initiatives. Revenue grew 1%, driven by demand for application modernization, data transformation and cybersecurity services as clients balance the need to increase productivity through AI with the need to strengthen resiliency and manage risk. Revenue growth was balanced, with both Strategy and Technology and Intelligent Operations up 1%. Generative AI represented about 50% of our signings in the quarter and now makes up over 30% of our backlog, underscoring the

demand for AI-powered transformations that extend beyond technology modernization into core business operations. As clients move from pilots to enterprise-wide deployment, they are increasingly turning to Consulting to reengineer business processes and unlock productivity and new business value through AI, automation and digital labor.

Let me now discuss profitability. Operating gross profit margins were down 70 basis points, largely driven by our revenue shortfall and mix. Despite this shortfall, productivity actions were ahead of plan, providing the flexibility to absorb Confluent-related dilution, continue investing for growth, and expand Adjusted EBITDA and operating pre-tax margins by 20 and 30 basis points, respectively. Segment profit margin expanded by 160 basis points in Consulting and 110 basis points in Software driven by ongoing productivity actions. Infrastructure segment profit margin declined 150 basis points reflecting the IBM Z mix headwind mitigated somewhat by strong Distributed Infrastructure margins.

Through the first half of the year, we generated $4.8 billion of free cash flow, flat year-over-year, driven by about a $700 million increase in Adjusted EBITDA offset by inventory, higher cash taxes, and net interest expense. Given the constrained infrastructure supply environment, we proactively took actions through the first half to strengthen our supply chain and support anticipated customer demand in the second half, reflecting the strength we see in our Infrastructure business.

We exited the second quarter with a strong liquidity position and a solid investment grade balance sheet, with cash of $8.2 billion. We returned $3.2 billion to shareholders in the form of dividends through the first half of the year. Our debt balance ending the quarter was $62.0 billion, including debt of $13.0 billion for our financing business, with a receivables portfolio that is 80% investment grade.

Summary

Over the last five years we have repositioned our business to higher-growth end markets, improved the durability of our revenue, and expanded operating pre-tax margins and free cash flow through disciplined execution and laser focus on productivity. As Arvind mentioned, we are confident in our portfolio and strategy, and the growth opportunities we see ahead. Let me now address our expectations for the remainder of the year.

We now expect revenue growth for 2026 in a range of four-to-five percent and are maintaining our expectation to grow free cash flow by about $1 billion. We believe the low end of the revenue range appropriately reflects the current environment and is our base case. Given the second-quarter shortfall, we are revising our Software growth expectation to a range of six-to-eight percent for the full year. While several of the deals that slipped from the second quarter have already closed in the first few weeks of the third quarter, the low end of the Software range assumes that recent spending dynamics persist through the second half. The high end assumes a more typical conversion of our pipeline. In light of the strong demand environment in Power and Storage, we now expect Infrastructure to grow low single digits in 2026 driven by growth in Distributed Infrastructure and continued strong program to program performance in Z through the second half of the year. Demand across Storage and Power remains strong, and we continue to secure inventory and accelerate our supply chain to capitalize on the opportunities we see in front of us. In Consulting, the quality of our backlog and momentum in GenAI continue to support an acceleration in revenue growth to low-to-mid single digits for the year.

We continue to see the strong fundamentals of our business play out in the second half of the year as we accelerate our productivity initiatives to help enhance our margin and free cash flow commitments while continuing to invest in growth. These actions include deploying AI and automation at greater scale across the company, reducing third-party spend, improving sales and marketing efficiency, using AI to drive more efficient software development, optimizing our supply chain, and enhancing services delivery. While revenue dynamics are creating margin pressure for the year, the pace of our productivity actions have exceeded our expectations. As a result, we now expect to deliver 100 basis points of operating pre-tax margin expansion, with productivity more than offsetting the revenue-related headwinds. Our operating tax rate for the year should be in the mid-teens, and the timing of discrete items can cause the rate to vary within the year.

For the full year, we continue to expect to grow free cash flow by about $1 billion. The primary driver of this growth will be Adjusted EBITDA, offset by cash tax headwinds, higher capex, and higher interest expense, the majority of which is behind us.

Looking to the third quarter, we expect constant currency revenue growth consistent with the full year. Given the strengthening of the dollar, we now expect currency to be a one-and-a-half-point headwind to revenue growth in the quarter. And for operating pre-tax margin we expect similar performance to the second quarter. Our third quarter operating tax rate should be in the mid-teens.

Let me close by saying that our strategy has not changed. We are a leader in hybrid cloud, we are investing behind an AI opportunity that plays directly to IBM's strengths in data, orchestration, and enterprise trust, and we continue to build leadership in quantum. We remain confident in the

growth opportunities ahead of us and our ability to capture them. Arvind and I are now happy to take your questions. Olympia, let’s get started.

Closing

Thank you, Jim. Before we begin 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.