IBM 4Q 2025 Earnings

Conference Call Transcript

IBM Participants:

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

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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, IBM: Thank you. I'd like to welcome you to IBM's fourth 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 with 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 our 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, IBM: Thank you for joining us today. Let me start by reflecting on our strong performance in 2025 and the execution of our Investor Day model, then get into more detail on the quarter. We are excited about the progress we made in 2025, delivering 6% revenue growth, our highest level of revenue growth in many years, and $14.7 billion of free cash flow, our highest level of cash generation in over a decade. As we laid out at our Investor Day in February 2025, we're executing on our strategy to advance IBM as a software-led hybrid cloud and AI platform company. We entered 2025 intently focused on investing in innovation and productivity initiatives to accelerate our shift towards durable, higher growth end markets in Software, with expanding margins and strong free cash flow.

Today's Software represents approximately 45% of our business, up from about 25% in 2018. Software grew 9%, our highest annual growth rate in history with three of our four Software sub-segments delivering double-digit growth rates. Innovation value can also be seen in our IBM Z performance, up 48% this year, achieving the highest annual revenue for Z in about 20 years. I'm proud of our achievements in 2025 as we exceeded all of our target metrics for revenue growth, profitability and free cash flow that we laid out at our Investor Day. Our flywheel for growth is

underpinned by client trust, flexible and open platforms, sustained innovation, deep domain expertise and a broad ecosystem, and that's exactly what played out for the year.

Let me now touch on the macro. We continue to operate in a dynamic environment, but one where client demand remains resilient in the categories that matter most to IBM. Enterprises are prioritizing technology investments that drive productivity, resilience and flexibility, particularly in hybrid cloud, AI, and mission-critical infrastructure. These technologies are no longer viewed as incremental tools, but as platforms that fundamentally change how businesses scale, compete, and operate. As clients modernize core systems, redesign workflows, and seek to extract more value from growing volumes of data, expectations for integration, security and performance continue to rise. These trends are structural, and they align closely with IBM's strategy and strengths.

Now turning to our execution in the fourth quarter. We delivered total revenue growth of 9%, our highest level in over three years. Software growth accelerated to 11% in the fourth quarter, driven by the strength of our diversified portfolio. Both Data and Automation are gaining strong momentum with clients, growing 19% and 14%, respectively, in the quarter. As AI adoption accelerates, enterprise clients are increasingly focused on how to keep operations running smoothly in a more complex and hybrid environment, fueled by a surge of new applications.

Our end-to-end portfolio of leading Automation and Data solutions, help clients manage and optimize operations, automate infrastructure and workflows, build resiliency, secure and govern data, and drive cost efficiency. Consulting continued to grow, up 1%, reflecting increased demand for AI services, as clients need help designing, deploying, and governing AI at scale. And Infrastructure we delivered another robust quarter, growing 17%, driven by strength in z17, which has been outpacing z16 performance. A key contributor to this momentum is the innovation value we are delivering with z17 processing 50% more AI inferencing operations per day than z16, and bringing real-time inferencing capabilities inside IBM Z.

The breadth of our AI offerings is another key differentiator, combining an innovative technology stack with consulting at scale and our Client Zero journey. Our cumulative GenAI book of business now stands at over $12.5 billion, of which Software is more than $2 billion, and Consulting is more than $10.5 billion, with both seeing their largest quarterly increase to-date.

As we look at the evolution of AI, our opportunity is to make it easy for clients to build AI that is specific to their data, their processes, and their competitive needs, including the effective use of smaller, more efficient models where they make sense. That is why IBM's approach spans Consulting, watsonx our agentic platform Orchestrate, and Red Hat AI.

Our announced acquisition of Confluent is another pillar in this strategy, helping unify our Hybrid Cloud and Automation solutions through a smart data platform. Confluent has the most capable technology to unlock the real-time value of data across applications, clouds, APIs, and as AI agents enter their enterprise, they will need access to that data in real time. Confluent is a great way to deliver that in a controlled, secured and governed manner.

Our hybrid approach to models also enables clients to use the best option for each use case. IBM's Granite models, third-party models or open models from Hugging Face, Meta and Mistral. In addition to being a demand driver, AI is also a powerful productivity driver for IBM, contributing to our strong financial performance. In 2023, we set out on a goal to achieve $2 billion of productivity savings exiting 2024. And today, we are well-ahead of that, exiting 2025 with $4.5 billion of annual run rate savings. We have been accelerating our productivity initiatives to enable investment in innovation and highly strategic acquisitions like HashiCorp and Confluent, while continuing to deliver strong margin expansion and free cash flow growth. HashiCorp continues to accelerate within IBM, benefiting from our go-to-market distribution and joint product innovation. We see a similar opportunity with the announced acquisition of Confluent, leveraging IBM's global go-to-market reach to accelerate growth and disciplined G&A structure.

Accelerating organic innovation is a core focus for IBM. Project Bob is IBM's next-generation AI-based software development system designed to transform developer productivity. Bob introduces intelligent orchestration between industry-leading frontier models such as Anthropic Claude and Mistral, small language models, including IBM Granite, and custom models, all optimized for cost and performance. We have more than 20,000 IBMers that are using Project Bob, reporting productivity gains averaging 45%, a powerful Client Zero use case.

We are also advancing innovation through deep M&A product synergies. For example, we recently developed Hashi infragraph, a real-time graph of infrastructure and application configuration. By fusing infragraph's insights with IBM Automation products like Concert, we unlock true root cause analysis and proactive prevention for clients.

All this leads to real tangible value for our clients. Companies like Morgan Stanley and FedEx are leveraging our technology solutions and infusing our GenAI products into core workflows. And Mastercard is leveraging our technology solutions, including data management platforms, software platforms, and GenAI products and solutions. In Infrastructure, clients such as CVS are turning to z17's AI capabilities for enhanced management of mainframe application workloads and increased resiliency. We also announced new or deepened strategic partnerships through the year with AMD, Anthropic, AWS, Microsoft, OpenAI and Oracle.

Recently, we announced a partnership between Red Hat and NVIDIA that aligns our hybrid AI solutions and NVIDIA's AI stack. This collaboration allows enterprises to deploy AI accelerated applications across any environment from the data center to the public cloud using a unified automated infrastructure. It represents a significant step forward in making high-performance AI more accessible and scalable for the hybrid enterprise. Innovation, combined with our strategic partnerships across consulting with key hyperscaler and ISV relationships and software with key data providers drive a multiplier effect that fuels our flywheel for growth.

We continue to make steady progress in quantum computing. Over the past quarter, we advanced our development roadmap, improved error correction capabilities, and expanded ecosystem partnerships. Our collaboration with organizations such as Cisco, and participation in government initiatives like the US Department of Energy's Genesis Mission and DARPA's Quantum Benchmarking Initiative reflect growing confidence in IBM's approach to building scalable, fault-tolerant quantum systems. Quantum advantage will require high-performing hardware, and in December, we deployed our first 120 qubit IBM Quantum Nighthawk-based system for use by our clients. Back in 2024, we predicted that we'd see quantum advantage by the end of 2026, and with the help of IBM hardware, software, and rapid cycles of learning, our partners in the scientific computing community are starting to make the first credible advantage claims. We remain on track to deliver the first large-scale, fault-tolerant quantum computer by 2029.

To conclude, we finished the year with strong execution and continued progress against our strategy. IBM has long been known for innovation. What matters most is how that innovation is used to help clients operate better, grow faster, and compete more effectively. We made a clear set of strategic choices over the last several years to help our clients do exactly that, and it is playing out in our results today and going forward. We enter 2026 with momentum and confidence in our ability to sustain 5%-plus revenue growth, and grow free cash flow by about $1 billion. With that, let me hand it over to Jim to go through the financials.

James Kavanaugh, IBM: Thanks, Arvind. As we entered 2025, we provided guidance of accelerating 5-plus percent revenue growth, greater than 0.5-point of operating pre-tax margin expansion, double-digit adjusted EBITDA growth, and about $13.5 billion of free cash flow. We exited 2025 beating all of these metrics, delivering 6% revenue growth, 100 basis points of operating pre-tax margin expansion, 17% adjusted EBITDA growth, and $14.7 billion of free cash flow, growing 16% over last year.

This represents our highest free cash flow margin in reported history, and we delivered 12% growth in operating diluted earnings per share. This performance reflects strong execution of our flywheel for growth through client trust, leadership in hybrid cloud and GenAI, accelerating innovation, deep domain expertise, and an ecosystem multiplier effect.

In 2025, we were intently focused on strengthening and accelerating our Software portfolio, delivering innovation value with our next-generation mainframe launch, expanding our early leadership in GenAI and quantum, and executing M&A growth synergies across IBM.
All of our segments accelerated in the second half of 2025, with these drivers playing out and demonstrating momentum across our diversified business. For the full year, Software grew 9%, our highest annual growth rate in history, with three of our four sub-segments delivering double-digit growth rates.

Infrastructure was up 10%, reflecting a record z17 launch, achieving the highest annual revenue for IBM Z in about 20 years, and outpacing z16 over the first three quarters of the program. And Consulting inflected back to growth in the second half, driven by GenAI momentum, with our GenAI book of business in Consulting at more than $10.5 billion, inception to-date.

Let me now dive deeper into our fourth quarter performance. Software revenue growth accelerated to 11% on top of last year's growth of 11.5%, which was the highest in 15 years. Growth was driven by the strength of our recurring revenue base, our shift to higher growth end markets, innovation, including our early leadership in GenAI, M&A growth synergies and modernization of our strong IBM Z placement with an inflection in Transaction Processing. Our ARR was strong at $23.6 billion, up over $2 billion from the end of 2024. This quarter's performance was broad based across our synergistic portfolio, with organic growth accelerating to over 7%. Data grew 19%, fueled by the demand for our GenAI products and strong performance with established strategic partners who enable customers to power our AI innovation and mission-critical workloads. These market dynamics underscore the synergy opportunity we see with Confluent. Automation grew 14%, including another record bookings quarter for HashiCorp. Red Hat decelerated to 8%, driven partially by the wrap on last year's elevated consumption-based services that we called out last quarter. And also from the encoder yield on single-digit bookings growth, driven by delays in US federal business deal activity related to the government shutdown. While a longer growth arc, virtualization continues to gain momentum, including over $500 million of contracts signed over the last two years. OpenShift is now $1.9 billion ARR business, growing more than 30%. And as we expected last quarter, given the record z17 placement this year, Transaction Processing inflected back to growth of 4%.

Consulting revenue grew 1% in the fourth quarter, with Intelligent Operations up 3% and Strategy and Technology remaining stable. Performance was driven by steady demand across key offerings. Business application transformation, application migration and modernization, application operations and cyber security, as clients prioritize cost efficiency, while continuing to invest in AI-enabled transformation.

As Arvind noted, clients are moving beyond experimentation, and need support designing, deploying, and governing AI at scale. Our Consulting generative AI book of business surpassed $2 billion in the

quarter, our largest quarter of GenAI, reflecting continued momentum. We're also expanding our impact through Client Zero, applying our generative AI experience in driving productivity and efficiency to help clients operationalize AI at scale. This practical experience, combined with our domain expertise, is resonating with clients. While overall signings were down as we wrapped on record fourth quarter signings last year, the mix continued to improve with the greater share of strategic wins from both new clients and expanded engagements within existing ones.

Infrastructure revenue grew 17% this quarter, with Hybrid Infrastructure up 24% and Infrastructure Support down 2%. Within Hybrid Infrastructure, IBM Z had another outstanding quarter, delivering its highest fourth quarter revenue in more than two decades, up 61% year-to-year, reflecting the enduring value of the platform, and the success of our latest z17 program. Clients are investing in z17 for its differentiated capabilities, real-time AI inferencing, quantum safe security, and AI-driven operational efficiency, which are critical as enterprises modernize mission-critical workloads and scale for data-intensive environments.

IBM Z continues to be the backbone of enterprise IT, enabling clients to integrate seamlessly with hybrid cloud, while unlocking new levels of resiliency, scalability, and performance. Distributed Infrastructure revenue was flat, with product cycle dynamics impacting storage, offset by growth in power, supported by solid adoption of our newly launched solutions.

Now turning to profitability. In 2025, we delivered our highest operating gross profit margin in recorded history, and highest operating pre-tax margin in a decade, demonstrating the evolution of our portfolio mix and our laser-focus on productivity. For the full year, productivity, mix and revenue scale drove expansion of operating gross profit margin by 170 basis points, adjusted EBITDA margin by 230 basis points, and operating pre-tax margin by 100 basis points.

And we achieved this despite absorbing more than $300 million of dilution from HashiCorp. Given the announcement of our intent to acquire Confluent, we accelerated productivity initiatives in the fourth quarter to help mitigate 2026 dilution, similar to our playbook on HashiCorp. Excluding resulting workforce rebalancing charges we took in the fourth quarter, operating pre-tax margin expanded by 140 basis points for the full year. Segment profit margins expanded by 100 basis points in Software, 180 basis points in Consulting, with Consulting margins at the highest level in three years, and 450 basis points in Infrastructure.

For the full year, we generated $14.7 billion of free cash flow, up $2 billion year-over-year, resulting in the highest free cash flow margin in reported history. The primary driver of this growth is adjusted EBITDA, up $2.8 billion year-over-year, partially offset by increased investments in CapEx, higher cash taxes and higher net interest expense, as we expected coming into 2025.

Let me talk about our free cash flow evolution in a little more detail. Our repositioning to a Software-led business, in addition to our cost discipline and productivity initiatives, drive significant operating leverage in our financial model. Since 2022, we have consistently delivered double-digit growth in free cash flow, well in excess of revenue growth, demonstrating this business model evolution.

Our flywheel for growth and disciplined execution of productivity initiatives lead to sustainable and high-quality free cash flow generation. This durable cash flow engine enables us to invest in our business to accelerate growth. This includes increased organic innovation, with R&D up about $2.5 billion since 2019. And it allows us to pursue highly strategic M&A transactions like Apptio, Software AG, HashiCorp, DataStax and Confluent that drive M&A synergies across IBM.

Our diversified and integrated business drives a platform multiplier effect that uniquely allows us to deliver M&A synergies. This includes synergies from our global go-to-market distribution scale, platform synergies that amplify value with IBM's complementary offerings, and operational synergies through our G&A discipline. Most recently, this can be seen with HashiCorp, delivering adjusted EBITDA accretion ahead of expectations within the first full year in IBM.

Our financial flexibility fuels innovation and our disciplined capital allocation policy, including our commitment to return capital to shareholders. We exited 2025 with a strong liquidity position and a solid investment-grade balance sheet, with cash of $14.5 billion. We invested $8.3 billion in acquisitions and returned $6.3 billion to shareholders in the form of dividends. Our debt balance ending the year was $61.3 billion, including $15.1 billion of debt for our financing business, with a receivables portfolio that is almost 80% investment-grade.

Now, let me discuss our expectations for 2026. Our strong performance in 2025 reflects the strength of our diversified portfolio and a multiyear execution of our strategic repositioning. Consistent with our Investor Day model, we expect to sustain constant currency revenue growth of 5%-plus in 2026 and free cash flow to be up about $1 billion year-over-year, growing high-single-digits.

Our revenue expectations are underpinned by our durable and accelerating Software business, which we expect to grow 10% this year. This acceleration is led by organic growth, driven by the strength of our recurring revenue base, our shift to higher growth end markets, GenAI traction, M&A growth synergies and monetization of our record Z placement with an inflection in Transaction Processing, a tremendous source of profitability and free cash flow for IBM. And we continue to expect Confluent will close by the middle of 2026.

In Consulting, our backlog levels and momentum in GenAI, with backlog penetration over 25%, support an acceleration in revenue growth to low- to mid-single-digits for the year. The powerful combination of our integrated platforms, Services as Software model, and Client Zero experience

allow us to deliver differentiated value to clients. We enter 2026 three quarters into the z17 launch, we expect Infrastructure revenue to be down low-single-digits, about a 0.5 point impact to IBM, with Z growth in the first quarter balanced by product cycle dynamics throughout the rest of the year. The strength of our Z placement fuels our flywheel for growth with its attractive 3x to 4x stack multiplier across IBM.

Let me now touch on our GenAI book of business before I turn to profit. We have been reporting our cumulative GenAI book of business since the third quarter of 2023 when it was in the low hundreds of millions of dollars. We exited 2025 with a GenAI book of business greater than $12.5 billion, demonstrating strong momentum in Consulting and Software. This will be the last quarter in which we report this metric separately. AI is now embedded across our business, from how we deliver services, to our Software portfolio, to the capabilities we are adding to our infrastructure platforms, and how we drive our own productivity. As a result, a standalone GenAI metric no longer reflects the full scope of how AI is driving value across IBM.

For the full year, we expect IBM's operating pre-tax margin to expand by about 1 point. Our Software portfolio mix and ongoing productivity initiatives continue to drive margin expansion and mitigate Z product cycles and the impact of dilution from acquisitions. 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.

Let me give a little bit more color on Confluent dilution dynamics. We anticipate absorbing about $600 million of dilution from Confluent in 2026, driven largely by stock-based compensation and interest expense. We expect Confluent will be accretive to adjusted EBITDA within the first full year and to free cash flow in year two, post close. We have multiple levers that underpin our confidence in these accretion targets, including revenue synergies, operational spend synergies, and ongoing productivity savings.

Revenue synergies include both the ability to accelerate revenue leveraging our go-to-market distribution platform, as well as drive product synergies, which play out over time. We expect to realize about $500 million of operational spend run rate synergies by the end of 2027. We continue to accelerate our productivity initiatives and now expect an incremental $1 billion of productivity savings this year, driving $5.5 billion of annual run rate savings by the end of 2026. Taking this all into account, we are confident in our ability to expand operating pre-tax margin by about 1 point in 2026.

For free cash flow, we expect to grow by about $1 billion in 2026, in line with our Investor Day model of high-single-digit growth. Given the strong fundamentals of our business, adjusted EBITDA growth will be the primary driver of our free cash flow, offset by similar factors as last year, including cash tax headwinds, higher CapEx, and higher net interest expense. Looking to the first quarter, we expect our constant currency revenue growth rate to be similar to the full year, and for operating pre-tax margin,

we expect about 100 basis points of expansion, with workforce rebalancing fairly consistent with the prior year. Our first quarter operating tax rate should be in the mid-teens.

We are excited about our prospects in 2026. Our growth accelerators – portfolio mix, integrated value, and continued investment in innovation – are driving sustainable revenue growth and strong free cash flow. As we shift toward a Software-led business and speed our pace of innovation, our growth flywheel continues to strengthen. We entered 2026 with a solid momentum across our business and remain focused on disciplined execution with unwavering focus on productivity, enabling investing for the future and delivering value for our shareholders.

Arvind and I are now happy to take your questions. Olympia, let's get started.

Olympia McNerney, IBM: 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 asking multipart 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] Our first question comes from Brent Thill with Jefferies. Please go ahead.

Brent Thill, Jefferies: Thanks. Good afternoon. Arvind, good to see the comment around Software growth accelerating to double-digit growth this year. I was just curious if you could maybe dig into the components and why you're excited for that organic led initiative. And then, anything else that's important to note this year on the Software portfolio that maybe we haven't seen in 2025? Thanks.

Arvind Krishna, IBM: I'll give you a bit of a perspective on the dynamics of the different parts of the Software business, and then for quantification, I'll turn it over to Jim. So, first, we are incredibly pleased with how we got to the end of the year on Software. We are pleased with the organic growth in Software and we are pleased with the inorganic contribution.
If I sort of peel it first from the subsegments, Automation, I think, is on a secular demand increase. The reason for that is, as people have more and more infrastructure, they put more and more AI, they put more and more compute. They need that software to help them manage all of it, and we're seeing that play through in the demand for HashiCorp, which helps you deploy hardware and software; with the demand for Apptio, which helps you manage the costs and gives you a perspective of what is happening, as well as all the pieces around how do you integrate applications, how do you integrate data and all of those components. So, I think that expecting well into double-digit growth for that part is appropriate and we see that in our early demand signals.

If I look at Data, Data benefits both from our Data products that we provide, the organic innovation we have done with watsonx, both the AI pieces and the Orchestrate piece for agents. And we expect that that demand will keep pulling through and going forward as people are deploying AI for enterprise productivity and inside the enterprise. Then, we also have a lot of partnerships in the Data space that we see strong demand for and that we expect are going to continue. Mainframe, given the very strong cycle we had, somewhere between low- to mid-single-digit growth is reasonable, and we have seen that dynamic play through, where it kind of follows the hardware placement by a few quarters. So, all that hardware, as people consume it, is going to cause that to grow.

And then, we get to Red Hat. First, we're very pleased with the doubling almost, more than doubling of the Red Hat business since we acquired it. It was 3-point – early-$3 billions, $3.2 billion when we made the acquisition, finishing the year at $7.5 billion on a run rate, just extrapolating from the fourth quarter, towards $8 billion. We see strong demand in many of the pieces there, including on Red Hat Linux, but that probably in the mid-single-digits more than in the high to double, which is in line with server growth. You're still taking share, and the piece there that continues to be very, very attractive to growth is OpenShift, which is almost at $2 billion and running at a 30% growth rate, and we expect that to continue, both for containers for hybrid applications and for virtualization.

So, if you put all of that together, then that gives me confidence on the growth that Jim laid out, about 10% for the year. This all assumes a midyear closing for Confluent, which is sort of baked into our expectations right now. Now, of course, we're going to strive to do even better, but I think that this is a prudent set of numbers to put out.

James Kavanaugh, IBM: Yeah. The only thing I would add, just to wrap it up, and I'll say it on behalf of Arvind's, given how humble he is, when you look at 2025 and our Software execution, I think what you see, one, is the strength of our portfolio and the diversification of that portfolio. And that's a reflection of a multiyear strategic repositioning of the IBM Company to a Software-led, platform-centric company. We finished 2025 with one of the highest growths we've ever had in Software overall, but it's pervasive with three of our four Software categories growing double-digits.

You dial back only about three years ago, we only had one growth vector, and that was Red Hat. That is the foundation of our Hybrid Cloud and AI strategy. The work we've done around repositioning the portfolio, a disciplined capital allocation to build out an Automation portfolio, a Data portfolio, and always capitalizing on that high profit margin Transaction Processing portfolio has just been phenomenal, and it's leading to a sustainable, durable growth engine that gives us that conviction of double-digit growth here in 2026.

But when you cut to the underpinnings, it reflects that diversity, ARR roughly $24 billion growing high-single-digits, GenAI over $2 billion book of business, up 2x in the fourth quarter, and that M&A growth synergies, you're just seeing the beginnings of that play out with Hashi with another record quarter overall. So, we are excited about the opportunity ahead and we feel confident about Software now at double-digits, not approaching double-digits.

Olympia McNerney, IBM: 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: Yeah. Good afternoon, everyone, and congrats on some nice numbers here. I just want to focus on free cash flow a bit. And if I go back to the start of the year in 2025, you folks talked about $13.5 billion free cash flow guide. You sort of ended up being $14.7 billion, I think, when it's all said and done, and I think revenue growth helped you somewhat, but it was really good free cash flow margin conversion.

So, I'd love to know from your perspective what drove this trend, the better performance in free cash flow in 2025. And where I really want to go with this is I want to understand the $15.7 billion free cash flow guide for this year, which is impressive, but it implies high-single-digit free cash flow growth versus a 16% that you saw last year. So, please just help me appreciate, was there something unique that you saw in 2025 that led to the 16%, and any puts and takes around the $15.7 billion number for this year?

James Kavanaugh, IBM: Thanks, Amit. Appreciate the question. As we've been talking about for five years, six years now going on as Arvind has taken over this company, we've got two key measures that we drive this company on: revenue growth and free cash flow generation. And by the way, they're synergistically aligned, because it provides that flywheel of investment flexibility.

But you're exactly right, we entered the year, and I remember a year ago sitting in this chair, I got asked the question. I think it was either you or Ben about are we – in my words, are we sandbagging free cash flow. And at that time, we said $13.5 billion, and the underpinnings behind that was double-digit growth in adjusted EBITDA and that we would have partially mitigating that some headwinds on – or I would talk about tailwinds, higher cash tax, because we got a higher profit profile, higher CapEx, because we're going to invest in this business for long-term future growth, and we were going to have higher net interest and acquisition-related charges.

Now, you fast forward a year later, we posted $14.7 billion, by the way, up $2 billion, up 16%, highest free cash flow we've seen in well over a decade, highest free cash flow margin on record of 114-year

history of our great company, and the underpinnings behind that cash flow were entirely driven by the fundamentals of our business, the acceleration we saw in our revenue growth throughout the year and the strong operating leverage we continue to get out of this business.

So, where we started with adjusted EBITDA at double-digit growth, we finished at 17%. That's an incremental $1 billion of adjusted EBITDA from where we were a year ago. And by the way, that's a flywheel engine. Revenue acceleration, operating leverage, and driving an efficient balance sheet, where we're very proud about a solid investment grade balance sheet, generates significant substantial free cash flow. So now, you fast forward to this year. We enter 2026 with a lot of momentum, confidence, by the way, I should have said over the last three years, we've grown free cash flow $5.5 billion. So that growth vector of what's been happening. But you look at 2026, our investor models, high-single-digit, we got a lot of work to do in 2026. We said we'd guide confidently up $1 billion at $15.7 billion, that's on a high-single-digit growth. It's early in the year. High-single-digit growth of adjusted EBITDA. And we are sitting here with the tremendous amount of leverage and opportunity just like we were a year ago, and our goal is to continue driving the durable, sustainable performance of this company as we move forward.

So, why do we feel excited? One, we have a focused portfolio, disciplined capital allocation, diversification of our business model and a relentless focus on profitability that drives the durability of free cash flow engine in this company, that gives us the financial flexibility to continue to invest for long-term sustainable advantage. So, we feel confident about that $15.7 billion, and our job is to beat it this year.

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

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

Ben Reitzes, Melius Research: Yeah. Hey, guys. Thanks a lot. At the risk of getting in trouble with Olympia here, on Amit's question, I was surprised you didn't say there's a multi-hundred million hit due to Confluent in the cash flow guide, which without it, it would be higher. But my real question is with regard to Red Hat. And I wanted to just clarify, I appreciate the double-digit guidance for Software. I wanted to see what – how we're going to bridge Red Hat. What – how do we get the 8% to the mid-teens or is mid-teens no longer the growth rate there? Obviously, everything else was great, and better than our model, but I'd like to just focus – laser-focus on Red Hat, and how we bridge it to – within your forecast and towards the prior goals. Thanks.

James Kavanaugh, IBM: Yes. Thanks, Ben. And I didn't say the dilution effect because, to be honest with you, dilution is part of our model. Our investors expect us to be disciplined capital allocators. I

think we've earned a credibility about that. And we had to take that into account. That's why we drive portfolio mix. We drive revenue scale. We drive productivity, which, by the way, I also didn't say, we exited last year $4.5 billion over the last two years. And we see that going up by another $1 billion this year.

So, we got a lot of levers in this business, and we understand that dilution. But you know what, the strategic value of Confluent and the synergistic value of what it does to our portfolio, we definitely can take into account that dilution. So, I know you were trying to help on $15.7 billion is higher. Yes, it is. But all-in, which is how we operate and report, we got to deliver or beat that number, so.

But let's get back to Software. We talked a lot about the first question. We enter 2026 with confidence around the momentum, the diversification of our portfolio, about the strategic repositioning, about the flywheel of growth. And we expect now double-digit growth. Underneath that, one, that's going to deliver 4.5 – over 4.5 points to IBM's growth in 2026 above our model, and as Arvind said, an acceleration organic growth. Organic will be north to 7 points this year, and acquisitions about 3 points.

How're we going to do that? We're going to do that, one, we have to acknowledge we're operating in an attractive TAM, with a market backdrop for tech that we think is pretty exciting, and Arvind has been on that point about opportunistic. Two, we continue the thing I think is underappreciated in our disciplined capital allocator. We continue to shift this portfolio mix to higher growth end markets with companies that we buy, which we always say category leaders and structurally growing markets that we can provide unique value, integrate and deliver differentiated synergies to accelerate growth. That is shifting our underlying portfolio. That's also advancing our organic growth profile.

Annuity strength $24 billion exiting the year, growing high-single digits, 8-plus percent. New innovation GenAI in the fourth quarter, up 2x. And we see that continuing as we move forward. M&A growth synergies kicking in off of a record Hashi year. And Arvind talked about TP cycle modernization.

By the way, one point on TP that I think is underappreciated, we talk about a very similar to z16 cycle. z16 first year cycle TP was flat. We finished this year flat. One big difference. That flat on z16 was off a down 9. The flat this year in 2025 was off a plus 10. So, you could see the compounding effect of what's happening to TP, and we see that inflecting the growth.

So, underpinning, and Arvind gave you some of the math, one, data high-teens contributing about 4 points to net Software growth, well-above model. That's going to be driven by new innovation, GenAI capability, platform economics. Two, hybrid cloud. We think that's double-digit. Back to where I started my first answer. Three, four years ago, we only had one growth vector. Now, we got three

growth vectors that are growing double-digit. Underpinning that, we got a subscription revenue under contract that's growing mid-teens.

That's not at model. We only delivered single-digit ACV bookings in the fourth quarter because as we stated in prepared remarks, we were disrupted by the shutdown of the federal government. We got to get through that. We're monitoring it. And I would say the word choices we're being prudent on Red Hat's guidance right now, because we only need that at double-digit to get Software over the line of double-digit. Upside, we'll deliver upside to Software overall. Automation, great portfolio, low-double-digit, 2.5-point contribution to Software on or better than the model. And that's leveraging M&A growth synergies off Hashi's success.

And then TP, we're pretty much back to model, low-single mid-single-digit growth, capitalizing on that economic multiplier. So, it gives you a little of the underpinnings behind why we're confident in that 10-plus percent growth of Software.

Olympia McNerney, IBM: Let's take the next question.

Operator: Your next question comes from Wamsi Mohan with Bank of America. Please state your question.

Wamsi Mohan, Bank of America: Yes. Thank you so much. Just to follow up a clarification quickly on the last couple of questions around Hybrid Cloud growth. Are you anticipating any potential pressure on the server refresh cycle from higher memory pricing? And could that sort of have any adverse effect on the Red Hat Enterprise Linux side of things?

And my question really is, Jim, on the cadence of PTI improvement, clearly you're driving a lot of productivity improvement in being able to absorb entirely the dilution from Confluent and then some. So, how should we think about the cadence of the progress of that, given that Confluent is going to hit mid-year, but you've already taken some productivity actions here in 4Q of last year? So, should we be seeing more outsized PTI improvements in maybe second quarter? I think you already said where it is in the first quarter, but like in the second quarter, is that the right way to think about it? Thank you so much.

Arvind Krishna, IBM: Okay. So, Wamsi, let me take the first part of that question, and I'll ask Jim to address the second part of your question. Look, the server dynamics are volatile. And you're right. If I remember correctly, spot memory, DRAM prices are 6 times that of last year. A big reason for that, for those who're interested, is because a lot of the capacity is moving over to HBM or High Bandwidth Memory, which is required for AI servers.

And if I remember correctly, it takes about 4, maybe 8 times the capacity of DRAM to do HBM, and the pricing and the demand for HBM is driving all the vendors into that. I personally believe as long as that dynamic is there, those pricing issues are going to be there through the year.

Now, the demand side. There is no AI server without a bunch of CPUs right next to it. So, the reality becomes that the AI demand also drives demand for normal servers that in turn feed and load up those servers. So, I don't expect that the overall server dynamic on which there may be a little bit of an issue is actually going to be any headwind to us on the Hybrid Cloud or the Linux side. And the reason for that is that there is enough growth going on.

There is also a market share movement towards Red Hat, as opposed to alternate answers in the marketplace. So that mix, overall, I think keeps us growing well. I also believe that both Red Hat AI and OpenShift AI will feed into the demand from the AI servers, which is going to help that demand.

So, let's acknowledge, there is going to be memory pressure, and that probably lasts at least a couple of years. But as we look at that, it also gives the opportunity for the AI portions of the portfolio to get a lot of tailwinds. So with that, I'll give it to Jim for, I think, another free cash flow question.

James Kavanaugh, IBM: Yeah. The skew of profitability, Wamsi, I think, was your question. So, thanks very much. And I appreciate that. Just given we do still expect Confluent to close by mid-year. This year, obviously, very excited about the strategic capabilities that's going to add. But I think I was very transparent in the prepared remarks about the level of dilution, et cetera. But let me bring it up a level first around how do we run this company and how do we drive the operating leverage that's been going up well-above our model over the last three to four years.

Portfolio – we drive this through portfolio mix. That's why Software being the underpinning of IBM's leverage, around 45% of IBM's revenue, but about two-thirds of our profit. Also, the high value recurring revenue, our ARR book of business, high marginal profit dollar. So, portfolio mix being one lever.

Productivity, every dollar we invest in this company around go-to-market, around R&D, around innovation, and around our consulting services, we look and we drive a very maniacal ROI concept around that profile, just as you would expect us to as an investor, like a inorganic M&A acquisition. And three, we drive to bring this company the most productive company in the world, and getting G&A scale leverage overall.

Fundamentally, you manage those three separate buckets differently. When you look at 2026, we set about 1 point growth in margin. We're going to get about 0.5 point out of revenue scale just given the leverage of the acceleration of revenue. We will lose 0.5 point on portfolio mix, because we are going

to wrap on an unprecedented launch momentum on mainframe, which carries higher profit and higher mix.

The remaining full 1 point basically is going to be driven out of productivity. And our model, as you know quite well, we've been driving north of 300 basis points per year of productivity, and we've been reinvesting about 200 basis points of that. That's why you've seen over the last handful of years, our R&D up double-digit growth year-over-year. And we've taken over the last, what, five years, we've taken $2.5 billion of R&D up overall.

But when you look at 2026, productivity is going to drive the day. We feel confident. We took up our productivity target to $5.5 billion. We will get revenue scale leverage on G&A, which will mitigate dilution and mitigate product cycles overall.

To your last question, we think the skew of that profitability is going to follow our normal historical attainment. First quarter will be pretty much on historical attainment. By the way, you do the math. That's double-digit profit growth, double-digit EPS growth. So, pretty consistent building off the momentum of fourth quarter.

Olympia McNerney, IBM: Operator, next question, please.

Operator: Thank you. And your next question comes from Jim Schneider with Goldman Sachs. Please state your question.

Jim Schneider, Goldman Sachs: Good afternoon. Thanks for taking my question. I was wondering if you could maybe outline the path or trajectory you're expecting for the Consulting business throughout the year. Signings were a little bit weaker in this quarter, but you noted the strong backlog in AI that you're seeing. So, maybe talk about how you expect that to convert into revenue over the course of the year. And whether you see any kind of further improvement in discretionary or short cycle spending in projects, as you head throughout 2026? Thank you.

James Kavanaugh, IBM: Great, Jim. It's good to hear from you. And I appreciate the question. First of all, we're encouraged by the inflection shift that we see in Consulting business exiting 2025. We returned to business back to durable, sustainable growth in the second half, a little bit over 1%. But more importantly, and I think underappreciated, we got a lot of headroom to go, and the team is working diligently around improving the fundamentals of this business, and our operating pre-tax margins were up by almost 200 basis points in 2025.

When you look at the market, market definitely remains dynamic, as we talked about earlier. We continue to see opportunity for growth as clients accelerate their investments in AI-driven

transformation to unlock operational efficiency, to unlock business model innovation, and unlock growth. I think it's a very different mindset and client buying behavior. And we saw 18 months ago when it was pure disruption and discretionary spend that's moving out. So as we look at 2026, that's what gives us the confidence that we guided low-sing to mid-single, which we think is going to be pretty much where the market is at overall. And we still believe we've got continued headroom on operating margins. We guide about another 1.5-point improvement year-over-year. Both of them are going to be accretive and contribution to IBM overall.

How's that going to happen? One – I would put it in a handful of buckets. One, backlog realization in what we see. Two, our GenAI momentum, and the rate and pace and growth and acceleration we're seeing. Three, strategic partnership headroom that we still have. Four, our portfolio composition we've been talking about is aligned to much more growth end markets, higher growth end markets where our portfolio is less around pure BPO. It's more around digital transformation, application modernization, AI, around data transformation, cyber security, governance. And then, five, Mohamad and team, we've been doing a ton of work around reshaping our model to an asset-based services-as-a-software model with our industry-leading IBM Consulting advantage.

So, let me talk about just a couple of them to give you some math and statistics on why we feel confident. One, backlog, $32 billion, up 2% overall, but underpinning record low erosion, duration that has continued to come down. And our realization, to your question, we see a realization around that backlog that fully supports that low- to mid-single-digit growth. And we see it pretty much modestly growing throughout the year. So, low-single-digit first quarter, and then growing throughout the year.

Two, we added over 400 new clients this year, and that has improved our net new business contribution as we've been talking about by 8 points, which is having a higher revenue realization by 4 points year-over-year. So, backlog composition and the acceleration is one aspect, GenAI is the second. GenAI now represents over a third of our bookings. Over 25% of our backlog right now, $32 billion backlog, and over 15% of our revenue on an exit run rate. We have a $3.6 billion ARR GenAI revenue run rate in Consulting. And we see that continuing to accelerate.

And then finally, the repositioning. We see more headroom on margin leverage, about 1.5 point as we go forward. And that's through productivity, portfolio mix. But we have to manage, we are operating in a very aggressive pricing environment, and we'll continue to monitor that.

Olympia McNerney, IBM: Great, Operator, next question.

Operator: Thank you. And your next question comes from Erik Woodring with Morgan Stanley. Please state your question.

Erik Woodring, Morgan Stanley: Awesome. Thank you, guys, for squeezing me in here. Arvind, a really strong Infrastructure year, obviously outstanding performance in Z. I think there's an argument to be made, and I hear from you, that with the Telum II processor, given the amount of data and transactions on the mainframe, the mainframe can be an AI workhorse. You had really strong outperformance relative to your historical model in Z. You're guiding to a bit of Infrastructure decline in 2026.

And so, I'm just trying to understand, was there just some kind of different buying trends in 2025, and perhaps a bit of pull-forward that was different than maybe past Z launches? Or could you just be a bit conservative as you look out into 2026? I know you cite cycle dynamics, but could you see some more sustainability in the Infrastructure business and the Z cycle, that maybe isn't fully accounted for in the Infrastructure guidance that you gave? Thanks so much.

Arvind Krishna, IBM: Yeah. So, Erik, as Jim actually explained in answers to a few questions, we want to give guidance, and we want to be where we have incredibly high confidence that we can hit or beat those numbers. So, let me just caution that all guidance we give is with that in mind.

Let me just actually go back to a few of the dynamics that are driving even stronger adoption of the mainframe. Let's point out. z17 has been the strongest start three quarters in. Before that, z16 was the strongest in about 20 years. Before that, z15 was better than z14, z13 and z12. So, we've been on this continuing improvement.

Let me point to, I think, at least three secular factors under it. Number one, there is a lot more demand for people to have, we can use the word sovereignty, or we can use the word on-premise control, which goes along with the economics of the mainframe platform. I think more and more clients have woken up to that for certain workloads. The mainframe is actually the lowest unit cost economics platform, and that is really important.

Number two, the ding often is, well, but it's a very hard platform for our developers to use, and for our operators to leverage. The GenAI tools we have provided with the watsonx Code Assistant for Z really takes that onus away. It can re-factor COBOL into Java. It can help people understand code that is already running on the platform. It can help you re-factor that code, if you want to keep it exactly as it is. It can help you take things out, so that headwind of people saying this is a hard platform to modernize has gone away.

That then comes to your AI capabilities. You're right. I'm incredibly excited by our ability to do AI right in line. If you can do it right in line with the transactions, that's a milliseconds delay as opposed to multiple seconds, if you take it off platform, which is how people have been doing it so far.

That capability, while we introduced it in the beginning of 2025, really came to market only in the fourth quarter of 2025. So, I do expect, and we look forward to helping our clients install that. And a very large number of our clients actually told us they're interested, and they kept space in the machines to put in those cards, we call them the Spyre cards, or you can think of it as a GenAI card which gives you all that capability.

As those cards go in, then the software stack to support that goes in. But we also have to give help to our clients to let the models run on the platform, and to get their use cases up and going. I expect that will take some months to happen, but that does provide possible tailwinds against some of the dynamics that both Jim and I have explained.

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

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

Matt Swanson, RBC: Great. Thank you. Arvind, if I can maybe take a more holistic view of part of your answer you just said. So, I mean, as you were talking about, there's been a lot more conversations right now about where enterprise GenAI workload should reside.

And it really feels like that conversation is the intersection of your dual pillars of AI and Hybrid Cloud. So, when looking at the strength of the refresh cycle, as you mentioned, but also the strength in demand for the Data segment, the Automation segment or conversations in Consulting, what do you think combining all these things says about the current state of enterprise transformation for GenAI, maybe today and heading into 2026?

Arvind Krishna, IBM: Yeah. Matt, thanks, and thank you for that question, because it is one, as you can imagine, that we both think about a lot and then play out the various scenarios. So, let's look at GenAI so far. GenAI so far has largely been a consumer topic. People use chatbots. People use it to improve their e-mails. People are using it to improve document writing. Half the videos, if I believe the statistic I read, are now generated with the help of AI.

I'm not saying only AI, but with the help of AI. All of that tends to be AI that is running on a hyperscaler public cloud somewhere, and that people go leverage. As we look forward now to the enterprise, I am convinced this is an and world. I'm not saying that the hyperscaler public model usage is going to decline, but the enterprise is going to get concerned with how much of – not the data, I don't think people are going to steal data, though that has happened a few times. But I do think that there is going to be a lot of concern around the nature of what are the models learning from answering these questions, and do we really want to share that with everybody else or not.

There is going to be issues around sovereignty on the usage of these models, and there is going to be questions around just basic privacy, hey, this is not data that we want to take anywhere else. So, I take that into, I believe if I look out three to five years, 50% of the enterprise usage of AI is going to be in either a private cloud or it's going to be in their own data centers. And the other 50% is going to be usage of public models.

Now, there's also an efficiency question. So, if what's being used on-premise is smaller models, then actually it could be that 80% to 90% of all the inferencing is really in a private/on-premise, and 10% of the inferencing is on a public, but that 10% could be at 5 to 10 times the price, and hence the dollars, sort of, even out. We see this playing out really importantly over the next three to five years. And that is why we've been positioning very strongly.

We use the word sovereign or sovereignty for how people want to manage their technology. We announced a sovereign core offering last week to help get this done. But we do believe that this is going to play out. The mainframe is an important element, but not the only element in that story. So, it's an and. Matt, sorry, really long answer. But this is what is going to play out over the next three to five years.

So, thank you, all, for all of these questions. As you can see, we have been excited about our year. And the changes we have made to our business over the last few years, and our performance in 2025 reinforce our confidence on the next chapter of our growth. We look forward to continuing this dialogue through the year.

Olympia McNerney, IBM: 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.