SEC Settles With IBM for Misleading Statements Regarding Stock Option Expenses

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Washington, D.C., June 5, 2007 - The Securities and Exchange Commission announced today a settled enforcement action against International Business Machines Corporation for making materially misleading statements in a chart concerning the impact that the company’s decision to expense employee stock options would have on its first quarter 2005 (1Q05) and fiscal year 2005 (FY05) financial results. The misleading chart caused analysts to lower their earnings per share (EPS) estimates for the company.

Linda Chatman Thomsen, Director of the SEC’s Division of Enforcement, said, "Information regarding a company's earnings is one of the most important factors that many investors consider in making an investment decision, and it is essential that the information companies provide be clear and accurate."

The Commission found that IBM provided the misleading information during an April 5, 2005 conference call with analysts. The call was simultaneously webcast, and a transcript and the accompanying exhibits were filed with the Commission in a Form 8-K. During the call, IBM announced that beginning in 1Q05 it would report stock options as an expense in its financial statements and advised analysts to adjust their earnings models to account for the change. At the time, IBM expected that its stock options expense for 1Q05 would have a $0.10 impact on first quarter EPS results and estimated a $0.39 impact on FY05 EPS results. However, IBM did not disclose this information. IBM included a misleading chart in its presentation which, to many analysts, conveyed that the EPS impact of IBM's stock options expense would be $0.14 for 1Q05 and $0.55 for FY05. After IBM's April 5 announcement, the majority of analysts reduced their EPS estimates by these amounts.

SEC Associate Director of Enforcement Scott W. Friestad said, "IBM misled investors by failing to disclose information that would have allowed them to accurately determine the impact that the company's decision to expense stock options would have on its financial results. The facts here are particularly troubling because the disclosure decision was driven, in part, by management's perception of how the news would be interpreted by analysts."

The Commission’s Order finds that IBM did not disclose its expected stock options expense because it was concerned that analysts would add back to their EPS estimates any year-to-year reduction in the options expense instead of using the reduction to off-set an unrelated, previously-announced increased pension expense. According to the Order, management wanted to avoid this outcome because it would have increased the expected growth rate that analysts had set for IBM, which would have been difficult for the company to achieve because of the year-to-year increase in pension expense.
On April 14, 2005, IBM announced its 1Q05 financial results and disclosed earnings of $0.85 per share, which was $0.05 less than the amount that many analysts were expecting following the April 5 presentation. IBM also disclosed that its equity compensation expense was $0.10 per share for 1Q05, or $0.04 lower than what many analysts had understood IBM's April 5 misleading chart to have indicated it would be. IBM's stock price dropped $6.94 the next day, or over 8%, closing at $76.33.

The Commission found that IBM violated Section 13(a) of the Securities Exchange Act of 1934 and Rules 13a-11 and 12b-20 thereunder. Without admitting or denying the Commission's findings, IBM consented to the issuance of the Order, which requires IBM to cease and desist from committing or causing violations of these provisions.

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Additional materials: Administrative Proceeding Release No. 34-55858


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