

International Business Machines Corp. (NYSE: IBM)  
Sector: Technology  
Current Price:\$141.66  
P/E:8.70  
Dividend Yield:3.67%

Intrinsic Value: \$193.63  
52 Week High: \$190.89  
52 Week Low :\$140.62  
Market Cap. \$138.7B

## Business Description

International Business Machines Corp. (IBM) is a diversified technology company focused on providing enterprises with individualized information technology solutions. It has four operating segments: Global Services, Software, Systems & Technology, and Global Financing. In the past three years, IBM has significantly divested its hardware capabilities and heavily invested in services and software. In 2015, it is primarily a services and software company; those two capabilities account for nearly 85% of revenue. Moving forward, management is focused on growing four strategic imperatives: cloud computing, cognitive computing, enterprise mobile solutions, and digital security.

## Industry Trends

The information technology industry has been disrupted in the past five years due to a trend towards cloud computing. Cloud computing is a business model in which IT companies build hardware and software that can be rented remotely “as a service” by enterprises. It is important because enterprises no longer have to install hardware on-site, which lowers IT costs and allows them to store a vast amount of data. As a result, most companies are inundated with “big data” that they are incapable of analyzing for actionable insights. Since most enterprises have outdated cloud and analytics capabilities, there are huge opportunities for companies offering solutions in these areas.

## Competitive Advantage

IBM’s major competitors are Microsoft, Oracle, Amazon, HP, Cisco, and Accenture. IBM has several competitive advantages that will drive long-term revenue growth. One of IBM’s main competitive advantages is its ability to scale its hybrid cloud offerings using IT expertise and infrastructure capabilities. Second, IBM has advanced data analytics capabilities with the first commercially viable artificial intelligence engine: Watson. Data security is an issue of analytics, allowing IBM to use its expertise to capitalize on the growth of this industry. IBM has a strong diversity of complementary offerings making it a compelling option over competitors for companies looking for a single package to augment and improve their IT infrastructure and capabilities.

## Investment Thesis

Until now, IBM has been negatively affected by the cloud computing trend due to its focus on traditional hardware solutions. However, it is at the end of its transition out of traditional hardware and into higher margin software and services businesses, and it is set to grow revenue and free cash flow over the next 10 years. Despite current struggles, IBM is the market leader in the IT Services industry with an 8% market share – the industry is projected to grow to \$450B by 2021. With its strategic imperatives growing at nearly 30% per year, it is positioned to gain market share moving forward. Strategic imperatives are expected to account for 40% of revenue by 2018. At a price of \$141.66, IBM has a 9.9% free cash flow yield and a 3.7% dividend yield. With our growth projections for the next 10 years, IBM is an outstanding investment opportunity at this price.

## Key Valuation Statistics

Value Estimate: \$160 - \$220

WACC: 10%

Yearly Revenue Growth Rate: 3%

## Risks

The major risk that IBM faces is its ability to successfully transition from a company focused on hardware to a company focused on software, analytics, and IT services. There is strong competition in IBM’s various growth initiatives that may impede IBM’s growth in these markets. Likewise, IBM is dependent on innovation which may stall, and IBM may be unable to capitalize sufficiently on certain innovations. In addition, the increasing threat of cyberattacks poses a risk as they may result in the disclosure, modification, or destruction of data in addition to general disruption of services, particularly those relating to cloud computing.

## Corporate Social Responsibility

ESG Disclosure Score: 49.49 (Avg. 34.97)

Environmental Disclosure Score: 50.39 (Avg. 33.64)

Governance Disclosure Score: 60.71 (Avg. 55.84)

Equal Opportunity Policy: Yes

ESG Linked to Compensation: Yes

% Women on Board: 23.08 (Avg 20.12)

Energy Intensity/Sales: 66.03 (Avg 44)

Human Rights Policy: No

Water Intensity/Sales: 109.4 (Avg 95.02)

Health/Safety Policy: Yes

Business Ethics Policy: Yes

Equal Opportunity Policy: Yes

Fair Pay Policy: No

Community Spending as a % of EBITDA: .165% (Avg: 14.7%)

Employee CSR Training: No