

International Business Machines Corporation (NYSE: IBM)



Sector: Technology

Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap.	Dividend Yield	Beta
\$199.71	\$157.36	\$164.95	\$116.90	12.52	\$147.18B	3.61%	0.88

Business Description

International Business Machines Corporation (IBM) provides information technology (IT) products, solutions, and services globally. IBM has 4 business segments: Global Services (GS), Software Capabilities Systems Hardware, and Global Financing. Furthermore, Global Services can be broken down between Global Technology Services (GTS) and Global Business Services (GBS). GTS provides IT infrastructure services such as cloud computing, analytics, mobile, security, and social. GBS delivers predictable business outcomes through consulting in strategy, application, and software. The breakdown based on percent of revenue in 2015 is (\$81.7 billion total):

GS: 44% | Software: 43% | Hardware: 12% | Global Financing: 2%
IBM provides products and services directly and through third party distributors.

Industry Trends

Global Services: Cloud computing remains to be the driving force behind IT services. Despite only capturing 7% of the cloud market share (while the industry leader, Amazon, has 31%), IBM is the industry leader in hybrid cloud. Hybrid cloud is a combination of using the public and private cloud. Due to better security and more architectural flexibility, IT services are trending towards hybrid cloud.

Software: Software is expected to grow due to cloud, mobile, and analytics. The \$65 billion cloud software market is projected to continuously grow at 16% per year through 2020. As a leader in hybrid cloud, IBM is heavily exposed to this growth area. Also, the transition to the cloud and the digitization of data is expected to drive demand for analytics and artificial intelligence like IBM's Watson.

Hardware: The hardware industry is shrinking. The sales growth has decreased by 5.04% year over year. This is due to the increasing commoditization of hardware as developing countries are entering the market and capturing market share.

Global Financing: As the technology industry strays from hardware, the demand for refinancing is expected to decrease. However, IBM offers financing for all IBM solutions including financing for analytics, cloud, and systems.

Investment Thesis

IBM is significantly undervalued due to the corporation's recent transition from a hardware and software services company into a solutions provider. This transition has led to recent trends in declining revenue. However, throughout the transition process, IBM has maintained profitability with an EPS of 13.50 or more since 2012. IBM's transformation will be powered by development and growth in Cognitive Solutions and IBM's Cloud Platform. IBM is an industry leader in Data and Analytics with products such as Watson, a supercomputer that combines artificial intelligence and analytical software to provide solutions as a question answering machine. Additionally, IBM is a global leader in Hybrid Cloud, which will drive their efforts to compete with Amazon Web Services in the cloud industry.

Valuation Assumptions

WACC: 7.84%
Terminal FCF Growth Rate: 2.5%
Estimated EPS: 13.5; EST P/E: 11.63x
Estimated BVPS: 16.46; P/B: 9.54x

Key Financials

ROA: 10.3%
ROE: 81.1%
Pretax Margin: 19.5%
Net Income 2015: \$13.19 million

Corporate Social Responsibility

ESG Disclosure Score: 47.5 (Industry average: 42.56)
Sustainalytics ESG Score: 95.2 (Industry average: 81.05)
Percent Female Executives: 26.32% (Industry average: 15.34%)
Women Mgmt. to Employee Ratio: 0.84 (Industry average: 0.89)
Average Exec. Salary + Bonus: \$842.6K (Industry average: \$755.12K)

5-Year Stock Performance



Competitive Analysis

IT Services: IBM's main competitors are Accenture, Hewlett Packard, and Wipro Technologies.

Infrastructure Software: IBM's biggest competitors are Microsoft, Oracle, and Amazon.

Hardware: IBM mainly competes against Oracle, Dell, and HP.

Global Financing: IBM competes with numerous small players.

Competitive Advantages

IBM has transitioned into more profitable, faster growth areas. It calls these growth areas its 'Strategic Imperatives'. These Strategic Imperatives consist of the Cloud, Analytics, Mobile, Social, and Security. As companies become more and more technologically advanced, they will invest more into technologies such as hybrid cloud and cognitive solutions. It's estimated that hybrid cloud market alone will grow to be a \$400B industry and that analytics will grow to become a \$2T industry. As the industry leader in both of these segments, IBM is primed for success. Furthermore, IBM is in a strong, stable position due to its stable leadership team, its stable owners (largest investor is Berkshire Hathaway), and its commitment to investing in growth.

Risks

Transition Risk: There are inherent risks in transitioning a business model. As IBM transitions from a software and hardware services company to a solutions provider, IBM must remain innovative to overcome increased competition in cloud, analytics, and IT services.

Cybersecurity Risk: There is cybersecurity risk when using cloud computing. IBM will mitigate this risk with the use of hybrid cloud and security intelligence and analytics to detect vulnerabilities.

Competition: Due to the rapid growth in cloud, artificial intelligence, and data and analytics, there is increased competition. IBM will be able to overcome increased competition through utilizing previous relationships with current clients and utilizing economies of scale.

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Sources: Bloomberg, Yahoo! Finance

