



International Business Machines Corp. (IBM)

Updated October 27th, 2022 by Prakash Kolli

Key Metrics

Current Price:	\$135	5 Year CAGR Estimate:	5.6%	Market Cap:	\$120.19 B
Fair Value Price:	\$118	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	11/09/22
% Fair Value:	115%	5 Year Valuation Multiple Estimate:	-2.7%	Dividend Payment Date:	12/10/22
Dividend Yield:	4.9%	5 Year Price Target	\$143	Years Of Dividend Growth:	27
Dividend Risk Score:	B	Retirement Suitability Score:	A	Rating:	Hold

Overview & Current Events

IBM is a global information technology company that provides integrated enterprise solutions for software, hardware, and services. IBM's focus is running mission critical systems for large, multi-national customers and governments. IBM typically provides end-to-end solutions. IBM spun off Kyndryl, its managed infrastructure business, on November 3rd, 2021, but is still one of the largest IT services companies in the world. The company now has four business segments: Software, Consulting, Infrastructure, and Financing. IBM had annual revenue of ~\$57.4B in 2021 (not including Kyndryl).

IBM reported solid results for Q3 2022 on October 19th, 2022. Companywide revenue increased 6% to \$17,739M from \$16,339M while diluted adjusted earnings per share fell (-2%) to \$1.81 from \$1.84 on a year-over-year basis. Diluted GAAP earnings per share declined to a loss of (\$3.55) in the quarter from \$1.14 in the prior year on pension settlement charges. Also, IBM's earnings are being impacted by the strong US dollar, but growth was strong in constant currency.

Revenue for Software increased 7% to \$5,811M from \$5,406M in comparable quarters due to 8% growth in Hybrid Platform & Solutions and a 33% increase in Transaction Processing. Revenue was up 12% for RedHat, (-2%) for Automation, (-1%) for Data & AI, and (-1%) for Security. Consulting revenue increased 5.4% to \$4,700M from \$4,457M due to 5% rise in Business Transformation, 6% growth in Technology Consulting, and 6% growth in Application Operations. The book-to-bill ratio is a healthy 1.05X. Revenue for Infrastructure was up 14.8% at \$3,352M from \$2,921M due to a 33% rise in Hybrid Infrastructure and (-3%) decline in Infrastructure Support. Z Systems had 88% growth.

IBM completed its spinoff of Kyndryl at end of 2021, which was reported as discontinued operations.

IBM continues its higher pace of acquisitions with Envizi, Sentaca, Neudesic, Randori, Databand.ai, and Dialexa expanding its expertise and offerings. It is planning to sell Watson Health for \$1 billion.

IBM forecasts revenue growth in the high-single-digits and free cash flow of about \$10 billion in 2022.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	\$14.37	\$14.94	\$15.59	\$13.60	\$12.39	\$13.66	\$13.81	\$12.81	\$8.67	\$7.93	\$9.80	\$11.92
DPS	\$3.30	\$3.70	\$4.25	\$5.00	\$5.50	\$5.90	\$6.21	\$6.43	\$6.51	\$6.56	\$6.60	\$6.94
Shares¹	1117	1054	991	966	946	922	893	887	893	898	898	898

IBM's core operations are profitable. But IBM had difficulty generating growth in the past several years due to the transition to cloud and SaaS in the IT industry and IBM's late emphasis on this market. However, IBM is now focusing on cloud and SaaS and intends to be a major player in hybrid cloud as illustrated by the Red Hat and many smaller acquisitions. Earnings in 2020 were impacted by COVID-19 and non-operating pre-tax charges for business simplification. The company spun off Kyndryl in 2021, which had declining revenue and was not profitable. IBM has reorganized the remaining businesses into three operating segments. Due to the Red Hat acquisition and impact of the coronavirus we are not expecting any share buybacks in 2022 as the company deleverages. The company is increasing the dividend but at a very low rate of less than 1% annually.

¹ Share count in millions.

Disclosure: This analyst is long IBM.



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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	13.7	13.0	11.7	11.4	12.1	11.6	10.4	11.2	14.4	13.4	13.8	12.0
Avg. Yld.	1.7%	1.9%	2.3%	3.2%	3.7%	3.7%	5.8%	4.5%	5.2%	4.9%	4.9%	4.8%

IBM's stock price is up since our last report on good results. We have maintained our earnings estimate for 2022. Our fair value estimate is now \$118 using a fair value multiple of 12X. We increased the multiple due to rising software revenue. Our five-year price target is now \$143 share. The current dividend yield is still well above the market average.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2021	2027
Payout	23%	25%	27%	37%	44%	43%	45%	50%	75%	83%	67%	58%

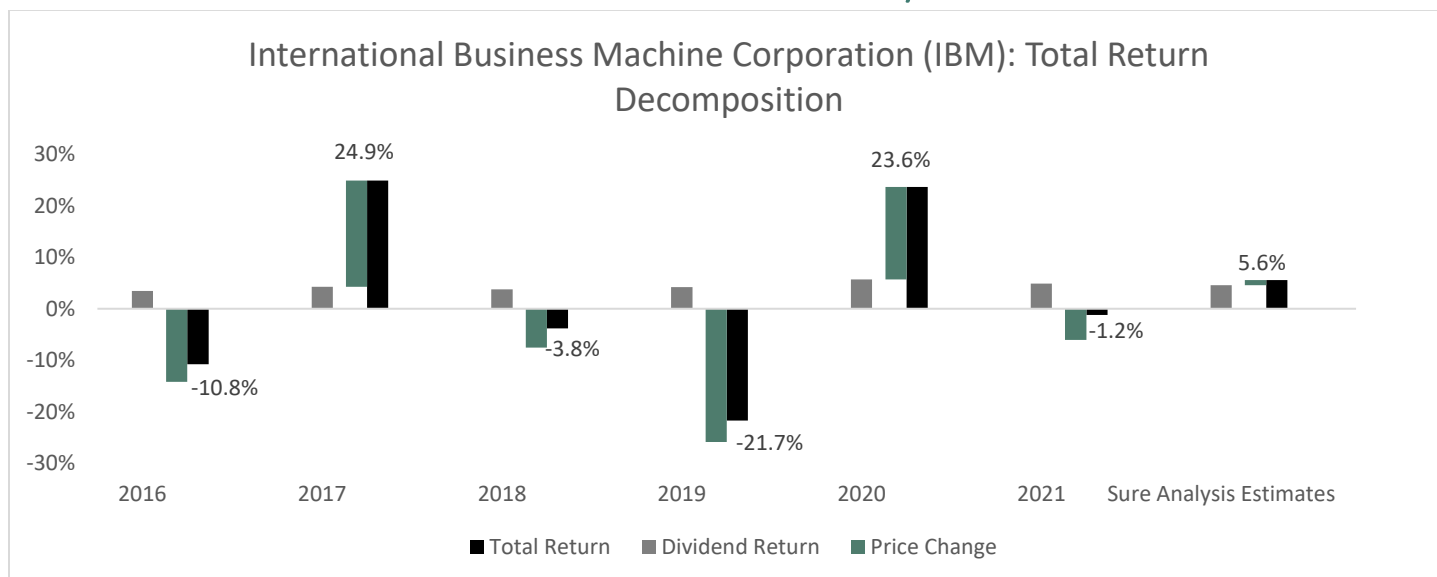
IBM's competitive strength is its brand, entrenched customer relations and extensive patent portfolio. IBM is also the market leader in mainframe computers where it has 90% of the market and little competition. IBM is a different company after the Kyndryl spin off, but it should still be recession resistant. The nature of mission critical IT enterprise systems and software makes this unlikely to change in the near future. IBM has a leading position in networking, global cellular connections, credit card transaction processing, airlines, banks, hotels, retail, etc. However, the company does face risks in that many of its competitors have emphasized the cloud earlier and are growing faster.

IBM is deleveraging after increasing debt for acquiring Red Hat. IBM divides its debt into core debt and financing debt. Debt is down ~\$22B+ since the acquisition and core debt is now \$39.7B and is offset by \$9.7B in cash, equivalents, and securities. Global Financing debt is \$11.2B and it is decreasing due to winding down of OEM financing.

Final Thoughts & Recommendation

At present we are forecasting a 5.6% annualized total return for the next five years from a dividend yield of 4.9%, 4% EPS growth, and (-2.7%) from P/E contraction. IBM is now primarily a software and consulting company focusing on the hybrid cloud. IBM should benefit moving forward as software sales are higher margin. The current dividend yield is attractive, and earnings coverage has improved since 2021. At the current price, we rate this stock a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue (\$B)	102.87	98.37	92.79	81.74	79.92	79.14	79.59	77.15	73.62	57.35
Gross Profit	50361	48684	46407	40684	38516	36943	36936	36488	35575	31490
Gross Margin	49.0%	49.5%	50.0%	49.8%	48.2%	46.7%	46.4%	47.3%	48.3%	54.9%
SG&A Exp.	23085	22924	22472	19894	20279	19128	18863	20604	23082	18740
D&A Exp.	4676	4678	4492	3855	4381	4541	4480	6059	6695	6416
Operating Profit	22156	20313	18532	15690	13552	13140	13218	10543	6786	6865
Op. Margin	21.5%	20.7%	20.0%	19.2%	17.0%	16.6%	16.6%	13.7%	9.2%	12.0%
Net Profit	16604	16483	12022	13190	11872	5753	8728	9431	5590	5742
Net Margin	16.1%	16.8%	13.0%	16.1%	14.9%	7.3%	11.0%	12.2%	7.6%	10.0%
Free Cash Flow	14869	13345	12685	13104	12934	12951	11283	12400	15155	10420
Income Tax	5541	3363	4234	2581	449	5642	2619	731	-864	-124

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets (\$B)	119.21	126.22	117.27	110.50	117.47	125.36	123.38	152.19	155.60	132.00
Cash & Equivalents	10412	10716	8476	7686	7826	11972	11379	8172	13212	6650
Acc. Receivable	10667	10465	9090	8333	9182	8928	7432	7870	7132	6754
Inventories	2287	2310	2103	1551	1553	1583	1682	1619	1839	1649
Goodwill & Int.	33034	35055	33659	35507	40888	40529	39353	73456	73413	68150
Total Liab. (\$B)	100.23	103.29	105.26	96.07	99.08	107.63	106.45	131.20	135.24	113.00
Accounts Payable	7952	7461	6864	6028	6209	6451	6558	4896	4908	3955
Long-Term Debt	33270	39719	40722	39889	42168	46823	45812	62899	61538	51700
Total Equity	18860	22792	11868	14262	18246	17594	16796	20841	20597	18900
LTD/E Ratio	1.76	1.74	3.43	2.80	2.31	2.66	2.73	3.02	2.99	2.74

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	14.1%	13.4%	9.9%	11.6%	10.4%	4.7%	7.0%	6.8%	3.6%	4.0%
Return on Equity	85.2%	79.1%	69.4%	101.1%	73.0%	32.1%	50.8%	50.1%	27.0%	29.1%
ROIC	32.0%	28.7%	20.8%	24.6%	20.7%	9.2%	13.7%	12.9%	6.7%	7.5%
Shares Out.	1117	1054	990	965	946	922	892	892	889	905
Revenue/Share	89.03	89.18	91.87	83.18	83.36	84.43	86.86	86.41	82.11	63.40
FCF/Share	12.87	12.10	12.56	13.33	13.49	13.82	12.31	13.89	16.90	11.51

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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