



# International Business Machines Corp. (IBM)

Updated October 16<sup>th</sup>, 2018 by Bob Ciura

## Key Metrics

<b>Current Price:</b>	\$139	<b>5 Year CAGR Estimate:</b>	11.7%	<b>Volatility Percentile:</b>	30.3%
<b>Fair Value Price:</b>	\$170	<b>5 Year Growth Estimate:</b>	3.0%	<b>Momentum Percentile:</b>	44.7%
<b>% Fair Value:</b>	81%	<b>5 Year Valuation Multiple Estimate:</b>	4.2%	<b>Growth Percentile:</b>	10.6%
<b>Dividend Yield:</b>	4.5%	<b>5 Year Price Target</b>	\$197	<b>Valuation Percentile:</b>	83.1%
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	70.9%

## Overview & Current Events

IBM is an information technology company, which provides integrated solutions that leverage information technology and knowledge of business processes. The company was founded in 1911. Today, it has a market capitalization of \$131 billion.

On 10/16/18 IBM reported third-quarter earnings results. Revenue of \$18.68 billion declined 2% year-over-year, but was flat in constant currency. Revenue missed analyst estimates by \$330 million. Adjusted earnings-per-share of \$3.42 beat analyst expectations by \$0.02 per share, and increased 5.0% from the same quarter a year ago. Assessing IBM's results by segment, Global Business Services revenue increased 3%, led by consulting, while Cognitive Solutions declined 5% in constant currency. The Technology Services and Cloud Platform was flat for the quarter. Systems revenue increased 2% driven by IBM's power and IBM Z businesses.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$8.93	\$10.01	\$11.52	\$13.06	\$14.37	\$14.94	\$15.59	\$13.60	\$12.39	\$12.04	<b>\$13.80</b>	<b>\$16.00</b>
<b>DPS</b>	\$1.90	\$2.15	\$2.50	\$2.90	\$3.30	\$3.70	\$4.25	\$5.00	\$5.50	\$5.90	<b>\$6.60</b>	<b>\$7.65</b>
<b>Shares</b>	1339	1305	1228	1163	1117	1054	990	965	946	922	<b>920</b>	<b>900</b>

We continue to expect a gradual turnaround for IBM. As shown in the above table, the company grew earnings at a rapid pace after the end of the Great Recession. Growth began slowing down dramatically starting in 2014 and earnings have declined each year since. Now that IBM has returned to revenue growth, chances are good that the company can return to earnings growth this year as well. The key areas of growth for IBM are data, mobile, security, and analytics.

Collectively, IBM refers to its group of growth initiatives as the "strategic imperatives", which continue to perform well. In the past 12 months, total strategic revenue increased 11% to \$39.5 billion. Total cloud revenue increased 20% to \$19 billion in the past four reported quarters. The annual exit run rate for as-a-service revenue increased 24% in the quarter to \$11.4 billion. As the strategic imperatives become a larger part of the overall organization, IBM should return to earnings growth in the years ahead. Due to the disappointing third-quarter earnings, we are reducing our forecast. We now expect 3% annual earnings growth through 2023.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	12.3	10.9	11.4	13.1	13.7	13.0	11.7	11.4	12.1	13.1	<b>10.0</b>	<b>12.3</b>
<b>Avg. Yld.</b>	1.7%	2.0%	1.9%	1.7%	1.7%	1.9%	2.3%	3.2%	3.7%	3.7%	<b>4.5%</b>	<b>3.9%</b>

IBM expects to generate earnings-per-share of \$13.80 in 2018. Based on this, stock trades for a price-to-earnings ratio of 10.5. This is below the historical valuation of the stock. Over the past 10 years, IBM traded for an average price-to-earnings ratio of 12.3, which is a reasonable estimate of fair value. IBM is still having difficulty turning itself around, but the company remains highly profitable and has a strong brand. Assuming a price-to-earnings ratio of 12.3 and earnings-



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per-share of \$13.80, the fair value price for IBM stock is approximately \$170. A rising valuation could add 4.2% to IBM's annual shareholder returns over the next five years.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

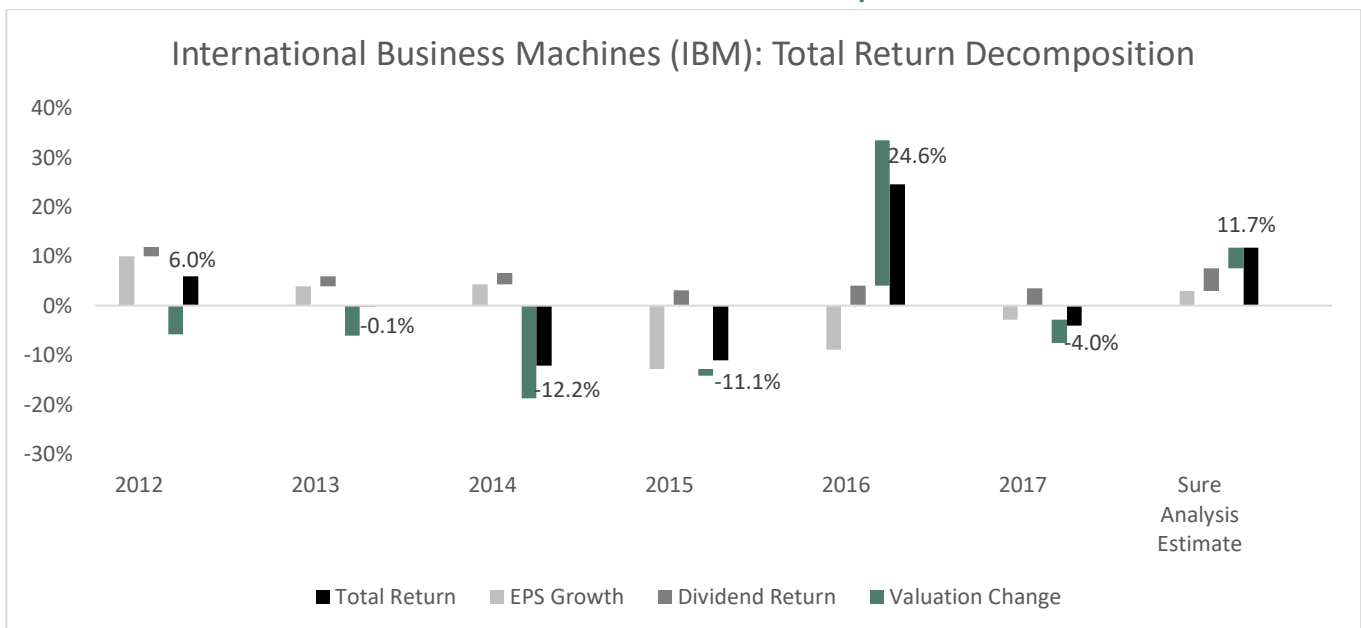
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	41.7%	40.2%	40.5%	43.1%	42.2%	38.6%	39.6%	36.8%	32.6%	28.9%	<b>29.0%</b>	<b>29.0%</b>
<b>Debt/A</b>	87.6%	79.1%	79.6%	82.6%	84.1%	81.8%	89.7%	86.9%	84.3%	85.9%	<b>86.0%</b>	<b>86.0%</b>
<b>Int. Cov.</b>	52.7	60.2	72.8	77.9	65.7	62.9	51.9	45.6	24.8	25.5	<b>25.5</b>	<b>25.5</b>
<b>Payout</b>	21.3%	21.5%	21.7%	22.2%	23.0%	24.8%	27.3%	36.8%	44.4%	49.0%	<b>47.8%</b>	<b>47.8%</b>
<b>Std. Dev.</b>	32.0%	20.7%	12.6%	18.5%	15.3%	15.9%	18.1%	15.6%	21.1%	16.6%	<b>16.5%</b>	<b>16.5%</b>

Despite IBM's prolonged difficulties, the company still has a strong balance sheet. The company also has a dividend payout ratio below 50%, which indicates sufficient dividend coverage. IBM has a strong brand and an impressive patent portfolio. The company has led the world in U.S. patents earned for 25 years in a row. Last year it set a new record with over 9,000 patents, nearly half of which are in strategic areas such as artificial intelligence, cloud technology, blockchain, and other emerging technologies. IBM is a surprisingly recession-resistant company. Despite operating in a cyclical industry, IBM grew earnings-per-share in 2008 and 2009, during the worst years of the Great Recession. Quantitatively, the company earns C ratings for both Dividend Safety and Retirement Suitability. It is a suitable choice for those looking to add passive income to their investment portfolios.

## Final Thoughts & Recommendation

Investors have likely been disappointed with IBM's performance over the past few years. While the turnaround has taken longer than many investors would prefer, it is not easy to turn around a company as large as IBM. The good news is, growth has finally returned, meaning IBM stock could be a buying opportunity at its current valuation. The combination of valuation changes, earnings growth, and dividends are expected to result in annual returns of 11.7%. This estimate earns IBM a buy recommendation from Sure Dividend at current prices.

## Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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## Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue</b>	103.6	95.8	99.9	106.9	102.9	98.4	92.8	81.7	79.9	79.1
<b>Gross Profit</b>	45.7	43.8	46.0	50.1	50.4	48.7	46.4	40.7	38.3	36.2
<b>Gross Margin</b>	44.1%	45.7%	46.1%	46.9%	49.0%	49.5%	50.0%	49.8%	47.9%	45.8%
<b>SG&amp;A Exp.</b>	22.8	20.5	21.5	23.2	23.1	22.9	22.5	19.9	20.5	19.6
<b>D&amp;A Exp.</b>	5.5	5.0	4.8	4.8	4.7	4.7	4.5	3.9	4.4	4.5
<b>Operating Profit</b>	15.9	17.0	19.3	21.4	22.2	20.3	18.5	15.7	13.1	11.8
<b>Operating Margin</b>	15.4%	17.8%	19.3%	20.0%	21.5%	20.7%	20.0%	19.2%	16.4%	14.9%
<b>Net Profit</b>	12.3	13.4	14.8	15.9	16.6	16.5	12.0	13.2	11.9	5.8
<b>Net Margin</b>	11.9%	14.0%	14.9%	14.8%	16.1%	16.8%	13.0%	16.1%	14.9%	7.3%
<b>Free Cash Flow</b>	13.9	16.7	14.8	15.2	14.9	13.3	12.7	13.1	12.9	13.0
<b>Income Tax</b>	4.4	4.7	4.9	5.1	5.5	3.4	4.2	2.6	0.4	5.6

## Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Total Assets</b>	109.5	109.0	113.5	116.4	119.2	126.2	117.3	110.5	117.5	125.4
<b>Cash &amp; Equivalents</b>	12.7	12.2	10.7	11.9	10.4	10.7	8.5	7.7	7.8	12.0
<b>Accounts Receivable</b>	12.1	11.9	12.0	11.2	10.7	10.5	9.1	8.3	9.2	8.9
<b>Inventories</b>	2.7	2.5	2.5	2.6	2.3	2.3	2.1	1.6	1.6	1.6
<b>Goodwill &amp; Int. Ass.</b>	21.1	22.7	28.6	29.6	33.0	35.1	33.7	35.5	40.9	40.5
<b>Total Liabilities</b>	95.9	86.3	90.3	96.2	100.2	103.3	105.3	96.1	99.1	107.6
<b>Accounts Payable</b>	7.0	7.4	7.8	8.5	8.0	7.5	6.9	6.0	6.2	6.5
<b>Long-Term Debt</b>	33.9	26.1	28.6	31.3	33.3	39.7	40.7	39.9	42.2	46.8
<b>Shareholder's Equity</b>	13.5	22.6	23.0	20.1	18.9	22.8	11.9	14.3	18.2	17.6
<b>D/E Ratio</b>	2.52	1.15	1.24	1.56	1.76	1.74	3.43	2.80	2.31	2.66

## Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Return on Assets</b>	10.7%	12.3%	13.3%	13.8%	14.1%	13.4%	9.9%	11.6%	10.4%	4.7%
<b>Return on Equity</b>	58.8%	74.4%	64.9%	73.4%	85.2%	79.1%	69.4%	101%	73.0%	32.1%
<b>ROIC</b>	22.2%	27.9%	29.5%	30.7%	32.0%	28.7%	20.8%	24.6%	20.7%	9.2%
<b>Shares Out.</b>	1339	1305	1228	1163	1117	1054	990	965	946	922
<b>Revenue/Share</b>	74.67	71.39	77.58	88.09	89.03	89.18	91.87	83.18	83.36	84.43
<b>FCF/Share</b>	10.03	12.45	11.49	12.51	12.87	12.10	12.56	13.33	13.49	13.82

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

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