



# International Business Machines Corp. (IBM)

Updated January 22<sup>nd</sup>, 2019 by Bob Ciura

## Key Metrics

<b>Current Price:</b>	\$123	<b>5 Year CAGR Estimate:</b>	14.3%	<b>Volatility Percentile:</b>	40.1%
<b>Fair Value Price:</b>	\$178	<b>5 Year Growth Estimate:</b>	3.0%	<b>Momentum Percentile:</b>	22.9%
<b>% Fair Value:</b>	69%	<b>5 Year Valuation Multiple Estimate:</b>	6.2%	<b>Growth Percentile:</b>	11.4%
<b>Dividend Yield:</b>	5.1%	<b>5 Year Price Target</b>	\$193	<b>Valuation Percentile:</b>	86.8%
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	A	<b>Total Return Percentile:</b>	78.9%

## 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, and currently trades with a market capitalization of \$112 billion. It operates five business segments: Cognitive Solutions, Global Business Services, Technology Services & Cloud Platforms, Systems, and Global Financing. IBM generates annual revenue above \$79 billion. In late January (1/22/2019) IBM reported fourth-quarter and full-year 2018 financial results. IBM delivered a beat on both the top and bottom line for the fourth quarter. Revenue of \$21.8 billion beat analyst estimates by \$30 million, while adjusted earnings-per-share of \$4.87 beat by \$0.05 per share. Revenue declined 3.5% from the same quarter last year, continuing a concerning trend. The Global Business Services and Cognitive Solutions posted revenue growth of 2% and 6%, respectively. Technology Services and Cloud Platforms was flat for the quarter. Growth was more than offset by declines 9% in Global Financing and 20% in Systems. However, IBM shares rose 4% in after-hours trading following the announcement, so it seems investors appreciated IBM's results for being better than expected.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$10.01	\$11.52	\$13.06	\$14.37	\$14.94	\$15.59	\$13.60	\$12.39	\$13.66	\$13.81	<b>\$13.90</b>	<b>\$16.11</b>
<b>DPS</b>	\$2.15	\$2.50	\$2.90	\$3.30	\$3.70	\$4.25	\$5.00	\$5.50	\$5.90	\$6.60	<b>\$6.80</b>	<b>\$7.88</b>
<b>Shares</b>	1305	1228	1163	1117	1054	990	965	946	922	916	<b>910</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. But growth began slowing down dramatically starting in 2014. Now that IBM has returned to growth, it appears the turnaround is finally materializing. The key areas of future growth for IBM are data, mobile, security, and analytics. In 2018, total strategic revenue increased 9% to \$39.8 billion. Total cloud revenue increased 12% to \$19.2 billion for the year. The annual exit run rate for as-a-service revenue increased 21% in the quarter to \$12.2 billion.

In late October (10/29/18) IBM announced it will acquire Red Hat, Inc. for \$190 per share, representing a total enterprise value of \$34 billion, the largest deal in IBM's history. Red Hat operates in the open-source software market and primarily distributes technology products used in data centers. It generates annual revenue of nearly \$3 billion. IBM made the deal to boost its cloud platform, which is one of its most important strategic growth areas. We expect 3% annual earnings growth through 2024.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
<b>Avg. P/E</b>	10.9	11.4	13.1	13.7	13.0	11.7	11.4	12.1	13.1	8.2	<b>8.9</b>	<b>12.0</b>
<b>Avg. Yld.</b>	2.0%	1.9%	1.7%	1.7%	1.9%	2.3%	3.2%	3.7%	3.7%	5.8%	<b>5.1%</b>	<b>3.9%</b>

IBM expects to generate earnings-per-share of \$13.90 in 2019. Based on this, the stock trades for a price-to-earnings ratio of 8.9. This is below the historical valuation of the stock. Over the past 10 years, IBM traded for an average price-

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to-earnings ratio of 12.3. Our fair value estimate is a price-to-earnings ratio of 12.0. IBM is still having difficulty turning itself around, but the company remains highly profitable and has a strong brand. The stock appears to be significantly undervalued at the present time. A rising valuation could add 6.2% to IBM's annual shareholder returns over the next five years if the stock's valuation expands to our fair value estimate during this time horizon.

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

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	21.5%	21.7%	22.2%	23.0%	24.8%	27.3%	36.8%	44.4%	49.0%	47.8%	<b>58.1%</b>	<b>55.0%</b>

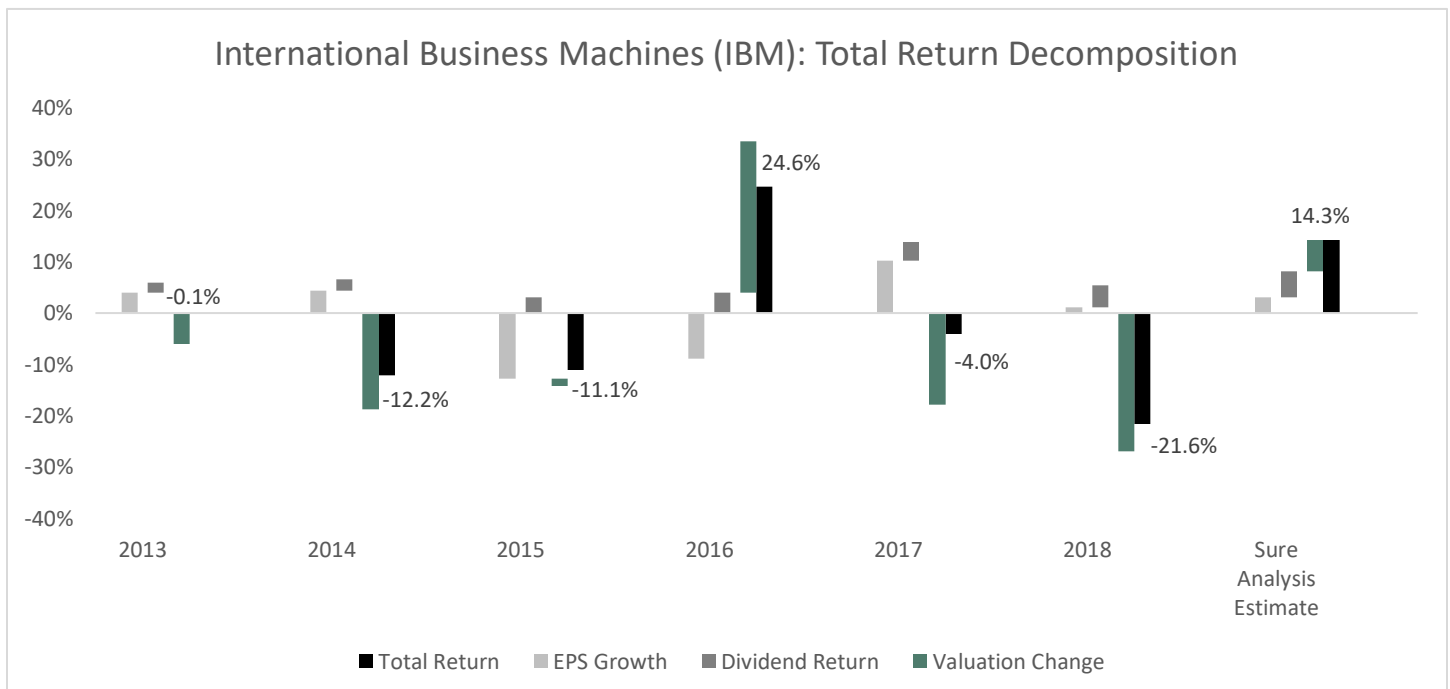
Despite IBM's prolonged difficulties, the company still has a strong balance sheet and a sustainable dividend. It has a dividend payout ratio below 50%, which indicates sufficient dividend coverage. IBM has a strong brand and an impressive patent portfolio. The company received the most patents of any U.S. company in 2018, for the 26<sup>th</sup> year in a row. IBM received 9,100 patents across artificial intelligence, cloud computing, and cybersecurity, which represent the company's most promising growth areas.

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 high 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 14.3%. This estimate earns IBM a buy recommendation from Sure Dividend at current prices.

## Total Return Breakdown by Year



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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 millions of U.S. Dollars unless per share or indicated otherwise.

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