



International Business Machines Corp. (IBM)

Updated October 25th, 2021 by Prakash Kolli

Key Metrics

Current Price:	\$128	5 Year CAGR Estimate:	6.5%	Market Cap:	\$114.62B
Fair Value Price:	\$114	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	11/10/21
% Fair Value:	112%	5 Year Valuation Multiple Estimate:	-2.3%	Dividend Payment Date:	12/10/21
Dividend Yield:	5.1%	5 Year Price Target	\$138	Years Of Dividend Growth:	26
Dividend Risk Score:	B	Retirement Suitability Score:	A	Last Dividend Increase:	0.6%

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. In the services business, IBM is the world's largest IT provider with ~5.5% market share. In software, IBM's software business is mostly middleware, which is the software layer that connects applications and devices to each other. In hardware, IBM sells the z15 mainframes, storage, and the Power-based servers. The company has five business segments: Cloud & Cognitive Software, Global Business Services, Global Technology Services, Systems, and Global Financing. IBM had annual revenue of ~\$73.6B in 2020.

IBM reported results for Q3 2021 on October 20th, 2021. Companywide revenue increased 0.3% to \$17,618M from \$17,560M while diluted adjusted earnings per share fell (-2%) to \$2.52 from \$2.58 on a year-over-year basis. Diluted GAAP earnings per share fell (-34%) to \$1.25 in the quarter from \$1.89 in the prior year due to one-time charges.

Revenue for Cloud & Cognitive Software increased 2.5% to \$5,692M from \$5,553M in comparable quarters due to 10% growth in Cloud & Data, flat growth in Cognitive, and a (-9%) decline in Transaction Processing. Global Business Revenue increased 11.6% to \$4,427M from \$3,965M due to 17% growth in Consulting, 19% rise in Global Process Services, and 5% growth in Application Management. Revenue for Systems fell (-11.9%) to \$1,107M from \$1,257M due to declines in Z (-33%) and Power (-24%) offset by 11% growth in Storage. Revenue for Global Technology Services was down (-4.8%) to \$6,154M from \$6,462M due a decline in Infrastructure & Cloud Services (-5%) and Technology Support Services (-4%).

The company paid down about \$7B in total debt in the first three quarters of 2021. IBM is acquiring companies to reinforce its product and services offerings and has spent ~\$3.0B on Rego Consulting, 7Summits, Bluetab, BoxBoat, Waeg, Turbonomic and other companies. IBM is splitting into two companies, a new IBM and Kyndryl (Managed Infrastructure Services) by end of CY 2021. Shareholders will receive 80.1% of the new company and IBM will retain the remaining 19.9%. Kyndryl will have about \$1B in debt. The total dividend between the two companies will be no less than the current dividend.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$13.06	\$14.37	\$14.94	\$15.59	\$13.60	\$12.39	\$13.66	\$13.81	\$12.81	\$8.67	\$10.32	\$12.56
DPS	\$2.90	\$3.30	\$3.70	\$4.25	\$5.00	\$5.50	\$5.90	\$6.21	\$6.43	\$6.51	\$6.56	\$7.98
Shares¹	1163	1117	1054	990	965	946	922	892	892	893	893	807

IBM's core operations are profitable. But IBM has 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 impending spinoff of Kyndryl will affect future earnings, debt, and dividend growth estimates. Due to the Red Hat acquisition and impact of the coronavirus we are not expecting any share buybacks in 2021 as the company deleverages.

¹ Share count in millions.

Disclosure: This analyst is long IBM.



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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	13.1	13.7	13.0	11.7	11.4	12.1	11.6	10.4	11.2	14.4	12.4	11.0
Avg. Yld.	1.7%	1.7%	1.9%	2.3%	3.2%	3.7%	3.7%	5.8%	4.5%	5.2%	5.1%	5.8%

IBM's stock price is down since our last report. After two better quarters IBM missed revenue estimates and we have reduced our earnings estimate to match the consensus. Our fair value estimate is now \$114 using our fair value multiple of 11X. Our five-year price target is now \$138 share. The current dividend yield is still well above the market average.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	22%	23%	25%	27%	37%	44%	43%	45%	50%	75%	64%	64%

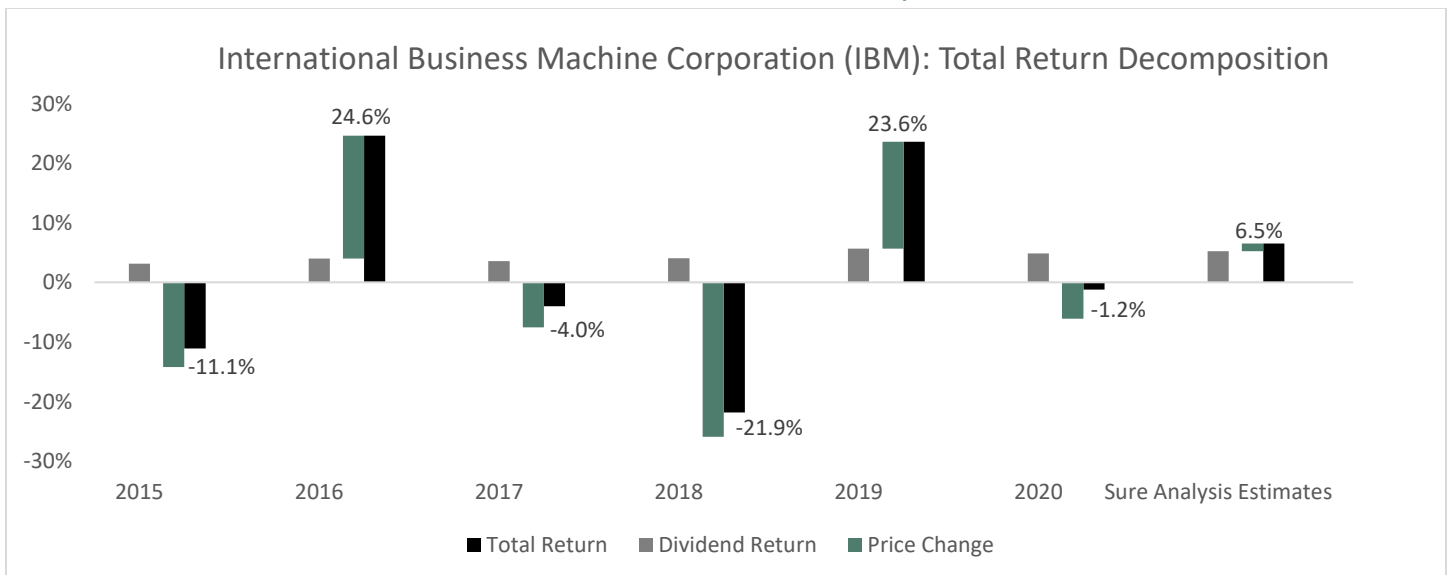
IBM's competitive strength is its brand, entrenched customer relations and extensive patent portfolio. IBM is also the market leader in mainframe computers where it has little competition. IBM is a surprisingly recession-resistant company since the company has long-term service and maintenance contracts leading to recurring revenue and cash flows. The nature of mission critical IT enterprise systems makes this unlikely to change in the near future. 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 \$18.5B since the acquisition and core debt is now \$38.6B and is offset by \$8.4B in cash, equivalents, and securities. Global Financing debt is \$15.9B and it is decreasing due to winding down of OEM financing.

Final Thoughts & Recommendation

At present we are forecasting a 6.5% annualized total return for the next five years. After two consecutive quarters of revenue growth IBM's revenue grew weakly this quarter. IBM's performance is improving and the company is deleveraging. The separation of Kyndryl will alter IBM as it becomes more of a software and consulting company rather than a services company. This should benefit IBM as software sales are higher margin. Income investors may want to consider this stock for the high dividend yield and decent dividend safety. At the current price, we rate this stock a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue (\$B)	106.92	102.87	98.37	92.79	81.74	79.92	79.14	79.59	77.15	73.62
Gross Profit	50138	50361	48684	46407	40684	38516	36943	36936	36488	35575
Gross Margin	46.9%	49.0%	49.5%	50.0%	49.8%	48.2%	46.7%	46.4%	47.3%	48.3%
SG&A Exp.	23217	23085	22924	22472	19894	20279	19128	18863	20604	23082
D&A Exp.	4815	4676	4678	4492	3855	4381	4541	4480	6059	6695
Operating Profit	21394	22156	20313	18532	15690	13552	13140	13218	10543	6786
Op. Margin	20.0%	21.5%	20.7%	20.0%	19.2%	17.0%	16.6%	16.6%	13.7%	9.2%
Net Profit	15855	16604	16483	12022	13190	11872	5753	8728	9431	5590
Net Margin	14.8%	16.1%	16.8%	13.0%	16.1%	14.9%	7.3%	11.0%	12.2%	7.6%
Free Cash Flow	15179	14869	13345	12685	13104	12934	12951	11283	12400	15155
Income Tax	5148	5541	3363	4234	2581	449	5642	2619	731	-864

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets (\$B)	116.43	119.21	126.22	117.27	110.50	117.47	125.36	123.38	152.19	15.60
Cash & Equivalents	11922	10412	10716	8476	7686	7826	11972	11379	8172	13212
Acc. Receivable	11179	10667	10465	9090	8333	9182	8928	7432	7870	7132
Inventories	2595	2287	2310	2103	1551	1553	1583	1682	1619	1839
Goodwill & Int.	29607	33034	35055	33659	35507	40888	40529	39353	73456	73413
Total Liab. (\$B)	96.20	100.23	103.29	105.26	96.07	99.08	107.63	106.45	131.20	135.24
Accounts Payable	8517	7952	7461	6864	6028	6209	6451	6558	4896	4908
Long-Term Debt	31322	33270	39719	40722	39889	42168	46823	45812	62899	61538
Total Equity	20138	18860	22792	11868	14262	18246	17594	16796	20841	20597
D/E Ratio	1.56	1.76	1.74	3.43	2.80	2.31	2.66	2.73	3.02	2.99

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	13.8%	14.1%	13.4%	9.9%	11.6%	10.4%	4.7%	7.0%	6.8%	3.6%
Return on Equity	73.4%	85.2%	79.1%	69.4%	101.0%	73.0%	32.1%	50.8%	50.1%	27.0%
ROIC	30.7%	32.0%	28.7%	20.8%	24.6%	20.7%	9.2%	13.7%	12.9%	6.7%
Shares Out.	1163	1117	1054	990	965	946	922	892	892	889
Revenue/Share	88.09	89.03	89.18	91.87	83.18	83.36	84.43	86.86	86.41	82.11
FCF/Share	12.51	12.87	12.10	12.56	13.33	13.49	13.82	12.31	13.89	16.90

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

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