



# International Business Machines Corp. (IBM)

Updated January 31<sup>st</sup>, 2022 by Prakash Kolli

## Key Metrics

|                             |       |  |       |                                  |                       |
|-----------------------------|-------|--|-------|----------------------------------|-----------------------|
| <b>Current Price:</b>       | \$135 | <b>5 Year CAGR Estimate:</b>               | 6.2%  | <b>Market Cap:</b>               | \$120.62B             |
| <b>Fair Value Price:</b>    | \$121 | <b>5 Year Growth Estimate:</b>             | 4.0%  | <b>Ex-Dividend Date:</b>         | 02/09/22 <sup>1</sup> |
| <b>% Fair Value:</b>        | 111%  | <b>5 Year Valuation Multiple Estimate:</b> | -2.1% | <b>Dividend Payment Date:</b>    | 03/10/22              |
| <b>Dividend Yield:</b>      | 4.9%  | <b>5 Year Price Target</b>                 | \$147 | <b>Years Of Dividend Growth:</b> | 26                    |
| <b>Dividend Risk Score:</b> | B     | <b>Retirement Suitability Score:</b>       | A     | <b>Last Dividend Increase:</b>   | 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. IBM spun off Kyndryl, its managed infrastructure business, on November 3<sup>rd</sup>, 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 excellent results for Q4 2021 on January 24<sup>th</sup>, 2021. Companywide revenue increased 6.5% to \$16,695M from \$15,682M while diluted adjusted earnings per share rose 78% to \$3.35 from \$1.88 on a year-over-year basis. Diluted GAAP earnings per share rose 106% to \$2.72 in the quarter from \$1.32 in the prior year.

Revenue for Software increased 8% to \$7,273M from \$6,719M in comparable quarters due to 9% growth in Hybrid Platform & Solutions, and a 14% increase in Transaction Processing. Revenue was up 21% for RedHat and 15% for Automation. Consulting revenue increased 13% to \$4,746M from \$4,196M due to 20% rise in Business Transformation, 19% growth in Technology Consulting, and 8% growth in Application Operations. The book-to-bill ratio is a healthy 1.2X. Revenue for Infrastructure was flat at \$4,414M from \$4,425M due to declines in Z (-4%) offset by 7% growth in Distributed Infrastructure, and 1% increase in Infrastructure Support.

For the year, total revenue increased to \$57,350 million from \$55,179 million driven by growth in Software and Consulting, while diluted adjusted earnings per share rose to \$7.93 from \$6.82 on a year-over-year basis. IBM completed its spinoff of Kyndryl, which was reported as discontinued operations. The company reorganized its remaining business units into three operating segments and the businesses remaining in GTS were moved to the Infrastructure segment.

The company paid down ~\$10B in total debt in 2021. IBM is reinforcing its product and services offerings and has acquired Rego Consulting, 7Summits, Bluetab, BoxBoat, Waeg, Turbonomic. SXiQ, and other companies in 2021.

## Growth on a Per-Share Basis

| Year                      | 2012    | 2013    | 2014    | 2015    | 2016    | 2017    | 2018    | 2019    | 2020   | 2021   | 2022           | 2027           |
|---------------------------|---------|---------|---------|---------|---------|---------|---------|---------|--------|--------|----------------|----------------|
| <b>EPS</b>                | \$14.37 | \$14.94 | \$15.59 | \$13.60 | \$12.39 | \$13.66 | \$13.81 | \$12.81 | \$8.67 | \$7.93 | <b>\$10.08</b> | <b>\$12.26</b> |
| <b>DPS</b>                | \$3.30  | \$3.70  | \$4.25  | \$5.00  | \$5.50  | \$5.90  | \$6.21  | \$6.43  | \$6.51 | \$6.56 | <b>\$6.63</b>  | <b>\$6.97</b>  |
| <b>Shares<sup>2</sup></b> | 1117    | 1054    | 991     | 966     | 946     | 922     | 893     | 887     | 893    | 898    | <b>898</b>     | <b>898</b>     |

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 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 2021 or 2022 as the company deleverages.

<sup>1</sup> Estimated dates based on prior years. IBM has not yet declared the next dividend.

<sup>2</sup> 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 | 16.8 | 13.3 | 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% | 4.7% |

IBM's stock price is up since our last report after the Kyndryl spin off and an excellent fourth quarter. Our fair value estimate is now \$121 using a fair value multiple of 12X. We increased the multiple due to rising software revenue. Our five-year price target is now \$147 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%  | 66%  | 57%  |

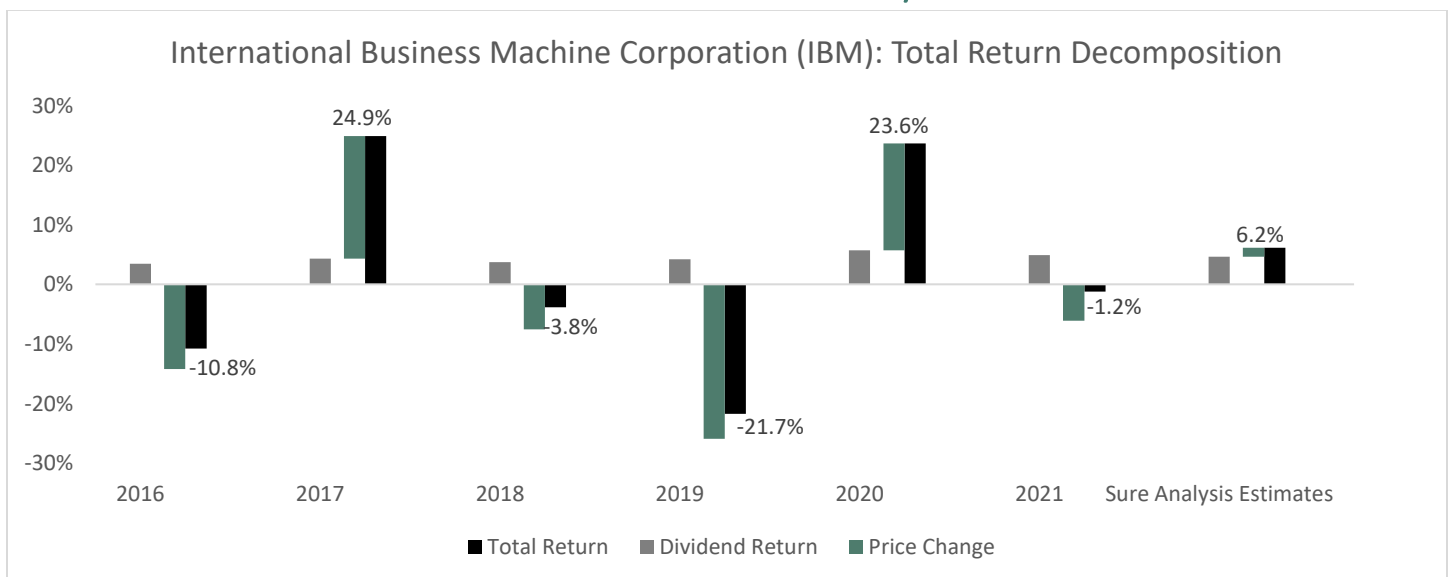
IBM's competitive strength is its brand, entrenched customer relations and extensive patent portfolio. IBM is also the market leader in mainframe computers where it has 90% of the market and little competition. IBM is a different company after the Kyndryl spin off, but it should still be recession resistant. 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, 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 ~\$21B+ since the acquisition and core debt is now \$37.8B and is offset by \$7.6B in cash, equivalents, and securities. Global Financing debt is \$13.9B and it is decreasing due to winding down of OEM financing.

## Final Thoughts & Recommendation

At present we are forecasting a 6.2% annualized total return for the next five years. IBM returned to growth in the latest quarter, performance is improving, and the company is deleveraging. Kyndryl was spun off and IBM is now primarily a software and consulting company focused on the hybrid cloud. IBM should benefit moving forward as software sales are higher margin, and Kyndryl had declining revenue. 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  |
|-------------------------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Revenue (\$B)</b>    | 102.87 | 98.37 | 92.79 | 81.74 | 79.92 | 79.14 | 79.59 | 77.15 | 73.62 | 57.35 |
| <b>Gross Profit</b>     | 50361  | 48684 | 46407 | 40684 | 38516 | 36943 | 36936 | 36488 | 35575 | 31490 |
| <b>Gross Margin</b>     | 49.0%  | 49.5% | 50.0% | 49.8% | 48.2% | 46.7% | 46.4% | 47.3% | 48.3% | 54.9% |
| <b>SG&amp;A Exp.</b>    | 23085  | 22924 | 22472 | 19894 | 20279 | 19128 | 18863 | 20604 | 23082 | 18740 |
| <b>D&amp;A Exp.</b>     | 4676   | 4678  | 4492  | 3855  | 4381  | 4541  | 4480  | 6059  | 6695  | 6416  |
| <b>Operating Profit</b> | 22156  | 20313 | 18532 | 15690 | 13552 | 13140 | 13218 | 10543 | 6786  | 6865  |
| <b>Op. Margin</b>       | 21.5%  | 20.7% | 20.0% | 19.2% | 17.0% | 16.6% | 16.6% | 13.7% | 9.2%  | 12.0% |
| <b>Net Profit</b>       | 16604  | 16483 | 12022 | 13190 | 11872 | 5753  | 8728  | 9431  | 5590  | 5742  |
| <b>Net Margin</b>       | 16.1%  | 16.8% | 13.0% | 16.1% | 14.9% | 7.3%  | 11.0% | 12.2% | 7.6%  | 10.0% |
| <b>Free Cash Flow</b>   | 14869  | 13345 | 12685 | 13104 | 12934 | 12951 | 11283 | 12400 | 15155 | 10420 |
| <b>Income Tax</b>       | 5541   | 3363  | 4234  | 2581  | 449   | 5642  | 2619  | 731   | -864  | -124  |

## Balance Sheet Metrics

| Year                          | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   |
|-------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>Total Assets (\$B)</b>     | 119.21 | 126.22 | 117.27 | 110.50 | 117.47 | 125.36 | 123.38 | 152.19 | 155.60 | 132.00 |
| <b>Cash &amp; Equivalents</b> | 10412  | 10716  | 8476   | 7686   | 7826   | 11972  | 11379  | 8172   | 13212  | 6650   |
| <b>Acc. Receivable</b>        | 10667  | 10465  | 9090   | 8333   | 9182   | 8928   | 7432   | 7870   | 7132   | 6754   |
| <b>Inventories</b>            | 2287   | 2310   | 2103   | 1551   | 1553   | 1583   | 1682   | 1619   | 1839   | 1649   |
| <b>Goodwill &amp; Int.</b>    | 33034  | 35055  | 33659  | 35507  | 40888  | 40529  | 39353  | 73456  | 73413  | 68150  |
| <b>Total Liab. (\$B)</b>      | 100.23 | 103.29 | 105.26 | 96.07  | 99.08  | 107.63 | 106.45 | 131.20 | 135.24 | 113.00 |
| <b>Accounts Payable</b>       | 7952   | 7461   | 6864   | 6028   | 6209   | 6451   | 6558   | 4896   | 4908   | 3955   |
| <b>Long-Term Debt</b>         | 33270  | 39719  | 40722  | 39889  | 42168  | 46823  | 45812  | 62899  | 61538  | 51700  |
| <b>Total Equity</b>           | 18860  | 22792  | 11868  | 14262  | 18246  | 17594  | 16796  | 20841  | 20597  | 18900  |
| <b>LTD/E Ratio</b>            | 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  |
|-------------------------|-------|-------|-------|--------|-------|-------|-------|-------|-------|-------|
| <b>Return on Assets</b> | 14.1% | 13.4% | 9.9%  | 11.6%  | 10.4% | 4.7%  | 7.0%  | 6.8%  | 3.6%  | 4.0%  |
| <b>Return on Equity</b> | 85.2% | 79.1% | 69.4% | 101.1% | 73.0% | 32.1% | 50.8% | 50.1% | 27.0% | 29.1% |
| <b>ROIC</b>             | 32.0% | 28.7% | 20.8% | 24.6%  | 20.7% | 9.2%  | 13.7% | 12.9% | 6.7%  | 7.5%  |
| <b>Shares Out.</b>      | 1117  | 1054  | 990   | 965    | 946   | 922   | 892   | 892   | 889   | 905   |
| <b>Revenue/Share</b>    | 89.03 | 89.18 | 91.87 | 83.18  | 83.36 | 84.43 | 86.86 | 86.41 | 82.11 | 63.40 |
| <b>FCF/Share</b>        | 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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