



International Business Machines Corp. (IBM)

Updated July 21st, 2023 by Prakash Kolli

Key Metrics

Current Price:	\$138	5 Year CAGR Estimate:	4.6%	Market Cap:	\$123.02B
Fair Value Price:	\$115	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	08/09/23
% Fair Value:	121%	5 Year Valuation Multiple Estimate:	-3.7%	Dividend Payment Date:	09/10/23
Dividend Yield:	4.8%	5 Year Price Target	\$139	Years Of Dividend Growth:	29
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 ~\$60.5B in 2022.

IBM reported results for Q2 2023 on July 21st, 2023. Companywide revenue fell 0.4% to \$15,475M from \$14,535M while diluted adjusted earnings per share fell 6% to \$2.18 from \$2.31 on a year-over-year basis. Diluted GAAP earnings per share increased to \$1.72 in the quarter from \$1.53 in the prior year on lower expenses and higher margins. Also, IBM's revenue and earnings are being impacted by the strong U.S. dollar causing a 0.8% headwind.

Software revenue increased 7.2% to \$6,608M from \$6,166M in comparable quarters due to 7% growth in Hybrid Platform & Solutions and a 10% increase in Transaction Processing. Revenue was up 11% for RedHat, 21% for Automation, +11% for Data & AI, and (-1%) for Security. Consulting revenue increased 4.3% to \$5,013M from \$4,809M due to 5% rise in Business Transformation, +5% increase in Technology Consulting, and 8% growth in Application Operations. The book-to-bill ratio is a healthy 1.1X. Infrastructure revenue was down 14.6% at \$3,618M from \$4,235M due to an 18% fall in Hybrid Infrastructure and 6% decrease in Infrastructure Support. Z systems revenue fell 30%.

IBM continued its tuck-in acquisition spree, acquiring software company Apptio for \$4.6B, expanding its AI offering. Also, in 2023, it has announced the purchase of StepZen and NS1. IBM has acquired 30+ companies under the present CEO.

IBM is exploring the sale of its weather business including Weather Company and Weather Underground.

IBM forecasts revenue growth in the mid-single-digits and free cash flow of about \$10.5 billion in 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$14.94	\$15.59	\$13.60	\$12.39	\$13.66	\$13.81	\$12.81	\$8.67	\$7.93	\$9.13	\$9.55	\$11.62
DPS	\$3.70	\$4.25	\$5.00	\$5.50	\$5.90	\$6.21	\$6.43	\$6.51	\$6.56	\$6.59	\$6.64	\$6.98
Shares¹	1054	991	966	946	922	893	887	893	898	907	907	907

IBM's core operations are profitable. But IBM had difficulty generating growth in the past decade due to the transition to cloud and SaaS in the IT industry and IBM's late emphasis on this market. However, IBM intends to be a major player in hybrid cloud as illustrated by the Red Hat and many smaller acquisitions. 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. Also, IBM is reinforcing its AI offerings as seen by the Apptio acquisition. Due to the large Red Hat acquisition and impact of the coronavirus we are not expecting any share buybacks in 2023 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.



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Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	13.0	11.7	11.4	12.1	11.6	10.4	11.2	14.4	13.4	13.4	14.5	12.0
Avg. Yld.	1.9%	2.3%	3.2%	3.7%	3.7%	5.8%	4.5%	5.2%	4.9%	4.9%	4.8%	5.0%

IBM's stock price is up since our last report because of good results. We have set our earnings estimate near consensus. Our fair value estimate is now \$115 using a multiple of 12X. We increased the multiple due to rising software revenue. Our five-year price target is now \$139 per share. The current dividend yield is well above the market average.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	25%	27%	37%	44%	43%	45%	50%	75%	83%	72%	70%	60%

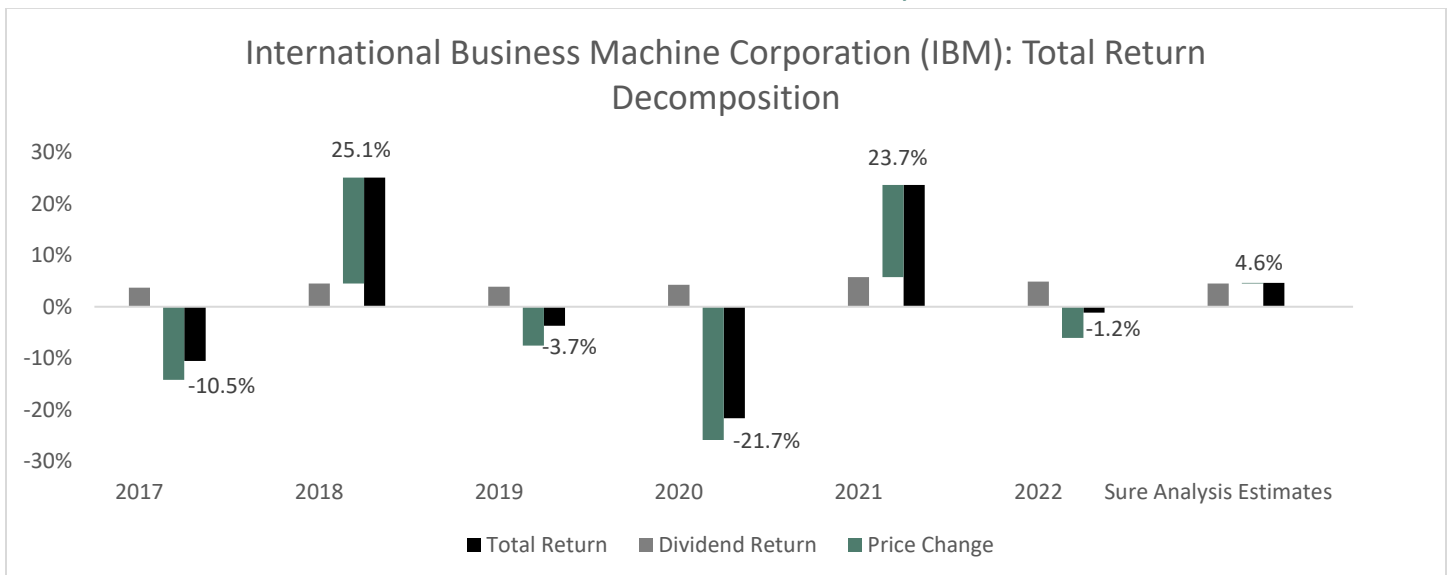
IBM's competitive strength is its brand, entrenched customer relations and extensive patent portfolio. IBM is also the market leader in mainframe computers where it has 90% of the market and little competition. IBM is a different company after the Kyndryl spin off, but it should still be recession resistant. 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 since the acquisition and core debt is now \$46.9B and is offset by \$16.3B in cash, equivalents, and securities. Global Financing debt is \$10.6B and it is decreasing due to winding down of OEM financing.

Final Thoughts & Recommendation

At present we are forecasting a 4.6% annualized total return for the next five years from a dividend yield of 4.8%, 4% EPS growth, and (-3.7%) from P/E contraction. IBM is now primarily a software and consulting company focusing on the hybrid cloud and AI. IBM should benefit moving forward as software sales are higher margin. The current dividend yield is attractive, and earnings and free cash flow coverage is improving. At the current price, we rate this stock a hold.

Total Return Breakdown by Year



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Disclosure: This analyst is long IBM.



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue (\$B)	98.37	92.79	81.74	79.92	79.14	79.59	77.15	73.62	57.35	60.53
Gross Profit	48684	46407	40684	38516	36943	36936	36488	35575	31490	32687
Gross Margin	49.5%	50.0%	49.8%	48.2%	46.7%	46.4%	47.3%	48.3%	54.9%	54.0%
SG&A Exp.	22924	22472	19894	20279	19128	18863	20604	23082	18740	18609
D&A Exp.	4678	4492	3855	4381	4541	4480	6059	6695	6416	4802
Operating Profit	20313	18532	15690	13552	13140	13218	10543	6786	6865	8174
Op. Margin	20.7%	20.0%	19.2%	17.0%	16.6%	16.6%	13.7%	9.2%	12.0%	13.5%
Net Profit	16483	12022	13190	11872	5753	8728	9431	5590	5742	1639
Net Margin	16.8%	13.0%	16.1%	14.9%	7.3%	11.0%	12.2%	7.6%	10.0%	2.7%
Free Cash Flow	13345	12685	13104	12934	12951	11283	12400	15155	10420	8575
Income Tax	3363	4234	2581	449	5642	2619	731	-864	-124	-626

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets (\$B)	126.22	117.27	110.50	117.47	125.36	123.38	152.19	155.60	132.00	127.24
Cash & Equivalents	10716	8476	7686	7826	11972	11379	8172	13212	6650	7886
Acc. Receivable	10465	9090	8333	9182	8928	7432	7870	7132	6754	6541
Inventories	2310	2103	1551	1553	1583	1682	1619	1839	1649	1552
Goodwill & Int.	35055	33659	35507	40888	40529	39353	73456	73413	68150	67133
Total Liab. (\$B)	103.29	105.26	96.07	99.08	107.63	106.45	131.20	135.24	113.00	105.22
Accounts Payable	7461	6864	6028	6209	6451	6558	4896	4908	3955	4051
Long-Term Debt	39719	40722	39889	42168	46823	45812	62899	61538	51700	50949
Total Equity	22792	11868	14262	18246	17594	16796	20841	20597	18900	21944
LTD/E Ratio	1.74	3.43	2.80	2.31	2.66	2.73	3.02	2.99	2.74	2.32

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	13.4%	9.9%	11.6%	10.4%	4.7%	7.0%	6.8%	3.6%	4.0%	1.3%
Return on Equity	79.1%	69.4%	101.0%	73.0%	32.1%	50.8%	50.1%	27.0%	29.1%	8.0%
ROIC	28.7%	20.8%	24.6%	20.7%	9.2%	13.7%	12.9%	6.7%	7.5%	2.3%
Shares Out.	1054	990	965	946	922	892	892	889	905	912
Revenue/Share	89.18	91.87	83.18	83.36	84.43	86.86	86.41	82.11	63.40	66.35
FCF/Share	12.10	12.56	13.33	13.49	13.82	12.31	13.89	16.90	11.51	9.40

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

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