

Intl Business Machines (IBM)

\$124.77 (As of 03/10/20)

Price Target (6-12 Months): **\$134.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/09/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: B

Growth: D

Momentum: D

Summary

IBM is benefiting from improving position in the hosted cloud, security and analytics domains. Moreover, RedHat acquisition has helped IBM to enhance containerized software capabilities and strengthen competitive position in the hybrid cloud market. Robust adoption of security solutions, including Resilient and QRadar, bodes well. Additionally, growing clout of Watson Health and growth in Payer, Provider, Imaging and Life Sciences verticals are noteworthy. Further, gains from z15 and high demand for data privacy and resiliency solutions across hybrid cloud are positives. Notably, IBM stock has outperformed the industry in the past year. However, stiff competition in the cloud computing market and high debt level pose concerns. Also, IBM's time-consuming business model transition to cloud is a headwind.

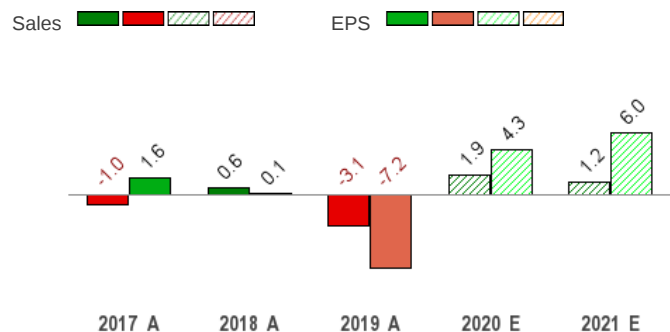
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$158.75 - \$115.76
20 Day Average Volume (sh)	6,129,235
Market Cap	\$110.8 B
YTD Price Change	-6.9%
Beta	1.28
Dividend / Div Yld	\$6.48 / 5.2%
Industry	Computer - Integrated Systems
Zacks Industry Rank	Top 20% (51 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.4%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	04/21/2020
Earnings ESP	0.0%
P/E TTM	9.7
P/E F1	9.3
PEG F1	2.4
P/S TTM	1.4

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	18,765 E	20,098 E	19,228 E	22,764 E	79,592 E
2020	18,252 E	19,701 E	18,781 E	22,079 E	78,610 E
2019	18,182 A	19,161 A	18,028 A	21,777 A	77,147 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.26 E	\$3.16 E	\$3.57 E	\$5.22 E	\$14.16 E
2020	\$1.95 E	\$3.08 E	\$3.24 E	\$5.07 E	\$13.36 E
2019	\$2.25 A	\$3.17 A	\$2.68 A	\$4.71 A	\$12.81 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/10/2020. The reports text is as of 03/11/2020.

Overview

Armonk, NY-based, International Business Machines Corporation (IBM) provides advanced information technology solutions, including cloud and data platforms, computer systems, software, storage systems and microelectronics. The company operates in more than 175 countries.

Starting from first-quarter 2019, IBM combined Cloud business and Cognitive Software in one segment. Further, the company merged security services with security software.

IBM also integrated all divested business to the other categories in order to provide enhanced transparency to the software and GBS segments. The divested business includes pending sales of seven software products to HCL, the sale of IBM's marketing platform and commerce software offerings to Centerbridge and the recently concluded sale of Seterus mortgage servicing business.

IBM reported revenues of \$77.15 billion in 2019.

The company's five segments are as follows:

Cloud & Cognitive Software segment (30% of 2019 revenues) that includes cloud and data platform, Cognitive application and transaction processing. Watson Platform, Watson Health and Watson Internet of Things (IoT) are certain offering which are included in Solutions Software.

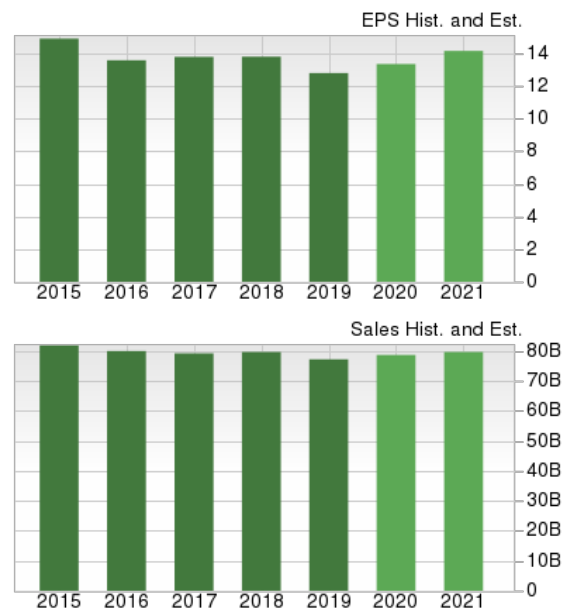
Global Business Services (21.6%) that includes consulting, global process services, application management. These professional services offer value and innovation to clients through solutions which leverage industry, technology and business strategy and process know-how.

Global Technology Services Segment (35.5%) that includes infrastructure services, technical support services, integration software. It provides comprehensive IT infrastructure and platform services that helps to build business value for clients.

Systems (9.9%) that includes systems hardware and operating systems software. It provides clients with innovative infrastructure platforms to help meet the new requirements of hybrid cloud and enterprise.

Global Financing (1.8%) that includes financing, primarily conducted through IBM Credit LLC (IBM Credit) and used equipment sales.

IBM faces significant competition in most of the segments it operates. The main competitors include Oracle, Dell, Hewlett-Packard and NetApp.



Reasons To Buy:

- ▲ IBM's growth is expected to be driven primarily by analytics, cloud computing, and security in the long haul. A combination of a better business mix, improving operating leverage through productivity gains and increased investment in growth opportunities will drive profitability.
- ▲ With the strength of its global on-demand model (responding to customer demand with flexibility and speed), IBM has been gaining a lot of traction in emerging markets. As growth and investment opportunities in developed countries continue to slow down, we believe that emerging economies will play a key role for the company.
- ▲ IBM has been building its portfolio through strategic acquisitions (over 150 companies since 2000), which are generating incremental revenues, strengthening its technology leadership and resulting in a more favorable mix of business. The company's strategy of making accretive acquisitions that can be easily integrated into its current business has expanded its product portfolio into higher-growth segments, such as cloud computing, analytics and security. The acquisitions have also increased its scale of operations globally.
- ▲ IBM has completed the acquisition of Red Hat for \$34 billion in cash on Jul 9, 2019. Notably, the deal is one of the notable software based acquisitions, surpassing Microsoft's LinkedIn buy for \$26.2 billion. The deal is part of the company's efforts to bolster Open Hybrid Architecture Initiative. The deal marks IBM's largest acquisition ever and the combined company is likely to alter the dynamics of "the cloud market for business." Specifically, IBM hopes to leverage Red Hat to help it become the world's largest hybrid cloud platform provider. The company anticipates Red Hat buyout to improve revenue growth approximately by a CAGR of two points over a five-year period. IBM Cloud remains the key to winning back investors' optimism regarding strength of the company's business model. IBM's cloud revenue as a percentage of total revenue has increased from 4% in 2013 to 25% in 2019. In fact, revenues from Red Hat in the fourth quarter improved 24% (at cc) on a normalized basis. Currently, more than 2,000 clients are utilizing Red Hat and IBM's hybrid cloud platform. We believe IBM's attempt to bolster its hybrid cloud business is likely to pave the way for the company's growth prospects. Apart from the aforementioned factors, Red Hat's expanding foothold across Asia Pacific is also anticipated to bolster IBM's TAM post buyout.
- ▲ IBM has been returning cash to shareholders for over a decade. From 2000 to 2018, IBM has returned more than \$175 billion to shareholders in the form of dividends and share repurchases. In 2019, IBM returned \$7.1 billion to shareholders through dividends and share repurchases. Strong free cash flow generation is expected to provide the financial flexibility required for strategic investments in the changing business environment. Considering the company's liquidity and emphasis on profitability, we believe IBM's solid growth rates will be sustainable in the long run.

Expanding product portfolio, accretive acquisitions, strong free cash flow generating ability and aggressive share buyback are key positives.

Reasons To Sell:

- ▼ IBM is having a tough time, given the ongoing and heavily time-consuming business model transition to cloud. Though IBM's Strategic Imperatives are performing well but these are not enough yet to make up for the weakness in its traditional business. Further, foreign exchange volatility is a significant concern.
- ▼ IBM faces stiff competition in most of its markets. In the hardware enterprise servers and storage segment, the company competes against Dell, Oracle, Hewlett-Packard, and NetApp. The IT services business is also becoming increasingly competitive due to its high-margin nature and the company is facing pricing pressure from Hewlett-Packard. Although it possesses massive data centers, we believe that the company will continue facing tough competition from Amazon Web Services (AWS) and Microsoft's Azure. In the services and software space, the company competes with Accenture, Hewitt Associates, Computer Sciences and FDC. The company competes with Oracle and Red Hat in the middleware software market. Although IBM continues to extend and build its capabilities in the analytics arena, competition from Oracle in this space is intensifying.
- ▼ Higher profit on lower revenues indicates that the company has been lowering costs to maintain profits. We believe that the scope for further cost cutting is limited. Consequently, if costs are further reduced, there could be a negative impact on product quality. It could also delay the launch of new products, causing it to lag its peers.
- ▼ Moreover, highly leveraged balance sheet has been troubling IBM over time. At the end of fourth-quarter 2019, total debt amounted to \$62.9 billion compared with total cash and marketable securities of \$9 billion.

Time consuming transition to cloud, weakness in traditional businesses, cash crunch and increasing competition are primary headwinds.

Last Earnings Report

IBM's Q4 Earnings Top Estimates, Cloud Momentum Drove Top-Line Growth

International Business Machines Corporation reported fourth-quarter 2019 non-GAAP earnings of \$4.71 per share, which surpassed the Zacks Consensus Estimate by 0.4%. However, the bottom line fell 3% on a year-over-year basis.

Revenues of \$21.78 billion surpassed the Zacks Consensus Estimate by 0.4% and inched up 0.1% on a year-over-year basis. At constant currency (cc), the top line improved 1%. Adjusting for currency and divested businesses, the top line increased 3%.

The year-over-year revenue growth can primarily be attributed to increase in Cloud & Cognitive Software Segment and Systems revenues. Markedly, total Cloud revenues came in at \$6.8 billion during the quarter, up 21% year on year.

However, revenues from signings declined 9% (at cc) in the fourth quarter to \$14.4 billion. Also, backlog fell 3% (at cc) year over year and amounted to \$112.4 billion.

Red Hat Acquisition

IBM completed the acquisition of Red Hat on Jul 9, 2019, for \$34 billion in cash. The deal is in sync with the company's efforts to bolster Open Hybrid Architecture Initiative. Red Hat is part of the Cloud and Cognitive Software segment.

Revenues from Red Hat in the fourth quarter rallied 24% (at cc) on a normalized basis. Infrastructure for Red Hat continued to grow in double-digits. Moreover, OpenShift and Ansible has supported advancements in application and technology developments.

Further, the acquisition has helped leveraging IBM containerized software and accelerate service engagement. Currently, more than 2,000 clients are using Red Hat and IBM's hybrid cloud platform.

Geographic Revenue Details

Revenues from Americas increased 6% (excluding divestiture impacts) and came in at \$10.5 billion. Revenues from Europe, Middle-East and Africa were \$7.1 billion, up 4% year over year. Meanwhile, revenues from Asia-Pacific declined 6% on a year-over-year basis and came in at \$4.2 billion.

Cloud & Cognitive Software Segment

The Cloud & Cognitive Software segment's revenues-external rose 8.7% year over year (up 9.4% on cc basis) to \$7.2 billion. The upside can be attributed to growth in cloud, security and IoT solutions. Markedly, cloud revenues surged 75%.

Further, revenues in the Cloud and Data platforms increased 19% year over year. The platform is gaining from Red Hat's acquisition synergies and traction in Cloud Paks suite.

Revenues in the Cognitive Applications inched up 1% year over year, driven by AI led software solutions in areas such as security and IoT.

Revenues in the Transaction Processing Software, which includes software that runs mission-critical workloads, moved up 3% on a year-over-year basis.

Global Business Services Segment

Revenues in the Global Business Services-external segment totaled \$4.2 billion, which declined 0.6% (down 0.3% at cc) from the year-ago quarter's figure.

Consulting revenues increased 4% year over year on solid performance of IBM's digital business. Application Management and Global Process Services revenues declined 3% and 10% (at cc) year over year, respectively.

Global Technology Services Segment

Revenues from Technology Services-external fell 4.8% (down 4% at cc) from the year-ago quarter's level to \$6.9 billion. The downside was caused by lower client business volumes.

Segmental revenues pertaining to cloud advanced 13% from the prior-year quarter's reported figure.

Infrastructure & Cloud Services and Technical Support Services revenues fell 5% and 2% (at cc) year on year, respectively.

Systems Revenues

Systems revenues rose 16% (up 16.5% at cc) on a year-over-year basis to \$3 billion, primarily owing to growth in the IBM Z and Storage Systems.

Further, Operating Systems Software and Systems Hardware revenues increased 8% and 18% (at cc) year over year, respectively.

IBM Z revenues surged 63% year over year owing to gains from z15 as well as higher demands for data privacy and resiliency solutions across hybrid cloud. However, Power revenues fell 23% from the year-ago quarter's tally.

Quarter Ending 12/2019

Report Date	Jan 21, 2020
Sales Surprise	0.38%
EPS Surprise	0.43%
Quarterly EPS	4.71
Annual EPS (TTM)	12.81

Storage revenues improved 3% year over year owing to growth in high-end storage systems.

Finally, Global Financing (includes financing and used equipment sales) revenues dropped 25.3% year over year and 24.9% at cc to \$301 million. The decline was caused by closure of OEM commercial financing operations.

Operating Details

Non-GAAP gross margin came in at 51.8%, up 230 basis points (bps) year on year. The gross margin benefited from high-value software and systems contributions.

Non-GAAP operating expenses (research & development expenses and selling, general and administration expenses) increased 12.9% year over year. On a GAAP basis, the metric increased 16%.

Pre-tax income margin from continuing operations contracted 150 bps on a year-over-year basis to 21.6%.

Balance Sheet & Cash Flow Details

IBM ended fourth-quarter 2019 with \$9 billion in total cash and marketable securities compared with \$10.82 billion in the previous quarter. Total debt (which includes \$24.7 billion from Global Financing debt) was \$62.9 billion, down \$3.4 million from the last reported quarter. Moreover, since the closing of the Red Hat acquisition, the company was successful at reducing debt by 10 billion.

The company reported cash flow from operations of \$3.5 billion and generated free cash flow of \$6 billion in the quarter under review.

Moreover, the company returned \$1.4 billion to shareholders through dividends.

Guidance

For 2020, IBM expects non-GAAP earnings per share to be at least \$13.35.

Further, IBM anticipates 2020 free cash flow of \$12.5 billion.

Recent News

On Mar 11, 2020, IBM announced new Natural Language Processing (NLP) capabilities to IBM Watson, with an aim to enhance business value of data.

On Jan 28, 2020, IBM added AI capabilities to its TRIRIGA solution to help real estate and facility management professionals better utilize office space and deliver a more engaging workplace experience.

On Jan 23, 2020, IBM and Yara announced collaboration in a bid to develop an open data exchange for farm and field data, aimed at improving efficiency, transparency and sustainability of global food production.

On Jan 15, 2020, IBM Services inked ten-year services agreement with Spain-based private banking group, Banco Sabadell. Per the deal, IBM's cloud capabilities will help the banking group to boost digitization.

On Jan 14, 2020, IBM announced that it has secured record patent wins in 2019. The company maintained the lead spot for the 27th year, with 9,262 patents, reflecting a year-over-year rise of 2%.

On Jan 8, 2020, IBM announced a multiyear collaboration with Delta Air Lines for exploring potentials of quantum computing. The announcement was made at CES 2020.

On Dec 19, 2019, it was announced that Spain-based tourism Group, Grupo Piñero, has adopted IBM's cloud and AI solutions. Moreover, IBM Watson's AI and business analytics capabilities will be utilized by Grupo Piñero to boost profitability and offer high-quality traveller experience.

Valuation

IBM shares are down 11.2% in the past six-month period and 5.6% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 13.2%, while the stocks in the Zacks Computer & Technology sector are up 2.3% in the past six-month period. Over the past year, the Zacks sub-industry is down 7.4%, while the sector is up 9.1%.

The S&P 500 index is down 3% in the past six-month period, but up 4.4% in the past year.

The stock is currently trading at 9.23X forward 12-month earnings, which compares with 8.82X for the Zacks sub-industry, 19.52X for the Zacks sector and 16.58X for the S&P 500 index.

Over the past five years, the stock has traded as high as 13.12X and as low as 7.68X, with a 5-year median of 10.47X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$134 price target reflects 9.91X forward 12-month earnings.

The table below shows summary valuation data for IBM

Valuation Multiples - IBM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.23	8.82	19.52	16.58
	5-Year High	13.12	18.34	22.04	19.34
	5-Year Low	7.68	8.08	16.87	15.18
	5-Year Median	10.47	10.33	19.34	17.42
P/S F12M	Current	1.41	1.24	3.24	3.05
	5-Year High	2.19	1.87	3.58	3.44
	5-Year Low	1.24	0.76	2.3	2.54
	5-Year Median	1.74	1.53	3.07	3.01
EV/EBITDA TTM	Current	9.3	8.55	11.18	11.04
	5-Year High	11.81	11.23	12.67	12.87
	5-Year Low	5.53	3.92	7.68	8.49
	5-Year Median	8.46	8.45	10.59	10.79

As of 03/10/2020

Industry Analysis Zacks Industry Rank: Top 20% (51 out of 253)



Top Peers

HP Inc. (HPQ)	Outperform
Microsoft Corporation (MSFT)	Outperform
SAP SE (SAP)	Outperform
Accenture PLC (ACN)	Neutral
Amazon.com, Inc. (AMZN)	Neutral
Blackbaud, Inc. (BLKB)	Neutral
salesforce.com, inc. (CRM)	Neutral
Oracle Corporation (ORCL)	Neutral

Industry Comparison Industry: Computer - Integrated Systems				Industry Peers		
	IBM Neutral	X Industry	S&P 500	AMZN Neutral	HPQ Outperform	MSFT Outperform
VGM Score	C	-	-	C	B	F
Market Cap	110.85 B	414.12 M	20.21 B	941.77 B	28.30 B	1,223.97 B
# of Analysts	8	2.5	13	13	4	14
Dividend Yield	5.19%	0.00%	2.18%	0.00%	3.56%	1.27%
Value Score	B	-	-	D	B	D
Cash/Price	0.08	0.14	0.05	0.06	0.14	0.11
EV/EBITDA	8.88	-7.09	12.36	24.36	6.06	19.98
PEG Ratio	2.36	1.35	1.78	2.54	4.11	2.17
Price/Book (P/B)	5.27	2.73	2.77	15.18	NA	11.12
Price/Cash Flow (P/CF)	6.32	10.20	11.04	28.22	7.06	25.33
P/E (F1)	9.34	8.55	16.09	68.51	8.23	28.64
Price/Sales (P/S)	1.44	1.69	2.17	3.36	0.48	9.12
Earnings Yield	10.71%	0.38%	6.20%	1.46%	12.13%	3.49%
Debt/Equity	2.58	0.15	0.70	0.38	-2.41	0.64
Cash Flow (\$/share)	19.75	0.35	7.01	67.05	2.80	6.35
Growth Score	D	-	-	A	B	C
Hist. EPS Growth (3-5 yrs)	-3.50%	0.13%	10.85%	110.19%	-8.88%	17.68%
Proj. EPS Growth (F1/F0)	4.30%	3.21%	6.14%	20.00%	7.37%	18.29%
Curr. Cash Flow Growth	2.09%	-5.38%	6.09%	31.33%	8.32%	19.70%
Hist. Cash Flow Growth (3-5 yrs)	-3.76%	-3.63%	8.52%	49.26%	-18.40%	11.99%
Current Ratio	1.02	1.35	1.24	1.10	0.73	2.80
Debt/Capital	72.05%	14.69%	42.57%	27.39%	NA	39.05%
Net Margin	12.23%	-4.01%	11.69%	4.13%	5.16%	33.02%
Return on Equity	62.27%	-1.00%	16.74%	21.07%	-261.23%	40.41%
Sales/Assets	0.53	0.90	0.54	1.41	1.81	0.48
Proj. Sales Growth (F1/F0)	1.89%	1.89%	3.71%	19.14%	-2.09%	12.82%
Momentum Score	D	-	-	D	F	F
Daily Price Chg	5.91%	0.00%	4.87%	5.07%	4.38%	6.84%
1 Week Price Chg	-1.86%	-6.13%	-0.67%	0.92%	2.98%	-0.27%
4 Week Price Chg	-18.71%	-18.86%	-15.65%	-12.04%	-10.98%	-12.75%
12 Week Price Chg	-7.04%	-0.99%	-13.60%	5.65%	-2.85%	4.03%
52 Week Price Chg	-9.77%	0.00%	-2.27%	13.07%	3.83%	41.63%
20 Day Average Volume	6,129,235	149,634	2,778,843	5,096,762	16,541,806	54,035,176
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	-0.41%	-0.16%	0.16%	5.25%	-0.37%
(F1) EPS Est 12 week change	1.34%	-2.85%	-0.57%	4.19%	5.58%	4.98%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.49%	-0.08%	-6.14%	-1.22%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	D
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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