

INTERNATIONAL BUSINESS MACHINE CORP. (NYSE: IBM) – STOCK PITCH



RECOMMENDATION: BUY (Price: \$193.43/Nov. 3rd 2012)

By: RUI XIAO – TUFTS FINANCIAL GROUP - TMT GROUP

INVESTMENT THESIS

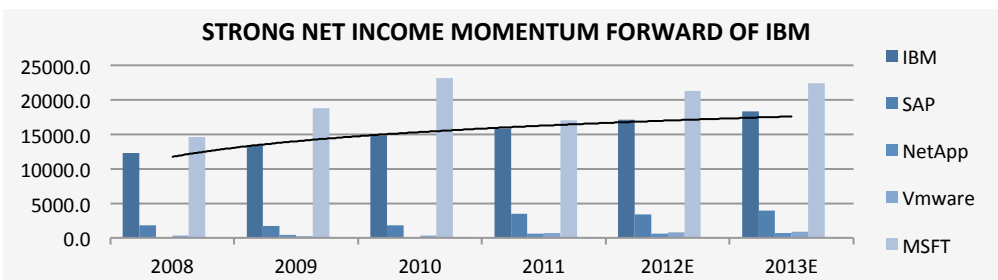
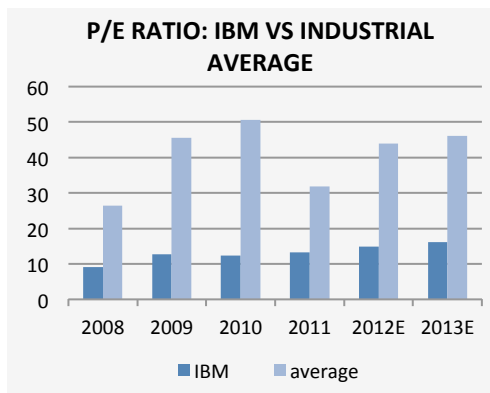
IBM possesses significant barriers to entry that slows competitive threats and increases profits. One of its competitive advantages lies in the switching costs of its customers. Even ignoring the expense, it is too much of a hassle for large companies to change over their IT service provider. IBM is positioning itself well to take advantage of the development of emerging economies. During the recession of global economy, IBM recorded double digit growth in 40 countries in 2010, where majority of IBM's organic growth will be achieved. Lastly, IBM's performance has been remarkable over such a long period of time, and the reason for its success over many generations is, without a doubt, its culture of innovation. Its employees have garnered a myriad of awards including 5 Nobel Prizes. IBM holds more patents than any other US technology company, which can be a major foundation for the long-term development of an IT company.

WHY UNDERVALUED

In the short term, the share price is mainly affected by the fluctuation, which, especially in 3Q12, results from the corporate transaction and M&A deals. However, considering its short-term income growth, the share price will move steadily upward. In a long term, that IBM shuts its retail product off leads to its recent pedestrian performance in finance market. Unlike Apple or Google which are active in real life, IBM does not offer as many products as others do to the retailing customer, which makes it unattractive to small capital investors. However, IBM is going gangbuster in the Big Data world which will soon populated in several years. By selling their retail store solutions business to Toshiba and ThinkPad product line to Lenovo in 2012 and 2006 respectively, IBM has been committing itself into the development of cloud service, big data service, process server and tons of products that can be popular and ubiquitous in the future, as Apple and Google at the present time. At last, cutting edge innovation is critical, but its full value is realized with integration into mainstream tools, products and companies. All IBM need is time.

INDUSTRY ANALYSIS

The technology industry tends to be sensitive to economic cycles. The global economy is currently in a recession. Therefore, it is the perfect time to purchase discretionary investments, because business significantly increases technology investments that they postponed during the recession. Considering financial aspects, the P/E ratio of IBM is much lower than that of other companies in the same industrial. IBM, with a P/E ratio lower than 15 in 2011, still possesses a potential to grow its P/E to around 17 to 20, which would lift the share price significantly.



COMPANY PROFILE

International Business Machines Corporation is an IT company. IBM operates in five segments: Global Technology Services (GTS), Global Business Services (GBS), Software, Systems and Technology and Global Financing. GTS primarily provides IT infrastructure services and business process services. GBS provides professional services and application management services. Software consists of middleware and operating systems software. S&T provides clients with business solutions requiring advanced computing power and storage capabilities. Global Financing invests in financing assets, leverages with debt and manages the associated risks.

RISKS

- Aggressive M&A activities resulting in stock price fluctuations
- Practicability of innovative idea
- Challenges in growing revenues from new signings and scope increases
- Global economic conditions

FINANCIALS

- Market Cap: \$218.56B
- P/E: 13.92
- EPS(GAAP): 13.89
- Cash Flow: \$8.7M (YTD 3Q12)
- Dividend yield: 1.76%
- Margins: \$50138M (FY2011)
- Debt: \$31322M (FY2011)

VALUATION

Our target price of \$300 is based off a comparable companies analysis, with a P/E multiple of 16.0 and EPS of 16.2 for FY2013. The upside net income growth maintains 7.5% assumptions, which may improve over time.

| Year | 2012E | 2013E |
|-------------|-------|-------|
| Net Income | 17104 | 18319 |
| EPS | 15.1 | 16.2 |
| P/E | 15.0 | 16.0 |
| Share Price | 216.6 | 243.1 |