

ANNEX BULLETIN

Annex Bulletin 2011-04

January 18, 2011

A partially *OPEN* edition

Recent...

HEADLINES

[IBM: Another Phoenix of the IT Industry](#) , Analysis of IBM's 4Q10 result

[One Man's Pain, Another Man's Gain?](#) (Analysis of possible impact of Steve Jobs' health on IBM, Intel, other IT companies)

IBM FINANCIAL

Updated 1/18/11, 7:00PM HST

Analysis of IBM's Fourth Quarter Business Results

IBM: Another Phoenix of IT Industry

The World's Oldest Computer Surges 69% as It Enters Its 47th Year, and Big Blue Starts Its Second Century

HAIKU, Maui, Jan 18 – Want to see a picture of good corporate health? Check out the latest results of IT industry's oldest company and of its oldest product - the mainframe. IBM started entered its second century, and its mainframe approached its 47th birthday with the kind of growth surge that's typical of successful start-ups. System z revenues soared by 69% in the fourth quarter, helping propel IBM revenues to \$29 billion, up 7% from a year ago, and its earnings per share (EPS) to \$4.18, up 16% since 2009.

Nor was the mainframe the only hero of the quarter. System x servers continue to outpace both IBM and the competition, rising 18% in the quarter. Storage, Microelectronics/OEM and retail store solutions also grew in double digits in constant currency. Even the System p, which grew by 3% in constant currency, represented an improved performance relative to earlier 2010 quarters in which these servers actually declined.

As a result, the company's hardware revenues surged 21% in the quarter. No surprised there (see [IBM Hardware to Rise and Shine Again](#), Jan 11, and [Big Blue Poised for Growth](#)



[Again](#) , Jan 2010).

Furthermore, software, IBM's most profitable segment with a gross

[Consumer Rules](#) (Analysis of top 15 global IT leaders' stock and business performances)

[IBM Hardware to Rise and Shine Again](#) (Analysis of IBM STG business results and outlook)

[BARRON'S: IBM Shareholders Will Like New Year](#) (Analysis of Barron's article on IBM stock)

[HP's "Stealth CEO" Sounds Bullish in First Public Appearance](#) (Analysis of HP's fourth quarter business results)

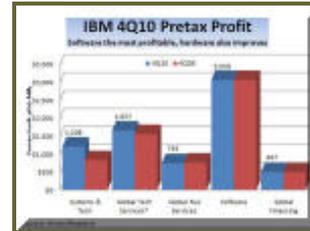
[Silicon Valley Rodeo](#) (Editorial on shenanigans and costly trivial pursuits)

[IBM Business Up, Stock Down](#) (Analysis of Big Blue's third quarter business results)



margin of 88.5% and pretax margin of 41%, also grew its business in double digits (revenues were up 12% in constant current when adjusted for a one-time event - sale of PLM).

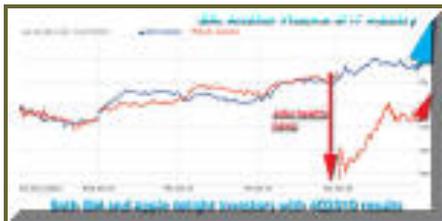
Last but not least, while revenues of IBM's largest segment - services - grew in low single digits, this segment had a "terrific quarter," according to Mark Loughridge, IBM CFO, when it comes to new contract signings and backlog. Since both are indicators of *future* revenues and profits, it is clear that the market place can expect much stronger growth of 2011 services revenues and profit.



Indeed, "at the end of the (four-year) roadmap period, we've delivered \$11.52 of earnings per share, well above the high end of the range of \$10 to \$11," the IBM CFO told the analysts during the post-earnings teleconference. And Big Blue did it against the "headwind of a global recession," he added.

Put it all together, and what we are seeing is the emergence of a another "Phoenix of the IT industry." First it was Apple, now the industry's most valuable company, a 36-year old computer veteran blazing the trail into the future.

And now Big Blue is starting to look like another Phoenix rising from the ashes and soaring to great heights (also see [One Man's Pain, Another Man's Gain?](#) - an analysis of possible impact of Steve Jobs' health on IBM, Intel, other IT companies).



(BTW - Apple also reported terrific quarterly results after the markets closed today. Net profit was \$6.43 a share in its first fiscal quarter, up 78% from \$3.67 a share last year. Revenues jumped 70% to \$26.7 billion, up from

\$15.7 billion a year ago. As with IBM, both numbers exceeded Wall Street expectations. Except that Apple is mostly in consumer markets. So its fourth calendar quarter results were boosted by holiday sales. Haven't heard of any companies putting mainframes under their trees). :-)

Business Segment Analysis

Geographies

The Americas' was IBM's best region in the fourth quarter. Revenues were \$12.2 billion, an increase of 9% from the 2009 period. Revenues from Europe (EMEA) was \$9.5 billion, down 2% as reported, but actually up 4% in constant currency. Asia-Pacific revenues rose 14% (up 7%, adjusting for currency) to \$6.6 billion. OEM revenues were \$784 million, up

21% compared with the 2009 fourth quarter.

Revenues from the growth markets rose 15%, led by the BRIC countries — Brazil, Russia, India and China — where it increased 19%. Russia and China were standouts in the fourth quarter, surging by 46% and 25% respectively. A total of 50 growth market countries had double-digit revenue growth, up from 32 in the third quarter, the IBM CFO said. For the full year, growth markets represented 21% of IBM’s revenue.

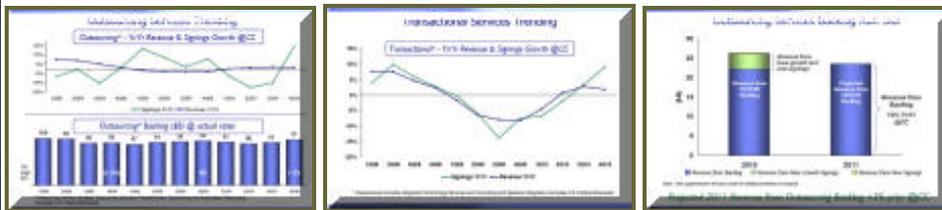


Services

IBM Global Services revenues increased 2%, with Global Technology Services (GTS) increasing 1%, to \$10.2 billion, and Global Business Services (GBS) rising 4% to \$4.8 billion.



The IGS backlog was \$142 billion, up \$8 billion quarter-to-quarter, and up \$5 billion year-over-year at actual rates. Big Blue signed services \$22.1 billion of new business contracts in the quarter of, up 18% from a year ago. Transactional signings were \$8.0 billion, an increase of 8%. Outsourcing signings were \$14.1 billion, up 24 %.



For the first time, the IBM CFO showed the explicit relationship between the backlog and revenues, both for outsourcing and transactional contracts. The correlation is much closer in the transactional business (middle) than in outsourcing (left). Which is something we have been pointing out not just for IBM, but also for many other services vendors in the last 20 years (EDS, for example - right).

The IBM bar chart (above right) also shows a relatively minor impact the new business signings have on current year's revenues, and a major role backlog plays in that respect. Again, something we have been pointing out for years.

It is refreshing to see the largest IT services company in the world take the lead in openness. By volunteering this kind of information now, IBM becomes the first IT services vendor to provide that level of detail about its business. HP and Accenture, the two largest vendors after IBM, for example, don't even provide the backlog figures, let alone a breakdown between outsourcing and consulting backlogs.

Software

Revenues from the Software segment were \$7.0 billion, an increase of 7% percent (8% adjusting for currency), or 11% on an apples-to-apples basis - excluding the first-quarter 2010 divestiture of the Product Lifecycle Management operations (PLM) (up 12% in constant currency).

Gross margin was up almost a point to 88.5%, as was the pretax margin, up to 41%.



Revenues from IBM's key middleware products were \$4.7 billion, an increase of 13% from the fourth quarter 2009. Operating systems revenues were \$690 million, up 11% from the corresponding period last year.

WebSphere led all key IBM brands surging 32% in the quarter. Information Management software was up 10% as was Rational, while Tivoli software rose 12%. Revenues from Lotus software decreased 3%.

Revenues from the company's business analytics operations across services and software segments increased 19%.

Hardware

There is not much we can add to what we have already said about Big Blue's "hero of the quarter" - its hardware segment. All of its product lines were operating at full throttle, led by the rejuvenated mainframe.



Industries

As one might expect in a quarter in which the mainframe outsold all other IBM products, the financial services sector led all other industry segments by growing 15% over the year before. That's more than double the IBM total growth rate and that of any other industry segments.



The small and medium size (SMB) business sector also turned in a

decent performance, rising 6%, roughly in line with IBM's overall growth.

Summary and Outlook

The latest IBM results have shown that IBM is indeed becoming another Phoenix of the IT industry. A 100-year old company is moving lightness and nimbleness of a start-up. From "dinosaur to springbok" we said in 2005, using the mainframe as an example. Well, the 69% jump in the last period is the springbok's biggest quarterly leap so far.



As a result, the whole hardware sector has a new spring to its step as it enters 2011 and the centenary celebrations as a centenarian in revenues (okay, \$99.9 billion, if you want to split hairs).

In his summary to analysts, the IBM CFO said that, "2010 marks the end of a very successful decade. The changes we've made over the last ten years have strengthened our business, and position us well to deliver over the next five years."

And what's ahead in the next five years is another steep climb up the "Mount EPS" (right chart). But IBM sounds undaunted by the challenge, buoyed by meeting and exceeding its last long-term commitment, made in 2007.



"We enter the year (2011) with a strong portfolio of offerings... We expect to deliver operating EPS of at least \$13 for the year, which is right on track to achieve at least \$20 of operating earnings in 2015" (see the IBM chart - right).

Why not? All that's missing so far is that Big Blue's "Mount Market Cap" slope isn't quite as steep as that of "Mount EPS." But that's something Wall Street needs to work on, not just IBM.

Happy bargain hunting

Bob Djurdjevic

 [Click here for PDF \(print\) version](#)



Or just click on [SEARCH](#) and use "company or topic name" keywords.

Volume XXVI, Annex Bulletin 2011-04
January 18, 2011

Bob Djurdjevic, Editor

e-mail: annex@djurdjevic.com

(c) Copyright 2011 by Annex Research, Inc. All rights reserved.

The copyright-protected information contained in the ANNEX BULLETINS is part of the Comprehensive Market Service (CMS). Reproduction by any means is prohibited..

[Home](#) | [Headlines](#) | [Annex Bulletins](#) | [Index 1993-2011](#) | [Special Reports](#) | [About Founder](#) | [Search](#) | [Feedback](#) | [Clips](#) | [Activism](#) | [Client quotes](#) | [Speeches](#) | [Columns](#) | [Subscribe](#)