

# ANNEX BULLETIN

Annex Bulletin 2007-22

May 17, 2007

A **CONFIDENTIAL** client edition

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## IBM CORPORATE

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*Echoes from IBM's Annual Conference for Financial Analysts*

## BRIC by BRIC... to Top Line Growth

### IBM Sees Emerging Markets as "Engine of Growth"

"Brick by brick my fellow citizens, brick by brick" (Roman Emperor Hadrian (76-138 AD)

"Rome was not built in one day" (John Heywood, British playwright, 1546)

SCOTTSDALE, May 17 - "BRIC by BRIC, my fellow Netizens, BRIC by BRIC," seems to be the modern Big Blue version of Roman Emperor Hadrian's famous epigram. The road to top line growth leads through Brazil, Russia, India and China (BRIC).

Nearly a year ago, IBM held its annual briefing for financial analysts for the first time ever in Bangalore, India (see "[A Tale of Two Blues](#)," June 2006). This year, Big Blue brought the topic of India and other emerging markets to its research lab at Yorktown Heights, New York (click on [fall 2005 travelogue](#) from there or on thumbnail to enlarge). The message was the same: Emerging markets and SMB are the place to be.



The BRIC countries are growing at twice the global GDP rate, said the IBM CEO, Sam Palmisano, in his opening remarks. They sounded remarkably similar to those at the [IBM Partnerworld](#), just over two weeks ago.

"We expect the IT markets in BRIC countries to grow revenue more than twice as fast as the worldwide economy as a whole, he said. This "should produce a market opportunity of more than \$150 billion by 2010."



The BRIC countries are "an economic growth engine that's fueling the IT industry," added Frank Kern, the top IBM

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Asia/Pacific executive. "China is the largest, India, the fastest growing."

Besides being fast-growing markets, the BRIC's are also "hubs for global innovation, and hubs for global delivery," Kern pointed out.

Together, they accounted for \$4.5 billion of IBM revenues last year, up 21% from 2005. The BRIC countries also represent 43% of worldwide population and just under 10% of global GDP. But by 2035, they will account for over 25% of the worldwide GDP, Kern predicted.

So "BRIC by BRIC my fellow Netizens, BRIC by BRIC," seems to be the modern Big Blue version of Roman Emperor Hadrian's famous epigram. The road to top line growth leads through Brazil, Russia, India and China.

### "Rome Was Not Built in One Day"

But "Rome was not built in one day," as John Heywood, a British playwright, noted in 1546. IBM's Palmisano also seem to plead for patience when it comes to Big Blue's global positioning and strategy.

"This is just the beginning. We have a lot of work ahead of us," said Palmisano, sounding like HP CEO. Mark Hurd said last night, "HP is still transforming... we're not even close to being done" (see "Per Ardua Ad Astra," May 2007).

"I know, everybody likes to obsess on revenues," Palmisano also said, echoing his Partnerworld speech. But he said IBM is a much more profitable company today than it was a few years ago.

"We have a lower center of gravity in our operations... and a business model that generates better earnings, profits and cash from every dollar of revenue," he said. "We've got better margins, more profitability and better cash flows."

The IBM CEO then proceeded to prove that assertion with a set of charts that compared IBM to its "Tech Peers" (Accenture, BEA, CSC, EDS, EMC, HP, Infosys, Microsoft, Oracle, Sun), and the "Dow 30 Companies."



Cash flow here is "fully loaded," with pension plan funding taken into account, the IBM CEO said, referring to the right chart above.

"We continue to use cash prudently," he added. " And we continue to invest in businesses that generate cash." Well, that is only partially true...

product strategies

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As we heard last month, IBM announced its intention to buy a record \$15 billion of its own shares, on top of nearly \$80 billion the company had already acquired so far (see ["To Buy \(back shares\) or Not to Buy?"](#), Apr 2006 and the left chart above).

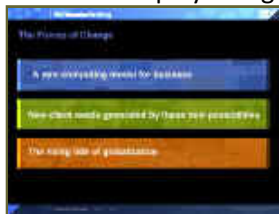
Since that time, IBM has been repurchasing about \$100 million of its shares every day, said Mark Loughridge, IBM CFO (see middle chart). That's a lot of money going into Wall Street's pockets instead of into IBM's business. Furthermore, the company is greasing their palms by borrowing money to buy back shares.

With share repurchases as the only blemish in an otherwise sound IBM growth strategy, Palmisano summed up his industry comparisons as follows:

"By any comparison, this (IBM) financial model has outperformed the Dow 30 and our tech peers."

### Outlook: Macro Trends Favor IBM

As he did in St. Louis on May 1, IBM's CEO also talked about three global macro trends that seem to play in Big Blue's favor (see left thumbnail).



"The past was defined by the PC-centric world," he said. "The PC was the center of the universe. But that architecture has run its course... PC client/server (era) is over. It is over," he added for emphasis.

The result is a new business model that will favor IBM's offerings, such as virtualization.

"Virtualization has been around since the early mainframe days (1967)," Palmisano said. "It has now been adopted to a new application... Virtualization drives an additional \$1 billion in gross profit."

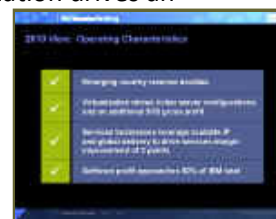
And what's driving that? Large customers, IBM says.

"Clients have reached a breaking point with IT... because of the infrastructure complexity," said Bill Zeitler, IBM's hardware boss, who followed Palmisano and Kern on stage. "Many data center managers have reached the point where they just cannot support this kind of growth (in servers)."



Zeitler's remarks also echoed some comments he and others made at last week's IBM press conference in New York City

(see ["The Greening of Big Blue,"](#) May 2007).



quarter fiscal 2007 business results) [[Annex clients click here](#)]

[Hedging the Bets](#) (Analysis of latest institutional shareholdings of leading IT companies: IBM, HP, Accenture, EDS, CSC, BearingPoint, ACS, Perot ) [[Annex clients click here](#)]

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[IBM: A \\$125-Stock?](#) (An update to "From Small Acorns Mighty Oaks Grow")

[Capgemini: Longest Sustained Stock Price Rise](#) (An update to "By Leaps and Bounds")

[HP: New King of the Hill](#) (Analysis of HP's fourth quarter business results)

[IBM: From Little Acorns Mighty Oaks Grow](#) (Analysis of IBM's "State of the Union")

[Capgemini: By Leaps and Bounds](#) (Analysis of Capgemini's preliminary third quarter business results)

[Fujitsu: Good Performance Gets Better, More Global](#) (Analysis of Fujitsu's first half FY2007 business results)

[IBM: A Slam Dunk Quarter](#) (Analysis of IBM third quarter business results)

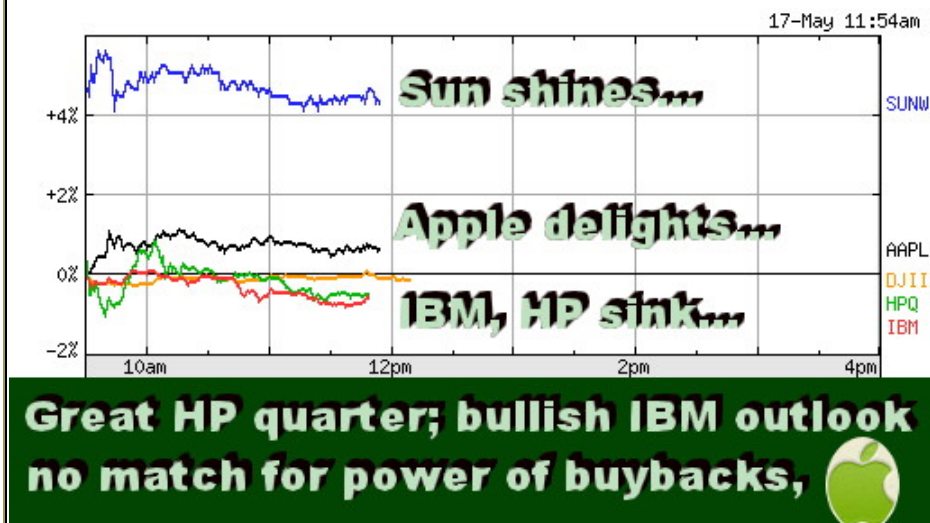
[Accenture's Emphatic Year-end Accents](#) (Analysis of Accenture's fourth quarter results) [[Annex clients click here](#)]

[IBM: Services in a Box](#) (Analysis of IBM Global

It is that kind of customer demand that has propelled IBM into the leading market share position in many of its hardware offerings (see the left thumbnail).

### Market Shrugs Off IBM, HP, Embraces Sun, Apple

Despite the bullish IBM comments and HP's excellent latest quarterly results, however, the stock market shrugged off the two IT leaders today's good news stories, while embracing Sun and Apple.



As of "high noon" today, both IBM and HP shares were down by almost a point, while Sun's surged by more than 4% on news of its new stock buyback programs. As for Apple, it's stock also rose today, well, "just because." People like apples as does Bear Sterns, as it turns out, that upgraded the stock (after we had done the above chart).

Later on this afternoon, Big Blue shares also briefly swung into positive territory, after the IBM CFO talked up the stock buybacks as a \$1.1-part of the \$5-hike to \$11 per share earnings by 2010 (right thumbnail). But they closed at \$105.31, down 0.53%.

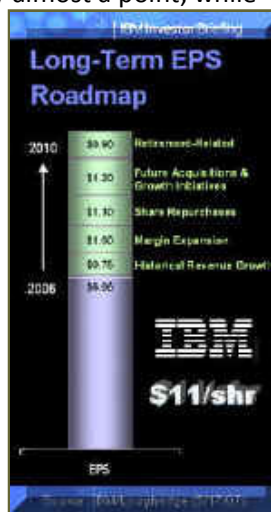
Oh well, you win some, you lose some...

*Happy bargain hunting!*

*Bob Djurdjevic*

### Market Update: IBM Stock Up, HP Down on Board News

SCOTTSDALE, May 18 - A day after the IBM, two things happened that helped the IBM stock move into record territory again. First, a realization seemed to sink in on Wall Street that \$11 per share in 2010, which IBM is now forecasting, will mean over \$13 billion in net profit that year, up 42% from the \$9.5 billion IBM



[Services' Ground-shifting Announcements](#)

[Strong Comeback by IT Stocks in Third Quarter](#)  
(Analysis of top 20 IT companies' market and business trends)

[Stock Buybacks: A Fading Fad](#) (Dell, erstwhile "King of Fluff," suspends its stock buybacks)

[Capgemini: Growth Continues](#) (Revenues, net profit up in double digits, margins also improve)

[HP Firing on All Cylinders](#)  
(Stock sets new multi-year record following excellent third fiscal quarter results) [Annex clients click here]

[Power of Manpower](#) (While others move to India, Russia... AMD invests in New York, hailing "phenomenal" quality of its labor force)

[Ebb Tide Lowers Most Boats](#)  
(Analysis of EDS' and CSC's latest quarterly results)

[IBM Stock Grossly Undervalued?](#) (Analysis of stock market valuations of IBM and its major competitors) [adds latest Fujitsu, Capgemini results]

[IBM vs. HP: A Tale of Two Blues](#) (Both companies are doing well in business, but only HP is favored by Wall Street; Big Blue trying to change that now with its new "India Opus") [Annex clients click here]

[Go East, Young Man!](#) (A speech delivered in St. Petersburg, Russia, May 25, 2006; click here for slides)

[IBM 5-Yr Forecast: Steady](#)

earned in 2006. And by the end of 2011, Big Blue's bottom line should be closing in on \$15 billion. That's a \$4 billion increase to our five-year forecast, as we suspect is to most Wall Street spreadsheets (click on right thumbnail a detailed forecast update).

Second, HP made an announcement this morning that a former IBM CFO was joining its Board.

[As She Goes \(Emphasis on quality continued\) \[Annex clients click here\]](#)

[Octathlon 2006: Accenture Again Wins "Gold!" \(HP gets "Silver," IBM "bronze"\) \[Annex clients click here\]](#)



So the HP shares promptly declined, while IBM's rose to new five-year records, One could almost "see" the money flowing out of the HP stock into IBM (see above chart). For more on the reasons for that, and John Joyce's legacy at IBM check out:

["Slam-Dunk of Bunk," \(Jan 19, 2000\)](#)

**A Slam-Dunk of Bunk!** Biggest Surprise: A Sharp Drop in ... delivering pure bunk, John Joyce has just scored a **slam-dunk!** A \$557-million loss incurred by the Bug Blue...

["A Grand Slam Dunk of Bunk:" Analysis of IBM 4Q01 Results \(Jan 18, 2002\)](#)

John **Joyce**, bravely drove the Big Blue ... truckloads of bad news. When **Joyce** pulled the same stunt two ... Jan 19, 2000 ). This afternoon, **Joyce** has outdone himself. Make it "**A Grand Slam Dunk of Bunk**"...

["Joyce Invents 'Rescoping':" Analysis of IBM Second Quarter Results \(July 17, 2002\)](#)

...Joyce rejoiced (that) IGS's backlog declined in the second quarter for the first time ever! That was evidently due to, what IBM now calls, "rescoping" - a "new English" word. It has been coined to depict the old-fashioned customer renegeing, or contract renegotiations, coupled with the usual cancellations and expirations...

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