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IBM CORPORATE

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Our Annual Update to Five-year Forecast for IBM

Minting "Green" into Greenbacks

IBM Benefiting from Industry's "Green" Tailwind at Both Top and Bottom Lines

SCOTTSDALE, June 20 – When we first invoked the "green" metaphor in reference Big Blue some 20 months ago (see "[From Little Acorns Mighty Oaks Grow](#)", Nov 2006), IBM was yet to think of itself as a green giant. Six months later, however, the company did launch its "green" initiative at a bash in New York (see "[The Greening of Big Blue](#)," May 2007). In August of last year, Big Blue... oops, Big Green, announced one of the world's largest server consolidation projects. Energy savings from the "greening of data centers," averaging over 40% for a typical data center, was its key underpinning (see "[The Greening of Big Blue, Part 2](#)," Aug 2007).



A year later, it is becoming increasingly evident that not only is Mother Earth starting to regard IBM as one of its favorite corporate sons, but IBM shareholders have also reasons to cheer the greening of Big Blue. For, IBM has found a way of converting the industry's "green" trend into greenbacks. Mucho greenbacks. The fact that the company is doing it in the midst of the world's latest energy crisis suggests that Big Green is moving into the greener pastures with the wind at its back. Not a bad way to read the industry's green tea leaves (double pun intended). :-)

As a result, the "greening of Big Blue" is one of the most important NEW factors that we've had to take into account when updating our five-year forecast for IBM. For, the company is benefiting from it, both at the top and the bottom lines. At the top, IBM Global Technology Service (GTS), the company's largest services arm, is raking it in. Attesting to the strength of the "green" tailwind, GTS has reportedly received over 2,000 new client engagements related to this powerful industry trend.



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IBM CFO, Mark Loughridge, for example, said in January that the company closed over \$300 million in "green"-related business in the fourth quarter alone. And in the first quarter, we figure that the greening of Big Blue has boosted its top line by another \$300 million in revenues. See what we meant when we said we'd have to update our long-term forecast with this new trend?

At the bottom line, some parts of IBM have realized more than 80% annual energy savings (for example, through consolidation of 3900 UNIX - to - 33 System Z servers). A typical 25,000 square foot data center can save about \$1.3 million in energy-related costs.

Client Demand Rises for "Green" Data Centers

At the Umeå University in Sweden, for example, almost 500 miles north of Stockholm, IBM installed the most [powerful Windows-based computer](#) in Europe, called Akka, which runs a mix of Xeon, Power 6 and Cell processors.

"What makes it special is it's very green," Andreas Ryden, Nordic sales manager for IBM's High Performance Computing, told the [InternetNews.com](#) (June 17). "It uses about 40 percent less energy and electricity for a supercomputer of the same size." Because of its mix of processors, "It gives researchers a chance to use other technologies, not just Power but Cell as well," added Ryden.

In Switzerland, IBM and GIB-Services announced on June 11 a new energy efficient "green" data center at a former military bunker outside of Zurich. The new data center is a highly secure data storage facility where GIB will support its clients in Switzerland, and will offer a first-of-its-kind energy model where a direct heat exchange will take place between the data center and a public swimming pool in the town.

"We found a partner for this unique project in IBM, a company that distinguishes itself through its vast experience in building high availability data centers with the highest demands on security," said Hans-Rudolf Schärer, president of the board of directors, GIB-Services in a release. "Our decision to collaborate with IBM was easily made given IBM's data center expertise, innovation and commitment to green technology."

New "PortaCenters:" Energy Savings in a Box

And now IBM is starting to replicate its success with greening of data centers. Last week, the company introduced a scalable modular data center. The June 11 press release used another typical IBM acronym - EMDC (Enterprise Modular Data Center) - to describe it. As if the world need another IBM acronym!? So we prefer to think of it as a "PortaCenter" (out term for it - see the right photo).



This new concept is reminiscent of IBM's "service products," announced nearly two years ago (see "[IBM Service in a Box](#)", Sep 2006). At first, services are by definition custom. Then as vendor gains knowledge and proficiency in delivering the solution, it packages it in a way that can be easily replicated elsewhere. That's why PortaCenters seem to have the earmarks of "service products" to us.

IBM said it has already installed over 40 such PortaCenters around the world, each at about 15% to 20% less cost, and 20% more energy efficiency, than the smaller-sized traditional data centers. Guess we can also think of them as energy "savings in a box."

results)

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(Analysis of IBM's full 4Q07 results)

[Big Blue Shines in 4Q](#)
(Analysis of IBM's preliminary 4Q07 result)

[Microsoft Still Wall Street Darling](#) (Analysis of institutional holdings of Top 10 IT Cos)

And so on, and so forth. The "green" beat goes on. And Mother Earth and the IBM shareholders are both loving it.

IBM Forecast Summary

Now, as to our updated five-year forecast, Annex clients can peruse the details by clicking on "IBM 2008-2009 Forecast" below. The gist of it is that we expect earnings of \$12.2 billion on revenues of \$108.6 billion in 2008, and \$13.4 billion on \$116.5 billion next year. The implied net margins are 11.2% and 11.5% for the two years respectively, while earnings per share of \$9.02 and \$10.10 during the corresponding periods.

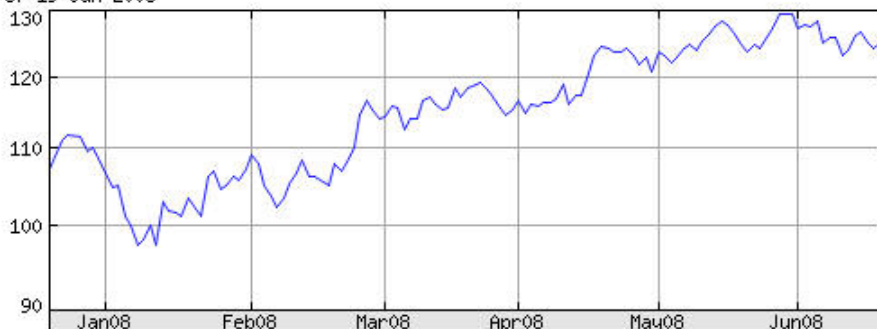


As you can see, IBM is indeed approaching the promised \$11 per share EPS for 2010, that its executives threw at Wall Street in May 2007 (see "[BRIC by BRIC... to Top Line Growth](#)"). And acting green and spreading the green gospel among its clients has become an important new factor that's boosting IBM's growth, especially for IBM Global Services and Systems & Technology businesses. It certainly was the key new ingredient in our forecast update.'



If all goes according to plan, and without any major external disruptions (such as those we talked about to the IBM scientists in Los Angeles last month - see "[Life in 2050?](#)" report within "[IBM and Google on Cloud Nine](#)"), IBM should be a \$140 billion company by 2012. in which hardware will account for only one-fifth of total revenues. At the bottom line, it will have over \$16 billion in net earnings, for a 12% net margin. And that's a future Wall Street should consider investing in.

INTL BUSINESS MACHINES
as of 19-Jun-2008



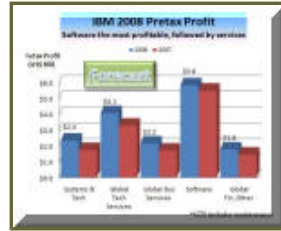
General stock market weakness drags down IBM stock from \$130 high (5/30)

It is more than a little ironic, therefore, that the day we are releasing this forecast report, the IBM stock has dropped to under \$123, after peaking at just under \$130 in late May (see the chart). Sounds like a buying opportunity to us. For, after reaching and surpassing last month our two-year target price of \$125, the Big Blue stock seems now poised for loftier heights. Assuming, of course, no major calamities elsewhere in the world or the stock market derail it.

Segment Analysis



Meanwhile, IGS is now starting to recover some of its former glory as the growth champion of Big Blue. Indeed, we expect the largest part of the company to grow its share of total revenue this year to 56% of total, up from 52% in 2007. And the IGS's share of pretax profit should also increase from 35% to 37% during the same period (see the charts).



But IBM Software continues to be the company's most profitable unit, as is evident from the right chart above.

For a detailed longer-term forecast, Annex clients can click on the link below. Suffices to say that we have slightly uplifted our expectations from a year ago. So the Big Green stock seems be getting a green light all around as the company is showing that it knows how to turn "green" into greenbacks.

Click on [IBM 2008-2009 forecast](#) for detailed tables and charts (Annex clients only)

Happy bargain hunting!

Bob Djurdjevic

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