

ANNEX BULLETIN

Annex Bulletin 2009-06

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IBM Again Exerts Market Leadership

Big Blue Tries to Pull Dow, HP Up

Stock Up Sharply after CFO's Remarks at Investor Conference

SCOTTSDALE, Feb 27 – Just as it did last July, IBM is again trying to take over the market leadership. Big Blue stock moved up sharply in the last two days, following yesterday's bullish remarks by its CFO at an investor conference in San Francisco. IBM shares are up by almost 10 points since Wednesday morning (Feb 25), while the laggard HP and the reluctant Dow are still dragging down the market (see the chart).

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IBM takes over market leadership, tries to pull reluctant Dow and laggard HP up

Obviously, the circumstances are very different now from those last July (see [IBM Delivers Explosive Growth](#) - Big Blue firing on all cylinders; double digit growth of both earnings and revenues). Back then, IBM stock soared to within a dollar of its all-time high (\$132). Now, it's struggling to get out of the \$80s - through no fault of its own. The decline in the IBM stock is a classic example of how low tides can drag down all boats regardless of how spiffy and great they are.

Unlike some of its other competitors, IBM has been sailing through turbulent global and U.S. economic waters practically unscathed. Yet it has been tarred with the same brush as HP, Dell, Microsoft etc., the IT companies whose business results disappointed investors and matched the general gloom and doom of the marketplace.



Guess that is why the IBM CFO Mark Loughridge (right) took an unprecedented step of speaking out publicly about the company's results mid-way through the first quarter. He reaffirmed its full-year \$9.20 per share earnings outlook on Thursday, and forecast growth in its services business in the first quarter, in sharp contrast to many technology companies that have scaled back expectations.

Shares of International Business Machines Corp rose 3.7 percent yesterday, and are up another \$3 this morning.

As the Big Blue did back in July, IBM's 4Q earnings, as well as its 2009 outlook, had exceeded market expectations. The company has credited its relative strength to its expansion from hardware to higher-margin businesses like software and services.

Contract signings for business services have grown so far this year, Loughridge said.

"On a quarter-to-date basis, our long-term signings are up double digits, and we would expect signings to be up for the quarter on a year-to-year basis and double digits on long-term. So I think we have a good hand," he said, according to Reuters.

Loughridge added that IBM has a good pipeline in software in the first quarter.

IBM has also said its expansion overseas has been helping its business. The company earns around two-thirds of its revenue from outside the United States. Revenue in growth markets in January outpaced growth in major markets by 7 points, Loughridge said.

Summary & Outlook

So why is IBM zigging while the market and its competitors are zagging? To find an answer to that question, we need to go back to something that its CEO Sam Palmisano said at another investor conference in Bangalore, India in June 2006 about the company's strategy. Here is our summary of it...

Palmisano on Quality over Quantity

(answering a question on commoditization at the IBM conference in Bangalore on June 7, 2006)

"We'll get out of any business that doesn't make financial sense. We're not wedded to anything. We don't measure ourselves by trying to be the biggest... we'd like to be the best earnings and cash generation entity in our industry... not necessarily *the biggest* – (but) with spaces of no income. We will exit any business that is a commodity business. We will not rationalize cases for synergy." (such as the PCs and developing markets).

So IBM has been focusing on quality rather than quantity of business. That is why such high margin units as software and services are thriving, while its competitors' hardware or commodity-based businesses are suffering.

Such a strategy had paid dividends for IBM shareholders in good times, as the record stock price of last summer showed. The same strategy is now helping protect the company from the economic storms that are raging around it. And that is why Big Blue is once again become a market leader, notwithstanding HP's bigger size.

EDITORIAL COMMENT

Why IBM Strategy Works in Good Times and Bad?

IBM's Holistic Approach

Treating Businesses Like Living Organisms: Secret to IBM's Success: Dawning of the Age of Aquarius

Why does IBM strategy work in both good times and bad? Because the company has had the vision to see the business as a living organism, and the courage to heal it using a holistic approach. While others in the IT industry are still stuck in the past paradigms of producing the best body parts, IBM has been focusing on integrating and optimizing the whole living organism, like the holistic approach of the New Age medicine practitioners (right).



And just what is Holistic Medicine? Here's a definition by the Canadian Holistic Medical Association:

Holistic medicine is a system of health care which fosters a cooperative relationship among all those involved, leading towards optimal attainment of the physical, mental emotional, social and spiritual aspects of health.

It emphasizes the need to look at the whole person, including analysis of physical, nutritional, environmental, emotional, social, spiritual and lifestyle values. It encompasses all stated modalities of diagnosis and treatment including drugs and surgery if no safe alternative exists. Holistic medicine focuses on education and responsibility for personal efforts to achieve balance and well being.

Sound familiar? No wonder. All you need to do is substitute IT techie-talk for medical terms above and you will get the essence of the IBM strategy. Its focus is on wellness of the whole, not just individual parts.

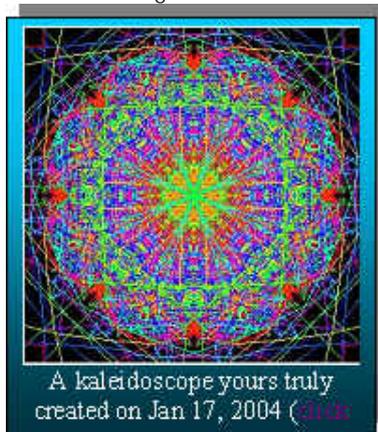
Virtualization, dynamic infrastructure, reusable service products... have been some of the instruments of integration the Big Blue practitioners have brought to the treatment table. And just as holistic medicine can help both healthy and sick people, IBM's strategy is healing both well-to-do and malignant companies. You don't have to be sick to benefit from yoga, jin-shin-jitsu, tai chi, reiki, chakra balancing or other shamanic energy healing treatments. The same works in business.

In a way, what IBM has put into practice is a convergence of two long-term macro trends



that we first identified in 1990 and 2004 respectively. In 1990, we talked about an upcoming Industry Stratification out of which a New World of IT will emerge, with global systems

integrators at the top of the food chain (see left chart from "[Industry Stratification Trend](#)", Mar 1990).



In 2004, we talked about searching for a "New Holy Grail." We found it when we said that the IT services companies would work with



"Chief Creative Officers" of their clients in structuring new corporate entities that would be flexible and adaptable, just like the human body. As a result, they would better able to adjust to a changing economic and physical environment. We also said that those who do not change, like some corporate dinosaurs (right below) will perish (see "kaleidoscope enterprises" - above right, in [IT Industry: Whither Goeth It?](#) - an Annex Bulletin on current and future industry trends).

It took a while, but now, over five years later, those messages are sinking in. Rigid "dinosaur" structures (like that of banks, auto companies, etc.) are all falling apart, while nimble and fluid enterprises are thriving. Continued Industry Stratification is forcing a creation of new nimble and flexible "kaleidoscope enterprises" that we first envisaged in 1996 (see [Annex Bulletin 96-42](#)) and again in 2004.



So tthis is truly the dawning of New Age of IT Aquarius. And it is heart-warming to see a giant Big Blue whale leading the way to transformation and renewal. It goes to show us that when you get in alignment with the forces of the universe, good things will happen no matter what age or size you are.

Happy bargain hunting!

Bob Djurdjevic

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