

Special Book Excerpt

Can IBM Make You Rich?

*Understanding IBM in
Less Than 17 Minutes*

Victor Freeman

5. Does the management have a determination to continue to develop products or processes that will still further increase total sales potentials when the growth potentials of currently attractive product lines have largely been exploited?

Chairman Samuel J. Palmisano, the preceding CEO, was the guy who brought IBM back to relevance and cutting edge with a spate of tough decisions like selling hardware division to Lenovo and buying PwC's consulting business. In his tenure, the EPS has grown five times and over \$100b free cash flow has been generated. His is a conservative leadership style that will suit value buyers, though the growth will not be spectacular.

5.1 Major products for the future

IBM makes some important products that have a great potential for the future. Here are some of the products that can be great revenue generators in the future.

1. IBM is the leader in **chip design** and has been selling a lot of them to portable device manufacturers. IBM designs the chips that powers all our gaming consoles – Xbox (PowerPC Tricore processor), Sony Playstation (Cell BE processor), Nintendo Wii (Broadway processor). Gaming consoles are set to take even more central role in our life with augmented reality technology and will supplement the smart phone apps. IBM is also partnering with Toshiba and other top companies to produce energy efficient, portable device chips. [Read More.](#)
2. **Watson series of supercomputers.** With proliferation of the data, companies are in need of fast machine that can perform enormous range of computations. IBM is targeting Healthcare, Telecom and Finance industry with this product line. Citigroup is the first customer in finance sector for this. IBM is placing a lot of bets on this product. Source: [TheInquirer](#)
3. **Cloud computing services:** IBM is one of the leading infrastructure service providers in the new hot area of cloud computing that companies around the world are adopting to. IBM provides data centre infrastructure, software, virtualization tools, hardware and the necessary guidance for companies to move their applications and data to the cloud. We have only barely scratched the potential offered by cloud computing.
4. **Internet of “Things”:** We have had Internet of content, can we have an Internet of things? IBM is working hard on a grand project to try to bring things around for us to interact in a way. Its partnership with Louvre museum in France, fully wired up with sensors, to provide a fantastic visiting experience is an example of this intention.

Since IBM's efforts are focused in the future and in the right direction, I see sustained growth in a decade to come. IBM is the leader in patenting and it is constantly trying to innovate new stuff and expand the markets.

Some of the leaders are quite passionate about what they do and are constantly looking to expand IBM's market reach. The following quote indicates the attitude of the leadership.

"It is not a job; it is a mission," said IBM industry solutions vice president David Bartlett, whose passion for figuring out how to make places more efficient has earned him the nickname "The Building Whisperer."

[Read more on this in Times of India.](#)

6. How effective are the company's research-and-development efforts in relation to its size?

IBM is the world's leader in technology research and maintains 9 laboratories worldwide with 5 Nobel laureates and hundreds of top researchers in various fields. The company spends \$6 billion annually in its R&D efforts and the revenues from IP licensing alone brings back \$1 billion of it annually.

IBM has been behind the development of:

1. ATM machines (IBM 2984 and IBM 3624 powering the original ATMs of 1970s)
2. Floppy discs and Hard discs
3. Relational databases that form the technology core of banks and other enterprises.
4. UPC code that is the US standard for shipping
5. Deep Blue supercomputer that has beaten Kasparov in Chess.

The R&D efforts maintain the IBM's lead in technology sphere and is helping the company gain more customers in the consultancy and servicing arena. Besides, IBM is very active in selling and licensing its technology, adding a steady stream of income.

6.1 Patents

IBM gets more patents than any other company in the US. In 2011, they had an unchallenged lead - getting almost 3 times as many patents as that of Microsoft. Licensing and selling patents have become one of the core businesses of IBM. Google has been a big buyer of IBM's patents and have bought almost 2000 in the last 8 months alone (Source: [PC world article](#)) in a deal that is speculated to be worth more than a billion dollars.

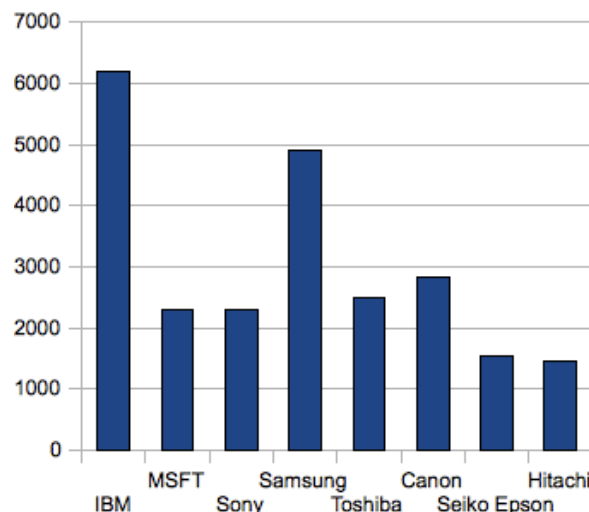


Table 2: List of top companies in the US by patents won in 2011

Data Source: [IBM press release](#)

10. Does the company have outstanding labor and personnel relations?

IBM has had historically terrific relationships with labor. In 2007 and 2008 it was ranked among the top 10 best places to launch your career by BusinessWeek. It has also been consistently ranked at the top by many rating agencies for best places to work. However, in the past 3 years, the situation has somewhat worsened in the rank and file, due to the layoffs.

The reviews at the employer review site, Glassdoor.com has some [unflattering reviews](#) of IBM at an overall ranking of 3.0 with only a 75% approval for the CEO. To put that in perspective, Microsoft has 3.4, Oracle has 3.1 and Google has 3.9 in the Glassdoor ratings. While it is clear that the reviews have been typically hard for all companies, IBM has ranked below its peers in this metric.

Minnesota public radio [reports](#) that IBM's US workforce has reduced by a third in the past five years and it has contributed to poor morale. Unlike other tech companies recently some of the labor have gone unionized and that have increased the friction between the management and the employees in the US facilities.

"Morale is pretty much rock bottom," said Lee Conrad, the national coordinator for the Alliance@IBM a labor union at the company. Conrad estimates IBM has about 97,000 employees in the U.S., down from roughly 135,000 five years ago.

Source: [Minnesota public radio](#)

The lower morale Mr. Conrad is referring to is presumably in the manufacturing utilities in the US. IBM unions continue to spread their influence on IBM's worldwide operations. [Source](#).

16. In the foreseeable future will the growth of the company require sufficient equity financing so that the larger number of shares then outstanding will largely cancel the existing stockholders' benefit from this anticipated growth?

IBM follows a very conservative and organic growth approach and its acquisitions are typically smaller (less than \$300 million in value). Moreover, they have over \$12 billion in cash to avoid any equity financing for big ticket acquisitions and investment. The leadership approach is cautious and the firm makes its investments primarily from the cash generated. Based on its acquisition history over the past century, it can be assumed that the company has a lesser probability to make a big acquisition blunder like what happened in AOL-Time Warner, Daimler-Chrysler or even HP-Compaq whose merger was not as catastrophic but not a great one either.

Since 1995 IBM has been increasing its dividends in a 16 year unbroken stretch. Since 2003, IBM has returned \$109 billion through stock repurchases and dividends and last October they announced that they will increase the fund for its stock repurchase program to \$12.2 billion. In 2005 they had an outstanding total of 1.67 billion shares and it has now reduced to 1.16 billion shares now. Thus an average investor in 2005 is holding 42% more of his share now. The timing of the purchases also proved to be right as the shares were purchased in the \$109 range while it is trading at over \$190. The repurchases have increased the EPS from about \$4.3 per share in 2003 to over \$13 in 2011. This shows IBM's commitment to adding investor's equity value.

Source: [InvestorPlace](#)