

International Business Machines (IBM)

Rating	NEUTRAL*
Price (14 Jun 11, US\$)	164.12
Target price (US\$)	175.00 [†]
52-week price range	172.87 - 121.86
Market cap. (US\$ m)	198,991.73

*Stock ratings are relative to the relevant country benchmark.
[†]Target price is for 12 months.

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COMMENT

Storage exposure deminimus

- **Retain Neutral rating.** While we retain an optimistic view on the storage market, it represents only 2% of IBM's operating income and only has a slight impact on the company's overall operating performance.
- **IBM with 14% market share in 2010 and ranks third on our scorecard.** We see IBM gradually losing share within the storage segment. IBM's high scores in most scorecard metrics are offset by low scores for price/performance, management functionality and product positioning. The company is reasonably well positioned in storage software (with ~10% share) and has strong global distribution, but legacy exposure (13% of storage revenue) and high end bias will remain a drag on overall storage share gains. Relatively new products within the portfolio, SONAS, XIV and StorWize V7000 could improve the growth trajectory but this could be a long term proposition given the low mix.
- **Storage market – secular growth outlook ahead.** Following an extensive study of the Storage market (see our sector note IT Hardware: Storage pure plays: Leverage to growth), we remain optimistic on the segment. We view the \$20bn storage market as one of the more attractive sub-segments within IT hardware with secular growth being driven by virtualization and unstructured data growth. Based on our proprietary forecast which we have updated actuals through Q111 and forecast networked storage revenue to grow at a 11.2% CAGR LT. We note more attractive growth dynamics in the low-end (+12.5% LT) and mid-range of the market (+14.9% LT).
- **Valuation is close to fair.** With over 50% of incremental EPS coming from M&A and buybacks over the next five years, the quality of growth is somewhat low. While shares trade at 11.0x our CY12 EPS, we believe shares do deserve to trade at a discount to the S&P. A blended average of P/E, DCF, and HOLT® suggests fair value of \$175, implying only 7% upside from current levels, and hence our Neutral rating. We would become more constructive below \$150 or with increased evidence of robust organic growth.

Share price performance



On 06/13/11 the S&P 500 index closed at 1271.83

Quarterly EPS	Q1	Q2	Q3	Q4
2010A	1.98	2.58	2.82	4.25
2011E	2.41	3.01	3.06	4.88
2012E	2.75	3.35	3.46	5.49

Financial and valuation metrics

Year	12/10A	12/11E	12/12E	12/13E
EPS - (Excl. ESO) (US\$)	11.67	13.36	15.06	16.92
EPS (CS adj.) (US\$)	11.67	13.37	15.06	16.92
Prev. EPS (CS adj.) (US\$)	—	—	—	—
P/E (CS adj., x)	14.0	12.2	10.8	9.6
P/E rel. (CS adj., %)	108.0	107.2	105.4	105.7
Revenue (US\$ m)	99,870.2	105,618.6	111,669.9	118,014.1
EBITDA (US\$ m)	24,238.9	26,553.3	28,234.9	29,851.4
Net debt (US\$ m)	17,964	11,761	8,785	5,402
OCFPS (US\$)	15.26	22.23	20.35	22.23
P/OCF (x)	9.6	7.3	8.0	7.3
Number of shares (m)	1,219.54			
BV/share (current, US\$)	18.4			
Net debt (current, US\$ m)	17,494.0			
Dividend yield (%)	2.0			
		Price/sales(x)		1.88
		P/BVPS (x)		8.9
		Dividend (current, US\$)		3.20

Source: Company data, Credit Suisse estimates.

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Companies Mentioned (Price as of 14 Jun 11)
 International Business Machines (IBM, \$164.12, NEUTRAL, TP \$175.00)

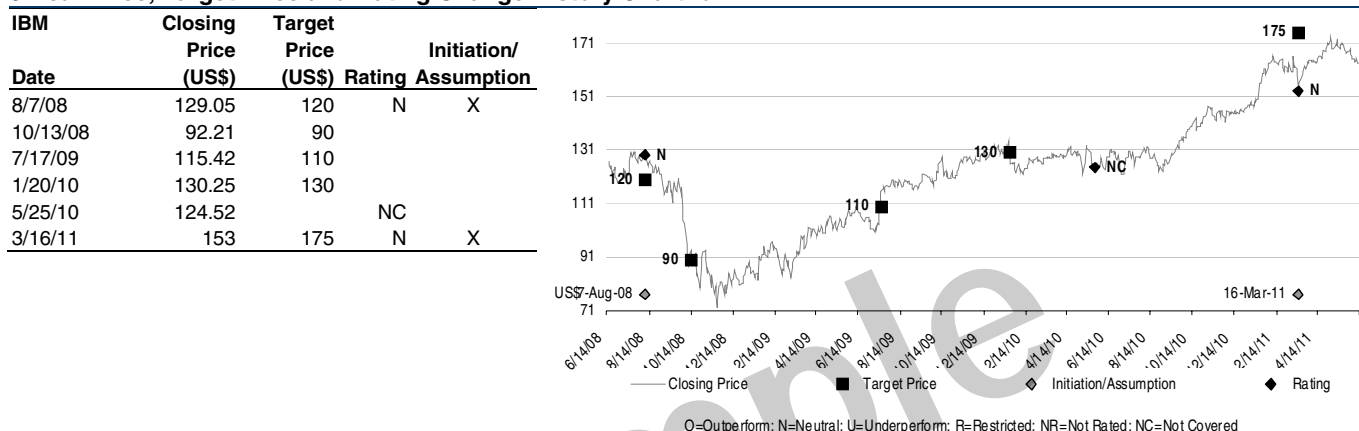
Disclosure Appendix

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3-Year Price, Target Price and Rating Change History Chart for IBM



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Price Target: (12 months) for (IBM)

Method: Our \$175 target price for International Business Machines Corp. is based on a blended average of Price per Earnings (P/E), Discounted Cash Flow (DCF), and HOLT analyses. (See "Important Credit Suisse HOLT Disclosures below.") Our P/E analysis assumes a 10.5x multiple applied to our 2012 EPS of \$15.06, resulting in a fair value estimate of \$158. Our DCF analysis which assumes long-term revenue growth of 2-3%, long term EBIT margins of 16%, terminal growth of 3% and a weighted average cost of capital (WACC) of 6.4% results in a fair value estimate of \$200. Lastly, Credit Suisse HOLT implies a fair value estimate of \$171 based on the assumption that CFROI will fade toward 20% long term from 26% in 2011.

Risks: Risks to achievement of our \$175 target price for International Business Machines Corp. include declining Information Technology spending as a result of macroeconomic downturn, increased competitive risks within server, storage, and services, as well as merger and acquisition integration risks as IBM remains acquisitive.

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