IBM, The Stock That Gets No Respect

IBM must be one of the least liked large cap stocks around. The criticisms are easy and familiar: they haven't grown revenues in years, they are involved in financial engineering to prop up earnings, they are taking on lots of debt to support cashflows. Recently, Barron's Roundtable noted that Fred Hickey had IBM as a short recommendation.

It's true IBM has been a poor performer against the S&P500 over the past year. However, it has less volatility than the market with a trailing Beta of 0.66 so all other things being equal you would expect it to lag somewhat when prices are rising. And it's true that revenue growth for years has been non-existent, hovering frustratingly around the $100BN annual level. However, earnings have grown nicely over the past ten years aided by improving margins and a reduced share count. So although revenues are flat since 2004, over that time EPS has more than tripled from $4.93 to an estimated $17.90 consensus forecast. The sharecount has dropped from 1.7 billion to around 1 billion as they relentlessly return cash to shareholders through buybacks.

As for debt, it's true that it's risen although IBM is hardly a leveraged company. They're expected to finish the year with $48BN of long term obligations less Cash of $17BN for $31 BN of net debt, supporting pre-tax operating income of $21BN. This hardly seems like reckless leverage. Meanwhile, they still look to be on track to hit their target of $20 in operating EPS next year. At $194 a share it just doesn't seem ridiculously expensive.

As for innovation, in 2013 IBM inventors received 6,809 patents, the 21st consecutive year of being the most prolific recipient of such awards.

So IBM isn't that exciting on a daily basis, but it does look like a fairly compelling place to invest some of your money if you're not one of those people who requires daily gratification on your stock picks. Fred Hickey's price objective on his short IBM was $150 in the abovementioned article. At the time of his interview it was trading at $182 but has since risen $12, over a third of Hickey's sought after gain. Shorting isn't easy, and don't imagine we're claiming victory because we still own IBM and anything can happen. But there must be better ways to make money than trying to short IBM. They just keep generating cash, $18.1 BN in Cash from Operations (less change in Financing receivables) over the past 12 months, or about $18 per share.

For excitement, watch Amazon (AMZN) as they continue to break records for the most inefficient converter of revenues into profits. In ten years sales have increased sevenfold while EPS has halved. In their most recent quarter over $19BN in revenues, up 23% year on year, generated a small operating loss. The best investment you can make in Amazon is to sign up for Amazon Prime. Being a customer is far more likely to be satisfying than being an owner.