

# IBM and Microsoft financial statement analysis

Business



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International Business Machines Corporation was founded in 1911 and has grown and adopted over nearly a century. IBM is nick-named “big blue” by Wall Street in reference to it being a quintessential blue chip stock. IBM currently is an information technology company that has four business segments; hardware, financing (to facilitate clients acquisition of IBM systems, software and services), services, software.

I thought these two dominant, global, large-cap technology companies would be interesting to compare. First let us review IBM. IBM has continued to deliver steady revenue over a long period of time.

They offer a wide range of technology products. Since 2000 IBM has added \$12 billion to pre-tax profit base, increased pre-tax margin 2.

5 times and quadrupled earnings per share and more than doubled free cash flow. They have achieved this by transforming over the last decade to emphasize software and services and reducing the hardware segment. IBM pursued this strategy a decade ago because they felt the global IT industry and broader world economies were changing to demand integration, computing architecture, data intelligence and innovation.

IBM has successfully capitalized on recognizing the demand for products and services they had an advantage in. They exited some of their hardware business, selling the PC hardware business to Lenovo in 2005 for \$1.75 Billion. It is safe to say IBM has successfully evolved from a computer hardware vendor to a systems, services and software company. The pre-tax income produced in each segment of business was; hardware accounted for

7% or \$1.4 billion in pre-tax revenue, financing 9% (\$1.7 billion), services 42% (8.

1 billion), software 42% (8. billion). IBM is the second largest vendor in software sales storage systems and microprocessors. Hewlett Packard and Dell are the main competition in this segment.

The software business focuses on operating systems, infrastructure management for data centers, application middleware for software development and deployment. They compete with Oracle and Microsoft in this segment. The services organization offers contracts to maintain and manage operations of large data centers, business process outsourcing, and developing custom systems.

These contracts are typically five to seven years for the engagement and are a good source of predictable recurring revenues.

They compete with Hewlett Packard, Accenture, Computer Sciences and Infosys in this business. IBM is the most trusted brand and it has a strong product portfolio which results in an edge winning new service business contracts. The management of IBM describes the business strategy for the next decade as "the decade of smart". Here they outline the four major growth opportunities they are focusing on.

The first of these is growth markets.

For IBM this is clients across 170 countries where infrastructure is being invested in or upgraded. IBM estimates that \$2 trillion has been earmarked for infrastructure improvements by governments across the world and they <https://assignbuster.com/ibm-and-microsoft-financial-statement-analysis/>

have a great opportunity to capture a large portion of this spending. The second is “analytics”. IBM has seven analytics solution centers around the world that employ 4,000 consultants, 200 mathematicians and analytics experts that will work on 2 service contracts.

This seems to me as if it is not so much of a new idea but rather continuing to expand on their success in the services segment.

Third is “cloud and nextgeneration data center”. The advent of cloud computing could throttle demand for IBM’s high end powerful hardware and software. Oracle and Sun are attempting to compete with IBM on this new frontier. Naturally the management discussion in the annual report and financial statements indicates that IBM believes this will be a great growth area for 18M. However, it is not going to be without competition but IBM should be one of the beneficiaries if cloud computing grows.

The fourth and final growth opportunity IBM management outlines is called, “smarter planet”.

In this growth opportunity they describe and map out 300 clients across the globe IBM categorizes in this smarter planet description. They are things such as; integrated baggage control and check-in system at Amsterdam airport, gas and oil seismic imaging efficiency improvements in Venezuela, an intelligent medical records system at Guan Dong Hospital in China. Again this does not sound like a new idea to me but rather a catchy marketing name for increasing and capitalizing on their success in the services segment. Clearly IBM likes these five to seven year highly profitable contracts.

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This is understandable and a good strategy that should be in the sweet spot for 18M.

Turning now to Microsoft I was surprised to learn that total revenue for Microsoft was 58.4 billion compared to 95.8 billion for IBM in 2009. This surprised me probably because Microsoft is more visible to the consumer such as me. Microsoft is the largest vendor of software in the world.

Microsoft was founded in 1975 and they consulting and hardware. Microsoft divides their business into five segments; client, server and tools, 3 online services, business division, and entertainment and devices division.

Microsoft recognizes there is a great deal of overlap and related business resulting from these segments and therefore they state that they should not be viewed of as easily separable businesses. The client segment is the segment that has the responsibility for Windows operating systems.

Microsoft dominates the PC market in this regard, while Apple receives a good deal of press and is well known for its iPod and iPhone, Microsoft is by far the dominant operating system used by computers.

Other competitors are Red Hat and Sun Microsystems.

The Windows operating system also faces competition from alternative platforms and new devices that may reduce consumer demand for traditional PC's such as Google's Android. The server and tools segment offers middleware software designed to support software applications built on the Windows Server operating system. The Windows Server based products include server platform, security software, development tools, database

storage and also standalone software development lifecycle tools for software architects. Some of the products in this segment are; Microsoft SQL Server, Visual Studio, Silverlight and Microsoft Consulting Services.

The competition for server products is Hewlett Packard, IBM and Sun Microsystems. In the enterprise computing solutions space IBM, Oracle and Sun are the main competitors. Numerous software vendors compete with the software in this segment for security, e-business servers, server management and server virtualization. Again, IBM and Hewlett Packard are the major competitors. The online services business consists of an online advertising platform with offerings for publishers and advertisers as well as online information offerings such as 4 Bing, MSN portals and channels, email and instant messaging.

Microsoft earns revenue primarily from online advertising in this segment but also through subscriptions and transactions from online generated services. The competition in this segment is AOL, Google, and Yahoo. Google dominates this business but Microsoft has made big gains with the Bing search engine and has a new business venture with Yahoo as Yahoo seems to be shrinking fast. Microsoft Business Division consists of the Microsoft Office system and Microsoft Dynamics business solution. The Office products account for 90% of this segment's revenue of which 80% are business customers.