ANNEX BULLETIN

Annex Bulletin 2006-26 June 12, 2006

A partially OPEN client edition

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INDUSTRY TRENDS

Updated 6/13/06, 8:50AM PDT, adds Revenue

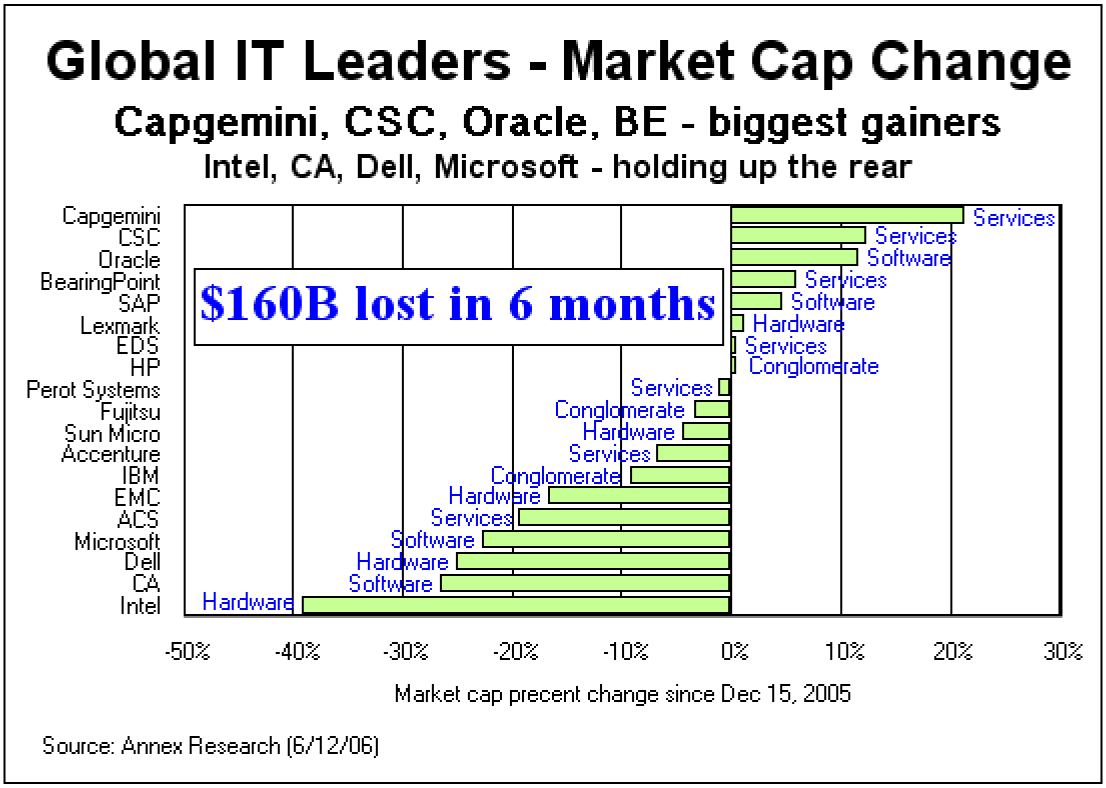
Analysis of Global IT Leaders' Business and Stock Performances

A $160 Billion Loss

That's How Much Money Investors Removed from Top 19 Global IT Companies' Market Cap in Last Six Months; Microsoft, Intel Lose the Most, But Is IBM the Most Undervalued?

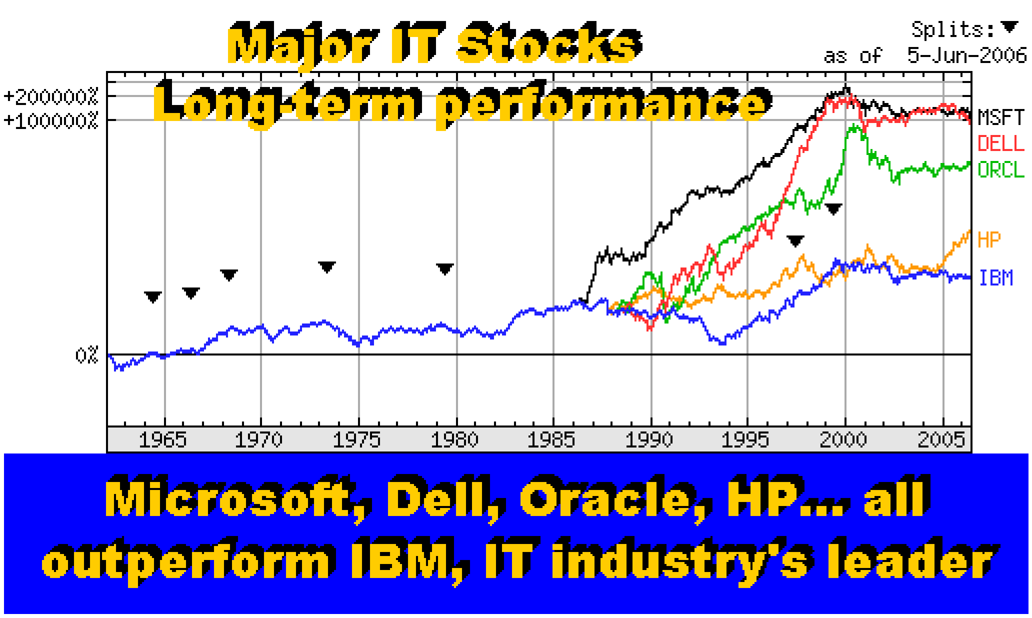
SCOTTSDALE, June 12 - One hundred and sixty billion dollars - that's how much we figure investors have removed from the pockets of the Top 19 IT companies' shareholders in the last six months. That's like an IBM and Dell combined going out of business. Or an Intel plus SAP. Or two HP's. Just to put things in perspective...

Now, not all top IT leaders saw their market caps decimated. Oracle, SAP, Capgemini and CSC, for example, actually saw an increase in it since Dec 15, 2005, the last time we took the market's temperature (see "A $100 Billion Gain!," Dec 16, 2006). But their gains were pittance in absolute figures as compared to the mammoth losses that Microsoft ($65 billion), Intel ($63 billion), Dell ($19 billion) and IBM ($12 billion) shareholders sustained (see above chart).

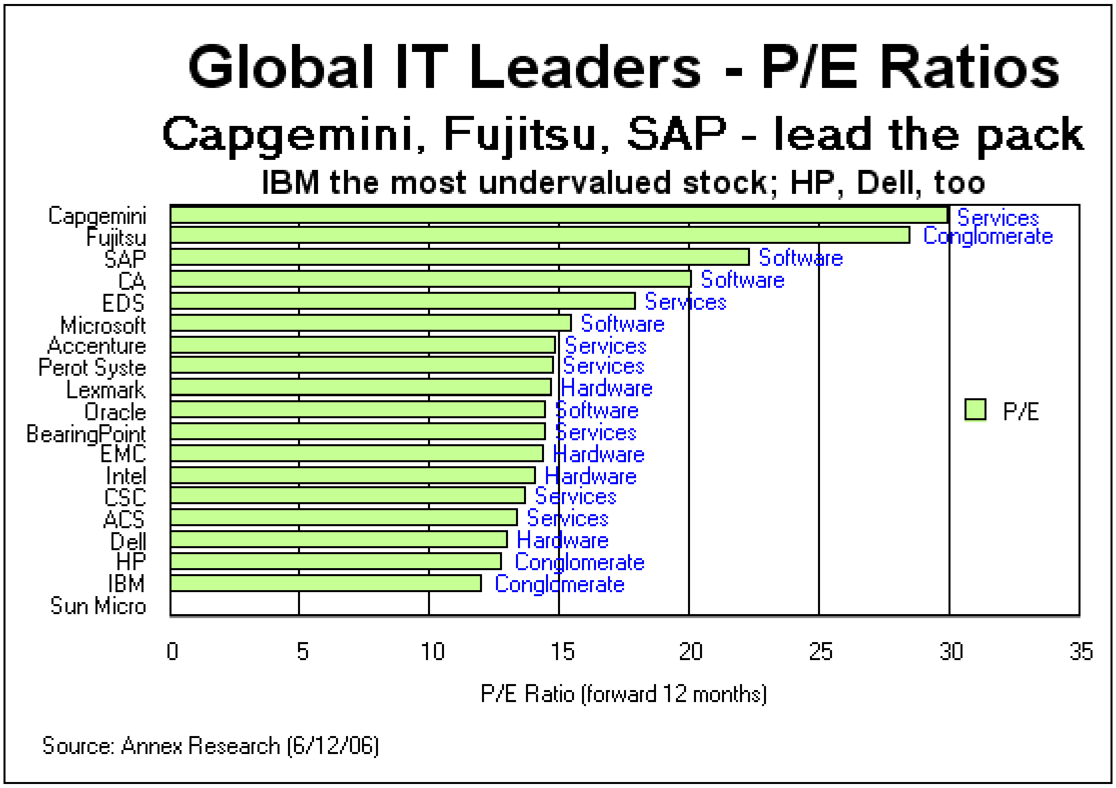


When it comes to market cap percentage changes in the last six months, the story is slightly different but the same three household names (Intel, Microsoft and Dell) crop up as three of the four biggest stock market losers (the fourth member of the "gang of infamy" being CA).

Now it is not very often that you will find the likes of Microsoft, Intel, Dell or IBM in the cellar of anything, especially in Wall Street's dungeons. Yet that's exactly where they ended up in the last six months. Yesterday's bellwether stocks became today's punching bags.



With exception of IBM, however, the rest of them can still point to long-term charts, such as the one above, when they feel a need to boost self-esteem and dignity. IBM appears to be in Wall Street's dog house no matter what.



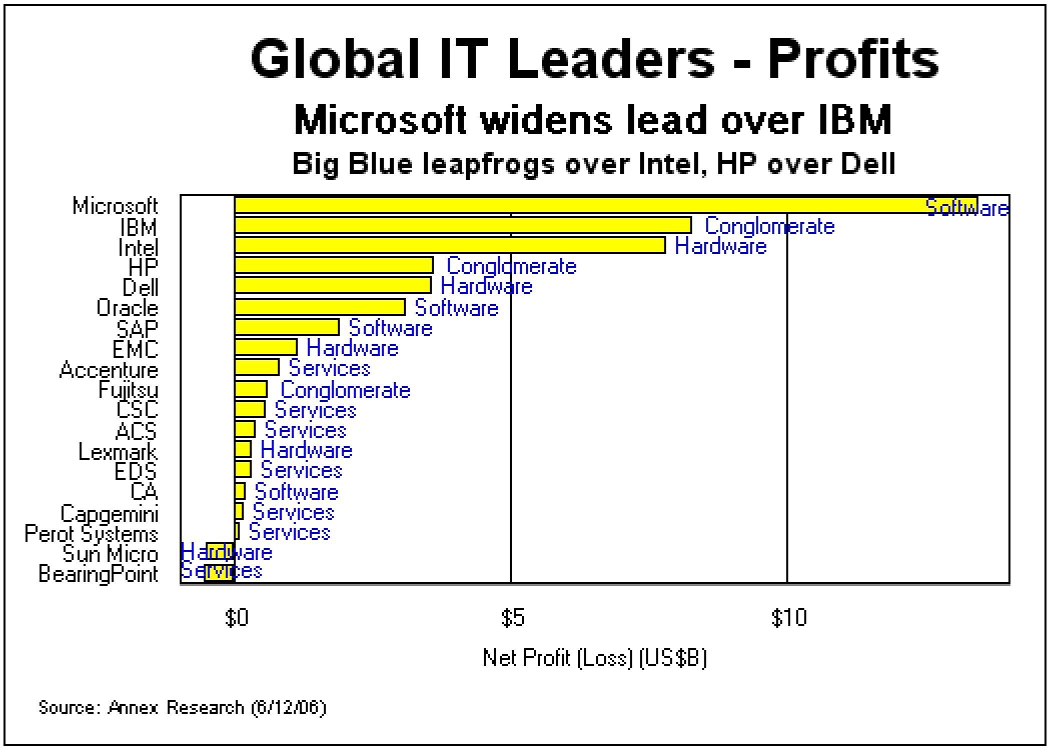
But perhaps nowhere is Wall Street's upside-down view of Big Blue as distorted as when one considers the (forward) P/E ratios. This is where IBM *is* the cellar, while Capgemini, Fujitsu and SAP top the charts.

But one man's loss is another man's gain. As we pointed out in our latest report, the IBM stock is at least 20% undervalued relative to its peers and the sum of its parts (see "A Tale of Two Blues," June 2006). Smart investors can use this situation to accumulate IBM shares. After all...

> “In short, the value is there; plenty of it as it turns out in *IBM*’s case. But Wall Street is blind for looking. Or it’s looking but not seeing the wheat for the chaff. Either way, the *IBM* shareholders are taking it in the chin. Which makes this stock probably the most undervalued among the top 19.”
>
> (A modified excerpt from "An Upside-Down View," Mar 2005)

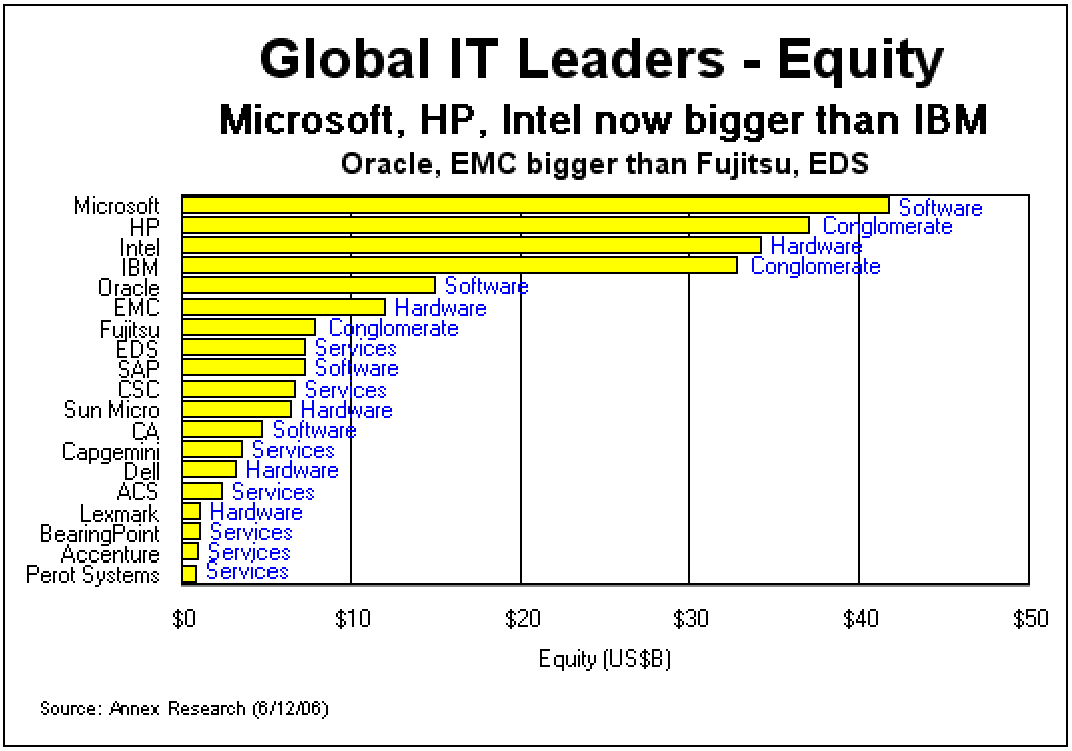
... just substitute HP for IBM in the above paragraph, and you will get what we actually wrote - *about HP* - in March 2005! And we all know that happened. HP became the best-performing Dow Jones component by the end of 2005. And it has kept most of its gains in 2006 despite a general market sell-off.

Of course, HP got a new leader in April 2005 and IBM disappointed investors with its first quarter results at about the same time.



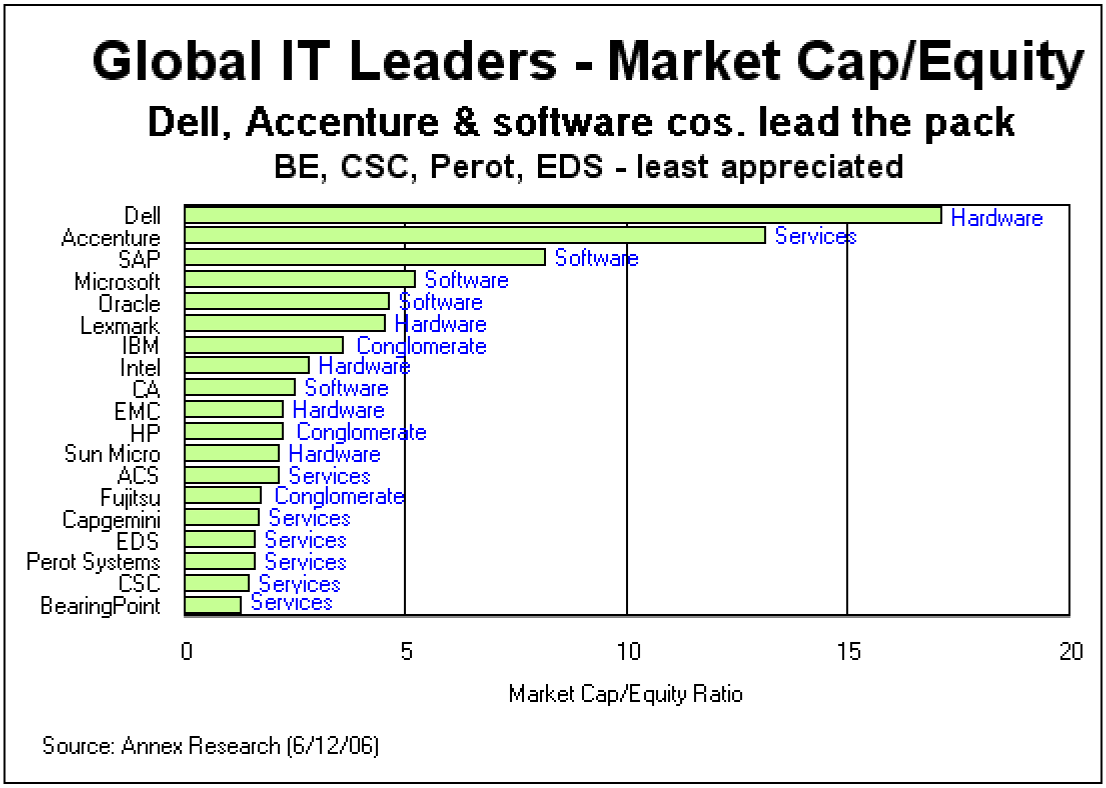
But Big Blue has since consistently improved the quality of its earnings and has leapfrogged over Intel to regain the No. 2 spot in the industry, after Microsoft, the leader in the earnings category. Despite a similarly stellar performance in the last 12 months, HP, the fourth most profitable IT company that has also leapfrogged over Dell, is still far behind IBM it terms of absolute net earnings (see the chart).

So any investor who still believes in the principle that stock prices ought to approximate the quality of business results should have a hard time ignoring IBM's solid fundamentals.



When it comes to another form of substance (shareholders' equity), Microsoft tops the charts again. And even though the 93+-year old IBM is the oldest IT company around, it ranks only fourth (after Microsoft, HP and Intel) in this category. Squandering $70+ billion of shareholders' money (on stock buybacks) does carry a price.

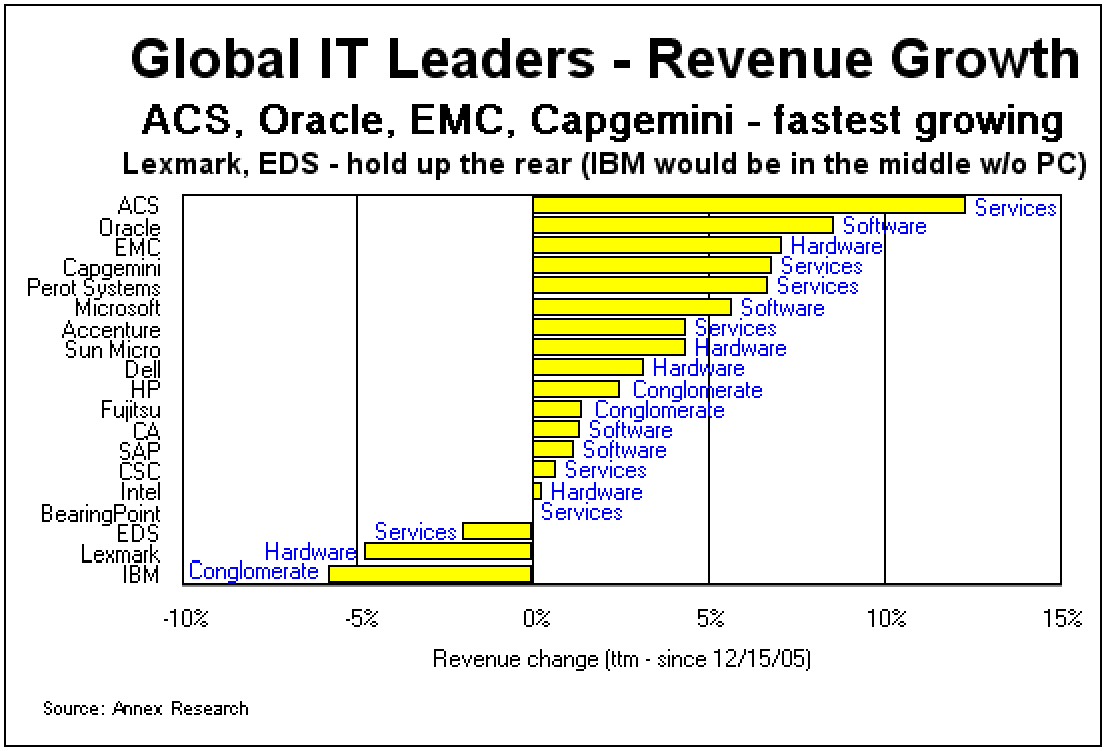
That relative newcomers, Oracle and EMC, are the two next biggest competitors in terms of equity, shows just how much things have changed in the IT industry in the last decade or so.



Even though IBM's $8.3 billion (trailing twelve months - ttm) net profit dwarfs Dell's $3.6 billion, Dell's market cap-over-equity ratio is over four times higher than IBM's. See what we mean about hype over substance?

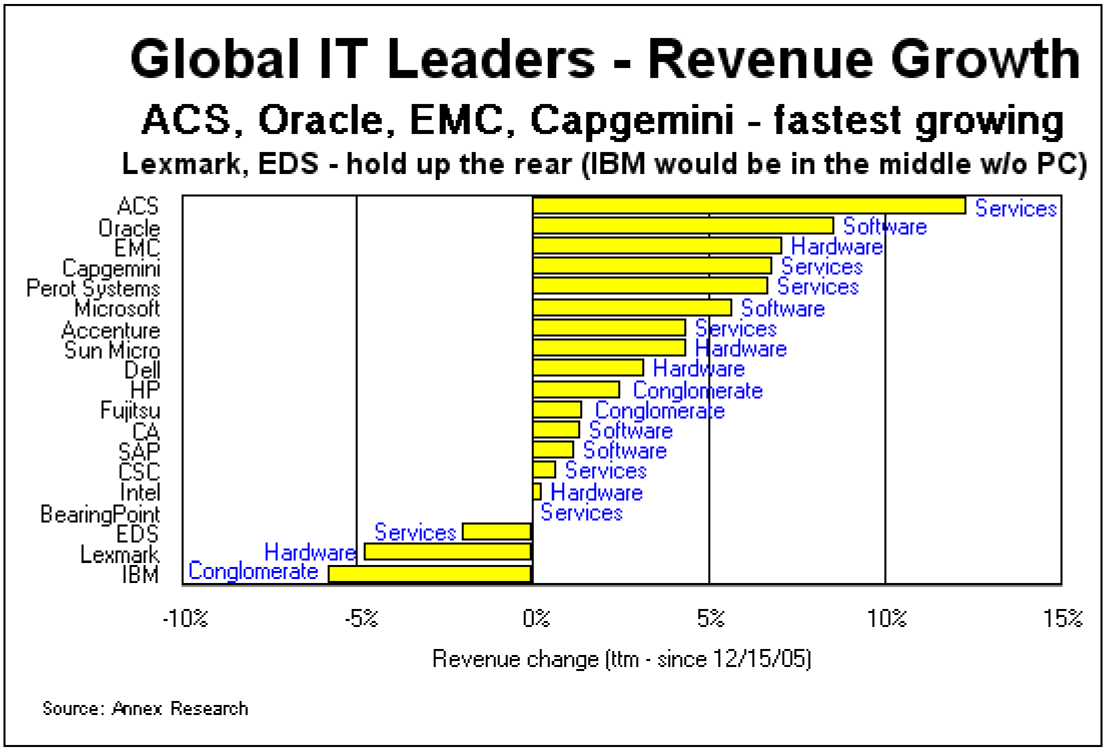
Nothing new there. Dell has been the "King of Fluff" from way back (we first named it that back in 1998 (see "Stock Buybacks: Corporate "Cabbage Patch" Dolls of 1990s and the "King of Fluff," Oct 1998).

That Accenture is the No. 2 company in this category only goes to show us that good old-fashioned PR and investor relations can yield similar results without a company having to squander tens of billions of dollars on stock buybacks. That's one expensive Wall Street and corporate fad that emerged in the last decade or so from which Accenture has largely abstained.



When it comes to sheer size (revenues), hardware makers occupy most of the top spots among the Top 19 IT industry leaders. The software behemoth Microsoft is the only exception in the top five (the other four being IBM, HP, Dell and Intel).

IBM and HP are tied for the top spot at the moment based on their latest 12-month reported results. But as you saw in our last report (see "A Tale of Two Blues," June 2006), HP is expected to take over as the IT industry's largest company by the end of the year.



In terms of nimbleness and growth, however, hardware giants are nowhere to be seen at the top of the IT leaders list. The much smaller ACS, Oracle, EMC, Capgemini, Perot Systems... rule the roost in this category. And IBM is again dead last, after Lexmark and EDS. But this is a temporary anomaly that should be a cause for celebration rather than worry. Without the PC sale to Lenovo, which improved the quality of its earnings, IBM would be in the middle of the list, along with other hardware vendors and conglomerates.

Summary

As you saw from HP's example, the Wall Street sometimes gets things upside-down that can lead to strange anomalies in the marketplace. Last year it was HP that seemed unjustly slighted by investors. This year, it is IBM.

But over time, stock prices and businesses tend to find their equilibrium. After some $160 billion has been removed from the pockets of the Top 19 global IT leaders' shareholders in the last six months, though many of them, starting with IBM, were reporting improved business results, the pendulum should start swinging the other way. When? When the investors' tide starts to lift all boats (i.e., when the non-IT worries, such as oil prices and interest rates, stop affecting investors' minds).

Which means that potential buyers may want to consider this ebb tide as an opportunity to add to their positions. Of course, things often get worse before they get better. But better they usually get... given patience and perseverance, as the HP holders found out last year.

For detailed tables, click here for Top 19 stock/business stats

Happy bargain hunting!

Bob Djurdjevic

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Volume XXII, Annex Newsflash 2006-26
June 12, 2006

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