

Equity Research
North America

United States of America

Systems and PC Hardware

IBM

Reuters: IBM.N Bloomberg: IBM NYSE: IBM

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STOCK RATING	EQUAL-WEIGHT
Price (January 15, 2004)	\$94.02
Price Target	NA
52-Week Range	\$94.54-73.20

Stock ratings are relative to the analyst's industry (or industry team's) coverage universe.

GICS SECTOR	INFORMATION TECHNOLOGY
US Strategist Weight	15.9%
S&P 500 Weight	18.4%

WHAT'S CHANGED	
F1Q04 Revenue	From \$20.5B to \$21.4B
F1Q04 EPS	From \$0.80 to \$0.90
F2004 Revenue	From \$90.7B to \$94.1B
F2004 EPS	From \$4.55 to \$4.80

Analysis of Sales/Earnings

January 15, 2004

IBM 4Q Signals Accelerating Enterprise Demand

- Stronger hardware shipments and services signings indicate momentum in 2004. Server and PC shipments were stronger than we expected and services signings came in well above our \$14-16B range. Both indicate enterprise spending improved in the December Q (particularly in Public, Financial Services, Industrial and SMBs markets).
- Currency, provisions and buybacks helped offset Services margin weakness Y/Y. Services margins fell 1.5 pts over last year (a \$0.07 hit to EPS), but FX (\$0.02), higher share repurchases (\$0.01) and lower A/R provisions vs. a year ago (\$0.06) helped offset this weakness. While somewhat unexpected, we applaud IBM's use of cash to buy back shares and believe lower A/R provisions is directionally the right move given improving demand trends.
- Adjusting our 2004 estimates to reflect momentum, currency and execution. Management believes 2004 revenues could come in a point above current consensus, but currency will remain the largest driver of revenue growth. We increased our 2004 Revenue and EPS to \$94.1B and \$4.80 (from \$90.7B and \$4.55).
- Systems & PC Hardware Industry View: In-Line. Recent CIO and channel data point to improving demand fundamentals and market sentiment. While we still don't think valuations are all that compelling, we believe improving fundamentals and market momentum will continue to support our stocks.

FY ending Dec 31:	2003e	2004e	2005e	2006e
EPS (\$)	4.33	4.80	5.20	-
Prior EPS Ests. (\$)	4.27	4.55	4.93	-
First Call Consensus (\$)	4.28	4.87	5.46	-
Revenue (\$ m)	89,131	94,133	98,063	-
P/E	21.7	19.6	18.1	-
P/E Rel. to (local index) (%)	103.9	104.5	105.0	-
EV/EBITDA	12.3	12.0	11.6	-
Market Cap (\$ m)	161,754			
Enterprise Value (\$ m)	178,427			
Debt/Cap (09/03)(%)	45.7			
Return on Equity (09/03)(%)	26.5			
L-T EPS Grth. ('02 - '06) (%)	9.0			
P/E to Growth	2.18			
Shares Outstanding (m)	1745.7			

Q'trly EPS	2002 Actual	2003 Actual	2004e	
			curr	prior
Q1	0.73	0.79	0.90	0.80
Q2	0.89	0.97	1.08	1.02
Q3	0.99	1.02	1.17	1.11
Q4	1.34	1.56	1.65	1.62

e = Morgan Stanley Research estimates

Morgan Stanley does and seeks to do business with companies covered in its research reports. Investors should consider this report as only a single factor in making their investment decision.

IBM 4Q Signals Accelerating Enterprise Demand

Company Description

IBM is the world's largest computer firm, involved in developing, manufacturing, and selling advanced information processing products, including computers and microelectronic technology, software, networking systems, and information-technology-related services.

Summary and Investment Conclusion

In a nutshell, we are encouraged by IBM's operating performance in the December quarter. The company's strength does signal improvement in the overall Enterprise segment (good for our universe) and IBM executed well in many segments of its portfolio. That said, currency, share buybacks and lower A/R provisions helped results more than we forecast. We also still have a few concerns — which keep us from saying the company hit on all 8 cylinders. While Services signings were stronger than anticipated and suggest revenue growth could accelerate, IBM's growth driver disappointed on both the top and bottom line (in constant currency terms). Y/Y revenues fell 1% in constant currency and Global Services margins fell to below 25% (less than Hardware margins over the last 4 quarters). IBM's Microelectronics division also continued to lag our expectations, though IBM clearly made progress here Q/Q. Net-net, IBM had a good quarter — but we don't think it was great. Management sounded upbeat about the future, but provided relatively modest guidance for the year. As we sum it all up, we do think there is upside to the stock and we do expect IBM to perform generally in line with the market this year (assuming broader returns in the low double digits). We reiterate our Equal-weight stock rating.

Highlights of What Happened

- **Revenues and EPS beat estimates:** Revenues (\$25.9B vs. our \$25.3B) and EPS (\$1.56 vs. our \$1.50) beat our 4Q estimates. Consensus called for \$25.0B and \$1.50 per share.
- **Comfortable with current C2004 consensus:** Management suggested current consensus revenue (\$93.7B) and EPS (\$4.87) estimates are reasonable — with some potential upside to revenue due to higher currency benefits. After adjusting our segment revenues and margins based on 4Q commentary, our C2004 revenue and EPS estimates increased to \$94.1B and \$4.80 (from \$90.7B and \$4.55).

What We Liked / Didn't Like

- **+++ Hardware growth accelerated:** IBM's hardware revenues improved ~4% in constant currency after several quarters of mid-to-high single-digit organic declines. We view this as an incremental positive for both IBM and the industry overall, but would note that zSeries growth is likely to slow from 4Q levels.
- **+++ Services signings well above expectations:** Services signings came in at \$17.3B, which is well above our \$14B to \$16B range. Business Transformation Outsourcing (BTO) drove \$3B of the signings (vs. none last year and \$650M in 3Q). While services revenue and margins (especially consulting and systems integration) disappointed, the strong signings number indicates a solid pipeline entering 2004.
- **+++ Pension income in 2004 will be higher than we expected:** In light of strong fund returns in 2003 (nearly 22%) and a lower discount rate (from 6.75% to 6%), IBM expects pension income will be flat from 2003 to 2004. Going into the call we expected pension income to decline ~\$500M (\$0.20 hit to EPS year to year). This was a key driver of our increased 2004 EPS estimate.
- **+++ Management commentary on demand trends and 2004 more bullish than a month ago:** From our perspective, management commentary on demand trends seemed more bullish than a year ago, characterizing 2004 as “the year when the IT industry will begin its next growth cycle”. Management blessed 2004 consensus EPS estimates and noted potential upside (a point or so) to current revenue expectations. Management also reconfirmed (for the first time since 2001) long-term guidance of both high single-digit revenue growth and low double-digit EPS growth.
- **--- Despite some improvement in Microelectronics fundamentals, revenues and margins missed our targets:** IMD revenue was slightly below our estimates

and management's estimate of \$1B (for internal + external revenue). Margins did improve significantly from 3Q (a pre-tax loss of \$34M vs. \$96M in 3Q) but, pre-tax income (PTI) missed our \$24M estimate. We believe management targeted a year-to-year improvement in Microelectronics PTI for 2003 and missed this target (with flat PTI from 2002 to 2003).

- **--- BCS revenues and services margins weaker than expected:** BCS revenues declined year-on-year in the first quarter that PwCC didn't meaningfully boost year to year compares. Clearly consulting and systems integration business remains soft, but strong BTO signings (\$3B in 4Q) could help grow the business in the second half of 2004. Services margins were 0.5 points lower than we expected and reflected continued pricing pressure, contract re-scoping and lower margins on early stage contracts. While management expects some margin improvement after significant investments in On Demand and BTO in 2003, we don't believe pricing and early stage contract pressures will mitigate anytime soon.
- **--- Currency, Share Repurchases and A/R provisions helped offset year-to-year Services margin weakness:** Services margins fell 1.5 pts over last year (a \$0.07 hit to EPS), but FX (\$0.02 benefit), higher share repurchases (\$0.01 benefit) and lower A/R provisions vs. a year ago (\$0.06 benefit) helped offset this weakness. While somewhat unexpected, we applaud

IBM's use of cash to buyback shares and believe lower A/R provisions is directionally the right move given improving demand trends.

How Does It Change Our View?

- **Adjusting 4Q expectations:** Given improved momentum in hardware and services signings, higher FX benefit expectations and lower than expected pensions hit in 2004, we increased our 2004 revenue and EPS. We now forecast revenues and EPS of \$94.1B and \$4.80 compared to our prior forecasts of \$90.7B in revenues and EPS of \$4.55.
- **Maintain Equal-weight:** While we're encouraged by improving demand trends in hardware and services (particularly BTO), 2004 organic revenue growth expectations are in the low single digits (with currency expected to largely drive reported revenue growth to the mid to high single digits). Services and Microelectronics margins remain risks to 2004 results and IP Income is unlikely to have another year-to-year benefit to the bottom line.

At a 19.6x 2004E P/E and 5% premium to the market, we think an Equal-weight on IBM makes the most sense. If organic revenue growth accelerates into the mid-to-high single digits or if the stock trades at a discount to the market, we'd likely get more aggressive on the name.

Exhibit 1

IBM: 4Q03 Product Breakdown

(\$ millions)	4Q02E	3Q03E	4Q03E	4Q03E			Comments
				% of Revs	YoY Chg	Seq Chg	
Product Breakdown							
Global Services	\$10,575	\$10,383	\$11,448	44.2%	8.3%	10.3%	Signings of \$17.3B were above our \$14-16B range. \$3B of signings from BTO.
<i>BCS</i>	\$3,543	\$3,439	\$3,456	13.3%	-2.5%	0.5%	First Q with Pw CC fully integrated (and tougher Y/Y compare).
<i>ITS</i>	\$2,931	\$2,920	\$3,135	12.1%	6.9%	7.4%	Grow th driven by business continuity and recovery services.
<i>Strategic Outsourcing</i>	\$4,101	\$4,024	\$4,858	18.7%	18.4%	20.7%	Grow th driven by strong signings over the past 18 months.
Hardware	\$8,136	\$6,697	\$9,121	35.2%	12.1%	36.2%	
Enterprise Systems	\$4,200	\$3,199	\$4,936	19.1%	17.5%	54.3%	Enterprises, particularly in Financial Services, Public, Industrial and SMB markets, began to spend again.
<i>Servers</i>	\$3,485	\$2,524	\$4,140	16.0%	18.8%	64.0%	
<i>zSeries</i>	\$1,317	\$536	\$1,744	6.7%	32.5%	225.6%	MIPS grew 62% driven by new functionality offerings in its new T-Rex product.
<i>pSeries</i>	\$919	\$723	\$1,025	4.0%	11.5%	41.9%	Continued to see strong demand across low , mid and high-end offerings and expects to gain share in the Q.
<i>iSeries</i>	\$566	\$529	\$575	2.2%	1.6%	8.6%	Linux on iSeries grew 10% Q/Q.
<i>xSeries</i>	\$567	\$636	\$678	2.6%	19.5%	6.7%	Overall shipment grow th of 40% with 48% grow th in 8-w ay and 45% grow th in one and tw o-w ay servers.
<i>Storage</i>	\$671	\$635	\$761	2.9%	13.5%	19.9%	Strength in mid-range, tape and disk systems.
<i>Other</i>	\$44	\$40	\$35	0.1%	-20.0%	-12.6%	
Personal Systems	\$3,002	\$2,796	\$3,478	13.4%	15.9%	24.4%	Improved expense management, continued supply chain execution and inventory reductions drove \$9M PTI.
<i>Desktops</i>	\$1,167	\$1,129	\$1,108	4.3%	-5.0%	-1.8%	Desktop units grew 3% Y/Y.
<i>Laptops</i>	\$940	\$872	\$1,279	4.9%	36.0%	46.7%	Notebook unit grow th of 40% Y/Y.
<i>Other</i>	\$895	\$795	\$1,090	4.2%	21.9%	37.1%	
Technology	\$963	\$695	\$775	3.0%	-19.6%	11.5%	Improved customer yields drove improvement in PTI (to a loss of \$34M), expect to be profitable for FY04.
<i>Microelectronics</i>	\$961	\$695	\$775	3.0%	-19.4%	11.5%	External revenue, net of divestitures declined 5%.
<i>Other</i>	\$2	\$0	\$0	0.0%	-99.0%	0.0%	Exited display business in F2002.
Software	\$3,891	\$3,461	\$4,250	16.4%	9.2%	22.8%	Management expects it gained share in all key segments, except for Lotus.
<i>Operating Systems</i>	\$626	\$657	\$568	2.2%	-9.2%	-13.5%	
<i>Middleware</i>	\$3,265	\$2,804	\$3,681	14.2%	12.8%	31.3%	Websphere grew 10% Y/Y, Rational grew 28% Y/Y, DB2 grew 3% Y/Y and Tivoli grew 17% Y/Y.
Global Financing	\$829	\$715	\$734	2.8%	-11.5%	2.6%	Financing originations grew Y/Y.
Enterprise Inv./Other	\$343	\$266	\$360	1.4%	5.0%	35.1%	
Total Revenues	\$23,774	\$21,522	\$25,913	100.0%	9.0%	20.4%	

Source: Morgan Stanley Research

E=Morgan Stanley Research Estimates

IBM – January 15, 2004

Please see analyst certification and other important disclosures starting on page 8.

Exhibit 2

IBM: Morgan Stanley F4Q03 estimates vs. Actuals

IBM: 4Q03 Morgan Stanley Estimates										
(\$ In Millions)	4Q02A	3Q03A	4Q03A	Est 4Q03E	% Delta	Per Share Impact	Q/Q Chg	Y/Y Chg	Cons. Est.	Comments
Revenues	23,684	21,522	25,913	25,254	2.6%	\$0.10	20.4%	9.4%	25,016	Growth driven by strength in hardware (servers & PCs) and 8 points of currency benefit.
Y/Y Growth	7.0%	8.6%	9.4%	6.6%						
Q/Q Growth	19.5%	-0.5%	20.4%	17.3%						
EPS	\$1.34	\$1.02	\$1.56	\$1.50	3.9%	\$0.06	53.1%	16.1%	\$1.50	\$3.1B in shares repurchases added \$0.01 vs our estimate (of \$1.3B in share repurchases).
Y/Y Growth	-8.1%	2.7%	16.1%	11.7%						
Q/Q Growth	35.4%	5.0%	53.1%	47.3%						
Expenses										
Gross Profit	9,191	7,812	9,975	9,749	2.3%	(\$0.01)	27.7%	8.5%		Benefit from mix shift to mainframes and normal seasonal trends offset by IMD and services weakness.
Gross Margin (%)	38.8%	36.3%	38.5%	38.6%						
SGA	4,966	4,303	4,874	4,922	-1.0%	\$0.02	13.3%	-1.9%		Benefit from supply chain cost savings.
% of revenues	21.0%	20.0%	18.8%	19.5%						
R&D	1,204	1,307	1,349	1,263	6.8%	(\$0.03)	3.2%	12.0%		Continued investment in R&D to support on Demand computing strategy.
% of revenues	5.1%	6.1%	5.2%	5.0%						
IP Income	329	406	281	232	20.9%	\$0.02	-30.8%	-14.6%		Closed \$15m sale of Pico processor PowerNP product line to Hifn Inc. at end of the quarter.
% of revenues	1.4%	1.9%	1.1%	0.9%						
Tax Rate	29.5%	30.0%	30.0%	30.0%						
Shares Out.	1,729	1,756	1,746	1,750		\$0.01				
Service Signings	\$18B+	\$15B+	\$17.3B	\$14-16B						
Backlog	\$112B	\$115B	\$120B	\$116B						
MIPS growth	13%	30%	62%	20-25%						Driven by new z900 installations.
Share Buyback	\$74M	\$1.2B	\$3.1B	\$1.3B						Improved share buybacks after Pw CC and Rational acquisitions and pension funding.
Segment Revs										
Global Services	10,575	10,383	11,448	11,337	1.0%	\$0.02	10.3%	8.3%		First quarter of tough compare post the Pw CC acquisition.
Y/Y Growth	16.7%	16.7%	8.3%	7.2%						
Hardware	8,136	6,697	9,121	8,627	5.7%	\$0.08	36.2%	12.1%		Benefit from shipments of mainframes.
Y/Y Growth	1.3%	-1.0%	12.1%	6.0%						
Software	3,801	3,461	4,250	4,167	2.0%	\$0.01	22.8%	11.8%		Driven by ISV alliances and growth in SMB sector. Rational Software products should be nearly integrated.
Y/Y Growth	0.4%	11.3%	11.8%	9.6%						
Financing	829	715	734	811	-9.5%	(\$0.01)	2.7%	-11.5%		
Y/Y Growth	-10.6%	-10.1%	-11.5%	-2.1%						
Segment Pre Tax-Income										
Enterprise Systems	821	387	1,068	905	18.0%	\$0.07	176.0%	30.1%		Higher volumes and mainframe mix drove profitability
Personal Systems	47	(50)	9	9	-2.4%	(\$0.00)	118.0%	-80.9%		Increased volumes offset pricing pressure.
Technology	42	(96)	(34)	(24)	43.8%	(\$0.00)	64.6%	-181.0%		Continued improvement in yields, expects to break-even in FY04.
Global Services	911	1,210	1,138	1,326	-14.2%	(\$0.08)	-6.0%	24.9%		Competitive pricing, rescoping and new contracts drove lower margins.
Software	1,284	858	1,461	1,333	9.6%	\$0.05	70.3%	13.8%		Strength from middle are brands.
Global Financing	278	292	321	333	-3.5%	(\$0.00)	9.9%	15.5%		
Enterprise Inv.	(89)	(54)	(44)	(53)	-16.9%	\$0.00	-18.5%	50.6%		

Source: Morgan Stanley Research Estimates

IBM – January 15, 2004

Please see analyst certification and other important disclosures starting on page 8.

Exhibit 3

IBM: Income Statement, F2002-2005E

(\$ Millions Except EPS)	2003				2004E				2002A	2003A	2004E	2005E
	MarA	JunA	SepA	DecA	Mar	Jun	Sep	Dec				
Total Revenue	20,065	21,631	21,522	25,913	21,369	22,832	22,918	27,013	81,186	89,131	94,133	98,063
Hardware	5,808	6,613	6,697	9,121	6,294	6,997	7,167	9,509	27,456	28,240	29,966	30,705
Global Services	10,169	10,635	10,383	11,448	10,736	11,216	11,064	11,914	36,360	42,635	44,930	47,503
Software	3,129	3,471	3,461	4,250	3,408	3,717	3,711	4,499	13,074	14,311	15,335	15,902
Global Financing	705	672	715	734	666	654	699	717	3,232	2,826	2,736	2,810
Enterprise Investments	254	240	266	360	265	249	277	374	1,064	1,120	1,166	1,142
Total Cost of Sales	12,833	13,633	13,710	15,938	13,743	14,541	14,521	16,774	50,903	56,113	59,580	62,438
Cost of Hardware	4,262	4,831	5,013	6,294	4,629	5,126	5,253	6,608	20,020	20,399	21,617	22,186
Cost of Global Services	7,637	7,879	7,777	8,608	8,123	8,398	8,216	8,921	26,812	31,901	33,658	35,479
Cost of Software	482	479	493	476	518	583	575	693	2,043	1,930	2,370	2,727
Cost of Global Financing	290	305	303	351	309	294	320	336	1,416	1,249	1,259	1,401
Cost of Enterprise Investment & Other	161	139	124	210	163	141	157	216	611	634	676	645
Total Gross Profit	7,232	7,998	7,812	9,975	7,626	8,291	8,397	10,239	30,283	33,017	34,553	35,625
Hardware Gross Profit	1,547	1,781	1,684	2,828	1,665	1,871	1,914	2,900	7,435	7,840	8,349	8,519
Global Services Gross Profit	2,531	2,757	2,606	2,840	2,613	2,818	2,848	2,993	9,548	10,734	11,272	12,023
Software Gross Profit	2,647	2,993	2,968	3,774	2,890	3,134	3,136	3,806	11,031	12,381	12,965	13,175
Global Financing Gross Profit	415	367	412	383	357	360	379	382	1,816	1,577	1,477	1,410
Enterprise Inv. & Other Gross Profit	93	100	142	150	102	109	121	158	453	485	490	498
SG&A	4,215	4,485	4,303	4,874	4,338	4,509	4,458	5,024	17,115	17,877	18,329	18,937
R&D	1,195	1,226	1,307	1,349	1,218	1,290	1,283	1,459	4,750	5,077	5,250	5,407
IP Income	282	199	406	281	256	251	252	297	1,100	1,168	1,057	1,275
Operating Income	2,105	2,486	2,608	4,033	2,326	2,743	2,908	4,053	9,517	11,232	12,030	12,555
Other Income	(84)	(4)	(26)	(124)	(75)	(50)	(15)	25	349	(238)	(115)	275
Interest	(40)	(41)	(33)	(31)	(30)	(30)	(40)	(45)	(145)	(145)	(145)	(230)
Pretax Income	1,981	2,441	2,549	3,878	2,221	2,663	2,853	4,033	9,720	10,849	11,770	12,600
Taxes	594	732	764	1,162	655	786	842	1,190	2,878	3,252	3,472	3,717
Effective Tax Rate	30.0%	30.0%	30.0%	30.0%	29.5%	29.5%	29.5%	29.5%	29.5%	29.5%	30%	30%
Reported Net Income	1,387	1,709	1,785	2,716	1,566	1,877	2,011	2,843	6,842	7,597	8,298	8,883
Preferred Dividend	0	1	0	0	0	0	0	0	0	1	0	0
E.P.S. (Basic)	0.80	0.99	1.04	1.59	0.92	1.11	1.19	1.69	4.02	4.41	4.90	5.31
Avg. Shares Basic (MM)	1,725	1,730	1,723	1,709	1,703	1,698	1,692	1,686	1,703	1,722	1,695	1,673
E.P.S. (Excluding Charges)	0.79	0.97	1.02	1.56	0.90	1.08	1.17	1.65	3.95	4.33	4.80	5.20
Avg. Shares Fully Dil. (MM)	1,759	1,764	1,756	1,746	1,738	1,732	1,726	1,720	1,731	1,756	1,729	1,707

Source: Morgan Stanley Research Estimates

Exhibit 4

IBM: Income Statement Ratios, F2002-2005E

(\$ Millions Except EPS)	2003				2004E				2002A	2003A	2004E	2005E
	MarA	JunA	SepA	DecA	Mar	Jun	Sep	Dec				
Margin Analysis (%)												
Total Gross Margin	36.0%	37.0%	36.3%	38.5%	35.7%	36.3%	36.6%	37.9%	37.3%	37.0%	36.7%	36.3%
Hardware Gross Margin	26.6%	26.9%	25.2%	31.0%	26.4%	26.7%	26.7%	30.5%	27.1%	27.8%	27.9%	27.7%
Global Services Margin	24.9%	25.9%	25.1%	24.8%	24.3%	25.1%	25.7%	25.1%	26.3%	25.2%	25.1%	25.3%
Software Gross Margin	84.6%	86.2%	85.7%	88.8%	84.8%	84.3%	84.5%	84.6%	83.3%	86.5%	84.5%	82.8%
Global Financing Gross Margin	58.8%	54.6%	57.7%	52.2%	53.6%	55.1%	54.2%	53.2%	56.2%	55.8%	54.0%	50.2%
Enterprise Investment Gross Margin	36.4%	41.9%	53.4%	41.7%	38.6%	43.6%	43.5%	42.3%	42.6%	43.3%	42.0%	43.6%
EBITDA Margin	16.1%	16.9%	17.6%	19.9%	15.9%	16.7%	17.3%	18.9%	17.1%	17.8%	17.3%	17.1%
Operating Margin	10.5%	11.5%	12.1%	15.6%	10.9%	12.0%	12.7%	15.0%	11.7%	12.6%	12.8%	12.8%
Pretax Margin	9.9%	11.3%	11.8%	15.0%	10.4%	11.7%	12.4%	14.9%	12.0%	12.2%	12.5%	12.8%
Net Margin	6.9%	7.9%	8.3%	10.5%	7.3%	8.2%	8.8%	10.5%	8.4%	8.5%	8.8%	9.1%
As a % of Revenue												
SG&A	21.0%	20.7%	20.0%	18.8%	20.3%	19.8%	19.5%	18.6%	21.1%	20.1%	19.5%	19.3%
R&D	6.0%	5.7%	6.1%	5.2%	5.7%	5.7%	5.6%	5.4%	5.9%	5.7%	5.6%	5.5%
Year-Over Year-Growth												
Total Revenue	11.3%	10.1%	8.6%	9.4%	6.5%	5.6%	6.5%	4.2%	-2.3%	9.8%	5.6%	4.2%
Hardware Revenue	-1.3%	-0.9%	-1.0%	12.1%	8.4%	5.8%	7.0%	4.2%	-10.3%	2.9%	6.1%	2.5%
Global Services Revenue	23.6%	22.8%	16.7%	8.3%	5.6%	5.5%	6.6%	4.1%	4.0%	17.3%	5.4%	5.7%
Software Revenue	8.0%	6.3%	11.3%	11.8%	8.9%	7.1%	7.2%	5.9%	1.0%	9.5%	7.2%	3.7%
Global Financing Revenue	-10.0%	-18.6%	-10.1%	-11.5%	-5.5%	-2.7%	-2.2%	-2.3%	-5.7%	-12.6%	-3.2%	2.7%
Enterprise Investment Revenue	7.1%	5.4%	3.5%	5.0%	4.4%	4.0%	4.3%	3.9%	-7.7%	5.2%	4.1%	-2.0%
SG&A	4.8%	8.3%	7.9%	-1.9%	2.9%	0.5%	3.6%	3.1%	0.4%	4.4%	2.5%	3.3%
R&D	5.3%	2.3%	7.7%	12.0%	1.9%	5.2%	-1.8%	8.1%	-4.7%	6.9%	3.4%	3.0%
Operating Income	28.5%	14.3%	10.8%	20.4%	10.5%	10.3%	11.5%	0.5%	-16.0%	18.0%	7.1%	4.4%
Pretax Income	9.2%	10.1%	6.1%	18.0%	12.2%	9.1%	11.9%	4.0%	-15.1%	11.6%	8.5%	7.1%
Net Income	8.0%	10.4%	5.4%	17.2%	12.9%	9.9%	12.7%	4.7%	-16.0%	11.0%	9.2%	7.1%
EPS	7.7%	8.3%	2.7%	16.1%	14.3%	12.0%	14.6%	6.2%	-13.9%	9.4%	11.0%	8.4%
Seq. Quarterly Growth (%)												
Total Revenue	-15.3%	7.8%	-0.5%	20.4%	-17.5%	6.8%	0.4%	17.9%				
Hardware Revenue	-28.6%	13.9%	1.3%	36.2%	-31.0%	11.2%	2.4%	32.7%				
Global Services Revenue	-3.8%	4.6%	-2.4%	10.3%	-6.2%	4.5%	-1.4%	7.7%				
Software Revenue	-17.7%	10.9%	-0.3%	22.8%	-19.8%	9.1%	-0.1%	21.2%				
Global Financing Revenue	-15.0%	-4.7%	6.4%	2.6%	-9.3%	-1.8%	6.9%	2.6%				
Enterprise Investment Revenue	-25.9%	-5.6%	11.0%	35.3%	-26.3%	-5.9%	11.2%	34.8%				
SG&A	-15.1%	6.4%	-4.1%	13.3%	-11.0%	4.0%	-1.1%	12.7%				
R&D	-0.7%	2.6%	6.6%	3.2%	-9.7%	5.9%	-0.5%	13.7%				
Operating Income	-37.2%	18.1%	4.9%	54.6%	-42.3%	17.9%	6.0%	39.4%				
Pretax Income	-39.7%	23.2%	4.4%	52.1%	-42.7%	19.9%	7.1%	41.3%				
Net Income	-40.1%	23.2%	4.5%	52.1%	-42.3%	19.9%	7.1%	41.3%				
EPS	-41.1%	22.7%	5.0%	53.0%	-42.1%	20.3%	7.5%	41.8%				

Source: Morgan Stanley Research Estimates

IBM – January 15, 2004

Please see analyst certification and other important disclosures starting on page 8.

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight	592	32%	241	38%	41%
Equal-weight	856	46%	287	46%	34%
Underweight	402	22%	98	16%	24%
Total	1,850		626		

Data include common stock and ADRs currently assigned ratings. For disclosure purposes (in accordance with NASD and NYSE requirements), we note that Overweight, our most positive stock rating, most closely corresponds to a buy recommendation; Equal-weight and Underweight most closely correspond to neutral and sell recommendations, respectively. However, Overweight, Equal-weight, and Underweight are not the equivalent of buy, neutral, and sell but represent recommended relative weightings (see definitions below). An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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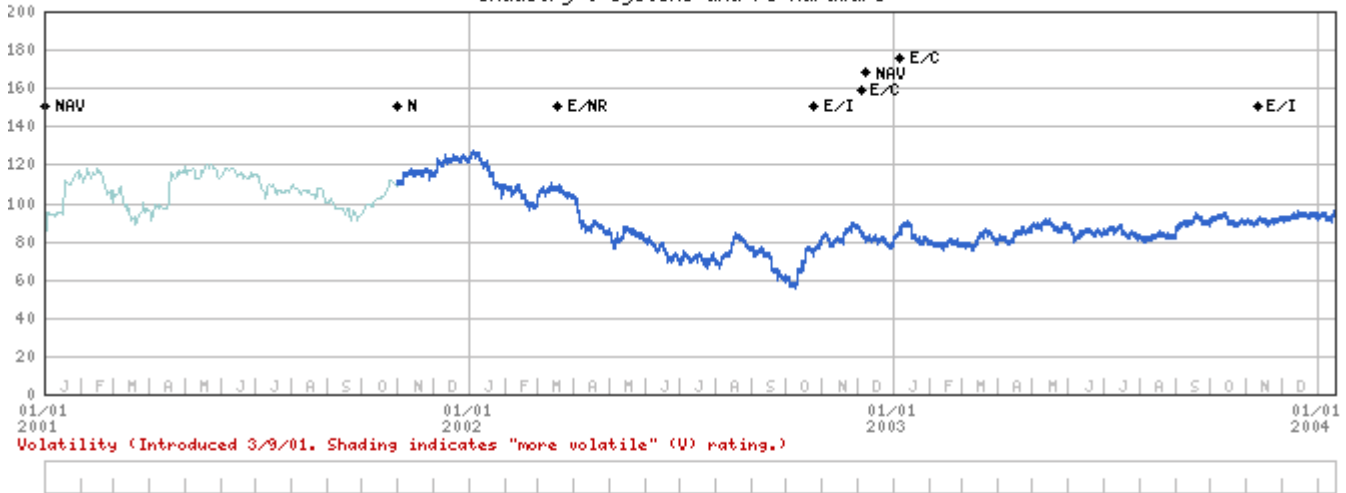
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Stock Price, Price Target and Rating History (See Rating Definitions)

IBM (IBM.N) - As of 1/15/04 in USD
 Industry : Systems and PC Hardware



Volatility (Introduced 3/9/01. Shading indicates "more volatile" (U) rating.)

Stock Rating History: 7/28/00 : NAV; 11/1/01 : N; 3/18/02 : E/NR; 10/25/02 : E/I; 12/4/02 : E/C; 12/9/02 : NAV;
 1/7/03 : E/C; 11/10/03 : E/I
 Price Target History: 7/28/00 : NA

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock Ratings abbreviated as below (Effective 3/18/02, ratings appear as Stock Ratings/Industry View) ♦
 Stock Ratings as of 3/18/02: Overweight (O) Equal-weight (E) Underweight (U) More Volatile (U) No Rating Available (NAU)
 Stock Ratings prior to 3/18/02: Strong Buy (SB) Outperform (OP) Neutral (N) Underperform (UP) No Rating Available (NAU)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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INDUSTRY COVERAGE: SYSTEMS AND PC HARDWARE

Company	Ticker	Rating as of	Price at 01/14/04
Apple Computer Inc.	AAPL.O	E 03/18/02	\$24.20
DELL	DELL.O	E 03/18/02	\$35.97
Gateway	GTW.N	U-V 03/18/02	\$4.54
Hewlett-Packard	HPQ.N	O-V 05/07/02	\$24.70
IBM	IBM.N	E 01/07/03	\$90.31

Company	Ticker	Rating as of	Price at 01/14/04
Lexmark International	LXK.N	E 03/18/02	\$79.43
NCR Corp.	NCR.N	O 12/22/03	\$40.10
Seagate Technology	STX.N	O-V 08/12/03	\$20.00
Sun Microsystems	SUNW.O	U-V 09/30/03	\$5.46

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