

IBM Services Revenue Under Pressure but Margins Expand

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IBM Global Services' 1Q09 results show its continued resiliency in the current economic environment, with cost controls driving IBM's profits. As expected, outsourcing outpaces consulting and system integration.

NEWS ANALYSIS

Event

On 20 April 2009, IBM reported its 1Q09 financial performance. During the quarter, services revenue declined 2% in constant currency to \$13.2 billion, reflecting three consecutive quarters of a sequential revenue decline. Services pre-tax profits remain solid, however, increasing by 4%.

Analysis

Although spending on IT services continues to contract industrywide, IBM's focus on higher value, its continuous adjustment to operations and its globalized delivery are helping the company maintain its competitive position and drive profitability. Highlights from its 1Q09 financial report include:

- Total service revenue of \$13.2 billion, a decrease of 10% (-2% in constant currency)
- Global Technology Services (GTS) revenue of \$8.8 billion, down 10% (-1% in constant currency)
- Global Business Services (GBS) revenue of \$4.4 billion, down 10% (-4% in constant currency)

In terms of future growth indicators, backlog dropped to \$126 billion from \$130 billion reported in the December quarter, and total services signings declined 1% to \$12.5 billion (up 10% in constant currency). The highlights were strategic outsourcing (SO) and applications outsourcing (AO) signings, which increased 23% and 49%, respectively. The inherent cost benefit of outsourcing is driving growth in AO and SO.

IBM signed a total of 16 deals at a value of over \$100 million each, down from 24 deals last quarter. This decline likely reflects the contracting market environment, as IBM seems to be capturing its share of the reported opportunities.

Demand for consulting and system integration services remains under pressure. Until business confidence increases at the enterprise level, this area is likely to continue to be lackluster across the market. Notably, however, IBM recently launched a 4,000-person service line focused on business analytics and optimization to better address current market needs.

Gartner is encouraged by IBM's reiteration of its statement regarding a mid-2009 recovery. However, we expect most areas of services to lag behind the general recovery of the IT sector, similar to the pattern experienced in the last economic downturn. We also do not believe that all service providers will weather the current adverse economic conditions equally well.

RECOMMENDATIONS

- **IBM service customers:** If you are seeking price concessions in current outsourcing deals, press IBM for greater standardization of services or increased offshore delivery percentages. If you have not attended to (or have let slip) ongoing IT innovation and are now in a position to prepare for the rebound, seek to engage IBM, which may have underutilized resources.
- **Prospective buyers of services:** Review your shortlist of suppliers to assess their ability to weather the current economic crisis. IBM's staying power makes it a safe

choice as a service provider. Slowing demand places you in a good position to get the "best deal" from IBM.

- **Service providers:** Now is the time to sharpen your value proposition. Carefully pursue a low-cost provider position as a means of competing with IBM, which remains a formidable competitor. Increase your focus on vertical sectors that are likely to outperform, such as the public sector and healthcare.

RECOMMENDED READING

- "IBM Earnings Show Resilience in Its Service Business"— The strength of IBM's 4Q08 and year-end 2008 service business results makes it the key vendor to watch during 2009 as a key indicator of industry performance and opportunity. **By Allie Young, Sandra Notardonato and Matt Goldman**
- "IBM GBS Breaks Ground on Analytic Solutions Practice"— Gartner reviews IBM's announcement of a new GBS consulting service line focused on business analytics and optimization. **By Alex Soejarto**

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