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Why So Cheery About I.B.M.?

By GRETCHEN MORGENSON

SHARES of I.B.M. popped last Wednesday when Steven Milunovich, technology strategist at Merrill Lynch, added the company to the firm's list of most promising stocks. The shares rose 2.8 percent.

Merrill's support for I.B.M. came nine days after the company disclosed that its accounting — specifically how it recognizes revenues — is the subject of a formal investigation by the Securities and Exchange Commission. From the day of that disclosure until the Merrill recommendation, I.B.M. stock was down 6.4 percent.

But Mr. Milunovich advised investors not to worry. "We would be surprised if the findings have a significantly negative impact on the shares from here," he wrote in his I.B.M. report. While he acknowledged that the outcome of the investigation is unknown, Mr. Milunovich said its harsh effect on the shares had made them a better value.

It is a Wall Street tradition, of course, for analysts to line up in defense of companies that receive unwanted attention from the S.E.C. Brokerage settlement or no, the need to accentuate the positive is still in many of these folks' genes.

John Gavin, president of SEC Insight Inc., an independent research firm in Plymouth, Minn., that tracks the commission's moves, is not so disposed. He questioned Mr. Milunovich's optimism. "We believe revenue recognition is, and continues to be, the S.E.C.'s No. 1 hot button," Mr. Gavin said. "And improper revenue recognition is a major, if not the primary, cause of earnings restatements in the technology sector."

Until investors get more details from I.B.M. on the investigation, Mr. Gavin has told his clients to avoid the shares.

The language that I.B.M. used in its terse disclosure, Mr. Gavin said, seemed deliberately vague. "It is not encouraging that I.B.M. refused to elaborate," he said. "It meets the threshold for disclosure but not openness."

A spokesman for I.B.M. said its news release is accurate and appropriate but declined to comment further about the investigation. Its disclosure said that the S.E.C. is seeking information "primarily concerning certain types of customer transactions" and that the company believes the investigation arises from another S.E.C. inquiry into a customer of I.B.M.'s retail store unit. That division sells point-of-sale products and, with around $500 million in revenue, is a small part of I.B.M.'s overall business.

Investors should not conclude, however, that they have heard the whole story, Mr. Gavin said. Other companies — Qwest and E.D.S. — have initially played down S.E.C. investigations this way, he noted, only to change their tunes later. And because I.B.M. stayed quiet in 2002 when it was the subject of an informal inquiry into its accounting by the S.E.C., Mr. Gavin said he can only conclude that the inquiry must be more serious this time. The commission closed the previous inquiry without acting.

On Friday, Mr. Milunovich said: "I'm just guessing, like everyone else, but I would be surprised if there was a systemic problem in revenue recognition at I.B.M. It's possible, but I doubt it."

Others aren't so sure. Notwithstanding the instruction given by Samuel J. Palmisano, I.B.M.'s chief, to a reporter to "find something else to write about" besides its accounting, some investors still fret about what may lurk in I.B.M.'s books. The aroma still wafts around I.B.M.'s secretive decision in the final days of 2001 to use the proceeds of an asset sale to offset its sales, general and administrative expenses. That maneuver, which came under previous I.B.M. management and was uncovered by Fred Hickey, editor of The High-Tech Strategist, went against S.E.C. rules and rattled investors. But the S.E.C. never moved against I.B.M. on the matter.

While it is impossible to say how the current investigation into I.B.M.'s accounting will play out, to pooh-pooh it seems odd. Wasn't one of the lessons of the late great market mania that rose-colored glasses, while providing a pretty view, can also blind you?