IBM 3Q disappoints as it sheds 'empty calories'

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In this Tuesday, July 16, 2013, file photo, an IBM logo is displayed in Berlin, Vt. IBM is paying $1.5 billion to Globalfoundries in order to shed its costly chip division. IBM will make payments to the chipmaker over three years, but it will take a $4.7 billion charge in the third quarter when it reports results, Monday, Oct. 20, 2014. (AP Photo/Toby Talbot, File)

IBM disappointed investors Monday, reporting weak revenue growth again and a big charge to shed its costly chipmaking division as the tech giant tries to steer its business toward cloud computing and social-mobile services. Shares fell more than 7 percent as investors sold off sharply and the stock dragged the Dow 30 into the red.

Is it too late for IBM? Or can Big Blue weather the competition as it transforms its business for the cloud?

Remaking itself is something IBM has done many times through its long history. Starting more than a century ago in punch-card tabulators and time clocks, it grew to encompass the giant mainframe computers and Selectric typewriters of the 1960s and launched its revolutionary personal computer in the 1980s.

But by the early 1990s its early lead in personal computing was destroyed by tough competition that left it on the brink of bankruptcy. So CEO Lou Gerstner reinvented the company's mission to focus on providing technology services to businesses and government. Business soared—technology and business services account for more than half of IBM's revenue today.

But the huge company—431,000 employees at last count—has struggled under the weight of capital-intensive businesses as nimbler competitors led expansion into cloud services, in which software and data storage run on servers connected to the Internet rather than on computers on the users' desktops. It faces companies such as Amazon.com and Salesforce.com that already offer "software as a service" to businesses in specialized areas. That new challenge has flattened out sales for IBM's services businesses.

"While the newer strategic areas are seeing significant growth, the traditional businesses are still declining at a faster pace," Wells Fargo analyst Maynard Um wrote in a note to investors Monday.

In the third quarter, IBM reported a 15 percent drop in hardware revenue, now just 11 percent of IBM's business. Services revenue was flat when adjusting for currency-exchange effects and the sell-off of a customer care outsourcing business. Software revenue, which made up 27 percent of total revenue, slipped 2 percent.

Part of the solution for IBM is to shed some of those older businesses, what CEO Ginni Rometty calls "empty calories." Besides Monday's sale of the chip unit, earlier this month the Armonk, New York company sold its low-end server business to Lenovo Group for $2.1 billion. At the same time, it has been making new investments to catch up in cloud computing. IBM opened a new center in North Carolina last month that provides cloud services to help companies keep running in the event of a disaster. Rometty said on CNBC Monday that said growth rates for its cloud businesses are exceeding 50 percent.

The Globalfoundries and Lenovo deals make sense as a way to minimize exposure to hardware, but IBM has not shown improving momentum in software and services, said Steve Milunovich of UBS in a client note.

Rometty told CNBC that one strategy not under consideration is that pursued by Hewlett-Packard Co.—splitting the company in two. She said IBM has been aggressive about changing internally.

"You don't get to be 100 years old in the technology industry without absolutely changing what you are," she added.

IBM's third-quarter adjusted earnings from continuing operations of $3.68 per share and revenue of $22.4 billion were short of what analysts polled by FactSet predicted. They forecast earnings of $4.32 per share on revenue of $23.39 billion.

With its transformation ongoing and a weaker-than-expected third quarter, IBM is backing away from a 2015 forecast for adjusted earnings of $20 per share.

Chief Financial Officer Martin Schroeter said in a conference call that IBM will give its 2015 outlook in January.

Janney Capital Markets' Joseph Foresi said that stepping back from the 2015 guidance may be a silver lining for the company, providing a chance for IBM "to shift its focus more toward growth initiatives and away from running the business to a specific long-term financial result."

Shares of International Business Machines Corp. fell $13.15, or 7.2 percent, to $168.90 shortly before the closing bell. The stock, which is down 10 percent year to date, hit a 52-week low of $166.69 during the session.