Should You Buy CGI Group?

Description

Information technology company **CGI Group** (TSX: GIB.A)(NYSE:GIB) reported its first quarter fiscal 2014 results today, which came in $0.05 shy of expectations. The stock dropped 5% yesterday, and has decreased over 17% from highs of over $40 in mid- November.

It is now trading at 14x fiscal 2013 EPS. Investors have many questions and doubts, including the level of CGI's organic growth profile going forward and the stock is therefore being punished.

Let's look at some of the facts:

Results for the period ended December 31			
$ in millions			
	2013	**2012**	**% Change**
Revenue	$2,644.7	$2,532.9	4.4%
EBIT (Adj)	$302.9	$209.5	44.6%
EBIT margin	11.5%	8.3%	38.5%
EPS	$0.60	$0.07	757.1%
EPS (excl integration costs)	$0.65	$0.44	47.7%
Backlog	$19,253	$18,281	5.3%

Growth this quarter looks good

Revenue increased 6% in North America, with a 14.2% margin. In the U.S., organic growth was 12%, reflecting growth in all segments. Total revenue in the U.S. (26% of total revenue) increased over 18% and EBIT increased over 11%. The EBIT margin in the U.S. was only 10% due to increased spending in the quarter in an effort to meet certain deadlines on different projects.

In Canada, revenue decreased over 1% year over year but increased 3% sequentially. Book to bill in Canada was 100% this quarter and management said that the outlook continues to improve. EBIT increased almost 8%, and EBIT margins in Canada were a very strong 21.4%.

Better cash flow generation coming…

On the conference call, management stated that they expect a CFO run rate of $300 million each quarter, as integration costs wind down.

Backlog and bookings are strong and growing

Current backlog stands at $19.2 billion, an increase of 5.3% year over year. The book to bill ratio in Canada was 100% in the quarter, meaning that CGI received as many orders as it filled. In the U.S., the book to bill ratio was 102% for the quarter and 108% for the year. In Europe, the book to bill was a strong 112% in the quarter, with 36% of these orders being new business, which is a good sign.

Obamacare contract loss is not a dealbreaker

In my view, the reaction of investors to the loss of the Obamacare contract is overdone. This is one small contract for a company that has more than $10 billion in revenues. In terms of reputation, the company has said that it has not harmed its reputation or its ability to keep and win new business, and this is evidenced by the strong bookings and backlog that the company has achieved.

The system has improved significantly, but as we know, the government decided not to renew CGI's contract and gave it to **Accenture** (NYSE:ACN) instead. Accenture was paid an initial amount of $45 million for the one-year contract. Accenture's EBIT margins are better than CGI's, at 14%, and it is currently trading at over 19 times earnings. This compares to CGI, which is trading at 14 times earnings with an 11.5% EBIT margin.

While it is a loss for CGI, it is still playing a role in six state health exchanges and they are all live. While some of the states' sites are performing better than others, CGI continues to work to ensure smooth functioning.

Foolish bottom line

CGI is plagued with doubt doubt over accounting and its ability to successfully handle big projects due to the Obamacare debacle. The stock is currently trading at 14.5 fiscal 2013 EPS, valuations that are looking more and more attractive.

Is it time to take advantage of all of this doubt in the market? I think so. If the company can meet its goals for margin improvement and improved cash flow performance, we have a very attractive stock on our hands.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:GIB (CGI Group Inc.)
2. TSX:GIB.A (CGI)

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