Is CGI Group Inc Really a “Screaming Buy”?

Description

While **BlackBerry** has drawn most of the headlines, another firm has emerged as the largest technology company in Canada: **CGI Group Inc** (TSX:GIB.A)(NYSE:GIB). And while most Canadians are unfamiliar with the name, it is actually one of the most polarizing companies in the entire country.

So what does the company actually do?

CGI provides IT consulting and outsourcing services to big customers (including governments) around the world – last year, revenue totaled $10.1 billion.

The company gained notoriety late last year, thanks to the healthcare.gov fiasco. CGI was the lead contractor, and by all accounts did a very poor job. Michelle Snyder, the COO for the Centers for Medicare and Medicaid Services, even told her colleagues, “If we could fire them, we would.”

But the healthcare.gov project was only a small part of CGI’s business (roughly 3%), so the company has been able to move on smoothly. Thus when evaluating CGI as an investment opportunity, one has to look beyond that project.

”A screaming buy”

In an interview with *The Globe and Mail*, Jason Donville of Donville Kent Asset Management called CGI “a screaming buy”. And Donville Kent has one of the best track records on Bay Street, so this quote is certainly worth paying attention to.

There is without doubt a case to be made for CGI. It was started back in the mid-1970s, and has rewarded shareholders spectacularly ever since. As of last year, the stock had returned 25% to shareholders per year over the previous 25 years. Much of this track record is due to strong growth from acquisitions – since its founding, CGI has acquired more than 70 businesses.

Fast forward to today, and CGI is well-positioned to benefit from a recovery in Europe. Further growth would come from buying more companies, a recipe that has worked well thus far.

Best of all, according to Mr. Donville, CGI is trading at about 10 times estimated 2015 cash flow. So what's not to like?

Dubious accounting

Despite these positives, many smart people are betting against CGI. This includes Jim Chanos, who became famous for betting against Enron.

The main concern with CGI is how it accounts for acquisitions. According to those who are betting against the company, CGI writes down the value of companies right before they are acquired. Then, after the acquisition is made, the targets are written back up again. These write-ups can then be counted towards revenue and earnings. This is commonly known as "cookie jar accounting".

These concerns are especially prevalent with CGI's 2012 purchase of UK-based Logica. In fact Veritas Investment Research's Michael Yerashotis, who is one of CGI's biggest critics, estimates that the company has made over $1.1 billion in accounting adjustments since the acquisition.

So what's the verdict?

Over the course of CGI's history, those who have bet against the company have paid a very expensive price for doing so. So there is a strong argument to trust management and buy the shares.

Then again, the company is not conservative with its accounting, and has every incentive to boost its share price (to make acquisitions easier). So there is always a danger that the picture isn't as bright as management would like you to believe. Unless you're looking for some adventure, it's probably best to leave CGI to the pros.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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