



## 4 Reasons Why CGI Group Inc. Deserves a Closer Look

### Description

**CGI Group Inc.** ([TSX: GIB.A](#))([NYSE: GIB](#)) released its Q3 earnings last week and the report showed signs of a healthy business, good execution, and strong financial management.

Let's take a closer look at the bright spots of the quarter and why I believe the stock represents a good investment with an attractive risk/reward profile.

#### 1. Demand is strong

CGI is experiencing increasing demand, as evidenced by the company's book-to-bill ratio. In Q3, the company reported a book-to-bill ratio of 101%. While not overly robust, it nevertheless indicates that more orders were received than filled, reflecting somewhat healthy demand. In fact, if we exclude U.S. federal, the book-to-bill ratio is a more robust 107%.

In Europe, where there has been growth concerns, CGI reported a strong book-to-bill ratio of 108%.

While overall revenue growth was a mere 4% in the quarter, digging deeper presents a different picture. In the U.S., which represents 25.5% of total revenue, revenue increased 6.9%. This is despite the fact the federal side of the business has been slow due to cutbacks and spending delays. The book-to-bill ratio in the U.S. commercial and local government segments is a healthy 113%, indicating strong demand in those segments, which is offsetting the weakness in U.S. federal.

#### 2. Margins are increasing

In Europe, CGI is focusing on repeat and sustainable high margin business, and to this end management is letting lower margin revenue run off. This is being replaced by higher margin revenue, as evidenced by the margin performance this quarter. Overall EBIT margins increased to 12.8% from 11.3% last year, and margins were up nicely in all areas except for France, which has more onerous regulations and is therefore taking longer to restructure.

As an example of the efficacy and benefits of CGI's restructuring strategy, we can look to the U.K. business, which is the first business to be restructured in Europe. Q3 revenue increased 19.3% in the

U.K., and EBIT margins were 13.1% versus 10% in the same quarter last year.

### 3. Cash flow and debt reduction

Cash flow from operations (excluding working capital) was a very robust \$387 million, representing a 27.5% increase over the same period last year. In fact, cash flow as a percent of revenue was 14.5% in the quarter versus closer to 10% in the same quarter last year, demonstrating the company's increased success at turning revenues into cash flow. Free cash flow came in at just under \$300 million. These numbers are in line with the goals that the company set out for cash flow generation last year.

Management has used some of this cash to reduce debt, and going forward, cash generated will be used for some of the following purposes: continued debt reduction, possible acquisition, and on the conference call management also mentioned a possible share buyback depending on circumstances.

### 4. Valuation

In my view, the stock offers an attractive risk/reward tradeoff. The stock is trading at a P/E ratio of 13.6 times, with an expected growth rate in 2014 of 23%. While I am aware of the accounting concerns that have spooked the market, I gain comfort by looking at the company's track record, which has been on the up and up.

I think that there is an opportunity here to take advantage of the market's skepticism related to this company, its potential in Europe and its ability to successfully turn around the Logica business, as well as the accounting concerns.

### Bottom line

CGI's strategy is to focus on margins, cash flow, and sustainability of the business, while being diversified so as to achieve stable and strong results for its shareholders. But the company is plagued with doubt at this time.

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)

### Category

1. Investing

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