The Pros and Cons of Investing in CGI Group Inc.

Description

IT services provider **CGI Group Inc.** (TSX: GIB.A)(NYSE: GIB) is unfamiliar to most Canadians, but it is Canada's largest technology company. It is also quite a controversial name, with some high-profile investors betting against it.

Should you add this company to your portfolio? Below we take a look at two reasons to consider investing, and two reasons to stay away.

Why you should buy

1. European growth

In 2012, CGI Group made a major acquisition, buying U.K.-based Logica PLC for $2.7 billion. This acquisition made it the sixth-largest IT services provider in the world,and was very well-received, sending the stock up 13% the following day.

Why did everyone like the deal so much? Well, CGI Group had previously made 95% of its revenue from North America, even though Europe accounted for 30% of global IT spending. After the deal, CGI Group was a clear global powerhouse; in fiscal 2013, North America accounted for only 43% of revenue.

The rest of its revenue mostly comes from Europe, which is looking a lot better than it did three years ago. In fact, many observers believe Europe is on the brink of a recovery similar to the one experienced in the United States. There is a strong argument for betting on Europe, and thanks to CGI Group's international presence, its shares seem like a great way to do that.

2. A cheap price

One of the most notable believers in the company is Jason Donville, president of Donville Kent Asset Management. In an interview this year, he called CGI Group "a screaming buy", and said it was trading at less than 10 times 2015 cash flow.

For a company with strong growth prospects in Europe, that is not an expensive price. Better yet, CGI Group could grow earnings through more acquisitions. If you believe in what management is doing, then this is a great opportunity.

Why you might want to stay away

1. Operational failures

CGI Group has gained notoriety in the past, but not for the right reasons. Most notable was its role in the botched rollout of healthcare.gov in the United States. Throughout the process, it was missing deadlines and frustrating government officials. One senior official even told her coworkers, “If we could fire them, we would.”

Another example occurred in 2012, when CGI Group played a part in Ontario’s eHealth disaster. The company won a $46.2 million contract to build an electronic diabetes registry, but that contract was canceled due to missed deadlines.

So far, these kinds of mishaps have yet to have an impact on revenue. However, if they are part of a wider problem, then that will eventually change, no matter where the company operates.

2. Accounting issues

The big problem with CGI Group is its accounting, which many see as aggressive. The main issue is how the company accounts for acquisitions, especially the Logica purchase. In fact, one analyst believes it has made as much as $1.1 billion worth of accounting adjustments since that acquisition.

This is why Jim Chanos, who gained fame for betting against Enron before its collapse, is betting against it too.

CGI Group’s management maintains that its accounting is clean, and that these issues will pass. If that is the case, the stock could see huge gains. However, unless you think you can outsmart Mr. Chanos, this company is probably too risky for your portfolio. You’re better off letting the pros fight this one out.

CATEGORY

1. Investing

TICKERS GLOBAL

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

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