3 Reasons CGI Group Inc. Is the Only Tech Stock You Need to Own

Description

While the headlines have been fixated on **BlackBerry Ltd.'s** (TSX:BB)(NASDAQ:BBRY) recent turnaround efforts, fellow Canadian tech company **CGI Group Inc.** (TSX:GIB.A)(NYSE:GIB) has been growing its EPS at an impressive 24% CAGR over the past five years, including 23% in 2014.

CGI Group is an IT services provider that focuses on IT systems integration, consulting, and outsourcing. With strong diversification geographically, as well as between industries and service types, nearly $1 billion in free cash flow, and a successful history of acquiring and integrating companies, CGI offers stable growth within the rapidly shifting IT industry.

Here are three reasons why CGI Group is the best way to play the huge coming growth in IT spending.

1. CGI Group has an economic moat

Warren Buffett loves economic moats. An economic moat refers to a durable competitive advantage, that is to say, any competitive advantage that allows a company to control pricing, or sell more products than its competition consistently. A company with an economic moat is able to protect its earnings from its competition, and grow over time.

Within the tech sector, economic moats are rare since any advantage created by a new technology can often be quickly replicated by competition. Knowing this, it is often difficult to forecast a tech company's earnings into the future, which is one reason Warren Buffett is known to avoid tech stocks.

CGI is an exception within this group as it has many moat-like qualities. CGI has a strong presence in five industry segments, most notably government services, and is well diversified globally.

This strong diversity and penetration into multiple industries deeply embeds CGI as a key player in a growing IT services sector. Although CGI's diversity does provide some competitive edge, is the type and quality of CGI's business relationships that provides a true economic moat.

Many of CGI's clients have been so for 25+ years, and CGI often has contracts with these clients averaging seven years. In addition, CGI has an admirable 95% on-time and on-budget record, compared to a 50% industry average. This excellent service prevents business from leaving CGI, and with vendors rapidly consolidating their IT providers, CGI is positioned to benefit further from strong client relationships, as well as from recommendations.

In addition, CGI obtains approximately 33% of its revenue from the government sector. Due to the specialized nature of this work, especially as it pertains to security and privacy, CGI benefits from a 98% renewal rate from this group, which further solidifies its competitive edge and protects its earnings.

CGI's economic moat is evident in its financial statements, and the company currently has industry leading margins, and is forecast to generate $1.1 billion in free cash flow by 2016. This cash will likely be used generate returns through acquisitions, buy-backs, and potentially a dividend.

2. Attractive valuation

CGI's strong client relationships and diversity provide it with an edge over its peers, and this advantage comes at an attractive valuation. Currently, CGI is trading at a P/E ratio of 16.3, compared to an industry average of 18.2.

In 2014, CGI posted an EPS of $2.78, and CEO Micheal Roach estimates 2015 will bring a $3.19 EPS. This would result in a forward P/E ratio of 13.97, significantly below CGI's peer group, and very low for a company with an estimated 11.3% long-term growth rate.

3. A good growth runway

CGI's 11% long-term growth rate will come from a range of organic and inorganic growth opportunities. In 2012, CGI acquired Logica, and after a two-year integration program, CGI has now realized $400 million in annual synergies, and EPS accretion of 85% since the acquisition closed in 2012, and 88.5% over 2014.

With strong free cash flow and $536 million in cash, CGI is widely expected to make a similar acquisition in 2015, likely in the U.S. commercial space. CGI has proven to be excellent at identifying, purchasing, and integrating acquisitions, and another large acquisition similar to Logica should provide further earnings accretion.

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