



Is CGI Group Inc. Headed for Another 25%+ Year in 2016?

Description

While the TSX may have clocked in the year down 10%, IT services firm **CGI Group Inc.** ([TSX:GIB.A](#)) ([NYSE:GIB](#)) shows that it is still possible to make money even in the most challenging markets—and plenty of it. CGI ended the year up about 25%, outperforming both the TSX as well as its own sector.

CGI's outperformance is a testament to its business model. The company has doubled its size every four years on average over the past 40 years through its “build and buy” growth strategy of consolidating the industry through acquisitions. It expands relationships with current clients and acquires new ones as firms face expanding IT needs.

With CGI shares up 200% over the past five years, however, does CGI have the means to continue its rally into 2016? Barring a severe market-wide incident, all evidence points to yes.

CGI has a business model that can continue to drive growth

CGI currently has the strategic goal of doubling its size yet again, and it appears to have the means to do so.

It is important to look at the big picture of the business and industry to understand why. CGI is currently one of the largest IT services companies in the world with a footprint that extends across 40 countries (with a focus on the U.S.) and across 10 major industries with specialization in government services, utilities, and financial services.

CGI provides a host of solutions from high-margin software and intellectual property solutions to high-margin consulting and outsourcing. Demand for these services is growing (with total IT spending in the U.S. expected to grow by 5.1% in 2016, according to Forrester Research) as businesses and governments invest in IT to reduce costs, enhance productivity, and remain competitive after years of relatively low investment.

The IT industry is currently undergoing a consolidation, and CGI has a distinct competitive edge. This is thanks to its deep, existing relationships with clients (CGI has an average contract length of seven years, and many customers have been with the company for over 25 years), proximity-based model

(where it looks to be geographically close to clients), and excellent service record (95% on time/on budget and 9/10 client satisfaction score).

More growth opportunities in 2016

CGI has several specific opportunities in 2016 to leverage its current model to bring in double-digit earnings growth. Firstly, one of CGI's key clients is the U.S. federal government. Slowing U.S. federal government spending has been a headwind for CGI over the past year, but these conditions are poised to improve.

The U.S. government recently signed a two-year deal that extends the debt limit and raises spending caps by \$80 billion. This should help CGI gain longer-term contract extensions as well as more contracts, and this is an area where CGI has a large competitive advantage due its long history with the U.S. federal government and 58 contracts that are already in place.

CGI also has major opportunities in the financial services space. Banks are currently in an investment cycle as they look to shift costs away from traditional branch banking to a more digitally based model. Banks are closing, merging branches, and reducing staff to free up cash to invest in IT spending.

CGI is set to directly benefit as it can provide consulting, software, and other solutions to banks. In addition, CGI has opportunities in the oil and gas space as oil companies reduce costs by investing in technology.

Finally, CGI is also widely expected to make a major acquisition sometime this year. This will likely be in the U.S. and should be a catalyst for the share price and should lead to earnings growth.

CGI is still undervalued

Currently, CGI is trading at a forward price-to-earnings ratio of 15.5 compared with its overall peer group average of 16.5. This is despite the fact that CGI has a greater projected 2016 growth rate than its peers, meaning that CGI has more upside in 2016 as the business grows and the market rewards it with a higher valuation.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

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

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