



CGI Group Inc. Reports Strong Results, But Are the Shares Overvalued?

Description

CGI Group Inc. ([TSX:GIB.A](#))([NYSE:GIB](#)) reported EPS of \$0.91, which was slightly below expectations as margins were slightly lower than expected; the adjusted EBIT margin came in at 14.5%. This compares to last quarter's margin of 14.8%.

Part of the reason for the margins being below expectations is a one-time delay in a specific project in the U.K., so this may not be anything to worry about. Longer term, software-related business is increasing as a percentage of total sales, and since this business is higher margin, we can expect margins to continue to rise.

Operating cash flow was \$366 million compared to \$349.7 million last quarter. This represents a 4.7% increase and 13.5% of revenue — very strong numbers. This continued strong cash flow generation has resulted in continued strengthening of the balance sheet, which has improved again this quarter. The total debt-to-capitalization ratio currently stands at 18.2%, down from 23.8% last year. Cash and cash equivalents on the balance sheet were \$282 million as at March 31, 2017.

Going forward, management stated on the earnings conference call that they are seeing accelerating demand, and that business from the financial services and oil and gas sectors are growing at double digits. Bookings are strong — at \$2.73 billion in the quarter. And although the book-to-bill ratio of one times for the quarter was not particularly strong, on a trailing-12-month basis, the book-to-bill ratio was better at 1.08. Recall that the book-to-bill ratio is indicative of demand, and that anything over one is good, as this is a signal of healthy demand.

So, the quarter was good. The company continued its “build and buy” strategy by growing almost 5% organically and by adding two U.S. companies to its list of acquisitions last week. These tuck-in acquisitions of two high-end consulting firms add to CGI's geographic presence in the U.S., strengthen its presence in the U.S. commercial business, and add to the company's high-end consulting capabilities worldwide. As per usual, management has stated that they will be earnings accretive within 12 months.

The stock trades at a P/E of 17.7 times this year's earnings, which are expected to see an 8% growth

rate. Considering the upward-trending margins, the strength of CGI's balance sheet (and therefore its ability to continue to be a consolidator in the industry), and accelerating demand, I believe that the upside in the earnings number justifies the valuation on the stock.

It will be harder and harder for CGI to achieve high growth rates just because the company has become so big, but this is more than offset by the company's stability and successful execution record.

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