This Growth Stock Has a 3-Year Return of 70% With More Upside to Come

Description

With $10.6 billion in revenue, **CGI Group Inc.** (TSX:GIB.A)(NYSE:GIB) is Canada's largest Information Technology (IT) services firm. The company will continue to grow by consolidating the industry and by growing organically.

Here are the reasons I believe CGI shares have more upside.

Expect further margin increases

CGI has done a phenomenal job at increasing its margins over the last few years. Recall that at the time of the Logica acquisition back in 2009, EBIT margins got below 10%.

But in the latest quarter, EBIT margins were 14.1%, with strength in Canada and the U.S. being offset by weakness in Europe. Going forward, we can reasonably expect margins to head higher as the company increases its intellectual property (IP) software/solutions revenue, which is a higher-margin revenue stream.

Currently, IP revenue accounts for 22% of revenue, and given that IP bookings account for 37% of bookings at this time, we can expect IP revenue as a percentage of total revenue to go higher, thus driving margins up further.

Continued strong cash flows

The company continues to churn out cash flow and has continued to make use of this cash by buying back shares.

In 2016, operating cash flow was $1.3 billion and free cash flow was $963 million. Buying back shares has been the choice to deploy the cash due to the flexibility it gives the company, as repurchases can stop at any time with no real negative impact.

So, when cash is needed for a big deal, CGI has its cash flow generated every quarter, $300 million in cash on its balance sheet, and, with a debt-to-total-capitalization ratio of only 20%, ample room to take on more debt.

Continued consolidation

CGI's goal is to double the company within the next five to seven years.

This will be done through organic growth as well as acquisitions. The company made four "tuck-in" niche acquisitions last year, and while these smaller acquisitions will continue to be made, investors can still expect a large, transformational acquisition at some point.

Considering the upward-trending margins, the strength of CGI's balance sheet, 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 for CGI to organically 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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Date
2025/07/22
Date Created
2017/10/02
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