

EQUITY RESEARCH

September 27, 2022

Company Update

CGI INC.

M&A Ramping Up – Takeaways From Our Montreal Tech Tour

Our Conclusion

CIBC recently hosted an in-person investor Tech Tour of Montreal’s leading companies. Our tour included a stop at CGI’s Innovation Centre, where we met senior management, including Jean-Michel Baticle (COO), Francois Boulanger (CFO), Julie Godin (EVP Strategic Planning and Corporate Development) and Mike Keating (SVP Mergers and Acquisitions). This stop followed a fireside chat with George Schindler (CEO) at CIBC’s 21st Eastern Investor Conference. These events confirmed our view that CGI is well positioned to execute on M&A as the valuation environment changes in its favor, with a special interest in transformational deals. We reiterate our Outperformer rating and our price target of \$135, which reflects +30% upside from current levels.

Key Points

Metro Market Acquisitions Have Ramped Up: For the past several years, CGI has focused on metro market tuck-ins, with this activity ramping up this year and the company spending just under \$600MM YTD on smaller deals. Management noted a solid pipeline of metro-market tuck-ins, with a customer focus on vendor consolidation driving businesses to merge.

Transformational Deals More Likely – And More Accretive: Mr. Schindler noted an improving M&A market on larger deals, with rising interest rates potentially making PE less competitive and the company noting that it has been following several potentially transformational targets for many years. We could see CGI acquiring a target headquartered in Europe given the valuation environment there and CGI’s success with the Logica acquisition in 2012. We calculate that a \$4B acquisition could be mid-teens accretive in year two, depending on the takeout multiple and sources of funding.

Available Capital: CGI has leverage of just under 1x currently, and we calculate that the company can spend up to \$6B and still remain within the targeted 3x leverage range that management is comfortable with.

Potential Targets? We ran a screen of potential targets that could meet CGI’s criteria of multi-geography IT Services providers with solid profitability and valuations below CGI’s available funding threshold. Sopra Steria (PAR: SOP), and TietoEVRY (HEL:TIETO) are two attractively valued European targets with enterprise values in the \$4B range. Valuations in the U.S. appear more fulsome, although firms such as Thoughtworks (NASDAQ: TWKS), and Perficient (NASDAQ: PRFT) could add attractive lines of business.

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Outperformer

GIB.A-TSX, Sector: Information Technology

Current Price (9/27/22): C\$103.43

Price Target (12-18 mos.): C\$135.00

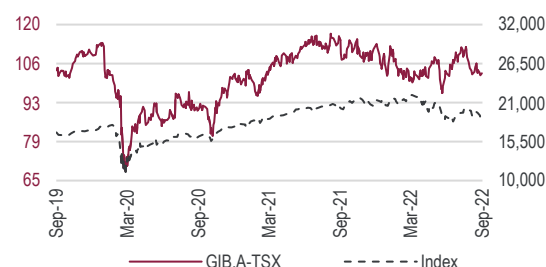
CIBC Estimates and Valuation

(Sep. 30)	2020	2021	2022	2023
Adj. EPS	4.89A	5.44A	6.15E	6.45E
Adj. EPS	Q1	Q2	Q3	Q4
2023	1.53E	1.62E	1.66E	1.65E
2022	1.49A	1.53A	1.54A	1.59E
Valuation	2020	2021	2022	2023
P/E	21.2x	19.0x	16.8x	16.0x

Stock Performance and Key Indicators

Enterprise Value:	C\$28,207M	Shares O/S:	272.7M
Market Cap.:	C\$28,205M	Float:	251.7M
52-wk Range:	C\$95.89 - C\$114.84	Div. / Yield:	NIL/NIL

TSX Composite Index vs. GIB.A-TSX



(Source: FactSet)

All figures in Canadian dollars unless otherwise stated.

Please see "Price Target Calculation and Key Risks to Price Target" information on page 4. For required regulatory disclosures please refer to "Important Disclosures" beginning on page 5.

CGI Inc. (GIB.A-TSX) — Outperformer

Price (9/27/22) C\$103.43 12-18 mo. Price Target C\$135.00

Sector: Information Technology

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Peer Comparison	2020	2021	2022E	2023E
P/E - Business Services	-	22.4x	16.4x	14.9x
P/E - CGI	-	19.6x	17.7x	16.7x
EV/EBITDA - Business Services	-	12.9x	11.5x	10.8x
EV/EBITDA - CGI	-	11.7x	11.2x	10.7x
Key Financial Metrics	2020	2021	2022E	2023E
Sales Growth	0.4%	(0.3%)	7.5%	2.2%
Per Share Data	2020	2021	2022E	2023E
FCFPS	6.19	7.28	6.25	8.14
Adj. EPS Dil.	4.89	5.44	6.15	6.45
Wgt Avg # of Shares	262.0	249.2	238.9	234.3
FD Number of Shares	266.1	253.0	242.5	237.7
Income Statement	2020	2021	2022E	2023E
Revenue	12,164	12,127	12,906	13,321
Tot Operating Exp	9,735	9,664	10,331	10,657
OpEx (% of Revenue)	80.03%	79.69%	80.04%	80.00%
EBITDA	2,429	2,463	2,576	2,664
EBITDA Margin	19.97%	20.31%	19.96%	20.00%
D&A	566	511	480	498
EBIT	1,863	1,952	2,096	2,166
Interest Expense	114	107	91	95
Other Pretax Income	232	7	13	0
Pretax profit	1,516	1,838	1,992	2,072
Tax Expense	398	469	510	539
Adjusted Net Income	1,300	1,375	1,491	1,533
Adjusted Net Margin	10.7%	11.3%	11.6%	11.5%
Cash Flow Statement	2020	2021	2022E	2023E
Net CFO	1,939	2,116	1,837	2,188
Capex	(128)	(122)	(148)	(120)
Free Cash Flow	1,810	1,994	1,689	2,068
Balance Sheet	2020	2021	2022E	2023E
Cash & ST Investment	1,708	1,699	983	2,141
Intangible Assets	521	507	621	621
Goodwill	8,380	8,140	8,353	8,353
Total Assets	15,550	15,021	15,382	16,405
ST Int-Bearing Debt	311	393	116	316
LT Int-Bearing Debt	3,276	3,009	3,040	2,840
Total Liabilities	8,286	8,035	8,211	8,451
Shareholders' Equity	7,264	6,986	7,171	7,954

Source: FactSet, Company Report, and CIBC World Markets Inc.

Company Profile

CGI Inc. is Canada's largest independent IT service, consulting and outsourcing company.

Price Target (Base Case): C\$135.00

Our price target of \$135 is based on 4.0% revenue growth, 10.8% net margins and a 21x EPS

Upside Scenario: C\$160.00

Our upside scenario of \$160 is based on 8% revenue growth, 11.5% net margins and 25.0x EPS

Downside Scenario: C\$85.00

Our downside scenario of \$85 is based on -1% revenue growth, 10.50% net margin and 16x EPS

Available Capital & Accretion Analysis

We estimate \$1.9B of FCF in the NTM period, and with a cash balance of \$780MM and available credit of \$1.496B, we estimate that CGI can take on \$2B of additional debt to fund M&A while remaining within its 3x leverage ratio – bringing total available funding to \$6B.

We do not include future M&A in our CGI model and see upside if the company is able to execute on a transformational multi-geography deal in the near term. We expect management to target a multiple of 1x-1.5x revenue. An overview of the possible EPS accretion from M&A spending between \$800 million and \$1.2 billion is included in Exhibit 1 below.

Exhibit 1: CGI – Available Capital and M&A Scenario, September 2022

FCF (est NTM)	1,870
Cash Balance	780
Available credit	1,496
Existing Funding	4,146
Add Debt to 3x	2,068
Total Funding	6,214

Assumptions	Year 1	Year 2
Takeout Revenue Multiple	1.3x	
Takeout EBIT margins	10.0%	15.0%
Cost of debt	4%	
Tax rate	26%	

Acquisition Spending	\$800	\$900	\$1,000	\$1,100	\$1,200	\$2,000	\$2,500	\$3,000	\$3,500	\$4,000	\$4,500	\$5,000
<i>Incremental</i>												
Revenue	615	692	769	846	923	1,538	1,923	2,308	2,692	3,077	3,462	3,846
EBIT	62	69	77	85	92	154	192	231	269	308	346	385
Interest	1	5	9	13	17	49	69	89	109	129	149	169
Tax	15	16	17	18	19	27	31	36	41	46	50	55
Adj. Net Income	45	48	51	53	56	78	92	106	120	133	147	161
Incremental EPS (Year 1)	3.1%	3.3%	3.5%	3.7%	3.9%	5.4%	6.3%	7.2%	8.2%	9.1%	10.1%	11.0%
Incremental EPS (Year 2)	4.4%	4.8%	5.2%	5.5%	5.9%	8.8%	10.7%	12.5%	14.3%	16.2%	18.0%	19.8%

Source: Company reports and CIBC World Markets Inc.

Potential IT Consulting Acquisition Targets

We flag a few potential targets that we believe meet CGI's criteria of multi-geography IT Services providers with solid profitability profiles and valuation below CGI's available funding threshold. Sopra Steria (PAR: SOP) is a French IT Services provider headquartered in Paris with an enterprise value of ~\$4B. TietoEVRY (HEL:TIETO) is a Finnish IT Services provider with 24K professionals globally and an enterprise value of ~\$4.4B. Thoughtworks (NASDAQ:TWKS), based in Chicago, has a presence in 17 countries. It provides software design/delivery and consulting services. Perficient (NASDAQ: PRFT) is a global digital consultancy operating in enterprise mobile applications, creative services, Internet of Things, information technology and management consulting

Exhibit 2: CGI – IT Services & Consulting Possible Acquisition Targets

Company Name	Ticket	Price	Enterprise Value	Market Cap.	Net Debt	EBITDA Margin	Valuation		EV/EBITDA		P/E		P/FCF	
							Price/Sales	EV/Sales	FY1	FY2	FY1	FY2	FY1	FY2
CGI A	GIB.A-CA	102	27,029	24,581	3,056	20%	1.9x	2.1x	10.5x	10.0x	16.6x	15.3x	16.3x	13.7x
Bechtel	BC8-DE	48	6,414	5,993	594	8%	0.8x	0.9x	10.5x	9.9x	17.9x	16.8x	30.4x	15.4x
Reply	REY-IT	137	4,727	5,116	(223)	17%	2.2x	2.0x	11.7x	10.6x	21.9x	19.3x	23.2x	20.5x
TietoEVRY	TIETO-FI	30	4,384	3,633	1,004	16%	0.9x	1.1x	7.4x	6.7x	10.4x	9.5x	11.7x	9.7x
Sopra Steria Group	SOP-FR	171	4,147	3,488	1,019	12%	0.5x	0.6x	5.2x	4.8x	9.4x	8.8x	10.4x	11.8x
Insight Enterprises	NSIT-US	112	5,342	4,598	1,516	5%	0.3x	0.4x	8.0x	7.5x	9.5x	8.9x	186.7x	43.0x
Thoughtworks Holding	TWKS-US	15	5,340	5,047	353	19%	3.0x	3.4x	15.4x	12.7x	22.4x	17.5x	35.1x	18.4x
Capita	CPI-GB	0	1,167	703	1,152	8%	0.1x	0.2x	3.2x	3.0x	7.0x	5.6x	NA	39.6x
Perficient	PRFT-US	82	3,358	2,931	502	23%	2.8x	3.1x	11.8x	10.3x	14.0x	12.2x	19.0x	14.5x
Average						14%	1.4x	1.5x	9.3x	8.4x	14.3x	12.6x	41.6x	20.7x

Source: FactSet and CIBC World Markets Inc.

Price Target Calculation

We derive our price target of C\$135 based on 21.0x F2023E EPS. The multiple is supported by CGI's three-year average premium multiple to Business Services Peers. This is supported by a DCF with long-term growth of 0.5%, a discount rate of 7.88%, and a terminal cash flow multiple of 13.5x

Key Risks To Price Target

The primary risks to our price target include the following: 1) volatility in the global IT environment; 2) increasing competition from other enterprise application vendors; 3) the company's ability to introduce new or updated technology in a timely manner; 4) the company's ability to successfully integrate and operate any current or future acquisitions; 5) the loss of key management or other employees.

Note: The CIBC analyst who covers this security visited the company's IP Innovation Centre in Montreal on September 22. CIBC World Markets was responsible for the cost of transportation to and from the location.

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