

EQUITY RESEARCH

July 26, 2023

Earnings Update

CGI INC.

A Shift Towards Managed Services

Our Conclusion

CGI's stock was down ~5% despite what we viewed as solid FQ3 results. We believe that the stock was down due to concerns around longer sales cycles. We see the longer sales cycles as indicative of a client preference for ROI driven work, leading to greater demand for larger managed services contracts versus shorter-duration consulting engagements. We believe that the overall demand environment remains solid, with CGI seeing a strong book-to-bill in FQ3 (1.21x), but expect that the higher proportion of managed services bookings will take slightly longer to convert to revenue. Overall, we see CGI's focus on ROI-driven work and AI as a differentiator which we expect to benefit the company longer-term. We retain our Outperformer rating and \$150 price target.

Key Points

Demand Shifts Towards Managed Services: Given the macro-backdrop, CGI has seen a client shift towards ROI-driven projects, with a focus on managed services and IP. Bookings in the quarter were indicative of this trend, with both managed services and IP seeing book-to-bills of 1.2x and 40% of bookings for deals over \$50MM (versus 13% in the year-ago quarter). While the shift to managed services allows CGI to see more resilient growth than some more consulting-focused peers, we believe that managed services bookings take longer (3-9 months) to convert to revenue, so we expect that we could see a few quarters of slower growth as the business mix transitions and we have brought down our FQ4 constant currency revenue estimate by ~2%, with our F24 estimate roughly unchanged.

A.I. A Longer Term Tailwind: CGI announced earlier this week that it will be investing \$1B over three years on AI initiatives. The investments will focus on the expansion of AI offerings, including: AI consulting methodology, talent, go-to-market strategy and operational and delivery enhancements. Similar to IP development, we expect that CGI will work in partnership with clients to develop AI as clients move from experimentation to full-scale implementations. CGI noted that it is seeing early demand for AI offerings, particularly in healthcare and financial services, for very niche offerings (such as analysis of MRI scans). Longer-term, we expect that AI will be a tailwind to CGI's business, although we expect there could be a pivot from pricing based on labour to more of an output-based pricing.

M&A Market Tough – Expect A Near-term Focus On Buybacks: CGI noted that M&A activity has slowed significantly due to a valuation gap with potential sellers, with CGI spending \$13MM on M&A YTD. The company noted that it continues to have an active pipeline, but one that does not include any larger late-stage opportunities. We expect CGI to remain disciplined on M&A and expect the company to focus on share buybacks in the absence of large-scale M&A. CGI spent \$53MM on buybacks in FQ3.

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Outperformer

GIB.A-TSX, Sector: Information Technology

Current Price (7/26/23): C\$128.50

Price Target (12-18 mos.): C\$150.00

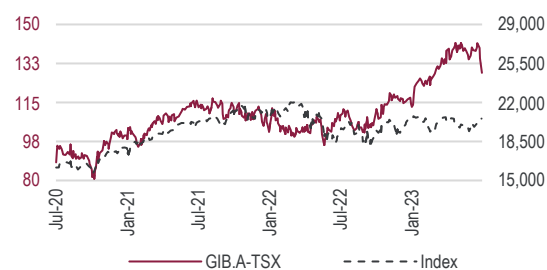
CIBC Estimates and Valuation

(Sep. 30)	2021	2022	2023	2024
Adj. EPS	5.44A	6.10A	7.02E	7.44E
Prior			7.13E	7.56E
Adj. EPS	Q1	Q2	Q3	Q4
2023	1.66A	1.82A	1.80A	1.74E
Prior			1.83E	1.82E
2022	1.49A	1.53A	1.54A	1.54A
Valuation	2021	2022	2023	2024
P/E	23.6x	21.1x	18.3x	17.3x

Stock Performance and Key Indicators

Enterprise Value	C\$34,073M	Shares O/S:	234.0M
Market Cap.:	C\$30,074M	Float:	207.5M
52-wk Range:	C\$101.58 - C\$141.62	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 5.
For required regulatory disclosures please refer to "Important Disclosures" beginning on page 6.

CGI Inc. (GIB.A-TSX) — Outperformer

Price (7/26/23) C\$128.50 12-18 mo. Price Target C\$150.00

Sector: Information Technology

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Peer Comparison	2021	2022	2023E	2024E
P/E - Business Services	25.7x	18.6x	17.4x	17.4x
P/E - CGI	25.0x	22.3x	19.2x	19.2x
EV/EBITDA - Business Services	16.0x	14.1x	12.7x	12.7x
EV/EBITDA - CGI	18.1x	14.3x	13.7x	13.7x
Key Financial Metrics	2021	2022	2023E	2024E
Sales Growth	(0.3%)	6.1%	13.1%	2.7%
Per Share Data	2021	2022	2023E	2024E
FCFPS	7.28	6.21	7.35	8.72
Adj. EPS Dil.	5.44	6.10	7.02	7.44
Wgt Avg # of Shares	249.2	239.3	233.9	229.3
FD Number of Shares	253.0	242.9	237.7	233.0
Income Statement	2021	2022	2023E	2024E
Revenue	12,127	12,867	14,355	14,949
Tot Operating Exp	9,664	10,306	11,520	11,959
OpEx (% of Revenue)	79.69%	80.09%	80.26%	80.00%
EBITDA	2,463	2,561	2,834	2,990
EBITDA Margin	20.31%	19.91%	19.74%	20.00%
D&A	511	475	520	570
EBIT	1,952	2,087	2,314	2,420
Interest Expense	107	92	70	93
Other Pretax Income	7	28	53	0
Pretax profit	1,838	1,967	2,191	2,327
Tax Expense	469	501	564	593
Adjusted Net Income	1,375	1,486	1,668	1,733
Adjusted Net Margin	11.3%	11.5%	11.6%	11.6%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	2,116	1,865	2,022	2,279
Capex	(122)	(156)	(155)	(120)
Free Cash Flow	1,994	1,709	1,867	2,159
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	1,699	966	1,750	3,000
Intangible Assets	507	616	605	605
Goodwill	8,140	8,481	8,706	8,706
Total Assets	15,021	15,175	17,011	18,124
ST Int-Bearing Debt	393	93	739	939
LT Int-Bearing Debt	3,009	3,174	2,374	2,174
Total Liabilities	8,035	7,903	8,556	8,686
Shareholders' Equity	6,986	7,273	8,455	9,438

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

Company Profile

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

Investment Thesis

The company's revenues are derived from Canada (15% of revenues), US (~30%), Europe (40% -50%) and rest of world (~10%), and split between outsourcing (~54% of revenue) and systems integration / consulting (~46% of revenue). The company generates strong profitability and cash flow, used to date on debt repayment and share buybacks, and acquisitions.

Price Target (Base Case): C\$150.00

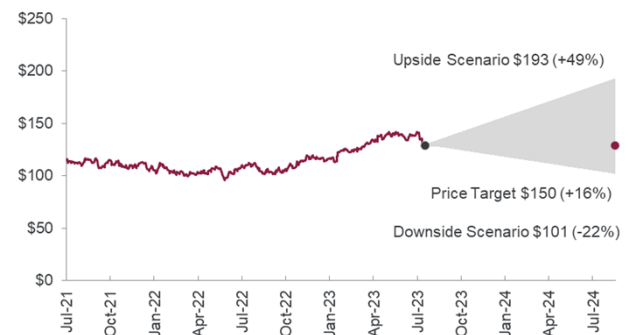
Our price target of \$150 is based on 3.6% revenue growth, 11.7% net margins and 20x 2024E EPS

Upside Scenario: C\$193.00

Our upside scenario of \$193 is based on 10% revenue growth, 12% net margins and 23.5x EPS

Downside Scenario: C\$101.00

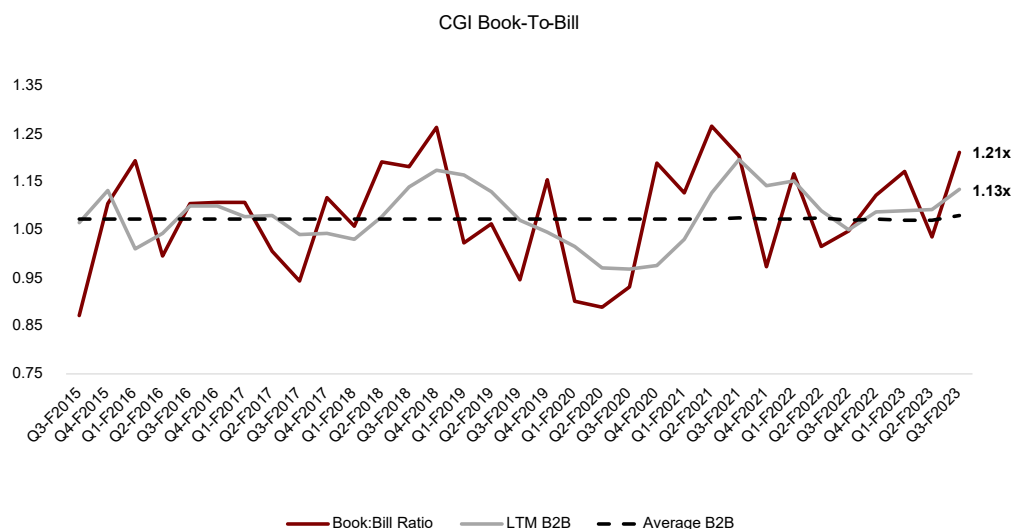
Our downside scenario of \$101 is based on 3% revenue growth, 10.50% net margin and 15x EPS

Scenario Analysis:

Q3/F23 Results In Line: CGI reported revenue of \$3.62B, (consensus of \$3.64B) and adjusted EPS of \$1.80 versus consensus of \$1.79. Constant currency revenue growth was 6.3% in the quarter. Adjusted EBIT margin of 16.1% was 20 bps below consensus and adjusted EBIT of \$585M was 1% below consensus at \$593MM and 2% below our estimate at \$599MM. Free cash flow (FCF) of \$308MM was in line with our estimate of \$310MM and below the Street of \$416MM.

Bookings: Contract signing of \$4.39B resulted in a book-to-bill ratio of 1.21x in FQ3 (TTM 1.13x), up from 1.09x in FQ2. TTM book-to-bill was driven by U.S. Federal (1.31x) and U.K. and Australia (1.23x). CGI's backlog ended the quarter at \$25.6B or 1.8x annual revenue.

Exhibit 1: CGI - Book-to-bill Ratio, Q3/F15 – Q3/F23



Source: Company reports and CIBC World Markets Inc.

Updates To Our Model: We have updated our model to reflect FQ3 results. We have decreased our revenue assumptions by 2% in F2023E and 1% in F2024E. We expect EBIT margins to increase 10 bps from F2023E to F2024E as the company offsets wage inflation and increased travel expenses with a shift in mix to more managed services/IP and improved efficiencies from global delivery centres.

Exhibit 2: CGI – Changes To Our Model, F2022 - F2024E

	Revenues (\$MM)	EBIT (\$MM)	Adjusted EPS (Continuing Operations)	CFO (\$MM)
2022A	12,867	2,087	6.10	1,865
2023E				
CIBC est. – new	14,355	2,314	7.02	2,022
CIBC est. – prior	14,580	2,351	7.13	2,028
Consensus	14,367	2,331	7.08	2,143
2024E				
CIBC est. – new	14,949	2,420	7.44	2,279
CIBC est. – prior	15,102	2,452	7.56	2,313
Consensus	15,047	2,487	7.75	2,328

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

Environmental, Social and Governance (ESG) Metrics for GIB.A-TSX

CIBC ESG Metrics

Governance Metrics	2017	2018	2019	2020	2021
Insider Ownership	1.5%	0.5%	0.4%	0.8%	1%
Board Gender Diversity	18.8%	28.6%	31.3%	31.3%	29%
Separation of Chair & CEO	YES	YES	YES	YES	YES
Dual-class Ownership?	YES	YES	YES	YES	YES
Disclose ESG Data?	YES	YES	YES	YES	YES
Social Metrics	2017	2018	2019	2020	2021
CEO Comp./Mkt Cap*	\$0.4	\$0.5	\$0.5	\$0.2	\$0.6
Diversity Targets	YES	YES	YES	YES	YES
Women Managers	14%	12%	14%	19%	33%
Environmental Metrics	2017	2018	2019	2020	2021
Emissions Intensity**	NA	NA	5	4	3
Net-zero Targets?	NO	NO	YES	YES	YES

*CEO Compensation is shown as per thousand dollars of market capitalization

**Emissions Intensity calculated as total emitted CO2e divided by million \$ of CAD revenue

Sustainalytics ESG Risk Rating

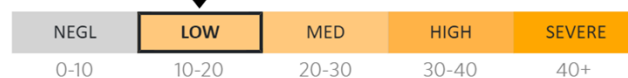
15.3

Updated on
Jan 14, 2023

+0.0

Momentum

Low Risk



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK (1 st = lowest risk)	PERCENTILE (1 st = lowest risk)
Global Universe	1559/15536	11th
Software & Services INDUSTRY	73/1074	8th
IT Consulting SUBINDUSTRY	24/235	11th

Sustainalytics Material ESG Issues

These are the Material ESG Issues driving the ESG Risk Report

Issue Name	ESG Risk Exposure Score Category	ESG Risk Management Score Category	ESG Risk Rating Score Category	Contribution to ESG Risk Rating
Corporate Governance	9.0 High	54.0 Strong	4.1 Medium	27.0%
Human Capital	7.6 Medium	48.2 Average	4.1 Medium	26.8%
Product Governance	2.1 Low	17.5 Weak	1.7 Negligible	11.3%
Business Ethics	4.8 Medium	53.8 Strong	2.3 Low	15.1%
Data Privacy and Security	7.6 Medium	75.0 Strong	3.0 Low	19.8%
Overall	31.0 Low	54.3 Strong	15.4 Low	100%

CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	5	0	Value	131	+4
Momentum	5	-3	Momentum	31	-23
Quality	2	0	Quality	13	-4
Market	3	0	Market	36	-1
Low Volatility	1	0	Low Volatility	13	-4
Growth	7	-4	Growth	114	-67

Note: Ranking out of 11 stocks

Note: Ranking out of 227 stocks

General Notes Behind the Quantitative Scorecard

Delta refers to the change in the ranking over the past month. Number of stocks "Within Sector" is defined by the number within the GICS. In the "Within S&P/TSX" category, we use all stocks in the S&P/TSX Composite. For detail on the Quant Factors included in each style above, please contact the CIBC Portfolio Strategy Team.

The table above is based upon quantitative, statistical, and mathematical analysis and is not intended to serve as a fundamental recommendation.

CIBC Technical Scorecard

Factor	TSM Score	Factor	TSM Score
TSM	7	Momentum	B
Beta	0.71	MACD	A
Volatility	↔	Alpha (Sector)	D
Trend	↑	Alpha (Index)	A
RSI	Neutral		

General Notes Behind the Technical Scorecard

TSM: The Trendspotting Matrix uses technical factors to score uptrend durability.

Momentum and alpha metrics compare performance over one-month, one-quarter and one-year timeframes, outputting a rating from A to D.

Trend/Volatility metrics measure price deviations relative to underlying moving averages. **RSI** is an oscillator that provides mean-reversion estimations.

MACD is a momentum indicator rated from A to D based off the strength of its signal.

The table above is based upon a technical methodology that examines the past trading patterns and trades and is not intended to serve as a fundamental recommendation.

Source: Sustainalytics, Compustat, FactSet, Bloomberg and CIBC World Markets Inc.

Price Target Calculation

We derive our price target of C\$150 based on 20.0x F2024E 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.

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Neutral	NT	Stock is expected to perform in line with similar stocks in the coverage universe during the next 12-18 months.
Underperformer	UN	Stock is expected to underperform similar stocks in the coverage universe during the next 12-18 months.
Tender	TR	Shareholders are advised to tender shares to a specific offer as we do not believe a superior offer will materialize.
Not Rated	NR	CIBC World Markets does not maintain an investment recommendation on the stock.
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Overweight	O	Sector is expected to outperform the broader market averages.
Marketweight	M	Sector is expected to equal the performance of the broader market averages.
Underweight	U	Sector is expected to underperform the broader market averages.
None	NA	Sector rating is not applicable.

Note: Broader market averages refer to S&P 500 in the U.S. and S&P/TSX Composite in Canada.

CIBC World Markets Inc. Price Chart

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- 12 The equity securities of these companies are subordinate voting shares: CGI Inc.

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Neutral	129	43%	Neutral	129	100%
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Tender	1	0%	Tender	1	100%
Restricted	5	2%	Restricted	5	100%

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