

Michael Roach still sees significant potential for CGI in the U.S.

Despite the economic crisis, this CEO has very ambitious objectives for the Quebec-based company

Les Affaires – Focus 500

Each month, we give you an in-depth look at a company included in our listing of Québec's top 500 businesses, which is published yearly in collaboration with *Commerce* magazine.

Don't count on Michael Roach to make passionate declarations. It's just not his style.

However, CGI Group's President and CEO has very bold objectives, such as doubling the size of the Montreal-based company within three to five years. His strategy for success includes a foray into the U.S. market.

As the economy goes through its worst crisis in 80 years, aiming for such a growth spurt may seem optimistic for the information technology and business process services provider.

"Our market analysis, combined with our effective operational methods both locally and overseas, make this objective an attainable one," says Mr. Roach with his usual enthusiasm during an interview he granted us at CGI's headquarters in downtown Montréal.

Far from being exotic, Mr. Roach's approach focuses on the values that built CGI's success; good old-fashioned soliciting on the field, attention to quality when completing projects and an entrepreneurship culture.

CGI's proven strategy and a mix of new contracts and eventual acquisitions will enable the company to achieve its objective—revenues totaling \$7.5–\$8 billion and around 50,000 employees by 2013.

This will be no small feat for the company. Its current order backlog, totaling \$11.4 billion, is not what it was in 2005 (\$13.3 billion), and its stock is still a far cry from the \$35 it yielded per share in 2000.

Client blitz

Since the beginning of the year, CGI has obtained six new contracts with a total value of \$725 million.

While this may come as terrific news in the current economic environment, it is no mere windfall, but rather the result of a systematic offensive by upper management, including CGI Founder and Executive Chairman of the Board Serge Godin.

Between 2006 and 2008, CGI executives met with their top 400 clients to promote the company's solutions, as well as its local and global approach.

"When the economy was doing well, they ignored us, but now that the recession is forcing them to rethink their operating procedures, they're more willing to hear us out

when we talk about reducing costs, increasing productivity and maintaining service quality,” says Mr. Roach.

“CGI is well positioned to earn U.S. contracts. Its services are competitive when compared to Indian providers, especially when you take into account the 20 to 30 hidden costs related to long-distance outsourcing,” explains Peter Kuske, an analyst at Branham, an Ottawa-based technology consulting firm. “What’s more, the current exchange rate gives the company a 25% cost advantage.”

CGI is reaping what it has sown over the last two years, since the signing of a permanent outsourcing contract comes 18 to 24 months after the first contact.

Obama’s arrival yields many interesting business opportunities

CGI plans to exploit the opportunities Obama’s election is generating in the U.S., including a new era of “Big Government” and reforms.

CGI draws nearly a third of its revenue from government contracts. Its U.S. branch serves 44 states. Donna Morea, President, CGI U.S., regularly meets with several state governors to better understand their needs.

Many state and municipal governments are currently dealing with the increasing urgency of updating their administrative systems, as Obama’s government requires thorough expense tracking before rolling out grants promised under the American Recovery and Reinvestment Act. In December 2008, the city of Cleveland, hit hard by the recession, opted to replace its financial management systems with CGI’s AMS Advantage software package.

“The mortgage crisis is also a source of potential contracts,” says Mr. Roach. As such, CGI has just recruited Roy Bernardi, former acting secretary of the U.S. Department of Housing and Urban Development, as Vice-President, Consulting Services. “CGI systems already manage roughly a quarter of all U.S. public housing access programs,” adds Mr. Roach.

CGI also plans to expand in the area of health care system reform, despite stiff competition from other firms.

Obama’s first budget plans to distribute \$634 billion over a decade to broaden Americans’ health care coverage and reduce costs. In February, the Centers for Medicare & Medicaid Services mandated CGI with the maintenance and update of systems used by the Medicare Advantage health and medication insurance plans. This five and a half year contract is valued at US\$135 million, if all its options are enacted.

“CGI has an edge in both of these specialties, as governments purchase their services locally,” says Richard Tse, an analyst at National Bank Financial. “Furthermore, this market niche isn’t exposed to competition, for example, from Indian providers.”

“Despite fielding 26,500 employees across 16 countries, CGI hasn’t lost its entrepreneurial core,” says Mr. Roach. “Every opportunity, no matter how small, is carefully considered.”

For example, CGI aims to capitalize on a general agreement regarding professional mobility between France and Québec signed last October. An advisory panel seeks to convince French companies that it is just as profitable to outsource services in Québec than in Vietnam's or Morocco's French markets.

CGI and an unnamed French client have set up a pilot project involving eight French professionals. CGI has sent two of its own employees in France to work with them.

Possible acquisition in Europe

CGI has long claimed to have the necessary means to complete a major acquisition in either the U.S. or Europe. Mr. Roach reaffirms that he is in no hurry and still looking for a rare find at a reasonable price.

However, Gabriel Leung of Paradigm Capital claims that the appointment of Bernard Bourigeaud, former president of IT service provider Atos Origin, to CGI's Board of Directors suggests Europe is his main focus. "Let's not jump to conclusions," says Mr. Roach. "Mr. Bourigeaud is a heavyweight in the field and brings his vast market knowledge to the table."

CGI also has the financial means to make a major transaction, as 20 banks have loaned the company a total of \$1.5 billion until 2012.

Employees taking care of business

Mr. Roach, a former Bell Canada executive, believes himself able to effectively compete in a field dominated by IBM, EDS, Accenture and Computer Sciences, and secure market shares through CGI's agility and flexibility.

"Our employees think like owners since 87% of them are also shareholders, and owners always pay greater attention to their business," explains Mr. Roach.

CGI says it completes 95% of its projects on schedule and on budget in an industry where an average of 60% of all IT projects suffers delays or go over budget. Mr. Roach attributes this capacity to CGI's simplified management structure. Indeed, a total of 30 business units report directly to him, and only a single organizational level separates him from their respective president or vice-president.

Projecting a growth image

The CEO is firmly convinced that setting bold objectives enables CGI to project a growth image to which clients, employees and investors respond positively.

"Our objectives represent a long-term commitment," explains Mr. Roach. "Clients want to do business with a supplier who can broaden its network and increase services. Professionals also want to work with us, as we can provide them with good career opportunities. As for investors, they know success when they see it."

"Michael Roach loves to serve, which is a key quality in our field and he knows how to project that onto others," says Serge Godin. "He is very versatile and as comfortable

talking strategy with the president of a client company as discussing systems with its IT manager.”

Stock that defies the market

After acting as a shelter in certain investment portfolios during the worst days of the 2008 crisis, CGI Group’s stock is now attracting interest through its growth potential.

In 2008, CGI's stock performed well, dropping by only 17%, while Toronto’s S&P/TSX plummeted by 35%. The stability of its order backlog, valued at \$11.4 billion, its healthy balance sheet and a \$214 million stock repurchase enabled it to withstand the stock market debacle.

“Companies that are prone to excel on the stock market are those with recurring income and whose services are an integral part of their clients’ activities, which is the case with CGI,” says Gabriel Leung, an analyst at Paradigm Capital.

\$725 million in new contracts

This year, a wave of new contracts, half of which are from the U.S., give financial experts an optimistic outlook toward CGI for fiscal 2009 and 2010 (its fiscal year ends September 30).

“So far this year, CGI has secured six projects, totaling \$725 million, the company’s biggest contracts in two years,” says Tom Liston, an analyst at Versant Partners.

“These contracts prove that CGI can close new deals under difficult conditions. These new projects also remind us that technology plays a key role in helping client companies cut costs and maintain services,” mentions Eric Bernofsky, an analyst at Versant Partners. “CGI’s new contracts boost its order backlog by 5% and add 3% to its projected 2009 revenue figures.”

The effects of these new contracts will be mostly felt in 2010, since revenue received from services provided increases as contracts evolve.

Projected earnings growth of 17%

Mr. Bernofsky estimates that returns per share will total \$1.11 in 2010, representing a 17% increase.

Analysts also appreciate CGI’s acquisition of new clients in key industries, namely health and financial services.

CGI will offer software updating and maintenance services to Cigna, a major U.S. health care services provider, as part of a five-year contract valued at US\$35 million per year.

At the heart of Wall Street, an unidentified investment bank has just mandated CGI with the management of certain technical support functions for its financial market activities. This initial two-year contract is valued at US\$44 million per year.

CGI will supervise 200 employees who will be working at its future center of excellence in New York. This center, together with others in Toronto and London, have a combined total of 500 employees and will service the financial and wealth management sectors.

Since CGI's stock has already bounced back by 24% since hitting its lowest mark last October, the company will have to sign new major contracts to boost it even further. Analysts estimate target rates over one year varying between \$12 and \$13 and representing a potential yield of 15% to 24%.

Despite the stock's good performance, Christian Godin, manager at Montrusco Bolton, believes the price-earnings ratio is rather low for a company whose financial performance is improving. To further increase their returns, investors should buy this stock when its stock exchange value is weak.

Pierre Bernard, manager at IA Clarington, hopes that new contracts will help CGI's stock, so that the company may finally clear the tight conditions it's been operating under for several years.

CV

Name: Michael Roach

Age: 57

Company: CGI Group

Function: President and Chief Executive Officer since 2006

Career profile: Chief Operating Officer from 2002 to 2006. Under his governance, CGI completed its most important transaction in 2004: the purchase of AMS, a U.S. firm, for \$1.1 billion. Prior to joining CGI in 1998 as Executive Vice-President, Mr. Roach was an executive at Bell Canada for 25 years.

Training: Bachelor's degree in Economics and Political Science from Laurentian University in Sudbury.

Personal notes: Married and has two daughters. His favorite pastimes are reading, golf and fishing. His favorite book is *The World is Flat* by Thomas L. Friedman.

Graph:

Stock evolution over three years (*GIB-A.TO*, \$9.87)

Potential

- Governments provide a third of its income.
- Client efforts to reduce costs stimulate U.S. sales.
- Can access \$1.3 billion in loans at a 1.8% rate

Risks

- Financial firms represent 29% of its income.
- CGI faces industry giants such as IBM, HP-EDS and Accenture.
- Its Canada revenue has capped.

Return

- \$1,000 invested a year ago is worth \$914 as of March 27, 2009.
- \$1,000 invested three years ago is worth \$1,248 as of March 27, 2009.

Ranking on *Les Affaires 500*: 11th

Number of employees in Québec: 9,200 (out of 26,500)

Vital stats

Stock market value: \$3 billion

Variance over the last 12 months: -8.6%

Revenue in 2008: \$3.7 billion

Earnings per share in 2008: \$0.92 (+28%)

Projections

- Revenue in 2013: \$7.5 to \$8 billion
- Earnings per share in 2009¹: \$0.95 (+3%)
- Earnings per share in 2010¹: \$1.11 (+17%)
- Price-earnings ratio in 2009: 10.3

1. *Projections provided by Desjardins Securities*