

EQUITY RESEARCH

August 4, 2023

Earnings Update

TELUS INTERNATIONAL (CDA) INC.

Positioning For Future Growth

Our Conclusion

Q2 results were in line with TI's pre-announcement and the company reiterated its full-year outlook. TI is seeing weaker demand (especially from the tech and games vertical) amid a difficult macroeconomic environment. While management characterizes the F23 outlook as conservative, we see potential for near-term volatility given limited visibility into customer demand. In the current environment, TI is focused on cost reduction and positioning the company for future growth once the macro backdrop improves. We retain our Outperformer rating given the stock's discounted valuation, currently trading at 6.0x 2024E EV/EBITDA vs. a blended peer average of 10.9x.

Key Points

Generative AI A Focus: Management discussed AI opportunities extensively, noting that TI has seen accelerated demand from clients looking at genAI transformation opportunities and noting several AI projects with large clients, including Google. With its AI offering still in early stages, management did not provide financial details or quantify opportunities, but noted varied test cases ranging from optimizing disease resistance in cattle to bot solutions for invoice creation and processing.

Second-largest Customer Drives Weaker Growth: TI continued to see weaker demand in Tech & Games, particularly from its second-largest customer, with the vertical up 3% Y/Y overall, or up 15% Y/Y excluding the impact of this customer. Management noted that it does not see any broader impact on demand in the content moderation sector or from AI in customer experience management, emphasizing that its second-largest customer is the key driver of weaker Q2 growth. eCommerce & Fintech was down 14% Y/Y as well. The two verticals combined were up 7% Y/Y excluding the impact of this customer. The sales funnel remains robust at \$2.9B in its pipeline, but the time to convert to revenue has slowed as clients exercise caution due to macro uncertainty.

TELUS Spend Is Partially Offsetting: TELUS has a \$200MM annual spend with TI under its MSA, but has spent \$262MM in H1 as TI ramps up work on the TELUS Health customer experience management contract and other digitization initiatives. We view TELUS as a driver of longer-term growth at TI as the telecom provider looks to drive digitization and automation within its base telecom business and its growth business, including TELUS Health and TELUS Ag. TELUS has been offsetting headwinds from other parts of the business, excluding TELUS and WillowTree; we calculate a 6% organic decline in the remaining business in Q2, driven primarily by Facebook.

WillowTree Continuing to See Sales Delays: WillowTree delivered \$45MM in Q2 revenue, down sequentially from \$57MM in Q1. WillowTree has been seeing sales delays as clients pause spending in an uncertain macroeconomic environment. TI continues to integrate WillowTree, and we see future upside from cross-selling within TI's customer base.

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Outperformer

TIXT-NYSE, Sector: Information Technology

Current Price (8/4/23): US\$9.56

Price Target (12-18 mos.): US\$20.00

CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
Adj. EPS	1.01A	1.23A	0.94E	1.14E
Prior			0.90E	1.12E
Adj. EBITDA(mln)	540.0A	607.0A	581.3E	701.6E
Prior			579.3E	701.3E

Adj. EPS	Q1	Q2	Q3	Q4
2022	0.26A	0.30A	0.32A	0.35A
2023	0.28A	0.17A	0.23E	0.27E
Prior		0.16E	0.20E	

Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	142.0A	150.0A	158.0A	157.0A
2023	155.0A	120.0A	141.3E	164.9E
Prior		118.0E		

Valuation	2021	2022	2023	2024
P/E	9.5x	7.8x	10.2x	8.4x
EV/EBITDA	7.8x	6.9x	7.2x	6.0x

Stock Performance and Key Indicators

Avg. Dly. Vol.:	289K	Shares O/S:	273.0M
Market Cap.:	US\$2,610M	Float:	70.4M
52-wk Range:	US\$8.97 - US\$31.48	Div. / Yield:	NIL/NIL

TIXT-NYSE



(Source: FactSet)

All figures in US 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.

TELUS International (CDA) Inc. (TIXT-NYSE) — Outperformer

Price (8/4/23) US\$9.56 12-18 mo. Price Target US\$20.00

Sector: Information Technology

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Key Financial Metrics	2021	2022	2023E	2024E
Sales Growth	32.6%	12.5%	10.1%	7.3%
Per Share Data	2021	2022	2023E	2024E
Diluted EPS	0.30	0.68	0.21	0.51
Adj. EPS Dil.	1.01	1.23	0.94	1.14
Wgt Avg # of Shares	261.7	266.0	273.0	273.0
FD Number of Shares	264.2	269.3	276.0	276.0
Income Statement	2021	2022	2023E	2024E
Revenue	2,194	2,468	2,716	2,914
Cost of Goods Sold	0	0	0	0
Gross Profit	2,194	2,468	2,716	2,914
Tot Operating Exp	1,752	1,926	2,212	2,262
OpEx (% of Revenue)	79.85%	78.04%	81.42%	77.61%
Adj. EBITDA	540	607	581	702
Adj EBITDA Margin	24.6%	24.6%	21.4%	24.1%
Net Income	78	183	57	141
Adjusted Net Income	267	332	259	315
Adjusted Net Margin	12.2%	13.5%	9.5%	10.8%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	282	437	321	380
Capex	(99)	(105)	(98)	(120)
Free Cash Flow	183	332	223	260
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	115	125	25	69
Intangible Assets	1,158	1,008	1,535	1,346
Goodwill	1,380	1,350	1,973	1,973
Total Assets	3,626	3,556	4,836	4,790
ST Int-Bearing Debt	328	83	122	122
LT Int-Bearing Debt	820	881	1,628	1,500
Total Liabilities	1,971	1,718	2,790	2,604
Shareholders' Equity	1,655	1,838	2,046	2,187
Tot Liab & SE	3,626	3,556	4,836	4,791

Source: FactSet, Company Reports & CIBC World Markets Inc.

Company Profile

TELUS International is a provider of multilingual digital customer experience and digital IT solutions to global clients.

Investment Thesis

TI's focus on digital services and high-growth verticals provides a long runway for growth as the company improves its digital offerings and expands within the customer base.

Price Target (Base Case): US\$20.00

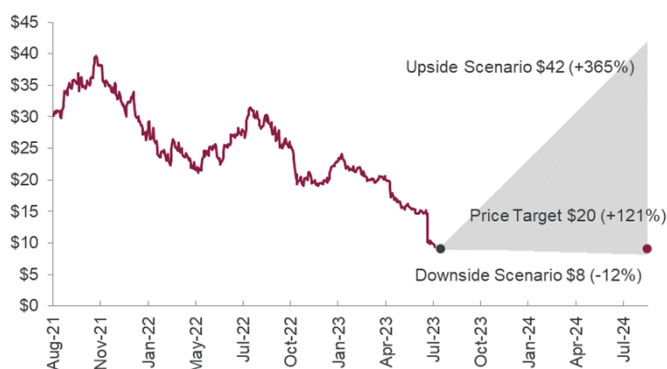
Our Price Target is calculated using 15% revenue growth, 24.9% EBITDA margin and an 11.0x EV/EBITDA multiple.

Upside Scenario: US\$42.00

Our upside scenario is calculated using 20% revenue growth, 25.0% EBITDA margin and a 17.0x EV/EBITDA multiple.

Downside Scenario: US\$8.00

Our downside scenario is calculated using 10% revenue growth, 19.5% EBITDA margin and a 8.0x EV/EBITDA multiple.

Scenario Analysis:

Financial Summary

TI reported revenue of \$667MM, up 7% Y/Y in constant currency and in line with consensus/our estimate (\$663MM/\$663MM), while EBITDA of \$120MM was slightly above the Street and our expectation (\$118MM/\$118MM) (Exhibit 1).

Exhibit 1: TIXT – Financial Summary, Q2/23

	Q2/23			Q1/23	Q/Q%	Cons.	Q2/22
	Cons.	Q2/22	Y/Y%				
Consolidated							
Revenue (\$MM)	667	663	663	624	7%	686	(3%)
Tech & Games	297	258	NA	287	3%	287	3%
Comm. & Media	157	146	NA	143	10%	153	3%
eCommerce	66	77	NA	77	(14%)	79	(16%)
Other	147	182	NA	117	26%	167	(12%)
EBITDA (\$mm)	120	118	118	150	(20%)	155	(23%)
EBITDA Margin	18.0%	17.8%	17.8%	24.0%	(600bps)	22.6%	(459bps)
Adjusted EPS	\$0.17	\$0.16	\$0.16	\$0.30	(44%)	\$0.28	(38%)

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

Free Cash Flow And Leverage: Free cash flow of \$66MM was flat Y/Y, driven by lower CFO offset by lower capex. The company had \$91MM in CFO, down 4% Y/Y.

Changes To Our Model: We have updated our model for Q2 results and made minimal other changes given the recent F23 guidance revision.

Exhibit 2: TIXT – Changes To Our Model, 2022 - 2024E

	Revenues (\$MM)	EBITDA (\$MM)	Adjusted EPS (\$)	CFO (\$MM)
2022	2,468	607	1.23	437
2023E				
CIBC est. – new	2,716	581	0.94	321
CIBC est. – prior	2,712	579	0.90	308
Consensus	2,712	587	0.94	397
2024E				
CIBC est. – new	2,914	702	1.14	380
CIBC est. – prior	2,913	701	1.12	336
Consensus	2,938	686	1.11	466

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

Environmental, Social and Governance (ESG) Metrics for TIXT-NYSE

CIBC ESG Metrics

Governance Metrics	2017	2018	2019	2020	2021
Insider Ownership	NA	NA	NA	NA	3.7%
Board Gender Diversity	NA	NA	NA	13%	30%
Separation of Chair & CEO	NA	NA	NA	YES	YES
Dual-class Ownership?	NA	NA	NA	YES	YES
Disclose ESG Data?	NA	NA	NA	YES	YES
Social Metrics	2017	2018	2019	2020	2021
CEO Comp./Mkt Cap*	NA	NA	NA	\$1.9	\$6.7
Diversity Targets	NA	NA	NA	YES	YES
Women Managers	NA	NA	NA	43%	NA
Environmental Metrics	2017	2018	2019	2020	2021
Emissions Intensity**	NA	NA	NA	NA	NA
Net-zero Targets?	NA	NA	NA	YES	YES

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

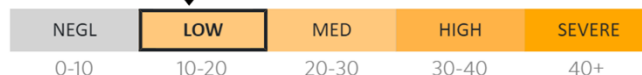
**Emissions Intensity calculated as total emitted CO2e divided by million \$ of CAD revenue

Sustainalytics ESG Risk Rating

14.8 +0.0 Low Risk

Updated on
May 23, 2023

Momentum



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK	PERCENTILE
	(1 st = lowest risk)	(1 st = lowest risk)
Global Universe	1347/15536	10th
Software & Services INDUSTRY	57/1074	6th
IT Consulting SUBINDUSTRY	16/235	7th

Sustainalytics Material ESG Issues

These are the Material ESG Issues driving the ESG Risk Report

Issue Name	ESG Risk Exposure	ESG Risk Management	ESG Risk Rating	Contribution to ESG Risk Rating
	Score Category	Score Category	Score Category	

CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	4	+4	Value	78	+49
Momentum	26	-1	Momentum	212	+12
Quality	8	-2	Quality	72	-15
Market	18	-1	Market	117	-20
Low Volatility	14	-7	Low Volatility	112	-49
Growth	14	-3	Growth	86	-17

Note: Ranking out of 26 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	NA	Momentum	D
Beta	0.75	MACD	D
Volatility	↑	Alpha (Sector)	D
Trend	↓	Alpha (Index)	D
RSI	Oversold		

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.

Price Target Calculation

We derive our price target of \$20.00 by applying an 11.0x EV/EBITDA multiple to our 2024E EBITDA estimate based on the current capital structure. The 11.0x multiple is a 1.0x discount to a blended average of Digital Services, BPO, and IT services peers.

Key Risks To Price Target

The primary risks we see to our price target include the following: 1) risks related to the concentrated customer base; 2) an increase in employee attrition rates; 3) litigation related to the working conditions for content moderation team members; 4) challenges in integration future acquisitions; 5) increased competition from well capitalized peers.

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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: TELUS International (CDA) Inc.

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Underperformer	7	2%	Underperformer	7	100%
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Restricted	4	1%	Restricted	4	100%

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