

# EQUITY RESEARCH

October 27, 2022

Company Update

## TELUS INTERNATIONAL (CDA) INC.

Adding High-end Services – Acquiring WillowTree For \$1.225B

### Our Conclusion

We view the \$1.225B acquisition of WillowTree as in line with TELUS International's (TI) strategy. The acquisition adds a high-growth (~50% Y/Y) business that expands TI's digital solution set and brings a blue-chip customer base. While TI paid a rich multiple, it has a strong track record of recognizing acquisition synergies. We see cross selling as the biggest synergy opportunity, with WillowTree adding high-value front-end design solutions to TI's product mix. With little customer overlap, WillowTree also diversifies TI's customer base, which has historically been concentrated within tech and games. We see upside for the combined business as TI explores cross-selling opportunities. We retain our Outperformer rating and \$39 price target.

### Key Points

**What Did TELUS Buy?:** WillowTree was founded in 2008 and offers a mix of design-and-build digital solutions including product and content design, tech/systems implementation, data engineering, analytics, and optimization. WillowTree has seen very strong and profitable growth, with H1/22 revenue of \$94MM, up 48% Y/Y, and adjusted EBITDA margins of 20%. The company operates 13 global studios, primarily in the U.S. and Europe, with its recent Poatek acquisition adding two new geographies (Brazil and Portugal). WillowTree employs over 1,000 digital strategists, designers, engineers, and project managers.

**Strategic Rationale:** WillowTree adds higher-value design-and-build capabilities and strong revenue per employee (\$190k). We see the transaction as complementary to TI from a domain and industry vertical perspective. The acquisition significantly enhances TI's front-end design-and-build capabilities and adds cross-selling capabilities. WillowTree brings 45 new customers to TI that present cross-sell opportunities, while TI looks to leverage WillowTree's best-in-class design-and-build capabilities to provide its 600 customers with enhanced digital experiences.

**Terms:** TELUS International is acquiring WillowTree for an enterprise value of \$1.225B. The purchase price equates to 8.75x F2021 revenue. The transaction is being funded with \$940MM in cash from TI's upsized and extended credit facilities, \$125MM in subordinate shares, and \$160MM reinvested by certain eligible WillowTree management team members. Following the close of the transaction, we calculate that TELUS International would have pro forma leverage of ~3.0x, up from 1.5x at the end of its most recent quarter.

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### Outperformer

TIXT-NYSE, Sector: Information Technology

Current Price (10/27/22): US\$25.91

Price Target (12-18 mos.): US\$39.00

### CIBC Estimates and Valuation

| (Dec. 31)        | 2020   | 2021   | 2022   | 2023   |
|------------------|--------|--------|--------|--------|
| Adj. EPS         | 0.71A  | 1.01A  | 1.20E  | 1.51E  |
| Adj. EBITDA(mln) | 394.9A | 540.0A | 619.6E | 729.7E |

| Adj. EPS | Q1    | Q2    | Q3    | Q4    |
|----------|-------|-------|-------|-------|
| 2022     | 0.26A | 0.30E | 0.31E | 0.34E |
| 2021     | 0.23A | 0.24A | 0.26A | 0.28A |

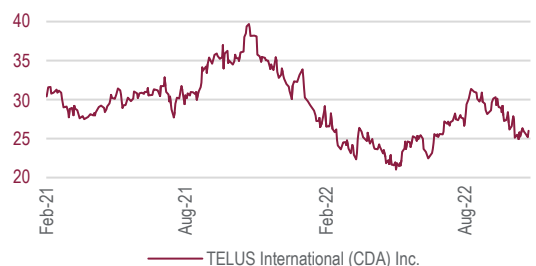
| Adj. EBITDA(mln) | Q1     | Q2     | Q3     | Q4     |
|------------------|--------|--------|--------|--------|
| 2022             | 142.0A | 150.0E | 155.3E | 172.3E |
| 2021             | 129.0A | 131.0A | 137.0A | 143.0A |

| Valuation | 2020  | 2021  | 2022  | 2023  |
|-----------|-------|-------|-------|-------|
| P/E       | 36.5x | 25.6x | 21.6x | 17.1x |
| EV/EBITDA | 18.2x | 13.3x | 11.6x | 9.8x  |

### Stock Performance and Key Indicators

|                 |                       |               |         |
|-----------------|-----------------------|---------------|---------|
| Avg. Dly. Vol.: | 80K                   | Shares O/S:   | 259.3M  |
| Market Cap.:    | US\$6,720M            | Float:        | 228.5M  |
| 52-wk Range:    | US\$21.06 - US\$38.32 | 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 (10/27/22) US\$25.91 12-18 mo. Price Target US\$39.00

Sector: Information Technology

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| Key Financial Metrics | 2020   | 2021   | 2022E  | 2023E  |
|-----------------------|--------|--------|--------|--------|
| Sales Growth          | 60.0%  | 32.6%  | 17.4%  | 15.0%  |
| Per Share Data        | 2020   | 2021   | 2022E  | 2023E  |
| Diluted EPS           | 0.46   | 0.30   | 0.69   | 0.93   |
| Adj. EPS Dil.         | 0.71   | 1.01   | 1.20   | 1.51   |
| Wgt Avg # of Shares   | 224.2  | 261.7  | 266.0  | 266.0  |
| FD Number of Shares   | 225.5  | 264.2  | 269.0  | 269.0  |
| Income Statement      | 2020   | 2021   | 2022E  | 2023E  |
| Revenue               | 1,582  | 2,194  | 2,576  | 2,963  |
| Cost of Goods Sold    | 649    | 0      | 0      | 0      |
| Gross Profit          | 1,006  | 2,194  | 2,576  | 2,963  |
| Tot Operating Exp     | 626    | 1,752  | 2,005  | 2,272  |
| OpEx (% of Revenue)   | 39.55% | 79.85% | 77.84% | 76.69% |
| Adj. EBITDA           | 395    | 540    | 620    | 730    |
| Adj EBITDA Margin     | 25.0%  | 24.6%  | 24.1%  | 24.6%  |
| Net Income            | 103    | 78     | 187    | 250    |
| Adjusted Net Income   | 160    | 267    | 323    | 407    |
| Adjusted Net Margin   | 10.1%  | 12.2%  | 12.5%  | 13.7%  |
| Cash Flow Statement   | 2020   | 2021   | 2022E  | 2023E  |
| Net CFO               | 263    | 282    | 597    | 353    |
| Capex                 | (59)   | (99)   | (104)  | (120)  |
| Free Cash Flow        | 204    | 183    | 493    | 233    |
| Balance Sheet         | 2020   | 2021   | 2022E  | 2023E  |
| Cash & ST Investment  | 152    | 115    | 276    | 93     |
| Intangible Assets     | 1,294  | 1,158  | 981    | 809    |
| Goodwill              | 1,500  | 1,380  | 1,327  | 1,327  |
| Total Assets          | 3,745  | 3,626  | 3,607  | 3,447  |
| ST Int-Bearing Debt   | 92     | 328    | 318    | 318    |
| LT Int-Bearing Debt   | 1,673  | 820    | 593    | 265    |
| Total Liabilities     | 2,634  | 1,971  | 1,803  | 1,393  |
| Shareholders' Equity  | 1,111  | 1,655  | 1,805  | 2,054  |
| Tot Liab & SE         | 3,745  | 3,626  | 3,608  | 3,447  |

Source: FactSet, Company Reports &amp; 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\$39.00**

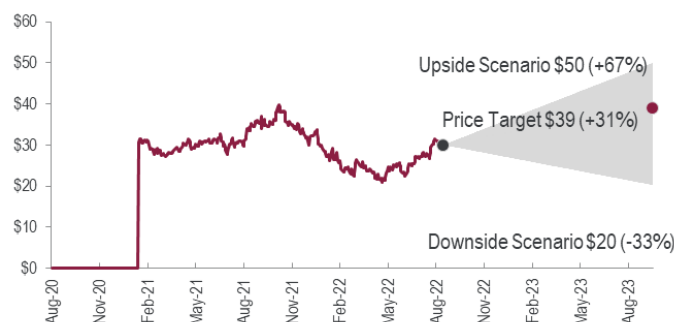
Our Price Target is calculated using 15% revenue growth, 24.6% EBITDA margins and a 15.0x EV/EBITDA multiple.

**Upside Scenario: US\$50.00**

Our upside scenario is calculated using 20% revenue growth, 25.0% EBITDA margins and a 18.0x EV/EBITDA multiple.

**Downside Scenario: US\$20.00**

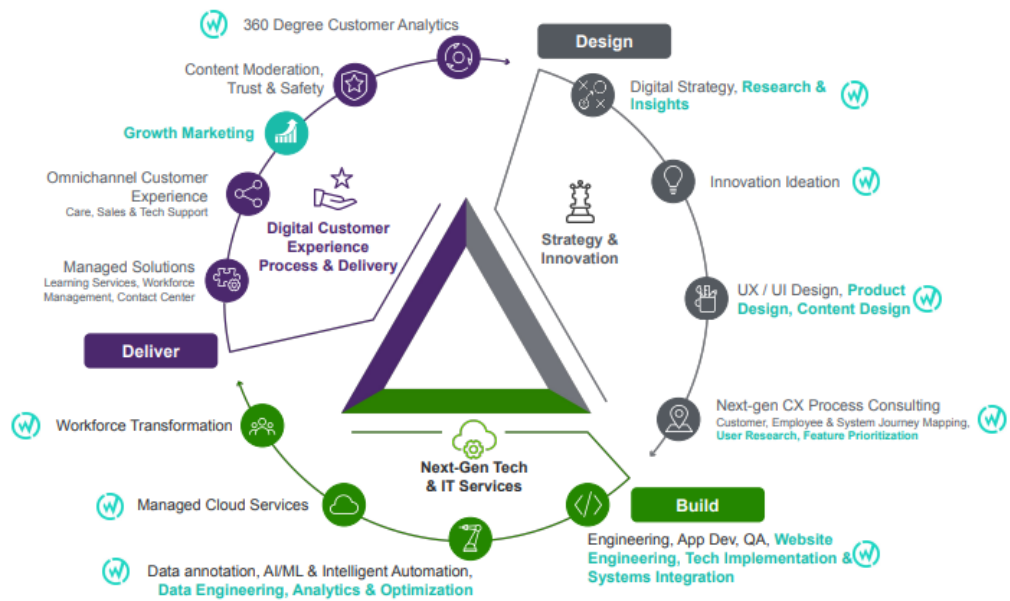
Our downside scenario is calculated using 10% revenue growth, 19.5% EBITDA margins and a 11.0x EV/EBITDA multiple.



## Strategic Rationale

We see the WillowTree acquisition as complementary to TI's existing solution set. The acquisition helps to accelerate growth, allowing TI to expand its design-and-build solution set and extend its potential product reach into existing customers.

**Exhibit 1: TI Service Offering Pro Forma WillowTree**



Source: Company reports and CIBC World Markets Inc.

The acquisition also improves client diversification, adding 45 new customers in a variety of industries including financial services, consumer, media, travel, healthcare, restaurants, and technology. Key clients include Manulife, Fox, Mastercard, HBO, Synchrony, CBC, AB InBev, Marriott, and Pepsico.

## Transaction Details

TELUS International is acquiring WillowTree for total enterprise value of US\$1.225B, inclusive of \$210MM of assumed debt. The \$1.225B purchase price represents an 8.75x EV/Sales multiple on F2021 revenue.

The transaction is being funded with \$125MM in subordinate shares, \$940MM in cash from upsized and extended TI credit facilities, and \$160MM reinvested by certain eligible WillowTree management team members. Following the close of the transaction, we calculate that TELUS International would have pro forma leverage of ~3.0x, up from 1.5x at the end of its most recent quarter. Management expects to reduce leverage over the subsequent quarters through cash flow generation. We are forecasting \$233MM in FCF for TI in F2023 and expect WillowTree to contribute to the FCF generation once the transaction closes.

**Exhibit 2: TIXT – WillowTree Acquisition, Financing Structure**

| <b>Estimated Financing Structure (US\$ millions)</b> |           |              |
|--|-----------|--------------|
| <b>Uses</b>  |           |              |
| Acquisition of WillowTree                            | \$        | 1,015        |
| WillowTree Debt                                      | \$        | 210          |
| <b>Total Uses</b>                                    | <b>\$</b> | <b>1,225</b> |
| <b>Sources</b>                                       |           |              |
| TI Transaction Debt (including WillowTree debt)      | \$        | 940          |
| TI Subordinated shares                               | \$        | 125          |
| WillowTree management reinvestment                   | \$        | 160          |
| <b>Total Sources</b>                                 | <b>\$</b> | <b>1,225</b> |

Source: Company reports and CIBC World Markets Inc.

**Pro Forma Financials**

Pro forma, WillowTree increases TI's F2021 revenue and EBITDA by ~5%. The WillowTree business appears well run, with a solid adjusted EBITDA margin and low capex requirements. With adjusted EBITDA margins of 20%, we expect that the majority of the synergies will be found through cross-selling opportunities. We will update our financial model with the close of the transaction, which is expected in January 2023.

**Exhibit 3: Pro Forma Revenue – TIXT And WillowTree, F2021**

| <b>US\$ in millions</b>     | <b>TIXT</b> | <b>WillowTree</b> | <b>Pro Forma Combined</b> |
|-----------------------------|-------------|-------------------|---------------------------|
| <b>Revenue (F2021)</b>      | 2,194       | 140               | 2,334                     |
| <b>Adj. EBITDA (F2021)</b>  | 540         | 28                | 568                       |
| <b>Adj. EBITDA Margin</b>   | 25%         | 20%               | 24%                       |
| <b>Net Debt</b>             | 928         |                   | 1,868                     |
| <b>Net Debt/EBITDA</b>      | 1.5x        |                   | ~3x                       |
| <b>Revenue per employee</b> | ~37K        | ~190K             | ~46.2K                    |

Source: Company reports and CIBC World Markets Inc.

Note: Net debt/EBITDA is calculated based on TTM period using EBITDA per credit facility agreement (includes lease payments that are backed out of Adjusted EBITDA).

## Price Target Calculation

We derive our price target of \$39.00 by applying a 15.0x EV/EBITDA to our 2023 EBITDA estimate based on the current capital structure. The 15.0x multiple is a blended average of Digital Services, BPO, and IT services peers.

## Key Risks To Price Target

The primary risks 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. |
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|----------------|--------------|---|
| Overweight     | O            | Sector is expected to outperform the broader market averages.               |
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| Neutral             | 135   | 45%     | Neutral                    | 135   | 100%    |
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