

# EQUITY RESEARCH

August 7, 2022

Company Update

## TELUS INTERNATIONAL (CDA) INC.

Strong Execution In An Unsettled Environment

### Our Conclusion

TELUS International (TI) continues to execute despite macro headwinds, with 21% constant currency revenue growth in Q2 and reiterated guidance that implies 20%-22% constant currency growth in 2022. TI is navigating an uncertain environment well, adding a record number of new hires to accommodate accelerating client demand. While recessionary concerns persist, TI's diversified customer base and client value proposition have offset past headwinds and we see the company as being well positioned to help customers reduce costs in the current environment. We view TI as undervalued at these levels, trading at 11.5x EV/EBITDA versus a blended average of digital services, BPO and IT Services peers at 13.5x. We retain our Outperformer rating and \$39 price target.

### Key Points

**Well Positioned To Win Share:** Within a more difficult macro environment, we believe that TI is well positioned to win share as clients consolidate vendors and look to reduce costs through automation/outsourcing. Management noted a sales funnel in excess of \$2.4B, with clients looking for providers with end-to-end capabilities. TI appears to be winning share in data annotation with its data solutions business growing double digits versus its closest public competitor (Appen), which reported a 7% revenue decline in H1.

**Navigating A Rising Cost Environment:** TI continues to manage inflationary pressures and a tight labour market well, with the company adding 1,286 employees in the quarter. While layoffs have started in some areas of the tech sector, TI has increased its headcount 2% sequentially and 23% Y/Y given accelerating demand for AI and CX services as companies look to manage costs and automate to increase operational efficiencies. TI expects wage inflation to continue for the remainder of the year, but is able to mitigate these pressures through price increases and automation initiatives.

**Managing FX Headwinds:** FX headwinds are expected to persist for the remainder of the year, with roughly one-third of TI's revenue euro denominated and impacted by the appreciating U.S. dollar. The reiterated guidance suggests that without the FX impact, revenue growth would be in the 20%-22% range (up from 19%-21% last quarter) and the margin guide would have been up 20 bps. to 30 bps.

**M&A Is Upside:** We see TI as well positioned to execute on M&A, with leverage of 1.5x and \$911MM in available liquidity. We believe the focus will be on targets that add technical adjacencies to its solutions and can be sold to its high-growth verticals. The company is indifferent between tuck-ins or larger transformational deals if the transaction meets their hurdle rates.

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### Outperformer

TIXT-NYSE, Sector: Information Technology

Current Price (8/5/22): US\$28.71

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	1.52E
Prior			1.19E	
Adj. EBITDA(mln)	394.9A	540.0A	621.1E	731.5E
Prior			620.4E	732.5E
Adj. EPS	Q1	Q2	Q3	Q4
2022	0.26A	0.30A	0.31E	0.34E
Prior		0.29E		
2021	0.23A	0.24A	0.26A	0.28A
Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	142.0A	150.0A	156.7E	172.3E
Prior		149.3E		
2021	129.0A	131.0A	137.0A	143.0A
Valuation	2020	2021	2022	2023
P/E	40.5x	28.4x	23.9x	18.9x
EV/EBITDA	18.2x	13.3x	11.6x	9.8x

### Stock Performance and Key Indicators

Avg. Dly. Vol.:	79K	Shares O/S:	259.3M
Market Cap.:	US\$7,445M	Float:	228.5M
52-wk Range:	US\$21.06 - US\$39.69	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 (8/5/22) US\$28.71 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%	17.7%	15.0%
Per Share Data	2020	2021	2022E	2023E
Diluted EPS	0.46	0.30	0.70	0.93
Adj. EPS Dil.	0.71	1.01	1.20	1.52
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	2,582	2,971
Cost of Goods Sold	649	0	0	0
Gross Profit	1,006	2,194	2,582	2,971
Tot Operating Exp	626	1,752	2,010	2,278
OpEx (% of Revenue)	39.55%	79.85%	77.85%	76.69%
Adj. EBITDA	395	540	621	731
Adj EBITDA Margin	25.0%	24.6%	24.1%	24.6%
Net Income	103	78	187	250
Adjusted Net Income	160	267	324	408
Adjusted Net Margin	10.1%	12.2%	12.5%	13.7%
Cash Flow Statement	2020	2021	2022E	2023E
Net CFO	263	282	578	353
Capex	(59)	(99)	(104)	(120)
Free Cash Flow	204	183	474	233
Balance Sheet	2020	2021	2022E	2023E
Cash & ST Investment	152	115	276	94
Intangible Assets	1,294	1,158	980	808
Goodwill	1,500	1,380	1,327	1,327
Total Assets	3,745	3,626	3,608	3,448
ST Int-Bearing Debt	92	328	318	318
LT Int-Bearing Debt	1,673	820	593	265
Total Liabilities	2,634	1,971	1,805	1,394
Shareholders' Equity	1,111	1,655	1,805	2,055
Tot Liab & SE	3,745	3,626	3,610	3,449

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



## Financial Summary

TI reported Q2 revenue of \$624MM (consensus \$622MM), adjusted EBITDA of \$150MM (consensus \$145MM) and adjusted EPS of \$0.30 (consensus \$0.27).

### Exhibit 1: TIXT – Financial Summary, Q2/22

	Q2 2022			Q2/F21	Y/Y%	Q1/F22	Q/Q%
	Actual	CIBCe	Cons				
Consolidated							
Revenue (\$mm)	624	628	622	533	17.1%	599	4.2%
Tech & Games	287	295	NA	244	18%	280	2.5%
Comm. & Media	143	145	NA	132	8%	139	2.9%
eCommerce	77	85	NA	61	26%	77	0.0%
Other	117	102	NA	96	22%	103	13.6%
EBITDA (\$mm)	150	149	145	131	15%	142	5.6%
EBITDA Margin	24.0%	23.8%	23.3%	24.6%	-2%	23.7%	1.4%
Adjusted EPS	0.30	0.29	0.27	0.24	24%	0.26	17.4%

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

**Free Cash Flow:** Free cash flow of \$60MM was above consensus expectations of \$54MM. The company had \$89MM in CFO, down from \$96MM a year ago and \$29MM in capex (versus \$24MM in the year-ago quarter).

**Leverage Update:** TI reduced debt by \$73MM, ending the quarter with leverage of 1.5x, down from 1.8x sequentially. Total liquidity is \$911MM through a combination of cash and revolver availability.

**Changes To Our Model:** We have updated our model to reflect recent results, with no changes made to the F2022 outlook.

### Exhibit 2: TIXT – Changes To Our Model, 2021 – 2023E

	Revenues (\$MM)	EBITDA (\$MM)	Adjusted EPS	CFO (\$MM)
<b>2021</b>	2,194	540	1.01	282
<b>2022E</b>				
CIBC est. – new	2,582	621	1.20	578
CIBC est. – prior	2,586	620	1.19	558
Consensus	2,574	620	1.20	464
<b>2023E</b>				
CIBC est. – new	2,971	731	1.52	353
CIBC est. – prior	2,975	732	1.52	354
Consensus	2,942	733	1.43	465

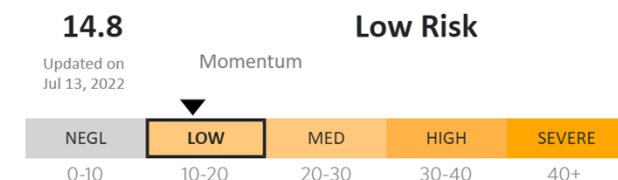
Source: Company reports and CIBC World Markets Inc.

## 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



## Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK (1 <sup>st</sup> = lowest risk)	PERCENTILE (1 <sup>st</sup> = lowest risk)
Global Universe	1297/14899	10th
Software & Services INDUSTRY	55/1023	6th
IT Consulting SUBINDUSTRY	17/214	8th

## 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
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## CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	8	0	Value	185	-1
Momentum	6	-1	Momentum	141	+33
Quality	7	0	Quality	91	0
Market	5	0	Market	77	+5
Low Volatility	4	0	Low Volatility	93	+8
Growth	6	0	Growth	75	0

Note: Ranking out of 14 stocks

Note: Ranking out of 239 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	B
Beta	NA	MACD	A
Volatility	↓	Alpha (Sector)	A
Trend	↑	Alpha (Index)	B
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 \$39.00 by applying a 15.0x EV/EBITDA to our 2023E EBITDA 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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Outperformer	OP	Stock is expected to outperform similar stocks in the coverage universe during the next 12-18 months.
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.
Restricted	R	CIBC World Markets is restricted (due to potential conflict of interest) from rating 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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Neutral	131	42%	Neutral	130	99%
Underperformer	8	3%	Underperformer	8	100%
Tender	3	1%	Tender	3	100%
Restricted	7	2%	Restricted	7	100%

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