

EQUITY RESEARCH

February 16, 2023

Company Update

TELUS INTERNATIONAL (CDA) INC.

Investor Day Highlights WillowTree Upside & The Market Opportunity

Our Conclusion

Telus International held its inaugural Investor Day, which focused on synergies from WillowTree, upside from AI, and the longer-term opportunity as TI transitions its revenue mix to higher-value digital IT solutions. In the medium term, TI is targeting mid- to high-teens organic growth and is looking to increase margins 100 bps - 200 bps over the next three years. Management also noted an aspirational target of growing the EV of the business by 10x over the next five years. We continue to see TI's stock as undervalued at these levels, trading at 8.3x EV/2024E EBITDA vs. a blend of BPO/IT Services/Digital Services peers at 11.4x despite TI's solid organic growth and best-in-class margins. We retain our Outperformer rating and \$30 price target.

Key Points

**WillowTree Opportunities:** WillowTree adds design/design applications to TI's develop/run offering, and both companies see attractive cross-selling synergies given the complementary product suite. TI expects to start seeing cross-selling synergies in four to six months, and we expect some of the early wins could come from TELUS (with multiple opportunities including TELUS Health and TELUS Ag). WillowTree has a long-term blue chip customer base (~60 customers), and the company has been asked to support/maintain its solutions in the past but did not have the capabilities. WillowTree has little overlap with TI's ~600 customers, and we see opportunities to cross-sell develop/design capabilities into its base. TI reiterated its expectation that WillowTree will be on its margin profile by F2024.

**AI Interest Leading To Near-term Opportunities:** Management noted that interest in Chat GPT has been driving customer discussions around cognitive AI. WillowTree is using AI in its developed solutions, and we see TI's data annotation business as a critical component of AI models. Within content moderation, we believe that context remains difficult for AI to determine and we expect that human intervention will remain crucial to the content moderation process for the foreseeable future.

**Mix Shifting To Higher Value Digital Solutions:** TI noted that post WillowTree, 52% of revenue is being driven by higher-value digital solutions, with Digital IT comprising 22% of overall revenue, AI Data Solutions (data annotation) 13%, and Trust & Safety (content moderation) 17%, with all three of these segments growing at a +20% CAGR. We expect this mix shift to continue to move towards digital services over time.

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Outperformer

TIXT-NYSE, Sector: Information Technology  
Current Price (2/13/23): US\$22.15  
Price Target (12-18 mos.): US\$30.00

CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
Adj. EPS	1.01A	1.23A	1.24E	1.50E
Adj. EBITDA(mln)	540.0A	607.0A	710.9E	818.9E

  

Adj. EPS	Q1	Q2	Q3	Q4
2022	0.26A	0.30A	0.32A	0.35A
2021	0.23A	0.24A	0.26A	0.28A

  

Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	142.0A	150.0A	158.0A	157.0A
2021	129.0A	131.0A	137.0A	143.0A

  

Valuation	2021	2022	2023	2024
P/E	21.9x	18.0x	17.9x	14.8x
EV/EBITDA	11.5x	10.2x	8.7x	7.6x

Stock Performance and Key Indicators

Avg. Dly. Vol.:	180K	Shares O/S:	270.0M
Market Cap.:	US\$5,981M	Float:	237.9M
52-wk Range:	US\$19.05 - 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 6. For required regulatory disclosures please refer to "Important Disclosures" beginning on page 7.

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

Price (2/13/23) US\$22.15 12-18 mo. Price Target US\$30.00

Sector: Information Technology

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Key Financial Metrics	2021	2022	2023E	2024E
Sales Growth	32.6%	12.5%	21.4%	12.2%
Per Share Data	2021	2022	2023E	2024E
Diluted EPS	0.30	0.68	0.75	0.95
Adj. EPS Dil.	1.01	1.23	1.24	1.50
Wgt Avg # of Shares	261.7	266.0	272.5	272.5
FD Number of Shares	264.2	269.3	276.5	276.5
Income Statement	2021	2022	2023E	2024E
<b>Revenue</b>	<b>2,194</b>	<b>2,468</b>	<b>2,996</b>	<b>3,362</b>
Cost of Goods Sold	0	0	0	0
<b>Gross Profit</b>	<b>2,194</b>	<b>2,468</b>	<b>2,996</b>	<b>3,362</b>
Tot Operating Exp	1,752	1,926	2,308	2,566
OpEx (% of Revenue)	79.85%	78.04%	77.04%	76.34%
<b>Adj. EBITDA</b>	<b>540</b>	<b>607</b>	<b>711</b>	<b>819</b>
Adj EBITDA Margin	24.6%	24.6%	23.7%	24.4%
<b>Net Income</b>	<b>78</b>	<b>183</b>	<b>207</b>	<b>263</b>
<b>Adjusted Net Income</b>	<b>267</b>	<b>332</b>	<b>343</b>	<b>414</b>
Adjusted Net Margin	12.2%	13.5%	11.4%	12.3%
Cash Flow Statement	2021	2022	2023E	2024E
<b>Net CFO</b>	<b>282</b>	<b>437</b>	<b>179</b>	<b>388</b>
Capex	(99)	(105)	(120)	(120)
<b>Free Cash Flow</b>	<b>183</b>	<b>332</b>	<b>59</b>	<b>268</b>
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	115	125	67	119
Intangible Assets	1,158	1,008	2,365	2,170
Goodwill	1,380	1,350	1,350	1,350
<b>Total Assets</b>	<b>3,626</b>	<b>3,556</b>	<b>5,273</b>	<b>5,375</b>
ST Int-Bearing Debt	328	83	83	83
LT Int-Bearing Debt	820	881	2,384	2,256
<b>Total Liabilities</b>	<b>1,971</b>	<b>1,718</b>	<b>3,227</b>	<b>3,067</b>
<b>Shareholders' Equity</b>	<b>1,655</b>	<b>1,838</b>	<b>2,045</b>	<b>2,308</b>
<b>Tot Liab &amp; SE</b>	<b>3,626</b>	<b>3,556</b>	<b>5,273</b>	<b>5,375</b>

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\$30.00**

Our Price Target is calculated using 15% revenue growth, 24.9% EBITDA margins and a 11.0x EV/EBITDA multiple

**Upside Scenario: US\$53.00**

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

**Downside Scenario: US\$18.00**

Our downside scenario is calculated using 10% revenue growth, 19.5% EBITDA margins and a 9.0x EV/EBITDA multiple



## 10x Over The Next Five Years

Management laid out the ambitious goal of growing the enterprise value of TELUS International by 10x over the next five years. The company did 10x its size between 2016-2021, and we expect the new target represents a similar mix of M&A and organic growth. While we see the target as ambitious, with strong organic growth rates in the base business and continued M&A, we also see a solid runway for significant growth over the next five years. Based on our math, TELUS International could get to 10x by F2027 assuming annual organic growth of 20%, annual M&A spend of \$1.5B at a take-out multiple of 1x sales and F2027 EBITDA margins of 28.2% at a 13x 2027 EV/EBITDA multiple.

### Exhibit 1: Assumption – 10x EV (F2023 To F2027)

#### Assumptions US\$MM (F2023 To F2027)

M&A Spend	\$	1,500
P/Sales Take-out Multiple		1.0x
Revenue Added	\$	1,500
F2027 EBITDA Margin		28.20%
Current Net Debt	\$	840
FCF Conversion		55%
Leverage		2.5x
Organic Growth		20.00%

	M&A Multiple (P/Sales)				
	1.0x	2.0x	3.0x	4.0x	5.0x
11.0x	8.3x	5.6x	4.7x	4.3x	4.0x
13.0x	9.8x	6.6x	5.6x	5.0x	4.7x
15.0x	11.3x	7.6x	6.4x	5.8x	5.4x
17.0x	12.8x	8.6x	7.3x	6.6x	6.2x
19.0x	14.3x	9.7x	8.1x	7.4x	6.9x

Source: Company reports and CIBC World Markets Inc.

## Telus Corp. Helping Offset Weakness From Other Verticals

The Investor Day highlighted TI's diversified customer base, with management noting that the Tech & Games strength through the pandemic offset a slowdown in Travel & Hospitality and other verticals. The environment has obviously changed since the pandemic, with the Ecommerce, Fintech and Tech and Games verticals impacted by the macro backdrop.

Amid the slowdown in Ecommerce (F2023 guidance assumes flat growth) and Tech & Games (modest growth) TI is expanding wallet share with TELUS Corporation. Revenue attributed to TELUS comprised 17.3% of F2022 revenue, up 20% Y/Y. We expect TELUS contributions will continue to grow at a healthy pace, with WillowTree adding incremental opportunities to engage in high value design and build work at TELUS and its subsidiaries.

In addition, TI has seen increased demand in its Travel and Hospitality vertical as travel opens up and the Healthcare vertical is also seeing an improved environment as efficiency becomes a focus and TI sees opportunities to expand wallet share with Telus Health.

## Revenue Growth And Margin Profile Superior To Comps

TI is trading below its peer set despite above average revenue growth and best-in-class margins. As noted in Exhibit 2, TI's revenue growth is forecasted to be 150 bps above the peer average in F2024E and margins 380 bps. At its Investor Day, TI noted a medium-term organic growth target of mid- to high-teens and a target to increase margins 100 bps-200 bps over the next three years, suggesting that 2024 estimates may be somewhat conservative.

Exhibit 2: TIXT And Peers – Financial Metrics, 2022 To 2024E

	Revenue Growth			EBITDA Margin			EBITDA Growth			FCF Yield Latest Fiscal Year
	2022	2023E	2024E	2022	2023E	2024E	2022	2023E	2024E	
<b>Next Generation Digital Services</b>										
EPAM Systems, Inc.	28%	16%	21%	18%	18%	19%	27%	16%	23%	NA
Globant SA	37%	21%	23%	20%	20%	20%	32%	20%	22%	NA
Appen Ltd.	-18%	7%	10%	4%	6%	9%	-82%	77%	56%	NA
Endava	33%	18%	23%	24%	30%	31%	24%	49%	23%	2.8%
<b>Average</b>	<b>20%</b>	<b>16%</b>	<b>19%</b>	<b>16%</b>	<b>19%</b>	<b>19%</b>	<b>0%</b>	<b>41%</b>	<b>31%</b>	<b>2.8%</b>
<b>Value-Added Business Process Management</b>										
Cognizant	7%	5%	5%	18%	19%	19%	8%	7%	8%	7.5%
Genpact Limited	16%	9%	7%	19%	19%	19%	34%	9%	11%	4.5%
Teleperformance SE (EUR)	16%	9%	9%	21%	21%	21%	24%	9%	9%	NA
WNS (Holdings)	26%	12%	11%	26%	26%	26%	50%	12%	10%	3.6%
ExlService Holdings, Inc.	25%	13%	11%	21%	22%	21%	45%	15%	6%	NA
<b>Average</b>	<b>18%</b>	<b>9%</b>	<b>9%</b>	<b>21%</b>	<b>21%</b>	<b>21%</b>	<b>32%</b>	<b>11%</b>	<b>9%</b>	<b>5.2%</b>
<b>Business Services</b>										
Accenture	28%	7%	9%	18%	19%	18%	24%	7%	8%	4.8%
Tata Consultancy Services	37%	10%	10%	26%	27%	27%	28%	13%	10%	2.9%
Capgemini	21%	5%	7%	16%	16%	17%	19%	5%	9%	NA
Infosys	34%	11%	11%	24%	25%	25%	14%	14%	12%	3.0%
CGI	15%	4%	4%	20%	20%	20%	11%	5%	2%	6.8%
TTEC	6%	4%	6%	13%	14%	13%	-1%	6%	3%	NA
DXC Technology	-13%	0%	0%	16%	16%	16%	-10%	-4%	1%	20.8%
<b>Average</b>	<b>18%</b>	<b>6%</b>	<b>6%</b>	<b>19%</b>	<b>19%</b>	<b>19%</b>	<b>12%</b>	<b>7%</b>	<b>7%</b>	<b>7.6%</b>
Telus International	12%	21%	12%	25%	24%	24%	12%	17%	15%	5.8%
<b>Overall Average</b>	<b>18.2%</b>	<b>10.2%</b>	<b>10.5%</b>	<b>19.4%</b>	<b>20.0%</b>	<b>20.2%</b>	<b>15.3%</b>	<b>16.5%</b>	<b>13.6%</b>	<b>6.2%</b>

Source: Company reports and CIBC World Markets Inc.

## Valuation Is Compelling

We see TI's stock as undervalued at these levels, trading at 8.3x EV/ 2024E EBITDA vs. a blend of BPO/IT Services/Digital Services peers at 11.4x. With an expanding percentage of revenue from Digital Services (52% post WillowTree), we see an argument for its multiple to continue to expand. Digital IT now represent 22% of revenue, up from 16% pre-acquisition. Digital IT peers are trading at 12.3x EV/ 2024E EBITDA given higher value mix of products and solutions.

## Exhibit 3: TIXT And Peers – Valuation, C2022 To C2024E

	Enterprise Value (\$mlns.)	EV/EBITDA			P/E			EV/S		
		C22	C23E	C24E	C22	C23E	C24E	C22	C23E	C24E
<b>Next Generation Digital Services</b>										
EPAM Systems, Inc.	19,450	22.2x	19.1x	15.5x	34.0x	29.2x	24.0x	4.0x	3.5x	0.9x
Globant SA	6,784	19.1x	15.9x	13.0x	33.1x	27.9x	22.7x	3.8x	3.2x	1.2x
Appen Ltd.	244	18.1x	9.5x	6.0x	NEG	NEG	>50	0.6x	0.6x	NEG
Endava Plc Sponsored ADR Class A	4,177	22.8x	18.2x	14.5x	35.6x	29.5x	23.8x	5.6x	4.5x	0.7x
<b>Next Generation Digital Services Average</b>		<b>20.5x</b>	<b>15.7x</b>	<b>12.3x</b>	<b>34.2x</b>	<b>28.9x</b>	<b>23.5x</b>	<b>3.5x</b>	<b>2.9x</b>	<b>0.9x</b>
<b>Value-Added Business Process Management</b>										
Cognizant Technology Solutions Corporation Class A	33,694	9.5x	9.4x	8.8x	15.3x	15.0x	13.9x	1.7x	1.7x	1.6x
Genpact Limited	9,789	12.4x	11.3x	10.3x	17.5x	16.1x	14.4x	2.2x	2.1x	1.9x
<b>Telus International</b>	<b>6,809</b>	<b>11.2x</b>	<b>9.6x</b>	<b>8.3x</b>	<b>17.9x</b>	<b>17.8x</b>	<b>14.8x</b>	<b>2.8x</b>	<b>2.3x</b>	<b>2.0x</b>
Teleperformance SA (EUR)	16,914	9.9x	9.0x	8.3x	18.5x	16.5x	14.8x	2.1x	1.9x	1.7x
WNS (Holdings) Limited Sponsored ADR	4,463	15.3x	13.8x	12.4x	23.7x	21.5x	19.1x	4.0x	3.6x	3.2x
TaskUs, Inc. Class A	2,061	9.4x	8.8x	7.5x	13.8x	13.8x	11.7x	2.2x	2.1x	1.8x
Majorel Group Luxembourg S.A.	2,340	6.8x	6.3x	5.7x	13.3x	12.5x	11.2x	1.2x	1.1x	1.0x
Concentrix Corporation	10,261	9.9x	NA	NA	12.6x	NA	NA	1.6x	NA	NA
ExlService Holdings, Inc.	5,906	19.9x	17.2x	16.2x	29.7x	26.6x	23.4x	4.2x	3.7x	3.4x
<b>Value-Added Business Process Management Average</b>		<b>11.6x</b>	<b>10.7x</b>	<b>9.7x</b>	<b>18.0x</b>	<b>17.5x</b>	<b>15.4x</b>	<b>2.4x</b>	<b>2.3x</b>	<b>2.1x</b>
<b>IT Services &amp; Consulting</b>										
<b>CGI Inc. Class A (CAD)</b>	<b>32,049</b>	<b>13.0x</b>	<b>11.5x</b>	<b>11.1x</b>	<b>19.8x</b>	<b>17.7x</b>	<b>16.9x</b>	<b>2.4x</b>	<b>2.3x</b>	<b>2.2x</b>
Accenture Plc Class A	186,930	16.2x	15.3x	14.2x	26.2x	24.3x	22.0x	3.0x	2.8x	2.6x
TTEC Holdings, Inc.	3,302	10.3x	9.7x	9.4x	14.5x	13.7x	14.7x	1.4x	1.3x	1.2x
Tata Consultancy Services Limited (INR)	12,306,429	21.2x	18.9x	17.0x	30.7x	27.2x	24.2x	5.7x	5.1x	4.6x
Infosys Limited (INR)	6,576,030	19.0x	16.7x	14.8x	27.7x	24.2x	21.2x	4.6x	4.1x	3.7x
<b>IT Services &amp; Consulting Average</b>		<b>15.9x</b>	<b>14.4x</b>	<b>13.3x</b>	<b>23.8x</b>	<b>21.4x</b>	<b>19.8x</b>	<b>3.4x</b>	<b>3.1x</b>	<b>2.9x</b>
<b>Overall Average</b>		<b>14.8x</b>	<b>13.0x</b>	<b>11.4x</b>	<b>22.6x</b>	<b>20.8x</b>	<b>18.3x</b>	<b>2.9x</b>	<b>2.7x</b>	<b>2.1x</b>

Source: Company reports and CIBC World Markets Inc.

## Price Target Calculation

We derive our price target of \$30.00 by applying an 11.0x EV/EBITDA to our 2024E EBITDA estimate based on the current capital structure. The 11.0x 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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Stock Ratings	Abbreviation	Description
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.

Sector Ratings	Abbreviation	Description
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

For price and performance charts, please visit CIBC on the web at <https://researchcentral.cibccm.com/#/disclaimer-central-new> or write to CIBC World Markets Inc., 161 Bay Street, 4th Floor, Toronto, ON M5H 2S8, Attn: Research Disclosure Chart Request.

## Important Disclosure Footnotes for TELUS International (CDA) Inc. (TIXT.N)

- 2g CIBC World Markets Inc. expects to receive or intends to seek compensation for investment banking services from these companies in the next 3 months: TELUS International (CDA) Inc.
- 7 CIBC World Markets Corp., CIBC World Markets Inc., and their affiliates, in the aggregate, beneficially own 1% or more of a class of equity securities issued by these companies: TELUS International (CDA) Inc.
- 12 The equity securities of these companies are subordinate voting shares: TELUS International (CDA) Inc.

For important disclosure footnotes for companies mentioned in this report that are covered by CIBC World Markets Inc., click here: [CIBC Disclaimers & Disclosures](#)

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(as of 16 Feb 2023)	Count	Percent	Inv. Banking Relationships	Count	Percent
Outperformer	148	49%	Outperformer	147	99%
Neutral	132	44%	Neutral	131	99%
Underperformer	7	2%	Underperformer	6	86%
Tender	3	1%	Tender	3	100%
Restricted	10	3%	Restricted	10	100%

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