

# EQUITY RESEARCH

February 16, 2023

Company Update

## TELUS INTERNATIONAL (CDA) INC.

Investor Day Highlights WillowTree Upside &amp; 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.

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.

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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

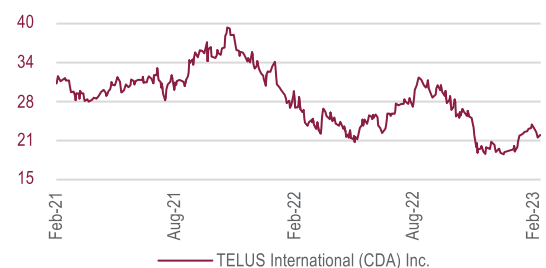
Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	142.0A	150.0A	158.0A	157.0A
2021	129.0A	131.0A	137.0A	143.0A

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)

**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
Revenue	2,194	2,468	2,996	3,362
Cost of Goods Sold	0	0	0	0
Gross Profit	2,194	2,468	2,996	3,362
Tot Operating Exp	1,752	1,926	2,308	2,566
OpEx (% of Revenue)	79.85%	78.04%	77.04%	76.34%
Adj. EBITDA	540	607	711	819
Adj EBITDA Margin	24.6%	24.6%	23.7%	24.4%
Net Income	78	183	207	263
Adjusted Net Income	267	332	343	414
Adjusted Net Margin	12.2%	13.5%	11.4%	12.3%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	282	437	179	388
Capex	(99)	(105)	(120)	(120)
Free Cash Flow	183	332	59	268
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
Total Assets	3,626	3,556	5,273	5,375
ST Int-Bearing Debt	328	83	83	83
LT Int-Bearing Debt	820	881	2,384	2,256
Total Liabilities	1,971	1,718	3,227	3,067
Shareholders' Equity	1,655	1,838	2,045	2,308
Tot Liab & SE	3,626	3,556	5,273	5,375

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
2027 EV/EBITDA Multiple	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	
Next Generation Digital Services										
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%
Average	20%	16%	19%	16%	19%	19%	0%	41%	31%	2.8%
Value-Added Business Process Management										
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
Average	18%	9%	9%	21%	21%	21%	32%	11%	9%	5.2%
Business Services										
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%
Average	18%	6%	6%	19%	19%	19%	12%	7%	7%	7.6%
Telus International	12%	21%	12%	25%	24%	24%	12%	17%	15%	5.8%
Overall Average	18.2%	10.2%	10.5%	19.4%	20.0%	20.2%	15.3%	16.5%	13.6%	6.2%

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
Next Generation Digital Services										
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
Next Generation Digital Services Average		20.5x	15.7x	12.3x	34.2x	28.9x	23.5x	3.5x	2.9x	0.9x
Value-Added Business Process Management										
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
Telus International	6,809	11.2x	9.6x	8.3x	17.9x	17.8x	14.8x	2.8x	2.3x	2.0x
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
Value-Added Business Process Management Average		11.6x	10.7x	9.7x	18.0x	17.5x	15.4x	2.4x	2.3x	2.1x
IT Services & Consulting										
CGI Inc. Class A (CAD)	32,049	13.0x	11.5x	11.1x	19.8x	17.7x	16.9x	2.4x	2.3x	2.2x
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
IT Services & Consulting Average		15.9x	14.4x	13.3x	23.8x	21.4x	19.8x	3.4x	3.1x	2.9x
Overall Average		14.8x	13.0x	11.4x	22.6x	20.8x	18.3x	2.9x	2.7x	2.1x

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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