

September, 26, 2017

Paycom Software Inc: PAYC

Kevin Boland

Sector: Information Technology

Industry: Application Software

Current Price: \$74.75

Target Price: \$91.34

Company Description: Paycom Software, Inc. provides cloud-based human capital management (HCM) solutions, in the form of software as a service (SaaS) for small to midsize U.S. companies. Paycom assists in tracking the employment life cycle by providing data analytics and a range of applications for these companies to utilize. Included in these applications are the tools to track and manage talent acquisition, labor management, payroll, human resources and more.

BUY

Current Price:	\$74.75
Target Price:	\$91.34
Market Cap:	4.4B
Beta:	1.72
EBITDA Margin:	16.4%
ROE:	39.89%
WACC:	9.6%
ROIC:	21.62%

Catalysts:

- **Short Term (within the year):** Strong earnings report and unique product package.
- **Mid Term (1-2 years):** Market expansion in existing and foreign markets
- **Long Term (3+):** Focus on innovation through research and development to combat high industry competition.

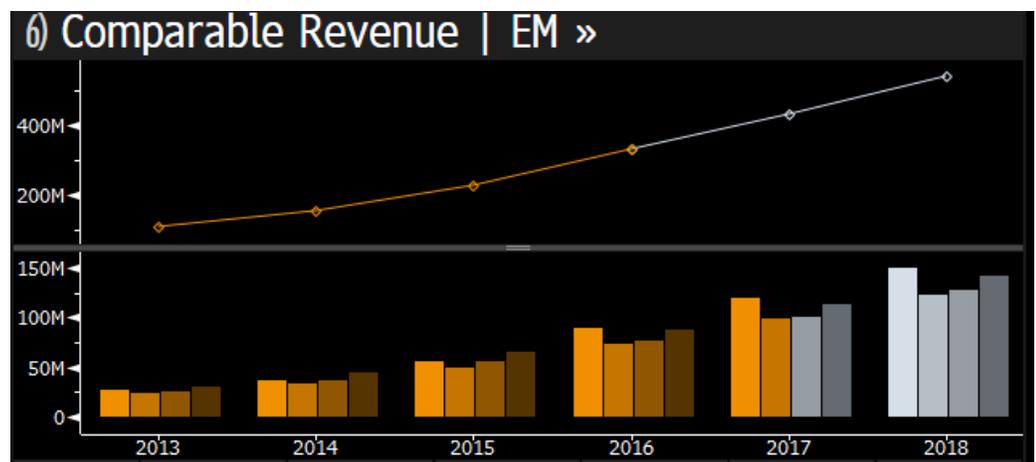


Thesis:

Paycom represents an opportunity for growth in the short and long term. The information technology industry alone is a great investment based on the constant need for innovation and simplification of tasks in the business sector. Combined with Paycom's outperforming revenues and tremendous quarter over quarter growth, the company has established a solid foundation for success. To continue this success and boost sales even higher, Paycom has begun to solidify its position in existing markets, while at the same time expanding into new markets. The U.S. based company eventually plans on expanding internationally, opening up a whole new world of opportunity. To solidify its position long-term, Paycom focuses on innovation through research and development. In this highly competitive industry, Paycom is aware that product differentiation means everything.

Earnings Performance:

Paycom's earnings are seasonal with Q1 being the most rewarding. There is usually a drop in Q2 and a steady rise in revenues to finish the year. This can be attributed to the fact that most companies process their payroll forms in Q1. However, Paycom's Q2 earnings for 2017 were quite promising. Paycom's founder and CEO, Chad Richison stated "Our second-quarter results reflect the strength of our position as more companies look to technology to help attract, retain and manage their talent". Revenues soared to \$98.2 million, an increase of 33% from Q2 of 2016. Paycom even posted its highest sales week in the history of the company. This being in what



is supposed to be their, seasonally, worst quarter. Revenues are expected to be similar in the following quarter, with the ability to break \$100 million. A high client satisfaction record has helped retain revenue at an annual rate of 91% over the last three years. This repeat business drives revenue and provides a solid base if non-repeat sales are low. Another key factor of the earnings report was an increase in EBITDA from \$22.6 million Q2 2016 to \$27.8 million Q2 2017. This increase and already high number relative to revenue shows that Paycom's business structure has produced consistent organic growth. EBITDA is one of the most important factors when trying to decide if a company has real ability to grow on its own or not.

Industry Outlook:

The information technology industry has been quite successful this year. This industry is fueled by tremendous investment in research and development that ultimately produces excellent products. Software as a service (SaaS), Paycom's main product, is one of the driving forces behind innovation in this industry. 57%

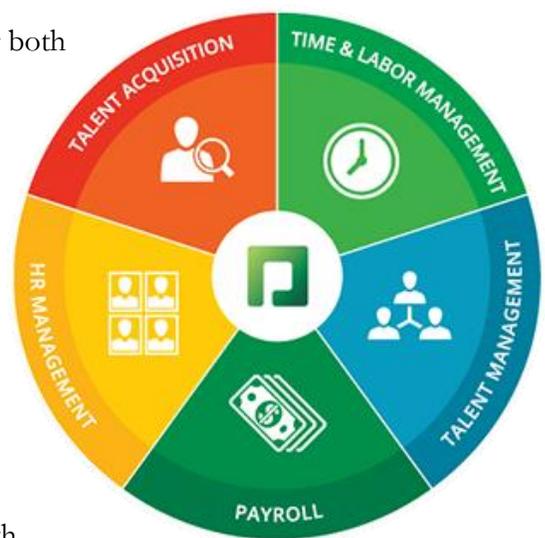


of software decision makers in the U.S. have used SaaS to complement or replace existing applications. The presence of cloud-computing and big data represent other lucrative investment opportunities for information technology companies to build their business model around. Cloud adoption is still in an earlier stage of growth. This gives small-medium companies, such as Paycom, a chance to emerge from the pack. This can be done mainly

through the quality of the product and the ability to meet the ever-changing demands of the consumer. More and more technology companies are expanding into different sectors globally and redefining what it means to be an information technology company (Amazon, Apple, and Facebook). While Paycom has nowhere near the product package as those companies, it shows the ability for expansion of a technology company into a business segment. There is an ability to find a niche in this rapidly growing, competitive industry. In order to stay relevant here companies, must be able to adapt to change.

Product Differentiation:

Paycom's end to end SaaS HCM solution is very helpful for both employees and employers. Employers are given the data and applications to analyze and track employees from recruiting to retirement. The software allows for employers to have every resource needed to perform HR duties and more. On the other end, Employees can also view pay stubs, W-2's, benefits information and manage vacation time in their own employee portal. What makes Paycom's HCM software stand out from other competitors are its centralized applications and its easy adoption by clients. While there are many competitors who offer products that overlap with Paycom's, few to none of them offer these in one package. Most companies utilize multiple software's, sometimes from different suppliers to fulfill their HCM needs. With Paycom's product, only one software is needed. There is low customization, which makes implementation of the software easier. The user-friendly software allows for a decreased administrative burden on employers



and an increased employee productivity. By not wasting time training employees on how to use the software, precious time and money is saved by the employer.

Market Expansion:

Paycom hopes to gain market share from large competitors in the HR services industry, such as ADP and SAP. Paycom is currently positioned in 32 of the 50 largest metropolitan areas in the U.S. They plan to incorporate multiple sales teams within these areas so that a greater number of people are reached in high business areas. Along with this, Paycom has begun to target larger employers in hopes of increasing the company's revenues per client. In their expansion efforts, Paycom plans to open 10 to 14 additional offices over the next two years, with potential of eventually expanding internationally. Paycom currently only operates in the U.S. but the need for HCM services exist everywhere. These new offices will be run by existing managers from day one to ensure a smooth transition. They have also staggered the openings of these offices so that disruption of activities are kept at a minimum. A new office at Paycom usually reaches its sales maturity in around 24 months. The opening of new offices throughout the years has been quite successful. As you can see below, the number of clients has consistently increased as more and more sales offices have opened in different areas. The retention of these clients is one of the drivers of revenue. Paycom's has done a great job at this with the annual revenue retention rate of 91% over the last three years. Paycom's opening of new offices will further expand these numbers and acquire clients who are committed to repeat business.

	Year Ended December 31,		
	2016	2015	2014
Key performance indicators:			
Clients	17,817	15,004	12,775
Clients (based on parent company grouping)	10,464	8,906	7,945
Sales teams	42	36	31
Annual revenue retention rate	91%	91%	91%

Focus on Research and Development:

Since the beginning of operations, Paycom has made Research and Development a main priority. They invested early in the company’s cloud based architecture that enables them to develop and deploy applications quickly and affordably. They have also strategically picked out their technology team from Oklahoma and Texas. This decision produced high-quality talent for a lower price, compared to other areas of the country. Because of cost-effective decisions like these, Paycom has been able to raise R&D expenses over the last three years by 143%, 99% and 102%, respectively. Despite these increases in R&D, R&D expenses to sales (R&D intensity) remain low at 6.37%. In the Q2 earnings call, Richison stated “I mean, we’ve increased our R&D anywhere from 80% to 100% each quarter of a prior year quarter. And we’ve also been able to expand the margin. And that’s because the R&D expenses are turning into revenue generating products that the clients are able to use”. He sees this low R&D intensity as a testament to its effectiveness. R&D expenses are turning into revenue generating products in cost-effective and timely manner. The quality of the research has been a catalyst behind sales. In fact, Paycom had the top trending app on the iOS Apple Store for employee self-service. The app was launched in July and Richison credits R&D for the feat. While R&D intensity is bound to increase overtime from this low figure, this shows that Paycom has a competitive advantage over other firms because they have produced better more effective research. Paycom also does not pay a dividend. This shows they are committing their extra capital elsewhere in places like R&D that can help advance the products and company as a whole for years to come.

Name (BICS Best Fit)	R&D/Sales
Median	12.96%
PAYCOM SOFTWARE INC	6.37%
REALPAGE INC	12.96%
COTIVITI HOLDINGS INC	0.00%
GUIDEWIRE SOFTWARE ...	25.34%
TABLEAU SOFTWARE INC...	36.61%
ZENDESK INC	29.19%
ALLSCRIPTS HEALTHCAR...	12.12%
INOVALON HOLDINGS I...	6.82%
PTC INC	20.11%

Conclusion:

Paycom is a company whose stock has seen a tremendous growth in price this year. This does not mean it is too late to invest in this company. There is still value to be made in this situation and it all drives from revenue. Paycom has positioned itself properly for future success with a great product that promotes repeat sales. Revenues will continue to grow, especially in Q1 2018 when the majority of payroll sales exist. The capital allocation into cost-effective R&D will ensure this for future years to come. This stock still has the ability to grow consistently for the long-term future.

Paycom Software, Inc.
(PAYC)

CENTER FOR GLOBAL FINANCIAL STUDIES

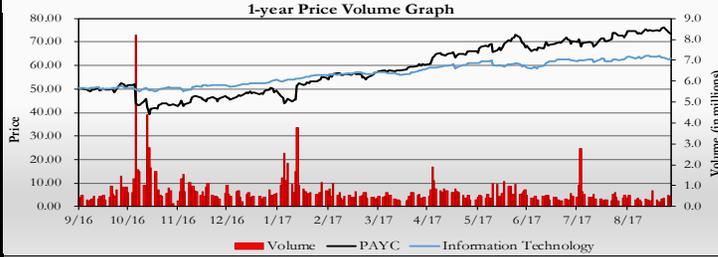
BULLISH

Analysis by Kevin Boland
9/29/2017

Current Price: **\$74.75**
Divident Yield: **0.0%**

Intrinsic Value **\$82.69**
Target Price **\$91.34**

Target 1 year Return: **22.2%**
Probability of Price Increase: **99%**

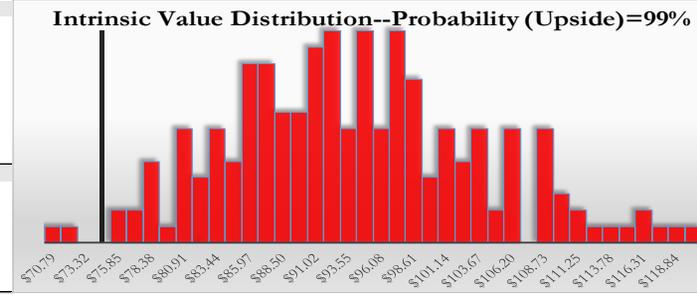


Description	
Paycom Software, Inc. provides cloud-based human capital management (HCM) software solution that is delivered as software-as-a-service for small to mid-sized companies in the United States.	
General Information	
Sector	Information Technology
Industry	Software
Last Guidance	November 3, 2015
Next earnings date	November 1, 2017
Estimated Country	Risk Premium 5.69%
Effective Tax rate	20%
Effective Operating Tax rate	25%

Market Data	
Market Capitalization	\$4,453.27
Daily volume (mil)	0.37
Shares outstanding (mil)	59.58
Diluted shares outstanding (mil)	59.02
% shares held by institutions	89%
% shares held by investments Managers	79%
% shares held by hedge funds	5%
% shares held by insiders	20.22%
Short interest	18.51%
Days to cover short interest	23.45
52 week high	\$76.75
52-week low	\$39.15
Volatility	0.00%

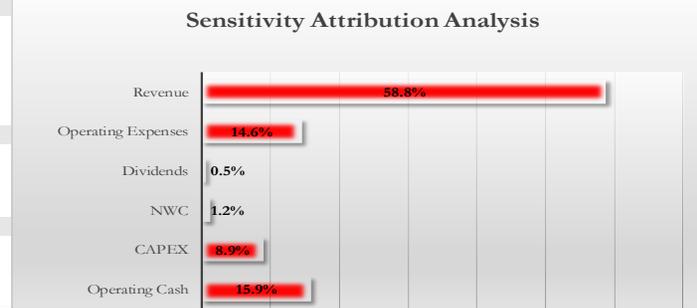
Past Earning Surprises	
Quarter ending	Revenue
6/30/2016	3.33%
9/30/2016	-0.13%
12/31/2016	0.75%
3/31/2017	2.67%
6/30/2017	1.79%
Mean	1.68%
Standard error	0.6%

EBITDA	
6/30/2016	16.51%
9/30/2016	-74.16%
12/31/2016	-18.94%
3/31/2017	-2.38%
6/30/2017	-43.33%
Mean	-24.46%
Standard error	15.8%



Management	Position
Richison, Chad	Founder, Chairman of the Boa
Boelte, Craig	Chief Financial Officer
Kerber, William	Chief Information Officer
York, Jeffrey	Chief Sales Officer
Pezold, Stacey	Chief Learning Officer
Oden-Hall, Kathy	Chief Marketing Officer

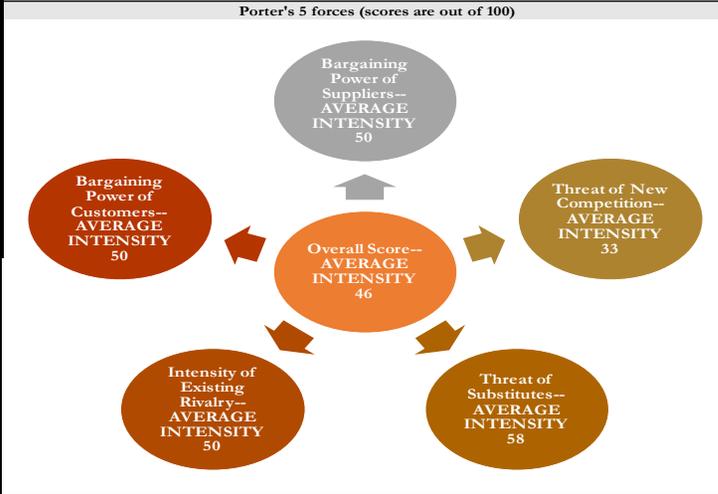
Total compensations growth	
45.81% per annum over 4y	N/M
53.02% per annum over 4y	N/M
51.57% per annum over 4y	N/M
46.33% per annum over 4y	N/M
87.63% per annum over 1y	20.89% per annum over 1y
N/M	N/M



Profitability	PAYC (LTM)	PAYC (5 years historical average)	Peers' Median (LTM)
Return on Capital (GAAP)	58.1%	18.50%	-50.38%
Operating Margin	13%	12.83%	-5.74%
Revenue/Capital (GAAP)	4.44	1.44	8.77
ROE (GAAP)	46.9%	36.4%	6.5%
Net margin	14.3%	6.5%	6.4%
Revenue/Book Value (GAAP)	3.29	5.57	1.02

Invested Funds	PAYC (LTM)	PAYC (5 years historical average)	Peers' Median (LTM)
Cash/Capital	37.9%	20.2%	77.1%
NWC/Capital	-16.0%	-10.6%	-23.5%
Operating Assets/Capital	49.2%	34.4%	32.5%
Goodwill/Capital	28.9%	55.1%	13.8%

Valuation			
Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	35%	22.5%	1.61
6/30/2018	25%	32.8%	1.49
6/30/2019	25%	33.2%	1.09
6/30/2020	23%	33.1%	0.88
6/30/2021	20%	33.0%	0.75
6/30/2022	18%	32.9%	0.66
6/30/2023	15%	32.7%	0.58
6/30/2024	13%	32.6%	0.52
6/30/2025	11%	32.4%	0.47
6/30/2026	8%	32.3%	0.42
6/30/2027	6%	32.2%	0.38
Continuing Period	4%	32.1%	0.34



Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	36.4%	8.3%	\$80.77
6/30/2018	48.9%	8.1%	\$87.95
6/30/2019	36.0%	8.9%	\$96.95
6/30/2020	29.1%	9.0%	\$106.71
6/30/2021	24.6%	9.4%	\$117.66
6/30/2022	21.5%	9.4%	\$129.47
6/30/2023	19.1%	9.4%	\$142.11
6/30/2024	17.0%	9.4%	\$155.56
6/30/2025	15.3%	9.5%	\$169.77
6/30/2026	13.7%	9.5%	\$184.67
6/30/2027	12.3%	9.5%	\$200.21
Continuing Period	10.9%	9.5%	

Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	35%	22.5%	1.61
6/30/2018	25%	32.8%	1.49
6/30/2019	25%	33.2%	1.09
6/30/2020	23%	33.1%	0.88
6/30/2021	20%	33.0%	0.75
6/30/2022	18%	32.9%	0.66
6/30/2023	15%	32.7%	0.58
6/30/2024	13%	32.6%	0.52
6/30/2025	11%	32.4%	0.47
6/30/2026	8%	32.3%	0.42
6/30/2027	6%	32.2%	0.38
Continuing Period	4%	32.1%	0.34