

Paycom Software, Inc. (PAYC)

\$290.71 (As of 02/06/20)

Price Target (6-12 Months): **\$305.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 08/19/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: F

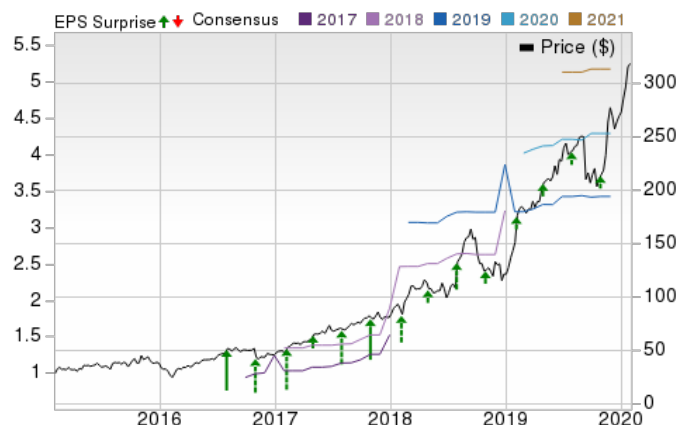
Growth: B

Momentum: A

Summary

Paycom Software's fourth-quarter 2019 results benefited from new business wins and its high-margin recurring revenue business. The company is gaining from its differentiated employee strategy, measurement capabilities and comprehensive product offering. Paycom's differentiated product offering, Direct Data Exchange, for all its clients is boosting customer addition. Further, the latest launch of Ask Here and Manager on-the-Go, both focusing on greater employee usage and efficiency, is a tailwind. The company is winning market share over the most critical client demand area of HCM, which in turn, supports its growth. However, stiff competition from companies like ADP is a headwind, which could induce pricing pressure and shrink Paycom's margins.

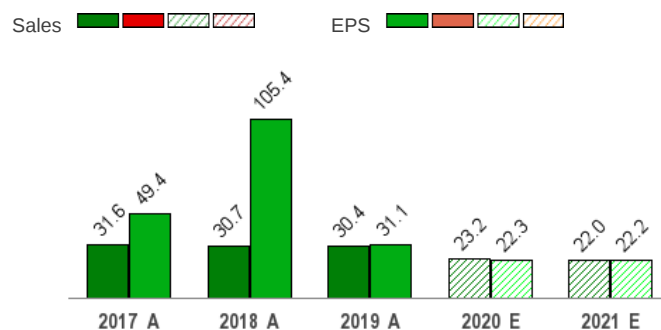
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$342.00 - \$165.98
20 Day Average Volume (sh)	1,433,203
Market Cap	\$17.0 B
YTD Price Change	9.8%
Beta	1.24
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Internet - Software
Zacks Industry Rank	Top 34% (87 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.7%
Last Sales Surprise	1.4%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/05/2020
Earnings ESP	-5.5%
P/E TTM	83.1
P/E F1	67.9
PEG F1	2.7
P/S TTM	23.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	302 E	256 E	267 E	291 E	1,109 E
2020		209 E	215 E	236 E	909 E
2019	200 A	169 A	175 A	193 A	738 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.77 E	\$1.11 E	\$1.09 E	\$1.23 E	\$5.23 E
2020	\$1.45 E	\$0.93 E	\$0.92 E	\$1.03 E	\$4.28 E
2019	\$1.19 A	\$0.75 A	\$0.70 A	\$0.86 A	\$3.50 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/06/2020. The reports text is as of 02/07/2020.

Overview

Headquartered in Oklahoma City, Paycom Software, Inc. is a provider of cloud-based human capital management (HCM) software as a service solution for integrated software for both employee records and talent management processes.

Founded in 1998, the company offers analytics that manages the complete employment life cycle from recruitment to retirement.

Paycom serves more than 23,500 clients or nearly 12,700 customers based on Parent Company Grouping. Its human resource services include retirement services administration, workers' compensation administration, employee benefit solutions, professional employer organization and other administrative services for businesses.

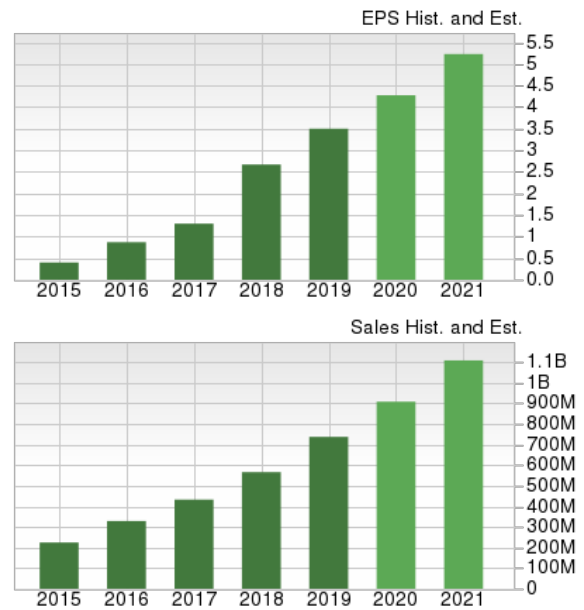
Paycom's HCM solution offers a full suite of applications that generally falls within the following categories, namely talent acquisition, time and labor management, payroll, talent management and HR management.

Its HCM software streamlines and automates many of the day-to-day record-keeping processes and provides a framework for HR staff to manage benefits administration and payroll, map out succession planning and document such things as personnel actions and compliance with industry and/or government regulations. The cloud-based HCM reduces the administrative burden on employers and increases employee productivity.

In 2019, Paycom reported revenues of \$737.7 million, representing growth of 30% year over year. Recurring revenues of \$724.4 million grew 30% from the prior year, and constituted 98% of total revenues.

Paycom talent acquisition and talent management applications compete primarily with Cornerstone OnDemand, Oracle, SAP and Workday. Its payroll applications including payroll processing rival primarily with Automatic Data Processing (ADP), Ceridian, Paychex, Paylocity and The Ultimate Software. Its HR management applications contend mainly with ADP, Ceridian, Oracle, Paychex, Paylocity, SAP and Workday. The company's time and labor management applications compete primarily with ADP, Ceridian, Kronos, Paylocity and The Ultimate Software Group.

As of Dec 31, 2019, the company had 3,765 employees across the United States.



Reasons To Buy:

- ▲ Paycom offers end-to-end SaaS HCM solution that minimizes data integrity issues across applications. Paycom's SaaS based solution reduces the time, risk and headcount related with installing and maintaining applications for on premise products. We are also positive as Paycom continues to invest in SaaS technology and mobile applications by acquiring SaaS-based businesses. Further, we believe that Paycom's cloud-based solution has greater demand across a wide section of verticals. Larger companies have greater and more complex HCM needs and Paycom's solution is evolving to serve them. The growth of cloud computing has supported the SaaS delivery model. According to Gartner, the global SaaS market is expected to be \$116 billion in 2020. With its SaaS-based applications, we think that Paycom is well-positioned to lead the market.
- ▲ Revenue growth is an important metric for any company as it is a vital part of growth projections and instrumental in strategic decision-making. Also, revenue growth is essential to justify the fixed and variable expenses incurred to operate a business. Paycom has grown meaningfully over the years by providing industry-leading service and technology solutions to its clients and their employees. Its solid business model, diversified products and services, and strategic acquisitions have boosted top-line growth. Higher revenues will expand margins and increase profitability in the long run.
- ▲ Paycom expands its client base with the help of direct sales force. The company is winning market share over the most critical client demand area of HCM, which in turn, supports its growth. The HCM solution includes talent acquisition, time and labor management, payroll, talent management and human resources ("HR") management applications. These offerings have been increasingly helping clients manage both permanent and temporary workforce. As a result, the company has a huge client base. Notably, continuous focus on client retention, on the basis of high client satisfaction, has helped the company to increase its average annual client retention rate to 93% in 2019, from 92% in 2018 and 91% for each of the preceding six years. The company is gaining foothold among larger companies. As a result of this, the company is expanding its proactive sales effort to target companies with 50-5000 employees against its earlier target of 50-2000 employees.
- ▲ Paycom is a cash rich company with a strong balance sheet. Cash rich companies not only guarantee protection but are also likely to reward shareholders from their deep cash balances. Paycom generated \$224.3 million of cash from operating activities in 2019, up from \$184.8 million generated in 2018. Since it has net cash available on its balance sheet, the existing cash can be used for pursuing strategic acquisitions, investment in growth initiatives and distribution to shareholders.
- ▲ Paycom continues with its share repurchase initiatives. We note that share repurchases are a good way of returning cash to investors and also boost the company's bottom line. During 2018, the company repurchased nearly 1 million shares including more than 900,000 shares purchased in the open market. Since the initiation of its repurchase program in 2019, Paycom has bought back more than 3.5 million shares at average price of \$79.56.

Better-than-expected demand for advanced human capital management and payroll software solutions are the positives.

Reasons To Sell:

- ▼ Competition in the HCM software market is increasing, which could lead to pricing pressure and affect Paycom's margins. Some of the possible competitors in this space include ADP, Ceridian, Oracle, Paychex, SAP etc., which offer similar services. Moreover, we believe that Paycom's dominance could be challenged by new entrants. This could lead the company to resort to competitive pricing to maintain and capture further market share. This apart, the ongoing trend to invest more in cloud solutions exposes Paycom to the risk of losing existing "on-premise customers", which can adversely impact its top-line performance, especially in the short run. Notably, improvement in ADP's retention rate and a transition of all its mid-market customers to internal SaaS solutions is a major threat to Paycom, which lured away customers from the former.
- ▼ Paycom's SaaS network infrastructure is a critical part of the company's business operations. These SaaS-based solutions are prone to certain disruptions caused by human error, cyber threats, security breaches etc. The impact of cyber-attack in today's computer-dependent economy poses a major concern across the globe. Cyber-warfare and espionage attacks are expected to rise. The attacks on Internet of Things (IoT) devices will increase rapidly due to whopping growth in the number of connected objects, poor security and the high value of data on IoT devices. These cyber-attacks and security vulnerabilities might result in lower revenues, higher costs, liability claims, and can be a competitive disadvantage. Paycom depends upon information technology ("IT") networks, cloud-based platforms, and systems to maintain various business processes. These disruptions may lead to increased customer dissatisfaction. Hence, if the company wants to maintain its key position in the industry, then enhanced levels of security to safeguard against such attacks are of utmost importance.
- ▼ A major portion of the company's business depends on agreement renewal on the part of customers and purchase of additional applications. If customers do not sense additional value and expected benefits from the new solutions, they are unlikely to upgrade themselves to the latest solutions, which in turn, will hurt the company's revenues. In case customers do not purchase additional applications or subscribe to latest applications, then it will become increasingly difficult for Paycom to hold its existing market share, adding to its woes. Additionally, the company is subject to risks related to human resource like maintenance of a gender-diversified workforce across the globe. Moreover, there is a dearth of skilled IT professionals, which exposes the company to risks of losing talented professionals, which in turn, might hurt its competitive position.
- ▼ Paycom currently has a trailing 12 month P/B ratio of 35.75X, which compares unfavorably to some extent with what the industry saw over the last year. Hence, valuation looks slightly stretched from a P/B perspective.

Competition from companies like Paylocity Holding, Intuit and Paychex remains a headwind.

Last Earnings Report

Paycom Software Q4 Results Surpass Estimates

Paycom Software's fourth-quarter 2019 non-GAAP earnings per share came in at 86 cents, which surpassed the Zacks Consensus Estimate of 77 cents and also grew 40.98% year over year.

Further, the company generated revenues of \$193 million, which increased 29% from the year-earlier period and also outpaced the Zacks Consensus Estimate of \$191 million.

Robust new business wins and the company's high-margin recurring revenue business drove results.

The company is benefiting from its differentiated employee strategy, measurement capabilities and comprehensive product offering.

Paycom's differentiated product offering, Direct Data Exchange, for all Paycom Software clients is boosting customer addition. Further, the latest launch of Ask Here and Manager on-the-Go, both focusing on greater employee usage and efficiency, is a tailwind.

Moreover, the company's top line received a 30% year-over-year positive impact in recurring revenues of \$724.4 million, which comprises 98% of the total revenue base.

Margins

Adjusted gross profit jumped 36.7% from the year-ago period to \$165 million. The company's adjusted gross margin expanded 100 basis points (bps) on a year-over-year basis to 85.3%.

Paycom Software's adjusted EBITDA rose 36.7% year over year to \$78.6 million. Adjusted EBITDA margin of 40.6% expanded 240 bps year over year.

Balance Sheet & Cash Flow

Paycom Software exited the fourth quarter with cash and cash equivalents of \$133.7 million compared with \$108.1 million in the sequential quarter.

The company's balance sheet comprises long-term debt of \$32.6 million compared with \$33.1million sequentially.

Cash from operations was \$47.8 million for the fourth quarter.

Guidance

For first-quarter 2020, Paycom Software expects revenues in the range of \$240-\$242 million.

Adjusted EBITDA is estimated in the band of \$113-\$115 million.

For 2020, the company envisions revenues within \$911-\$913 million.

Adjusted EBITDA is anticipated in the bracket of \$384-\$386 million.

Quarter Ending 12/2019

Report Date	Feb 05, 2020
Sales Surprise	1.37%
EPS Surprise	11.69%
Quarterly EPS	0.86
Annual EPS (TTM)	3.50

Recent News

On Feb 3, 2020, Paycom Software announced the release of Manager on-the-Go, a tool within the Paycom mobile app that allows for 24/7 accessibility to essential manager-side functionality within Paycom.

On Jan 28, 2020, Paycom Software joined the S&P 500.

On Jan 23, 2020, it was announced that Paycom will replace WellCare Health Plans Inc. in the S&P 500 from January 28 onwards.

On Dec 10, 2019, Paycom recently announced that it has started deploying two enhancements to its learning management platform Paycom Learning.

Valuation

Shares of Paycom have soared 20.9% in the past six months and 65.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector gained 1.2% and 18.4% in the past six months, respectively. Over the past year, the Zacks sub-industry and the sector gained 12.9% and 28.8%, respectively.

The S&P 500 Index has gained 13.9% in the past six months and 21.1% in the past year.

The stock is currently trading at 18.33X forward 12-month sales, which compares to 6.48X for the Zacks sub-industry, 3.7X for the Zacks sector and 3.45X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.63X and as low as 4.35X with a 5-year median of 8.91X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$305 price target reflects 19.2X forward 12-month sales.

The table below shows summary valuation data for PAYC

Valuation Multiples - PAYC					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	18.33	6.48	3.7	3.45
	5-Year High	21.63	15.61	3.7	3.54
	5-Year Low	4.35	3.06	2.3	2.54
	5-Year Median	8.91	5.31	3.02	3
P/B TTM	Current	35.75	7.44	5.6	4.54
	5-Year High	41.53	8.23	5.61	4.54
	5-Year Low	13.53	2.29	3.13	2.85
	5-Year Median	24.61	5.19	4.23	3.62
EV/Sales TTM	Current	24.33	7.25	4.4	3.35
	5-Year High	28.29	11.57	4.4	3.35
	5-Year Low	5.8	3.04	2.57	2.12
	5-Year Median	11.74	6.03	3.47	2.79

As of 02/06/2020

Industry Analysis Zacks Industry Rank: Top 34% (87 out of 255)



Top Peers

Paylocity Holding Corporation (PCTY)	Outperform
SAP SE (SAP)	Outperform
Automatic Data Processing, Inc. (ADP)	Neutral
Ceridian HCM Holding Inc. (CDAY)	Neutral
Cornerstone OnDemand, Inc. (CSOD)	Neutral
Oracle Corporation (ORCL)	Neutral
Paychex, Inc. (PAYX)	Neutral
Workday, Inc. (WDAY)	Neutral

Industry Comparison Industry: Internet - Software				Industry Peers		
	PAYC Neutral	X Industry	S&P 500	ADP Neutral	PAYX Neutral	PCTY Outperform
VGM Score	C	-	-	D	D	D
Market Cap	16.98 B	606.01 M	24.40 B	77.83 B	31.66 B	7.31 B
# of Analysts	8	5	13	11	11	10
Dividend Yield	0.00%	0.00%	1.75%	2.02%	2.80%	0.00%
Value Score	F	-	-	C	D	F
Cash/Price	0.01	0.11	0.04	0.02	0.02	0.02
EV/EBITDA	82.83	-1.88	14.17	17.38	17.92	80.26
PEG Ratio	2.76	2.50	2.05	2.25	4.07	3.83
Price/Book (P/B)	35.75	5.28	3.31	14.51	12.32	22.04
Price/Cash Flow (P/CF)	108.94	34.84	13.63	21.11	22.08	78.35
P/E (F1)	69.39	52.28	19.08	29.23	28.47	76.70
Price/Sales (P/S)	23.01	4.23	2.67	5.36	7.85	14.08
Earnings Yield	1.47%	0.80%	5.24%	3.42%	3.52%	1.31%
Debt/Equity	0.07	0.10	0.71	0.25	0.35	0.23
Cash Flow (\$/share)	2.67	-0.02	6.89	8.54	4.01	1.74
Growth Score	B	-	-	C	C	D
Hist. EPS Growth (3-5 yrs)	72.86%	16.72%	10.80%	16.45%	10.85%	126.93%
Proj. EPS Growth (F1/F0)	22.14%	14.30%	7.23%	13.16%	9.41%	28.77%
Curr. Cash Flow Growth	121.28%	1.28%	9.51%	15.63%	10.82%	96.78%
Hist. Cash Flow Growth (3-5 yrs)	69.57%	14.22%	8.55%	14.63%	12.37%	220.86%
Current Ratio	1.10	1.56	1.20	1.02	1.17	1.06
Debt/Capital	6.18%	15.07%	42.90%	20.26%	25.87%	18.83%
Net Margin	24.48%	-14.82%	11.76%	16.97%	26.72%	11.11%
Return on Equity	39.42%	-15.51%	16.98%	46.96%	41.21%	19.02%
Sales/Assets	0.40	0.66	0.54	0.33	0.44	0.27
Proj. Sales Growth (F1/F0)	22.73%	17.78%	4.15%	5.32%	10.17%	23.22%
Momentum Score	A	-	-	F	C	A
Daily Price Chg	-9.86%	0.00%	-0.11%	0.92%	0.48%	-0.36%
1 Week Price Chg	1.06%	-1.69%	-2.60%	-3.28%	-3.53%	2.32%
4 Week Price Chg	1.90%	0.00%	1.51%	5.29%	3.15%	3.07%
12 Week Price Chg	25.96%	5.13%	5.63%	5.95%	4.71%	24.69%
52 Week Price Chg	72.87%	0.00%	17.01%	23.74%	19.92%	68.01%
20 Day Average Volume	1,433,203	312,012	1,961,054	2,054,449	1,324,549	397,898
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-0.03%	0.00%	1.28%
(F1) EPS Est 4 week change	0.00%	0.00%	-0.00%	0.13%	0.00%	0.35%
(F1) EPS Est 12 week change	0.00%	0.00%	-0.16%	0.03%	0.01%	2.60%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-1.92%	0.00%	-1.12%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	B
Momentum Score	A
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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