

Paycom Software, Inc. (PAYC)

\$303.28 (As of 01/22/20)

Price Target (6-12 Months): **\$318.00**

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

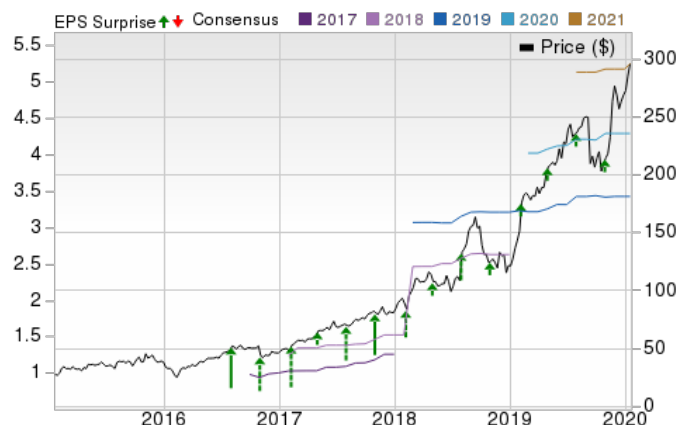
Growth: B

Momentum: C

Summary

Paycom Software is benefiting from new business wins and the company's high-margin recurring revenue business. Strong sales growth can be attributed to its employee usage strategy, sales efforts and investments. The first-quarter launch of differentiated product offering, Direct Data Exchange, for all Paycom Software clients is boosting customer additions. The release of Ask Here also makes us optimistic. The company is winning market share over the most critical client demand area of HCM, which in turn, supports its growth. Estimates have been stable ahead of the company's Q4 earnings release. The company has positive record of earnings surprises in recent quarters. However, stiff competition from companies like ADP is a headwind, which could induce pricing pressure and shrink Paycom's margins.

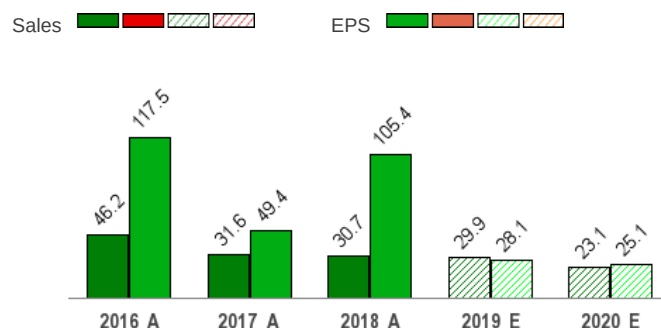
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$324.00 - \$135.15
20 Day Average Volume (sh)	414,624
Market Cap	\$17.7 B
YTD Price Change	14.6%
Beta	1.27
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Internet - Software
Zacks Industry Rank	Top 40% (103 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.5%
Last Sales Surprise	2.0%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/04/2020
Earnings ESP	0.0%
P/E TTM	93.3
P/E F1	70.9
PEG F1	2.8
P/S TTM	25.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	247 E	209 E	215 E	236 E	905 E
2019	200 A	169 A	175 A	191 E	735 E
2018	154 A	129 A	133 A	150 A	566 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.45 E	\$0.94 E	\$0.92 E	\$1.01 E	\$4.28 E
2019	\$1.19 A	\$0.75 A	\$0.70 A	\$0.77 E	\$3.42 E
2018	\$0.95 A	\$0.59 A	\$0.52 A	\$0.61 A	\$2.67 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 01/22/2020. The reports text is as of 01/23/2020.

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.

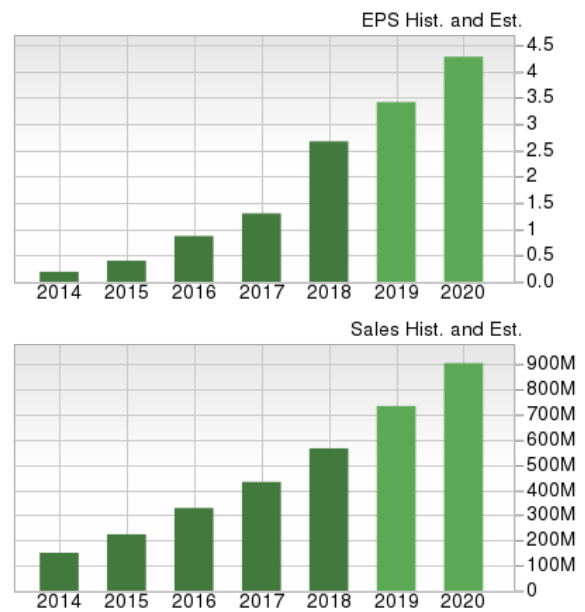
Its HCM software streamlines and automates many of the day-to-day record-keeping processes and provides a framework for HR staff to manage benefits administration and payroll, map out succession planning and document such things as personnel actions and compliance with industry and/or government regulations.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

The company stored data for more than 4.1 million persons employed by its clients during the year ended Dec 31, 2018.

In 2018, Paycom Software's recurring revenues contribute to 98% of its total revenues, which summed \$557.3 million. Implementation and other revenues accounted for the remaining 2% of total revenues and came in at \$9.08 million.

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, 2018, the company had 3,050 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 increase at a 4-year compound annual growth rate (CAGR) (2017–2021) of 18.1%. 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 maintain its average annual client retention rate of 92% after posting the same at 91% over the last six consecutive 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 \$184.8 million of cash from operating activities in 2018, up from \$130.6 million generated in 2017. 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 34.82X, 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 Q3 Results Surpass Estimates

Paycom Software's third-quarter 2019 non-GAAP earnings per share came in at 70 cents, which surpassed the Zacks Consensus Estimate of 69 cents and also grew 34% year over year.

Further, the company generated revenues of \$175 million, surging 31% from the year-earlier period and also outpaced the Zacks Consensus Estimate of \$172 million.

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

Strong sales growth can be attributed to its employee usage strategy, sales efforts and investments. The first-quarter launch of differentiated product offering, Direct Data Exchange, for all Paycom Software clients is boosting customer additions.

Moreover, the company's top line received a 31% year-over-year positive impact in recurring revenues, which comprises 98% of the total revenue base.

The better-than-expected earnings coupled with management's bullish guidance for the full year are expected to buoy investor confidence in the stock.

Margins

Adjusted gross profit jumped 33.7% from the year-ago period to \$148.6 million. The company's adjusted gross margin expanded 170 basis points (bps) on a year-over-year basis to 85.3%.

As a percentage of revenues, total adjusted sales and marketing expenses, administrative expenses, and research and development expenses increased 30 bps to 26.7%, 80 bps to 53.9% and 180 bps to 10.3%, respectively.

Paycom Software's adjusted EBITDA rose 35.3% year over year to \$66.6 million. Adjusted EBITDA margin of 38% expanded 110 bps year over year.

Balance Sheet & Cash Flow

Paycom Software exited the third quarter with cash and cash equivalents of \$108.1 million compared with \$94.8 million in the sequential quarter.

The company's balance sheet comprises long-term debt of \$33.1 million compared with \$33.5 million sequentially.

Net cash provided by operating activities in the nine months ending Sep 30, 2019 was \$176.4 million compared with \$145.8 million in the year-ago period.

Guidance

For fourth-quarter 2019, Paycom Software expects revenues in the range of \$188.5-\$190.5 million. Adjusted EBITDA is estimated in the band of \$72-\$74 million.

Paycom Software raised forecasts for the full year. The company envisions revenues within \$733-\$735 million, up from \$728-\$730 million predicted earlier. The mid-point of the guided range implies 30% improvement from the year-ago reported figure.

Adjusted EBITDA is anticipated in the bracket of \$311-\$313 million, up from the earlier guidance of \$306-\$308 million. The company projects adjusted gross margin within 84-85% compared with 83-85% envisioned earlier.

Quarter Ending 09/2019

Report Date	Oct 29, 2019
Sales Surprise	2.03%
EPS Surprise	1.45%
Quarterly EPS	0.70
Annual EPS (TTM)	3.25

Recent News

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 29% in the past six months and 119% over the trailing 12-month period. Stocks in the Zacks sub-industry fell 4%, while the Zacks Computer & Technology sector have risen 15.1% in the past six months. Over the past year, the Zacks sub-industry and the sector gained 17.2% and 33.8%, respectively.

The S&P 500 Index has gained 10.8% in the past six months and 24.9% in the past year.

The stock is currently trading at 19.3X forward 12-month sales, which compares to 6.49X for the Zacks sub-industry, 3.75X for the Zacks sector and 3.56X 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 8.88X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$318 price target reflects 20.27X 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 F 12M	Current	19.3	6.49	3.75	3.56
	5-Year High	21.63	15.61	3.75	3.56
	5-Year Low	4.35	3.03	2.3	2.54
	5-Year Median	8.88	5.31	3.01	3
P/B TTM	Current	37.3	7.25	5.62	4.54
	5-Year High	37.3	8.17	5.62	4.55
	5-Year Low	13.53	2.28	3.13	2.85
	5-Year Median	24.51	5.16	4.22	3.61
EV/Sales TTM	Current	18.94	5.72	4.41	3.33
	5-Year High	22.73	11.55	4.41	3.33
	5-Year Low	5.8	3	2.56	2.16
	5-Year Median	11.52	5.92	3.46	2.8

As of 01/22/2020

Industry Analysis Zacks Industry Rank: Top 40% (103 out of 255)



Top Peers

Cornerstone OnDemand, Inc. (CSOD)	Outperform
Paylocity Holding Corporation (PCTY)	Outperform
Automatic Data Processing, Inc. (ADP)	Neutral
Ceridian HCM Holding Inc. (CDAY)	Neutral
Oracle Corporation (ORCL)	Neutral
Paychex, Inc. (PAYX)	Neutral
SAP SE (SAP)	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	-	-	C	D	F
Market Cap	17.71 B	693.00 M	24.65 B	77.16 B	32.07 B	7.54 B
# of Analysts	8	5	13	11	11	10
Dividend Yield	0.00%	0.00%	1.77%	2.04%	2.77%	0.00%
Value Score	F	-	-	D	D	F
Cash/Price	0.01	0.11	0.04	0.06	0.02	0.02
EV/EBITDA	86.43	-1.88	13.98	16.38	18.15	82.82
PEG Ratio	2.96	2.63	2.05	2.23	4.12	4.02
Price/Book (P/B)	37.29	5.27	3.38	14.39	12.48	24.36
Price/Cash Flow (P/CF)	113.65	35.50	13.60	20.88	22.37	80.98
P/E (F1)	74.59	58.24	19.07	28.95	28.84	80.32
Price/Sales (P/S)	25.50	4.44	2.69	5.38	7.95	15.34
Earnings Yield	1.41%	0.77%	5.24%	3.45%	3.47%	1.24%
Debt/Equity	0.07	0.10	0.72	0.19	0.35	0.25
Cash Flow (\$/share)	2.67	-0.01	6.94	8.54	4.01	1.74
Growth Score	B	-	-	B	C	C
Hist. EPS Growth (3-5 yrs)	72.86%	16.72%	10.60%	15.36%	10.85%	126.93%
Proj. EPS Growth (F1/F0)	25.24%	14.46%	7.53%	13.01%	9.41%	27.10%
Curr. Cash Flow Growth	121.28%	3.33%	13.90%	15.63%	10.82%	96.78%
Hist. Cash Flow Growth (3-5 yrs)	69.57%	14.22%	9.00%	14.63%	12.37%	220.86%
Current Ratio	1.10	1.55	1.22	1.01	1.17	1.09
Debt/Capital	6.18%	19.79%	42.99%	15.77%	25.87%	19.79%
Net Margin	23.99%	-14.19%	11.21%	16.52%	26.72%	11.78%
Return on Equity	38.52%	-12.09%	17.16%	46.94%	41.21%	19.03%
Sales/Assets	0.40	0.66	0.55	0.34	0.44	0.28
Proj. Sales Growth (F1/F0)	23.17%	17.63%	4.08%	5.72%	10.17%	21.88%
Momentum Score	C	-	-	C	D	F
Daily Price Chg	1.17%	0.00%	-0.04%	1.21%	1.07%	-0.07%
1 Week Price Chg	3.73%	2.22%	2.29%	3.38%	3.48%	6.98%
4 Week Price Chg	14.60%	7.39%	2.05%	4.96%	5.85%	16.53%
12 Week Price Chg	42.38%	7.50%	6.92%	8.64%	5.85%	35.78%
52 Week Price Chg	121.34%	0.35%	21.50%	32.67%	28.29%	111.63%
20 Day Average Volume	414,624	238,087	1,518,423	1,374,729	1,167,022	296,284
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.92%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.92%
(F1) EPS Est 12 week change	-0.18%	-0.09%	-0.23%	0.00%	0.01%	2.77%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	-0.67%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	C
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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