Aug 24, 2020

Paycom Software, Inc. (PAYC)

$287.21 (As of 08/21/20)

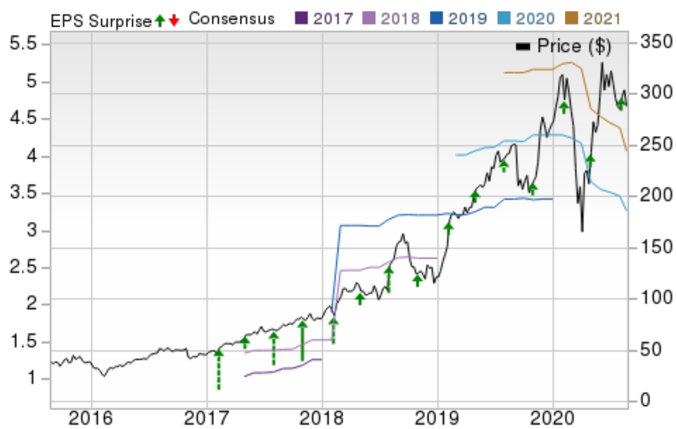
Price Target (6-12 Months): **$302.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 08/19/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:F
	Value: D | Growth: D | Momentum: F	

Summary

Paycom's second-quarter top-line results grew year-over-year despite the unexpected rate cuts and spike in unemployment level due to the coronavirus. It is benefiting 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. Paycom is winning market share over the most critical client demand area of HCM, which in turn, supports its growth. Shares of the company have outperformed the industry in the past year. However, stiff competition from companies like ADP is a headwind, which could induce pricing pressure and shrink Paycom's margins.

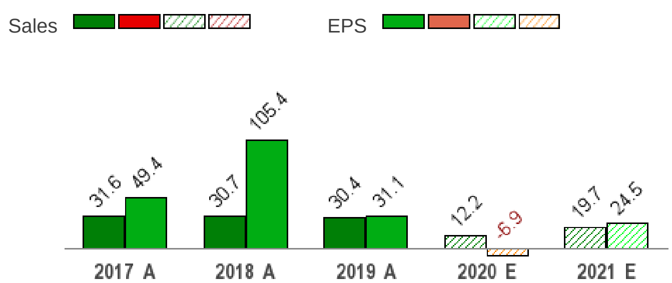
Price, Consensus & Surprise



Data Overview

52 Week High-Low	**$342.00 - $163.42**
20 Day Average Volume (sh)	**523,405**
Market Cap	**$16.8 B**
YTD Price Change	**8.5%**
Beta	**1.48**
Dividend / Div Yld	**$0.00 / 0.0%**
Industry	**Internet - Software**
Zacks Industry Rank	**Top 43% (108 out of 252)**
Last EPS Surprise	**3.3%**
Last Sales Surprise	**-0.4%**
EPS F1 Est- 4 week change	**-11.8%**
Expected Report Date	**NA**
Earnings ESP	**0.0%**
P/E TTM	**81.8**
P/E F1	**88.1**
PEG F1	**3.5**
P/S TTM	**21.2**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	266 E	225 E	236 E	262 E	991 E
2020	242 A	182 A	192 E	212 E	828 E
2019	200 A	169 A	175 A	193 A	738 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$1.36 E	$0.82 E	$0.86 E	$1.05 E	$4.06 E
2020	$1.33 A	$0.62 A	$0.56 E	$0.75 E	$3.26 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 08/21/2020. The reports text is as of 08/24/2020.

Overview

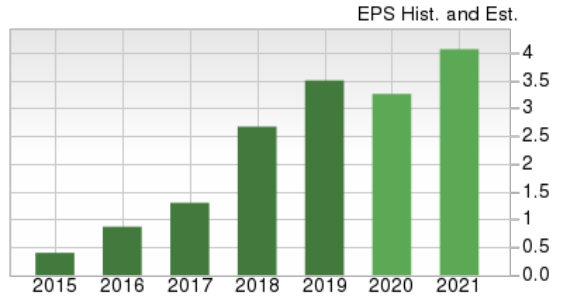
Headquartered in Oklahoma City, Paycom Software, Inc. is a provider of cloud-based human capital management (HCM) software as a service solution for integrated software for both employee records and talent management processes.

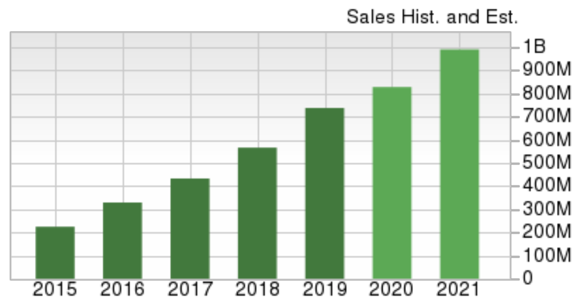
Founded in 1998, the company offers analytics that manages the complete employment life cycle from recruitment to retirement.

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:

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

- 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. As of Jun 30, 2020, the company had cash and cash equivalents of nearly $114 million, which is significantly higher than its total debt (long-term debt with current maturities) of approximately $32 million. Moreover, its times interest earned ratio of 372 is way higher than the industry average of mere 4.5. Additionally, Paycom's total debt to total capital ratio of 0.05 is significantly lower than the industry average of 0.29. 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 boasts a sturdy cash-flow generating ability. The company had generated operating cash flow of $224 million in 2019 compared with $185 million in 2018. In the first half of 2020, the company generated $108 million of cash flow from operational activities. The robust cash flow enables it to serve debt efficiently and enhance shareholders wealth through share repurchases. On Mar 12, 2020, the company increased its share repurchase program to $250 million which would be completed between Mar 13, 2020 and Mar 12, 2022. In the first half of 2020, the company repurchased $52 million of its common stocks. Since the initiation of its repurchase program in 2016, Paycom has bought back more than 4 million shares.

Reasons To Sell:

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

- 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 28.7X, 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.

Last Earnings Report

Paycom reported mixed results for second-quarter 2020, wherein earnings came in line with the Zacks Consensus Estimate but revenues missed the same.

The company generated revenues of $181.6 million, which increased 7% from the year-earlier period but fell short of the consensus mark of $182.3 million. Paycom Software's quarterly non-GAAP earnings per share of 62 cents came in line with the Zacks Consensus Estimate. However, the bottom-line figure dropped 17.3% year on year.

The company's overall performance was mainly impacted by payment deferrals by clients, headcount reductions at client offices and elevated operating expenses.

Quarter Ending	06/2020
Report Date	**Aug 04, 2020**
Sales Surprise	**-0.40%**
EPS Surprise	**3.33%**
Quarterly EPS	**0.62**
Annual EPS (TTM)	**3.51**

Margins

Adjusted gross profit increased 6.5% from the year-ago period to $153.8 million. However, adjusted gross margin contracted 60 basis points (bps) on a year-over-year basis to 84.7%.

Paycom Software's adjusted EBITDA fell 11.8% year over year to $61.2 million. Moreover, adjusted EBITDA margin shrunk 730 bps to 33.7%.

Balance Sheet & Cash Flow

Paycom Software exited the June-end quarter with cash and cash equivalents of $113.5 million compared with the $181.8 million recorded in the prior quarter.

The company's balance sheet comprises long-term debt of $31.8 million compared with the previous quarter's $32.2 million.

Cash from operations was $107.5 million in the first half of 2020 and the company repurchased approximately $52 million worth of its common stock.

Guidance

For the third quarter, Paycom Software estimates revenues between $191 million and $193 million. The Zacks Consensus Estimate is pegged at $188.6 million.

Management projects adjusted EBITDA in the range of $56 million to $58 million.

Recent News

On Mar 12, 2020, Paycom increases its share repurchase program to $250 million which would be completed between Mar 13, 2020 and Mar 12, 2022.

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 gained 8.5% so far this year and 13.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 61.7% and 23.7%, year-to-date (YTD), respectively. Over the past year, the Zacks sub-industry and the sector have soared 47.3% and 40.9%, respectively.

The S&P 500 Index has increased 5.4% YTD while has gained 18.3% in the past year.

The stock is currently trading at 18.02X forward 12-month sales, which compares to 8.51X for the Zacks sub-industry, 4.17X for the Zacks sector and 3.71X for the S&P 500 index.

Over the past five years, the stock has traded as high as 21.65X and as low as 4.35X with a 5-year median of 9.79X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $302 price target reflects 18.92X 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	18.02	8.51	4.17	3.71
	5-Year High	21.65	8.61	4.17	3.71
	5-Year Low	4.35	3.01	2.32	2.53
	5-Year Median	9.79	5.27	3.14	3.05
P/B TTM	Current	28.70	9.81	5.56	4.56
	5-Year High	37.45	10.13	5.84	4.56
	5-Year Low	13.53	2.28	3.16	2.83
	5-Year Median	25.39	5.31	4.44	3.75
EV/Sales TTM	Current	21.11	10.27	4.86	3.32
	5-Year High	26.60	10.47	4.86	3.46
	5-Year Low	5.80	3.02	2.59	2.14
	5-Year Median	12.45	5.99	3.63	2.87

As of 08/21/2020

Industry Analysis **Zacks Industry Rank:** Top 43% (108 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
Box, Inc. **(BOX)**	Neutral	3
Ceridian HCM Holding Inc. **(CDAY)**	Neutral	3
Cloudera, Inc. **(CLDR)**	Neutral	3
Evolent Health, Inc **(EVH)**	Neutral	3
HubSpot, Inc. **(HUBS)**	Neutral	3
Qutoutiao Inc. Sponsored ADR **(QTT)**	Neutral	3
StoneCo Ltd. **(STNE)**	Neutral	3
Zendesk, Inc. **(ZEN)**	Neutral	2

Industry Comparison Industry: Internet - Software

				Industry Peers		
	PAYC	**X Industry**	**S&P 500**	**BOX**	**CLDR**	**QTT**
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	F	-	-	C	B	A
Market Cap	16.81 B	978.30 M	23.62 B	2.68 B	3.53 B	747.86 M
# of Analysts	5	5	14	6	7	1
Dividend Yield	0.00%	0.00%	1.65%	0.00%	0.00%	0.00%
Value Score	D	-	-	D	D	C
Cash/Price	0.01	0.10	0.07	0.10	0.12	0.21
EV/EBITDA	62.34	-0.95	13.29	-50.29	-17.32	-2.02
PEG Ratio	3.50	4.86	3.03	NA	NA	NA
Price/Book (P/B)	28.70	7.92	3.11	65.52	2.53	NA
Price/Cash Flow (P/CF)	80.43	29.84	12.69	NA	NA	NA
P/E (F1)	87.40	88.15	21.51	35.28	42.21	NA
Price/Sales (P/S)	21.22	4.86	2.43	3.73	4.32	0.89
Earnings Yield	1.14%	0.21%	4.46%	2.82%	2.35%	-13.64%
Debt/Equity	0.05	0.13	0.76	9.06	0.13	-1.12
Cash Flow ($/share)	3.57	-0.00	6.93	-0.37	-0.40	-1.34
Growth Score	D	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	63.00%	15.48%	10.44%	NA	NA	NA
Proj. EPS Growth (F1/F0)	-6.91%	0.22%	-5.53%	1,577.77%	317.58%	73.53%
Curr. Cash Flow Growth	33.31%	6.87%	5.20%	-23.00%	-12.95%	35.27%
Hist. Cash Flow Growth (3-5 yrs)	58.95%	21.83%	8.52%	8.89%	NA	NA
Current Ratio	1.11	1.54	1.33	0.84	1.22	1.20
Debt/Capital	4.87%	25.21%	44.50%	90.06%	11.66%	NA
Net Margin	22.23%	-17.73%	10.13%	-18.56%	-35.67%	-43.29%
Return on Equity	30.80%	-14.72%	14.67%	-485.15%	-14.73%	-2,417.23%
Sales/Assets	0.38	0.59	0.51	0.80	0.36	1.98
Proj. Sales Growth (F1/F0)	12.27%	5.76%	-1.54%	9.81%	5.47%	17.41%
Momentum Score	F	-	-	D	D	D
Daily Price Chg	-2.12%	-0.42%	-0.15%	-1.77%	-2.37%	-2.58%
1 Week Price Chg	2.16%	0.00%	1.09%	-1.09%	0.09%	-11.36%
4 Week Price Chg	-1.37%	1.58%	1.64%	-2.84%	3.47%	-2.22%
12 Week Price Chg	0.00%	10.02%	6.72%	-8.88%	21.84%	12.82%
52 Week Price Chg	15.53%	9.25%	1.00%	31.26%	74.05%	-40.67%
20 Day Average Volume	523,405	547,595	1,873,576	1,440,753	2,746,620	1,219,721
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-11.80%	0.00%	1.79%	0.00%	0.00%	0.00%
(F1) EPS Est 12 week change	-14.01%	4.19%	3.35%	29.64%	2.34%	-4.00%
(Q1) EPS Est Mthly Chg	-28.42%	0.00%	0.42%	0.00%	1.23%	0.00%

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	D
Growth Score	D
Momentum Score	F
VGM Score	F

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.

Disclosures

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