

Paylocity Holding (PCTY)

\$128.81 (As of 01/06/20)

Price Target (6-12 Months): **\$135.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 10/30/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:F

Value: F

Growth: C

Momentum: C

Summary

Paylocity's performance is driven by client additions and ARPU growth. The company is benefiting from the growing adoption of its solutions among clients with less than 50 employees. Moreover, healthy momentum in the company's core and upper end of the market is a tailwind. Further, the release of Learning Management System and Community portal, which garnered a positive feedback from clients, is encouraging. Also, the addition of on-demand pay to its portfolio is likely to boost client wins going forward. Nonetheless, the near-term headwinds to margin given the lower interest rate are a concern. Increasing competition from ADP and Ceridian is an overhang.

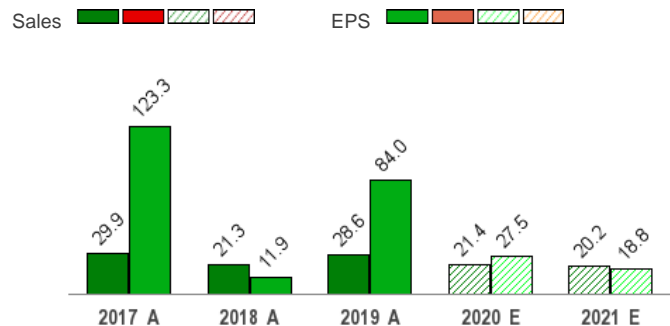
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$129.97 - \$60.69
20 Day Average Volume (sh)	278,797
Market Cap	\$6.9 B
YTD Price Change	6.6%
Beta	1.50
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Internet - Software
Zacks Industry Rank	Top 39% (100 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	33.3%
Last Sales Surprise	2.1%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/05/2020
Earnings ESP	0.0%
P/E TTM	84.2
P/E F1	73.2
PEG F1	3.7
P/S TTM	14.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	151 E	156 E	201 E	173 E	683 E
2020	127 A	130 E	167 E	144 E	568 E
2019	101 A	105 A	140 A	120 A	468 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.36 E	\$0.37 E	\$0.90 E	\$0.46 E	\$2.09 E
2020	\$0.36 A	\$0.29 E	\$0.73 E	\$0.37 E	\$1.76 E
2019	\$0.20 A	\$0.23 A	\$0.60 A	\$0.34 A	\$1.38 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 01/06/2020. The reports text is as of 01/07/2020.

Overview

Illinois-based Paylocity Holding Corporation offers cloud-based payroll and human capital management (HCM) software solutions to medium-sized organizations across the U.S.

The company defines medium-sized organizations as those with employee strength between 20 and 1,000. Paylocity served approximately 20,200 clients (excluding clients acquired as part of the BeneFLEX acquisition) across the U.S. at the end of fiscal 2019.

The company, through its broad product portfolio, helps organizations to make strategic human capital decision, enhance their human resource, payroll, and finance capabilities.

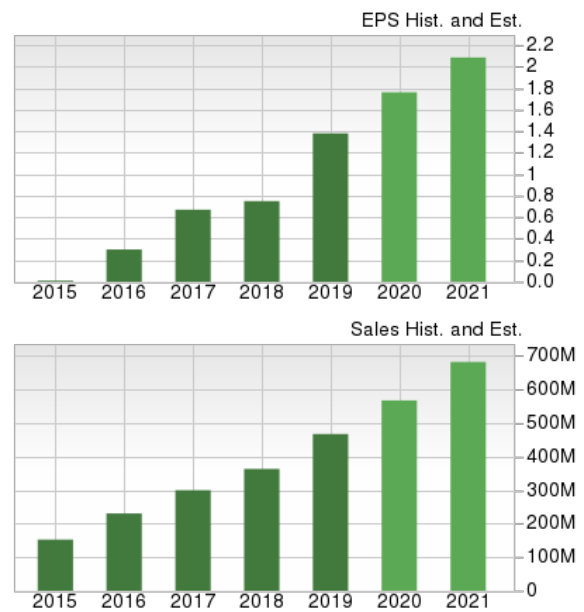
The company's key products include Paylocity Web Pay that provides enterprise-grade payroll processing and administration; Paylocity HR, a set of HR capabilities that improves HR compliance, reporting capabilities, and management of employee information; Paylocity Impressions, an advanced social media feature that integrates peer-to-peer collaboration and recognition in employees; Performance Management, which is used for employee performance appraisal process; Self-Service HR Portals designed to provide employees and managers access to critical payroll and HR information; Paylocity Web Onboarding that enables new employees to acquire necessary knowledge, skills and behaviors and events management; Paylocity Web Time, a time-and-attendance solution; and Paylocity Web Benefits and Paylocity Enterprise Benefits, powered by swift, which per the company "benefit management solutions that integrate with insurance carrier systems to provide automated administrative processes".

Paylocity reported revenues of \$467.6 million in fiscal 2019, up 26% year over year.

Recurring revenues (98% of total revenues) comprising recurring fees and interest income on funds held for clients increased 26% year over year to \$467.6 million in fiscal 2019.

Recurring fees, attributable to the company's cloud-based payroll and HCM solutions, accounted for 93.4% of total revenues while Interest Income on Funds Held for Clients contributed 4.3%. Implementation services and other revenues generated 2.3%.

Paylocity's main competitors are Automatic Data Processing, Inc., Oracle, Paychex, Inc., Paycom Software, Inc., Paycor, Inc., Cornerstone OnDemand, Inc., Ultimate Software Group, Inc. and Workday, Inc.



Reasons To Buy:

- ▲ Paylocity holds a dominant position in the payroll processing and human capital management market, primarily due to its robust product portfolio. The company continues to frequently upgrade its existing product portfolio as well as launch new products. Additionally, the Affordable Care Act compliance which was launched in fiscal year 2016 is a positive for the business as it makes it mandatory for companies to buy additional HCM solutions. We believe that higher traction of Paylocity's ACA dashboard application that tracks employee count, employee status and health care plan affordability will act as a tailwind for the company in the long run.
- ▲ Paylocity has grown significantly 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. Revenue growth seems to be steady and is positively impacted by higher recurring revenues and higher traction in cloud-based offerings. Higher revenues will expand margins and increase profitability in the long run.
- ▲ Paylocity offers end-to-end SaaS HCM solution that minimizes data-integrity issues across applications. SaaS solutions are easier and affordable to implement and operate than those offered by traditional software providers. It helps organizations update software faster, without the need for any new hardware investments, thereby allowing them to react better to changes in their business environment. In the last few quarters, a significant portion of revenues was generated from clients moving from traditional payroll service providers to the company's SaaS-based services. We are also positive on Paylocity's continued investment in SaaS technology and mobile applications. Paylocity's SaaS-based solution reduces time, risk and headcount related to installing and maintaining applications for on-premise products. SaaS deployments are easy and help in reducing ownership costs for customers. Growth of cloud computing has supported the SaaS delivery model. Gartner expects the global SaaS market to grow from \$80 billion in 2018 to \$143.7 billion in 2022. With its SaaS-based applications, we think that Paylocity is well positioned to lead the market.
- ▲ Paylocity expands its client base with the help of direct sales force. The company is gaining market share over the most critical client demand area of HCM, which in turn, supports its growth. The HCM solution includes 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, continued focus on client retention, on the basis of high client satisfaction, has helped the company to maintain its average annual revenue retention rate of more than or equal to 92% for all the said years.
- ▲ The acquisition of BeneFLEX has enriched Paylocity's product suite with a host of benefit administration related solutions. BeneFLEX manages employee benefit related plans including the likes of health savings accounts (HSAs), health reimbursement accounts (HRAs), flexible spending accounts (FSAs), and COBRA for the Midwest and California based mid-market clients.
- ▲ Paylocity is a cash-rich company with a strong balance sheet. Paylocity generated approximately \$115 million cash from operating activities in fiscal 2019 compared with \$97.9 million in the prior fiscal. Free cash flow was \$76.1 million or 16.3% of revenues for fiscal 2019 compared with \$48.8 million or 12.9% of revenues in fiscal 2018. Further, the company achieved its target free cash flow range of 15-20% of revenues. Cash and cash equivalents as of Jun 30, 2019 was approximately \$132.5 million. Since it has no debt on its balance sheet, the existing cash can be used for pursuing strategic acquisitions, investment in growth initiatives and distribution to shareholders.

Paylocity's regular investments in technological upgrades, along with product innovation, will continue to boost its top line.

Reasons To Sell:

- ▼ Paylocity is likely to be affected by weak economic conditions as employment levels tend to decline and interest rates become more volatile. Lower or falling interest rates generally cause Paylocity's float income to decline. These conditions may have an adverse effect on the company's business owing to lower transaction volumes or loss of clients. Potential clients tend to lower their overall spending on payroll and other HCM services. We believe that this will cause Paylocity to come under pressure, thereby reducing revenue growth potential in the future.
- ▼ Competition in the HCM software market is increasing, which could lead to pricing pressure and affect Paylocity'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 Paylocity's dominance could be challenged by new entrants. This could make the company take resort to competitive pricing to maintain and capture further market share. This apart, the ongoing trend to invest more in cloud solutions exposes Paylocity to the risk of losing existing "on-premise customers", which can adversely impact its top-line performance, especially in the short run.
- ▼ Paylocity's SaaS network infrastructure is a crucial part of its business operations. These SaaS-based solutions are prone to certain disruptions caused by human error, cyber threats, security breaches etc. 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. Cyber-attacks and security vulnerabilities might result in lower revenues, higher costs, liability claims, and can be a competitive disadvantage. Paylocity depends upon information technology (IT) networks, cloud-based platforms, and systems to maintain various business processes. These disruptions may lead to increased customer dissatisfaction.
- ▼ We note that Paylocity currently has a trailing 12 month Price/Book Value (P/B) ratio of 22.27. This level compares unfavorably with what the industry saw over the last year. Hence, valuation looks slightly stretched from a P/B perspective.

Competition in the payroll processing sector from new and existing players such as Automatic Data Processing, Oracle Corporation and Paychex remains a major headwind.

Last Earnings Report

Paylocity Reports Solid 1 Results

Paylocity delivered first-quarter fiscal 2020 non-GAAP earnings of 36 cents per share, topping the Zacks Consensus Estimate of 27 cents. The bottom line was also way higher than the year-ago quarter's 20 cents.

Additionally, Paylocity's revenues of \$126.7 million improved 26% year over year and also trumped the Zacks Consensus Estimate of \$117 million.

The company is benefiting from the growing adoption of its solutions among clients with less than 50 employees. Moreover, healthy momentum in the company's core market and upper end of the target market is a tailwind.

Further, the release of Learning Management System and Community portal, which garnered a positive feedback from clients, is encouraging. Also, the addition of on-demand pay to its portfolio is likely to boost client wins going forward.

Quarter in Detail

Paylocity's top line was driven by a 26% rise in recurring revenues (96% of total revenues), which totaled \$121.9 million. Interest income on funds held for clients jumped 38.4% to \$4.85 million.

Growing momentum from the company's new product offerings is reflected in client additions while an increase in average revenue per client is boosting recurring revenues. Further, channel referrals, mainly from benefit brokers and financial advisors, represented more than 25% of new business in the reported quarter.

Partnerships in the technology space with computer software provider Compete and the microsavings tech company EvoShare were noteworthy in the period.

The company's non-GAAP gross profit came in at \$90.3 million, up 28.3% year over year. Non-GAAP gross margin also expanded 120 basis points (bps) year over year to 71.2%, aided by consistent revenue growth and a steady scale in business model.

Adjusted EBITDA surged 30.9% from the year-ago quarter to \$30.5 million. Also, adjusted EBITDA margin of 24.1% expanded 100 basis points.

Non-GAAP operating income of \$21.5 million soared 40.6% year over year.

Paylocity exited the reported quarter with cash and cash equivalents of \$100.5 million compared with \$132.5 million in the earlier reported quarter.

Cash flow from operations for the fiscal first quarter was \$8.3 million compared with \$7.3 million in the year-ago period.

Guidance

For the fiscal second quarter, Paylocity expects revenues in the range of \$129.5-\$130.5 million, indicating 21-22% growth from the year-ago reported figure. Adjusted EBITDA is projected in the band of \$30-\$31 million.

For fiscal 2020, the company anticipates revenues in the bracket of \$567-\$569 million, up from \$563.5-\$565.5 million predicted earlier. Adjusted EBITDA is forecast within \$163.5-\$165.5, up from \$161.5-\$163.5 million envisioned earlier.

Lower interest rate and sluggish macroeconomic issues are a concern. The company's guidance takes into account the 25 bps rate cut announced by the Fed.

Quarter Ending **09/2019**

Report Date	Oct 30, 2019
Sales Surprise	2.09%
EPS Surprise	33.33%
Quarterly EPS	0.36
Annual EPS (TTM)	1.53

Recent News

On Oct 9, 2019, Paylocity and Compeat announced a partnership, per which the latter's customers will be able to make strategic decisions, cultivate a modern workplace and boost employee engagement on the platform of the former.

On Oct 4, 2019, Paylocity and EvoShare announced a partnership that aims at fully automating the process of funding additional savings account contributions with cash-back from employees' everyday spending for HR and Payroll teams.

Valuation

Shares of Paylocity have rallied 27.6% in the past six months and 107% over the trailing 12-month period. Stocks in the Zacks sub-industry declined 6.9%, while the Zacks Computer & Technology sector rallied 13.7% in the past six months. Over the past year, while the Zacks sub-industry has increased 14.7%, the sector gained 31.7%.

The S&P 500 Index has risen 9.7% so far this year and 25.1% in the past year.

The stock is currently trading at 10.98X forward 12-month sales, which compares to 6.02X for the Zacks sub-industry, 3.57X for the Zacks sector and 3.47X for the S&P 500 index.

Over the past five years, the stock has traded as high as 11.94X and as low as 4.5X with a 5-year median of 7.18X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$135 price target reflects 11.53X forward 12-month sales.

The table below shows summary valuation data for PCTY

Valuation Multiples - PCTY					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	10.98	6.02	3.57	3.47
	5-Year High	11.94	15.61	3.57	3.47
	5-Year Low	4.5	3.03	2.3	2.54
	5-Year Median	7.18	5.31	3.01	3
P/B TTM	Current	22.27	6.7	5.33	4.41
	5-Year High	22.27	8.17	5.38	4.45
	5-Year Low	10.98	2.28	3.13	2.85
	5-Year Median	16.18	5.16	4.21	3.6
EV/Sales TTM	Current	13.85	6.49	4.19	3.23
	5-Year High	13.85	11.57	4.2	3.3
	5-Year Low	5.51	3.01	2.56	2.16
	5-Year Median	8.79	6.01	3.44	2.8

As of 01/06/2019

Industry Analysis Zacks Industry Rank: Top 39% (100 out of 254)



Top Peers

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

Industry Comparison Industry: Internet - Software				Industry Peers		
	PCTY Neutral	X Industry	S&P 500	ADP Neutral	CDAY Neutral	PAYC Neutral
VGM Score	F	-	-	C	F	D
Market Cap	6.89 B	633.31 M	23.72 B	73.64 B	9.99 B	16.24 B
# of Analysts	10	5.5	13	11	5	8
Dividend Yield	0.00%	0.00%	1.79%	2.14%	0.00%	0.00%
Value Score	F	-	-	D	F	F
Cash/Price	0.02	0.11	0.04	0.07	0.03	0.01
EV/EBITDA	75.68	-2.04	13.90	15.60	93.40	79.22
PEG Ratio	3.64	2.39	2.00	2.13	NA	2.36
Price/Book (P/B)	22.27	4.98	3.34	13.74	5.36	34.20
Price/Cash Flow (P/CF)	74.04	33.83	13.67	19.93	156.24	104.21
P/E (F1)	72.84	54.27	18.72	27.63	102.68	64.97
Price/Sales (P/S)	14.03	4.35	2.66	5.13	12.45	23.38
Earnings Yield	1.37%	0.79%	5.31%	3.62%	0.98%	1.54%
Debt/Equity	0.25	0.09	0.72	0.19	0.37	0.07
Cash Flow (\$/share)	1.74	-0.01	6.94	8.54	0.44	2.67
Growth Score	C	-	-	B	C	B
Hist. EPS Growth (3-5 yrs)	126.93%	16.72%	10.56%	15.36%	NA	72.86%
Proj. EPS Growth (F1/F0)	27.68%	15.09%	7.42%	13.01%	13.80%	25.24%
Curr. Cash Flow Growth	96.78%	4.03%	14.83%	15.63%	14.89%	121.28%
Hist. Cash Flow Growth (3-5 yrs)	220.86%	14.52%	9.00%	14.63%	NA	69.57%
Current Ratio	1.09	1.53	1.23	1.01	1.10	1.10
Debt/Capital	19.79%	18.02%	42.92%	15.77%	27.16%	6.18%
Net Margin	11.78%	-14.19%	11.08%	16.52%	11.34%	23.99%
Return on Equity	19.03%	-12.09%	17.16%	46.94%	2.24%	38.52%
Sales/Assets	0.28	0.66	0.55	0.34	0.13	0.40
Proj. Sales Growth (F1/F0)	22.07%	17.93%	4.15%	5.72%	12.78%	23.17%
Momentum Score	C	-	-	B	C	D
Daily Price Chg	2.50%	0.55%	0.10%	0.14%	-0.14%	1.97%
1 Week Price Chg	3.26%	0.47%	-0.30%	-0.47%	2.45%	1.42%
4 Week Price Chg	6.41%	1.45%	2.33%	0.66%	12.40%	3.46%
12 Week Price Chg	28.68%	1.00%	7.02%	4.76%	41.16%	26.17%
52 Week Price Chg	110.23%	2.82%	24.61%	30.38%	93.29%	124.07%
20 Day Average Volume	278,797	249,566	1,589,897	1,380,995	646,209	355,317
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-2.90%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.10%	-5.63%	0.00%
(F1) EPS Est 12 week change	3.73%	-0.20%	-0.56%	-0.06%	-15.19%	-0.18%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-0.06%	0.00%	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	F
Growth Score	C
Momentum Score	C
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.

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