

Paycom

Unlocking value through efficient Human Resource Management

INTRODUCTION

Paycom provides a cloud-based platform delivering value across every aspect of human resource management (HRM). Revenues are derived from the payroll processing function that the users must incorporate in order to access the multitude of other functions that reduce administrative burden, increase efficiency and employee engagement. The platform requires no client customisation and so is truly scalable. Return on Invested Capital (ROIC) is very high at 40% and gross margins at 85%. The product is popular in the market with revenues growing at over 30% with recurring revenues at 98%. Enormous value is created for long-term equity holders with all growth and development being funded by internal cash flows, very little debt, and accumulating retained earnings.

Functionality Delivering Value

Paycom is a leading provider of HRM automation. They provide a self-service platform for every aspect of HRM management that delivers exceptional cost gains to the organisation. To access functionality across talent acquisition, education, HR management, and time and labour management the user must process payroll through the platform and in doing so Paycom collects revenue. Recent upgrades have included duplicate

finding functionality and a means of tracking employee engagement and productivity that allow the user to directly measure return on investment. These initiatives, industry firsts, have grown recurring revenues from 92% to 98%. The solution is demanded in the market with revenues growing at 39.5% CAGR over the last 6 years and still growing at 31% year on year as shown in Chart One below

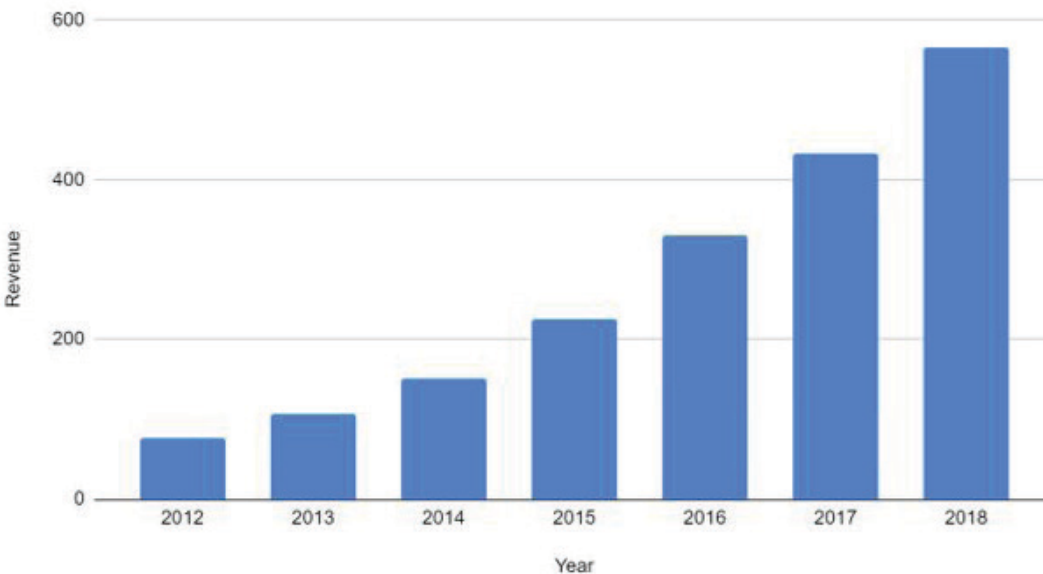


Chart 1. Paycom revenue growth from 2012 to 2018.

Significant Market to Grow Into

A large market opportunity remains untapped. Paycom currently serves 23,500 clients, a small fraction of the over 500,000 target clients in the 50 to 5000 employee range in the US alone, as shown in Chart Two below. However, recently Paycom has found market demand pulling upwards into the +5000 employees client range expanding market potential further. Significant need for the platform also exists outside of the USA and so we can see Paycom continuing its growth for some years to come.

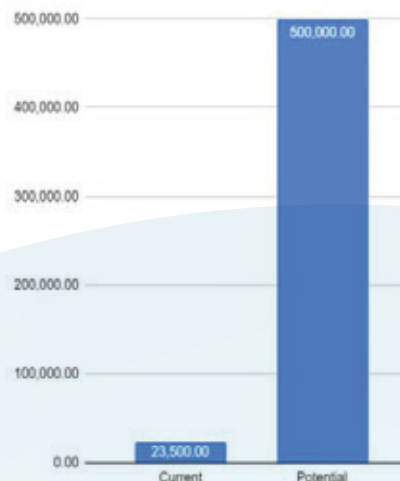


Chart 2. Current and potential market size in the USA.

No Competitor Matches Value Delivered

Nearest competitors amalgamate various providers of different solutions onto one platform. Various competitors operate in the payroll, HR management, and time and labour management segments but no competitor operates across all HRM requirements. By not providing a complete HRM solution these platforms are prone to error and duplicates and are not capturing all relevant data. By providing a complete end-to-end HRM solution, Paycom has positioned itself as a clear leader in value delivered, as evidenced by over 39% revenue CAGR and 98% client retention.

Exceptional Value Creation for Equity Holders

All development is conducted in-house on a single platform that eliminates the need to upgrade or access multiple databases as required by competitors. No client requires any customisation. The result is a true platform effect; adding additional clients requires very little friction. As investors, this results in ROIC of 40% and distributable earnings of \$186m USD. The scaling effects can be shown in Chart Three below with cash flow as a portion of revenue moving up to 39% in 2018 from 13% in 2012.

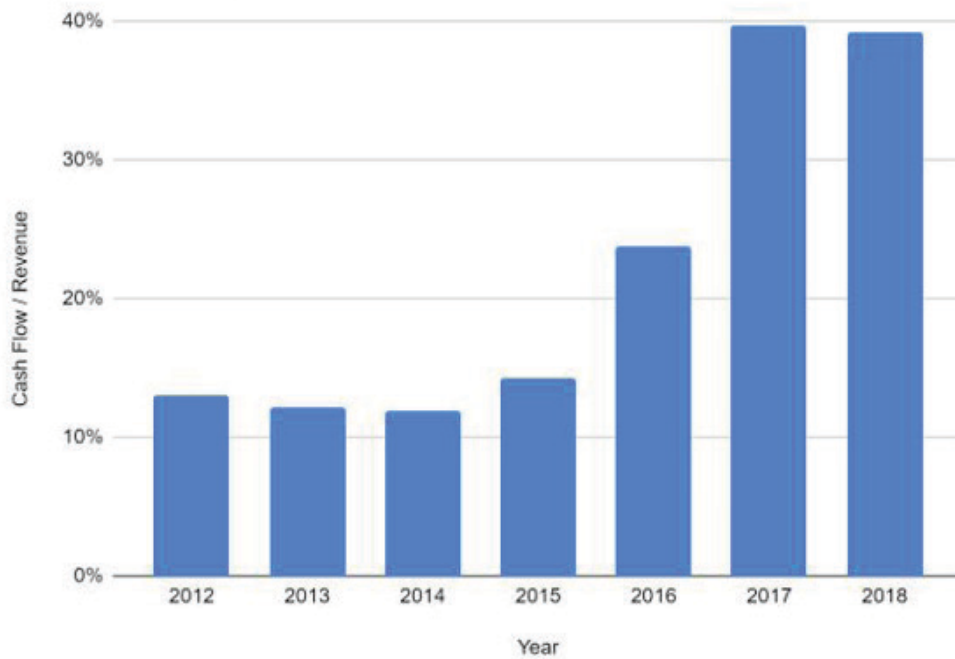


Chart 3. Cash flow as a portion of revenue growing from 13% in 2012 to 39% 2018.

Inherent profitability coupled with fast growth captures enormous value for long-term holders of equity in Paycom. With high margins, little debt, and a low requirement for capital expenditure free cash flows accumulate in retained earnings, and while this continues, so to must the company value. See Chart Four below.

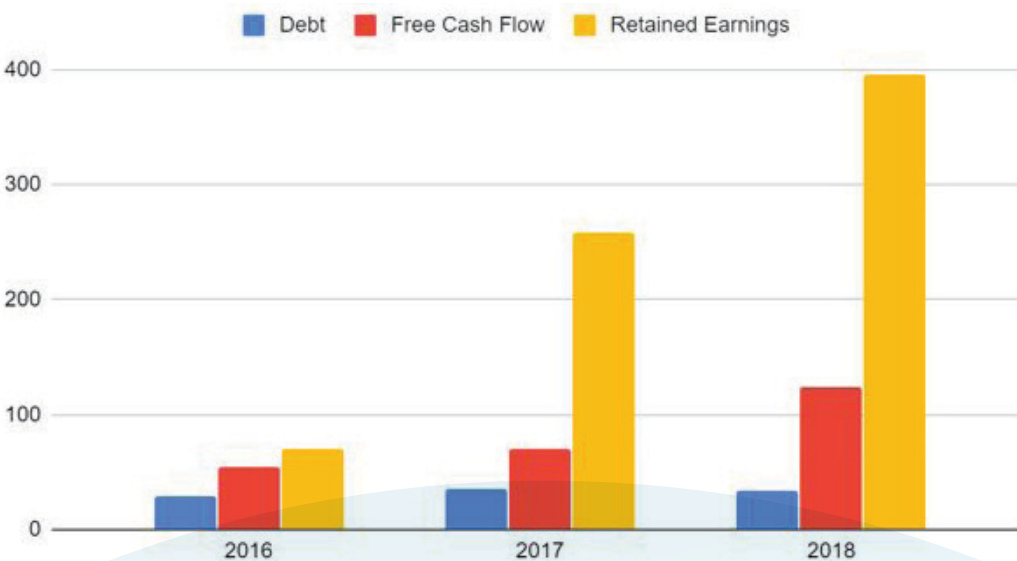


Chart 4. Low debt with high free cash flow and retained earnings.

Well Managed

Chad Richison manages Paycom as a sensible owner, having founded the company himself in 1998. This is evidenced in the balance sheet with total debt only 19% of annual cash flows. All growth is funded from cash flows and as such there is no need to sell shares. Diluted shares outstanding is flat: 57.92m in 2015 and 58.58m in 2018 with growth in revenue at a brisk 36% CAGR over that period. Management incentives display some of the best alignment we've seen with all management remuneration of a reasonable amount and directly linked to both revenue and net income growth.

Stock Price Usually Overvalued

The market has not overlooked Paycom's quality. Stock price usually represents a value higher than discounted future cash flows. We followed Paycom for some 12 months before finding our first entry points during the market crash of December 2018 as shown in Chart Five below.



Chart 5. Paycom entry points 13/12/18, 18/12/18, and 25/06/19.