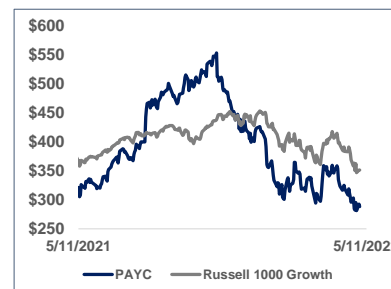


Recommendation:

I recommend a long position in Paycom (PAYC) with a 5-year price target of \$721 (~22% IRR) based on a 26x 2026 EV / EBITDA multiple. I believe that Paycom's stock price does not currently reflect (a) Paycom's ability to scale its best-in-class mid-market Payroll & HCM software solution; (b) Paycom's highly efficient sales and customer acquisition strategy; and (c) Paycom's ability to expand operating margins and generate 40%+ Tangible Returns on Capital.

**Investment Considerations:**

Paycom is a high-quality best-in-class mid-market payroll and Human Capital Management (HCM) software solution that is scaling rapidly in an industry historically characterized by high customer captivity and low churn. Furthermore, Paycom has several growth levers that will enable 18% and 26% revenue and earnings growth CAGRs over the next decade, respectively. At the same, Paycom has been unfairly punished by the contracting tech valuations. Since November, Paycom's stock price is down 48% while ADP and Paychex's shares are flat to up low single digits (*Exhibit 11*). As a result, Paycom is now trading a discount on a 2024 EV / Revenue multiple basis to longtime payroll management incumbent Paychex and offers a 9x risk/reward return ratio.

Key Quotes from Management, Customers, and Employees:

1. *"For me, it is not what has been built, but what's left to be built"*

-Chad Richison, Paycom Founder / CEO

2. *"I think the product is really, really good. When you demo Paycom over some of the competitors and they see how efficient it is, and they're starting to understand that*

ROI that they can bring into the organization with Paycom, I think that's the main selling, driving factor to switch."

-Former Paycom Executive

3. *"I would say that Paycom wins 75% of the time against ADP, Ceridian 60%, probably 70%, Ultimate probably 65%, Paylocity probably like 65%...Paylocity's solution is not as strong, but their cost-effectiveness kind of weights that out."*

-Former Paycom Sales Manager

4. *"He's very aggressive. He sees an issue, no matter how tiny it is that you would think a CEO shouldn't really be engaged in, and he will be engaged in it."*

-Former Product Adoption and Operations Manager at Paycom

5. *"Their customer support was exceptional, not only during the sales process, but during the implementation and stabilization process....That was hands down the best experience we had in terms of customer support."*

-Director of Strategic Initiatives – Office of the CFO at Peak Campus

6. *"What [Bill Ackman] doesn't understand is they've (ADP) never been as strong as they ought to be in software and technology, so they made up for that weakness by having a high-touch business model."*

-Leon Cooperman (ADP Board Member) responding on CNBC to Bill Ackman's ADP Activist Campaign in 2017

Trading and Operating Statistics			
Share Price	\$288.46	Beta	1.47
Market Capitalization (MM)	\$17,624	Avg. 3M Daily Vol. (MM)	0.54
Shares Outstanding (MM)	62.2	EV (MM)	\$16,638
Free Float (%)	84.4%	LTM Revenue (MM)	\$1,056
Short Interest (%)	1.7%	EV / LTM EBITDA	38.6x
52 Week Range	\$278.37-\$558.97	LTM EBITDA	\$432

(\$M)	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Revenue	\$737	\$841	\$1,056	\$1,336	\$1,564	\$1,921	\$2,317	\$2,756
Change (%)	30.2%	14.1%	25.4%	26.6%	17.0%	22.8%	20.6%	18.9%
Recurring	\$724	\$826	\$1,037	\$1,310	\$1,535	\$1,891	\$2,286	\$2,724
Change (%)		14.0%	25.5%	26.3%	17.2%	23.1%	20.9%	19.2%
Implementation and Other	\$13	\$16	\$19	\$26	\$28	\$30	\$32	\$33
Change (%)		17.6%	20.9%	38.3%	8.9%	6.7%	4.7%	3.2%
Gross Profit	\$628	\$718	\$894	\$1,149	\$1,334	\$1,642	\$1,986	\$2,368
Margin (%)	85.1%	85.3%	84.7%	86.0%	85.3%	85.5%	85.7%	85.9%
S&M	\$179	\$236	\$276	\$323	\$360	\$429	\$499	\$566
% of Total Sales	24.3%	28.0%	26.1%	24.1%	23.0%	22.3%	21.5%	20.5%
R&D	\$73	\$90	\$118	\$143	\$157	\$185	\$214	\$243
% of Total Sales	9.9%	10.7%	11.2%	10.7%	10.1%	9.6%	9.2%	8.8%
G&A	\$128	\$178	\$210	\$261	\$280	\$321	\$372	\$425
% of Total Sales	17.3%	21.2%	19.9%	19.5%	17.9%	16.7%	16.1%	15.4%
EBITDA	\$268	\$239	\$321	\$460	\$583	\$761	\$962	\$1,203
Margin (%)	36.4%	28.5%	30.4%	34.5%	37.3%	39.6%	41.5%	43.7%
Adjusted EBITDA	\$318	\$331	\$419	\$585	\$729	\$940	\$1,178	\$1,460
Margin (%)	43.1%	39.3%	39.7%	43.8%	46.6%	48.9%	50.9%	53.0%
Net Income	\$180	\$143	\$196	\$299	\$383	\$511	\$657	\$834
Margin (%)	24.5%	17.0%	18.6%	22.4%	24.5%	26.6%	28.4%	30.3%
Return on Tangible Capital	39.6%	26.2%	36.2%	41.7%	45.4%	47.9%	47.4%	45.5%
Key Metrics								
Number of Parent Group Clients	13,581	16,063	17,703	20,801	23,921	26,971	29,871	32,559
% Change	6.5%	18.3%	10.2%	17.5%	15.0%	12.8%	10.8%	9.0%
SAM Penetration Rate	8.4%	9.8%	10.6%	12.9%	15.0%	16.3%	18.6%	20.8%
TAM Penetration Rate	3.5%	4.1%	4.5%	5.5%	6.3%	6.9%	7.8%	8.8%
Average Number of Employees	331	330	325	328	318	329	341	353
Average PEPM	\$14.1	\$13.9	\$15.0	\$15.8	\$16.2	\$17.2	\$18.2	\$19.2
Float Interest (\$M)	\$24	\$4	\$1	\$19	\$53	\$57	\$61	\$74

Variant View:

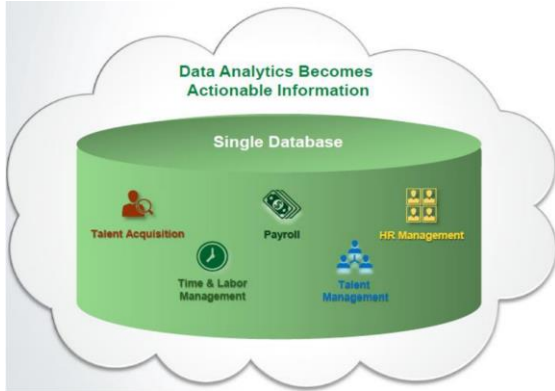
What the Bears Think	My View
Paycom's TAM is Saturated	Most of Paycom's 30% Revenue Growth CAGR (Since 2014) has come from expanding a regional Payroll SaaS solution nationwide. To date, Paycom has penetrated just 10% and 4.5% of the businesses in its Serviceable Addressable Market (SAM) and Total Addressable Market (TAM), respectively, while continuing to expand its SAM by moving upmarket.
Paycom Lacks a Competitive Advantage and Competition Will Dampen Growth Prospects	Paycom has a best-in-class Payroll and HCM SaaS solution that utilizes a single data base system of record, has strong product depth, a strong user experience, and can quickly adapt to an increasingly complex regulatory landscape. Paycom's rapid customer growth and customer testimonials suggest it is the clear bread winner in the upper mid-market segment.
Primarily all Mid-Market Clients use a 3rd Party Payroll and HCM Solution	Research suggests that 1 in 6 mid-market firms still use a regional payroll solution or process payroll in-house. Due to the increasingly complex regulatory landscape and customer preferences for an adaptive payroll / HCM solution coming out of the Pandemic, this number will fall to LSD by 2027.
Chad Richison is an Overpaid CEO	Chad made headlines as the highest paid CEO you have never heard of in 2020 due to a generous \$200M pay package. That entire pay package is long-term in nature, requires Paycom to hit \$1000 a share within 6 years (200%+ upside) and \$1700 within 10 (450%+), and it will be rather insignificant if those targets are hit. Furthermore, outside of Elon Musk and Tesla, it would be hard to find another CEO more critical to a firm's competitive advantage.
Paycom is Particularly Prone to Downside Risk in an Economic Contraction	Paycom does deploy a price per employee billing model. It is true that if an economic contraction were to occur that could directly cause a 5-7% hit to revenue. However, that is a short-term consequence and would provide a revenue boost as the economy recovers. Furthermore, the value proposition of Paycom's leaner, cheaper, and higher quality solution accelerates in an economic downturn.
ADP Can Quickly Adapt its Mid-Market Solution and Compete with Paycom	ADP's mid-market and HCM suite have been built almost entirely through acquisition. This has led to a fragmented and inconsistent user experience, with disparate data sharing processes, and a significant amount of tech debt that prohibits rapid product evolution. Furthermore, there is a massive underappreciated tech talent gap that prevents static incumbents such as ADP from acquiring the requisite tech talent to catch up to Paycom.
Paycom's Margin Upside is Limited	Paycom operates at structurally higher gross margins than its competitors. However, through operating leverage it will rapidly improve R&D, S&M, and G&A margins as the business matures leading to 1000 bps of EBITDA margin improvement by 2026. Float interest will add another 90 bps.
Paycom's Margin's are Overstated	Bears frequently point out that Paycom deploys a practice in which it defers contract acquisition costs leading to overstated margins relative to peers. However, this practice is commonly used by payroll competitors and helps smooth out customer acquisition costs in an industry where most of a customer's LTV is realized after the first year. Furthermore, this practice won't lead to margin contraction over time.
Paycom is an overvalued SaaS business trading at 10x+ EV / Forward Revenue	On paper a >10x multiple seems expensive. However, it is a very high margin business and when you compare SaaS businesses on normalized earnings the company looks much cheaper. Furthermore, Paycom is continuing to scale rapidly, and the current stock price implies an 8x 2030 earnings multiple. It is important to note that Paychex a company with 50 years of operating experience, a more mature margin profile, and slower growth prospects trades at 10x forward revenue.

Business Description:

Paycom was founded in 1998 by Chad Richison who through his experience working at ADP and a regional payroll processing firm realized how inefficient legacy payroll management solutions were. Since then, Paycom has focused on developing a best-in-class payroll and HCM SaaS solution to manage the complete employment lifecycle from recruitment to retirement. Since IPO'ing in 2014, Paycom has grown revenue at a 32% CAGR, expanded its customer base to 18,000 parent group clients, and operates in 40 of the 50 largest metropolitan areas. Over the last several months Paycom has added sales teams in Manhattan, Las Vegas, Jacksonville, New England, and South Jersey. Having penetrated just 8% of the businesses in its Serviceable Addressable Market (SAM), Paycom has a massive growth runway ahead and is positioned to continue to scale rapidly.

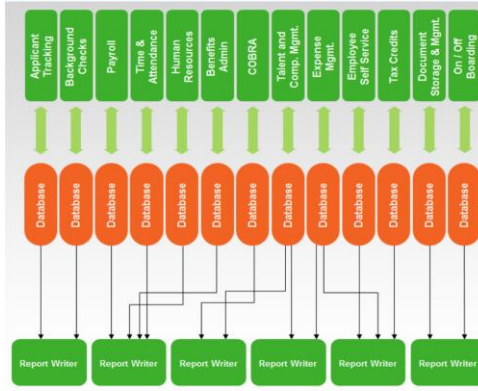
Paycom utilizes a single database for its payroll and HCM solution that requires virtually no customization. This allows for easy and cost-effective adoption and allows companies to self-manage their HCM activities in the cloud. Paycom's is also continuously expanding its HCM capabilities allowing it to quickly adapt to evolving HCM regulatory requirements, improve its user experience, and streamline HR processes. Paycom single database system of record differentiates itself from its closest competitors (Paylocity, and Paycor) in a meaningful way. Paycom also has a significant competitive advantage over legacy payroll providers that offer outdated and expensive on-premises solutions that are inefficient and have poor system integration and data integrity. Even as these legacy payroll providers (ADP and Paychex) have begun to migrate clients to cloud-based solutions, their platforms are laced with decades of technology debt creating a fragmented user experience. Furthermore, there is a massive and underappreciated technology talent gap that will prevent Paychex and ADP from hiring the requisite tech talent needed to catch up to Paycom and other SaaS competitors as this talent has largely concentrated at large technology firms (Google, Apple, Microsoft) and upstart SaaS companies.

Paycom Operating Model:



Source: Paycom Investor Presentation

Other Payroll Software Company Operating Models:



Source: Paycom Investor Presentation

Over the last couple of years Paycom has continued to iterate and innovate its payroll and HCM solution. In 2020, Paycom launched “Manager-on-the-go” which is a tool in Paycom’s mobile app that allows managers to perform a variety of HCM tasks 24/7 from anywhere. In 2021, Paycom launched BETI, an industry-first technology that empowers employers to do their own payroll by further automating and streamlining the payroll process.

Core Payroll and HCM Solutions:

Paycom’s core product suite includes payroll, talent acquisition, time and labor management, talent management, and HR management. With the exception of Paycom’s learning and expense management tools, a large share of Paycom customers use the full suite of payroll and HCM capabilities.

- **Payroll-** Paycom’s payroll and tax solution is the central part of its offering and is required to be used by all customers. Employee information is updated in real time enabling efficient payroll processing. Additional payroll processes include expense management, mileage tracking, garnishment administration, and general ledger reporting.
- **Talent acquisition-** Paycom’s talent acquisition capabilities include applicant tracking, enhanced background checks, onboarding, E-Verify, and tax credit services.
- **Time and labor management-** Paycom’s time and labor management capabilities include time and attendance, automated scheduling, vacation monitoring, labor allocation, labor management reports, and geofencing / geotracking.
- **Talent management-** Paycom offers a complete talent management suite including employee self-service, compensation budgeting, performance review and management, advanced analytics, and Paycom learning.
- **HR Management-** Paycom’s HCM suite includes advanced HR management capabilities including Manager-on-the-Go, benefits administration, COBRA administration, surveys, and employee support.

Pricing:

Payroll software providers are rapidly churning over customers from both ADP and Paychex by offering a streamlined payroll and HCM software solutions at less than half of the cost. On average ADP and Paychex charge \$405 and \$396 Per Employee Per Year (PEPY), respectively. In comparison Paycom, Paycor, and Paylocity charge \$180, \$173, and \$153 PEPY, respectively. While Paycom’s offering is priced at a 5-20% premium to Paylocity and Paycor, it has a more comprehensive SaaS solution, a more robust customer support department, and its HCM capabilities are nearly fully penetrated. In comparison, Paylocity and Paycor’s HCM suite is only partially penetrated and when accounting for this difference they are just as costly or more costly than Paycom’s solution.

On a per payroll basis, Paycom generates roughly \$7 in revenue per employee broken out as follows:

- Payroll and employee self-service (\$2); time and attendance (\$2-\$3); applicant tracking (\$.50); onboarding (\$.50); scheduling (\$.40); geofencing (\$.15); general ledger report updates (\$.10); performance and compensation (\$1-\$2); Paycom learning (\$3); expense management (\$.50).

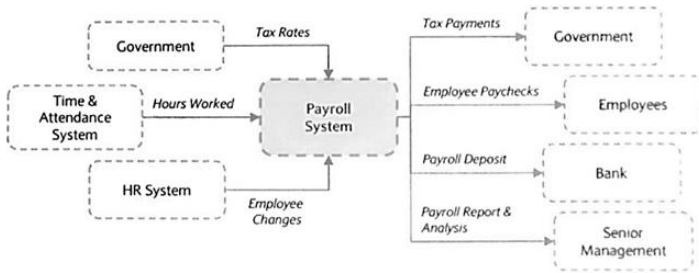
Industry Overview / TAM:

The payroll / HCM industry is a \$70 billion market growing at mid to high single digits annually. The TAM is comprised of the \$50B payroll market which has grown at a ~4% CAGR over the last decade and the \$20B HCM market which has grown at a

low double digit CAGR and is expected to grow at a ~10% CAGR through 2024. The payroll management space has long been controlled by incumbents Paychex, who has traditionally controlled the SMB – Mid-Market side of the market, and ADP, who has controlled the Mid-Market - Enterprise side of the market.

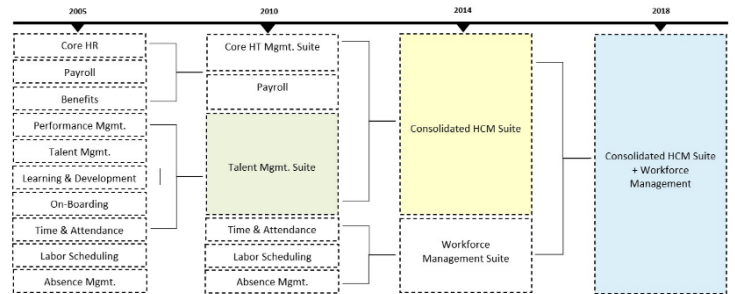
ADP (Founded in 1949) and Paychex (Founded in 1971) were originally founded as payroll management solutions that helped companies process payroll manually. According to ADP’s 1998 annual report, over 40% of payroll was still being processed manually, 10% was being processed by an accountant, while only 15% of payroll was being processed by third parties. The majority of these 3rd parties were regional payroll providers. Since then technological innovation and the evolution of direct deposit have transformed the payroll industry and the industry has naturally evolved from a fee per check model to a fee per employee model. Over the last 10 years, ADP, Paychex, and payroll software companies have introduced HCM capabilities that have natural synergies with payroll management solutions. As the payroll and HCM suite has become more complex, businesses have continued to move away from utilizing accountants, regional payroll providers, and processing payroll in-house. However, approximately ¼ of businesses still process payroll through these sources.

Payroll Process Steps:



Source: Barclays

Evolution of the HCM Suite:



Source: Barclays

There are three primary payroll methods that are utilized today:

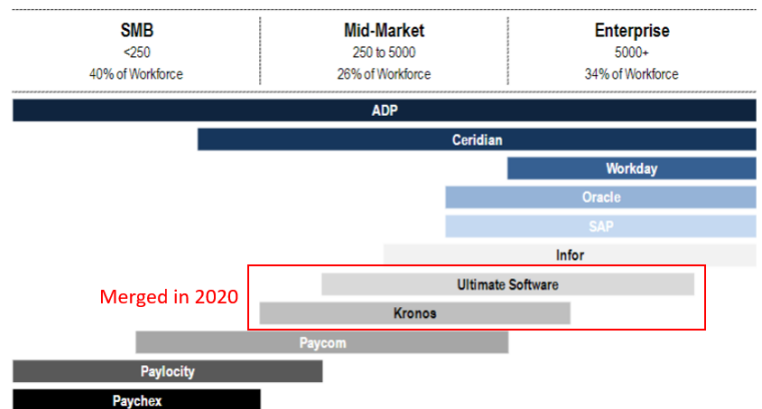
- Outsourced Payroll:** The payroll bureaus ADP, Paychex, and Ceridian have traditionally offered outsourced payroll solutions to handle payroll submission and reconciliation. These companies have typically provided a premium-priced comprehensive suite of payroll management capabilities to manage all payroll servicing needs. However, these solutions have generally been bulky, stagnant, and often provided businesses with far greater functionality than what was needed.
- PEO Model:** The PEO model is a completely outsourced payroll and HR solution that is offered by ADP, Paychex, and Trinet. PEO has been a sizable growth driver for legacy payroll bureaus and is a valuable solution for small businesses that often lack the capacity to manage a formal HR department.
- Software-Based Payroll and HCM Solutions:** Payroll software companies provide companies with a streamlined suite of software capabilities to efficiently manage payroll processing and HR in house.

Competition:

Competition in the payroll and HCM industry can best be analyzed by breaking out the various competitive forces across the SMB, Mid-Market, and Enterprise markets separately. Businesses that operate in each of these segments have distinct business needs that require a tailored payroll and HCM solution to fit their needs.

1. SMB (1-300 employees):

Long-time incumbent, Paychex, still controls 20% of the SMB market (based on # of employees). The SMB market segment accounts for 99% of all businesses and 44% of employees. At the lowest end of the market, Paychex (avg. client size = 15 employees) has seen increasingly fierce price competition as competitors have targeted Paychex’s expensive full-service outsourced payroll and HCM solution. Competitors include Gusto, Intuit, Square, ADP-run, Paycor, Paylocity, regional payroll providers, and accountants. Towards the middle portion of the SMB market, Paylocity (4-5% share of employees in SMB segment and an avg. client size of ~150 employees) and Paycor (2-3% share



of the SMB segment and an avg. client size of ~67 employees.) are scaling rapidly. Towards the upper end of the SMB market, Paycom (avg. client size is ~320 employees) competes with Paycor and Paylocity. Cost conscious customers will generally prefer Paycor / Paylocity while larger customers with sophisticated payroll and HCM needs prefer Paycom.

2. Mid-Market (300 – 5000 employees):

The mid-market is characterized by businesses that require more substantial payroll and HCM needs but have limited capacity to manage a robust HR department. Competitors include regional payroll providers, Paycom, Paylocity, Paycor, ADP-Workforce Now, UKG, SAP, Oracle, and Ceridian. In this segment, payroll software competitors are taking share from legacy solutions such as ADP and regional payroll providers who have struggled to keep pace with increasingly complex payroll and HCM requirements. In this segment, Paycom's robust offering tends to win out against Paycor and Paylocity. As a result, Paycor and Paylocity have opted to move down market while Paycom has continued to move upmarket. Towards the upper end of this market, Paycom competes with Ceridian, UKG, and ADP. However, Paycom's cost efficient and robust suite of capabilities has continued to capture clients from these competitors. Importantly, ADP has been a huge sort of churn as the firm lacks the tech. talent and capacity to remain competitive in this space.

3. Enterprise (5000 employees and up):

The enterprise side of the market has long been controlled by ADP (35-40% segment marketshare) who offers a comprehensive suite of domestic and international servicing capabilities. While ADP's servicing solution is clunky and laced with sizable technology debt there are few competitors that offer the breadth of servicing capabilities that most large enterprise customers require. Furthermore, many enterprise customers demand significant customization. The enterprise segment accounts for only .1% of domestic businesses but 22% of employees. However, UKG, Oracle, Workday, Ceridian, ADP, and Paycom all compete in this market segment. Paycom which operates toward the lower end of this market segment has begun to capture a handful of companies with 10,000+ employees. That being said, Paycom offers limited customizable functionality and primarily appeals to enterprise customers that have more streamline servicing needs.

Investment Thesis:

1. Paycom's is positioned to scale its best-in-class mid-market payroll and HCM software solution in an industry undergoing significant disruption

Paycom has built its single database core system of record from the ground up. Over time, Paycom has continued to expand its HCM suite to keep pace with an evolving regulatory environment and customer preferences. After IPO'ing in 2014, Paycom began to expand nationwide. Since then it has grown revenue at a 30%+ CAGR and has penetrated ~10% of the employees in its SAM (companies within between 50 and 10,000 employees). Over the next five years, I expect that Paycom will double its penetration rate and grow revenue at a ~21% CAGR.

Paycom's streamlined and comprehensive payroll and HCM SaaS solution is particularly attractive to midsize businesses that have sophisticated payroll and HCM needs but often lack the budget and resources to manage a large HR department. Legacy payroll solutions are expensive, not user friendly, and struggle to adapt to consumer needs in an evolving regulatory environment. Today, ~50-65% of the mid-market is still controlled by ADP, Paychex, and regional payroll providers providing a massive growth runway.

Paycom's single database core system of record differentiates the firm from its closest competitors, Paycom and Paycor. These competitors claim that Paycom is a closed loop system that lacks customization and does not support 3rd party integrations. While these are all true, anecdotal evidence including dozens of customer interviews, suggests that Paycom is the "Apple" of payroll software providing mid-size companies with a comprehensive and complete suite of payroll and HCM capabilities. These customer interviews suggest that while smaller cost-conscious businesses on the lower end of the mid-market may prefer a cheaper payroll software solution, Paycom has a dominant and highly defensible competitive moat that is attractive to businesses towards the upper-middle portion of the mid-market (150-5000 employee companies).

Paycom's competitive advantage over Paycor and Paylocity in terms of the breadth of its HCM offering can be understood by analyzing the adoption rates of HCM capabilities amongst each company. With the exception of Paycom's training and expense management tools, Paycom's HCM suite is close to fully penetrated across the majority of customers. In comparison, Paycor's core HCM suite is between 30-70% penetrated. While Paylocity does not disclose specific HCM capability penetration rates its actual Per Employee Per Year (PEPY) revenue generation of \$153 is only 36% of its stated full-suite PEPY suggesting that Paylocity's HCM suite has also not been as widely adopted. Given that these firms do not have as comprehensive HCM capabilities they rely on 3rd party applications to fill the gap. This gives Paycom long run

pricing power and I expect that Paycom will increase the cost of its payroll / HCM suite by 4-6% a year through a combination of HCM capability expansion and annual price increases.

That being said, the payroll management industry has been characterized by impressively high customer captivity and low churn as most C-Suite executives have taken the “If it isn’t broke, don’t fix it approach.” This is a double-edged sword in which Paycom will be able to maintain impressively low churn rates but will face challenges churning away customers from other payroll software competitors. As a result, Paycom will likely continue to scale by feeding on the churn coming from ADP and other regional payroll providers who offer inferior solutions for at least the next decade. Over the next five years, I assume that Paycom can grow its customer base at a 13% CAGR and can continue to acquire ~30% of its new customers from ADP churn and 25% of its new customers from regional payroll servicers (*Exhibit 9*). I assume that the remaining 45% of customer growth comes from new business formation as well as Paychex, Paylocity, Paycor, UKG, and Ceridian churn.

2. Paycom has a highly efficient sales team that will position the firm to continue to rapidly acquire new customers

It would be an understatement to say that Chad Richison is an integral part of Paycom’s expansion efforts. Anecdotal evidence from interviews with former employees paint a consistent picture; he demands excellence and sets exceptionally high benchmarks. His leadership has helped Paycom expand into a nationally recognized payroll software company. Under his watch, Paycom has opened offices in 40 of the 50 largest metropolitan areas. These offices are often staffed with between 6-8 employees and an experienced office leader. As a result of hundreds of inbound requests, Paycom has also expanded its inbound sales team to capture down market customers.

Chad Richison has deployed a unique and efficient sales strategy that has helped Paycom expand into new markets and accelerate penetration rates in existing markets. Unlike Paycor and Paylocity who prefer to build their sales teams by poaching talent from competitors, Paycom tends to hire young and hungry sales professionals with a few years of general sales experience. Through a rigorous training process, these employees are groomed into highly efficient Paycom sales team members. Former employees have described Paycom as one of the most intense sales environments in the U.S. In return for a rigorous work culture and exceptionally high sales standards, Paycom sales personnel are compensated generously. That being said, Chad Richison has been quoted several times in the past as saying that he is continuously monitoring SG&A spend to ensure that Paycom is spending efficiently on customer acquisition. This is evidenced by a LTV / CAC ratio between 4-6x. Furthermore, Paycom’s LTV / CAC is growing as Paycom ramps up its sales offices and existing teams become even more efficient. When looking at the LTV of customers acquired per sales team, Paycom sales teams have become 125% more efficient over the last five years (85% productivity and 40% PEPY increase).

Furthermore, Paycom’s decision to focus on the higher end of the mid-market provides a distinct competitive advantage in terms of retention rates. The involuntary churn rate of businesses with between 25-150 employees could be upwards of 10% as a result of business closures and consolidation. In comparison the involuntary churn rate of Paycom’s typical target market (300+ employees) is likely around 6-7%. Since its IPO in 2014, Paycom has realized significant operating leverage that resulted in 190 bps of gross margin improvement as a percentage of sales, 1190 bps of S&M improvement, 370 bps of G&A improvement, while R&D expenses rose by 350 bps as Paycom continued to expand its HCM suite. During this time EBITDA margins expanded by 1460 bps. In comparison to other competitors, Paycom’s gross margins are at least 1300 bps higher than any competitor while G&A and R&D expenditures remain near or above the highest levels in the industry as Paycom has continued to focus on product and market expansion. Over the medium term, I expect that Paycom will quickly recover towards pre-pandemic operating margins while realizing sizable operating leverage as its business continues to expand and mature over time. Over the next five years, I expect that gross margins will grow 25 bps a year, S&M will contract by 100 bps a year, R&D will contract by 40 bps a year, and G&A will contract by 80 bps a year. This will result in 260 bps of annual EBITDA margin expansion.

3. Paycom will be able to expand operating margins and generate strong returns on invested capital that will give Paycom flexibility to buy back stock and / continue to invest in expanding its suite of HCM capabilities

In the three years leading up to the Pandemic, Paycom’s gross margin expanded by 150 bps and the firm’s EBIDA margin expanded by 190 bps. Furthermore, while S&M expenditures dropped by 190 bps, a significant portion of S&M spend was attributable to building out and scaling new offices. I expect that the improving efficiency of Paycom’s sales teams coupled with the ability to cut back on S&M expenditures as Paycom’s penetration rate matures will lead to significant S&M margin improvement. In the long-run, S&M expenditures should approach those of ADP / Paychex.

Payroll and HCM Competitive Margin Profiles

Margin Performance	Paylocity	Paycor (Normalized)	Paycom	Paychex	ADP
Gross Profit Margin	67.6%	71.6%	84.7%	68.7%	46.0%
S&M Margin	25.9%	31.4%	26.1%	32.7%	20.6%
G&A Margin	18.7%	15.6%	19.9%		
R&D Margin	11.2%	8.8%	11.2%		
EBITDA Margin	12.2%	(4.5%)	30.4%	36.0%	22.0%
Adjusted EBITDA Margin	26.7%	15.6%	39.7%	36.8%	22.9%

Source: Company Filings

From 2021- 2026, I expect that EBITDA will expand from \$320M to \$1.3B. I expect that margin expansion will account for close to 30% of EBITDA growth. The other sources of EBITDA expansion are listed in Exhibit 5. As operating margins expand, I expect that returns on tangible invested capital will expand from ~35% pre-pandemic to 45+% by 2024.

Valuation Methodology:

Base Case:

My base case valuation is based off a 26x 2026 EV / Adjusted EBITDA multiple which implies a 2026 price target of \$721, 162% upside and a 22% investment IRR. This multiple is ahead of legacy payroll incumbents but slightly below the average payroll software multiple. I conservatively used a 26x multiple as I do believe that Paycom's payroll software peers have a deeper runway to grow operating margins. That being said, I do believe that Paycom has a distinct competitive advantage over its payroll software peers, operates in the more attractive (upper middle-market) end of the market, and will continue to expand its operating margins. I expect that from 2021 to 2026 Paycom will grow Adj. EBITDA at a 28% CAGR to \$1.46B and Adj. EBITDA margins will expand by 1330 bps. From 2026 to 2031, I expect that Paycom will continue to grow EBITDA at a 17% CAGR at which point Paycom's market penetration will begin to mature. Chad Richison has already stated that the firm may adopt international servicing capabilities over the medium to long-term providing an additional lever of growth and the ability to move further and further up market.

Bull / Bear Cases:

My bull case valuation is based off a 32x 2026 EV / Adjusted EBITDA multiple which implies a 2026 price target of \$1177, 327% upside and a 36% investment IRR. This multiple is a slight premium to other payroll software peers. In my bull case I assume that Paycom continues to benefit from ADP / Paychex churn, successfully continues its goal of moving upmarket, expands into additional large metropolitan markets, launches international servicing capabilities, realizes an acceleration in customer acquisition from other payroll software peers, and expands PEPM by introducing additional HCM capabilities. In my bull case I assume that Paycom can grow revenue at a 27% CAGR through 2026 and adj. EBITDA margins expand to 55%. My bear case valuation is based off a DCF with a 15x Terminal EV / EBITDA multiple (*Reference Exhibit 10*). The terminal multiple is in line with ADP / Paychex's historical multiple and is fairly conservative. This DCF implies a 19x 2026 EV / EBITDA Multiple. In my bear case, I assume an actual recession scenario in 2022, a moderate recovery, and customer growth tapering faster than expected due to increased competition. This scenario implies that Paycom's current price is within 20% of floor prices and an investment in Paycom currently offers a 9x risk / reward ratio.

	Base	Bull	Bear
2026 Revenue	2,756	3,449	1,990
2026 Adj. EBITDA	1,460	1,900	925
2026 Adj. EBITDA Margin	53.0%	55.1%	46.5%
Multiple	26.0x	32.0x	19.0x
2026 EV	37,970	60,795	17,580
- Net Debt	782	1,071	393
Equity Value	38,752	61,867	17,973
2026 D.Shares Outs.	54	53	55
Price Target	\$721	\$1,177	\$327
Current Stock Price	\$276	\$276	\$276
Implied Upside (Downside) on Investment	162%	327%	19%
IRR	22.4%	35.8%	3.6%
PV of Price Target	\$505	\$824	\$229
Implied Upside (Downside)	83%	199%	(17%)
Bull Bear Risk Reward Tradeoff		8.9x	

*Bear Case reflects immediate recessionary scenario + increased competitive pressures. Multiple is triangulated using recession scenario DCF in the Appendix

Comps:

Payroll Comps	Ticker	Market Cap (B)	EV (B)	Net Debt (Cash) (B)	Rev. CAGR (2022-2024)	Adj. EV / Rev. (2024)	Adj. EBITDA Margin (2024)	Adj. EBITDA CAGR (2022-2024)	Adj. EV / EBITDA (2022)	Adj. EV / EBITDA (2024)	Adj. Net Income Margin (2024)	Adj. EPS CAGR (2022-2024)	Adj. P/E (2022)	Adj. P/E (2024)
Paychex	PAYX	\$46.1	\$46.0	-\$0.1	6.5%	8.9x	44.2%	6.9%	22.9x	19.8x	30.1%	7.7%	34.3x	29.4x
ADP	ADP	\$92.1	\$94.2	\$2.1	7.5%	5.0x	27.0%	10.2%	22.5x	18.6x	18.5%	10.1%	31.8x	25.4x
Paylocity	PCTY	\$10.7	\$11.0	\$0.3	21.1%	7.6x	28.8%	25.8%	39.5x	24.7x	18.5%	22.3%	63.5x	37.6x
Paycor	PYCR	\$4.4	\$4.4	\$0.0	16.5%	7.5x	30.1%	34.3%	45.4x	25.3x	9.1%	N/A	140.7x	80.6x
Ceridian	CDAY	\$8.7	\$9.7	\$1.0	17.5%	5.2x	17.9%	25.9%	50.0x	31.5x	4.0%	N/A	153.4x	64.5x
Average					13.8%	6.8x	29.6%	20.6%	36.1x	24.0x	16.1%	13.3%	84.7x	47.5x
Median					16.5%	7.5x	28.8%	25.8%	39.5x	24.7x	18.5%	10.1%	63.5x	37.6x

Management Team and Incentives:

Management Team:

Chad Richison, Founder and CEO:

Chad is the Founder and CEO of Paycom. Prior to founding Paycom, Chad worked at a regional payroll company in Denver and at ADP. Having realized that there was an opportunity to transform payroll and move it online, Chad sold his house, cashed out his 401K, and applied for a small business loan to launch Paycom. As an owner operator holding ~14% of Paycom's stock, Chad is known for demanding excellence, and setting the highest bar in the payroll management industry. Since Paycom's IPO in 2014, Chad has been instrumental in helping Paycom realize a 2100%+ share price appreciation.

Craig Boelte, CFO:

Craig has served as Paycom's CFO since 2006 and has been instrumental in helping Paycom achieve best-in-class payroll software operating margins with gross margins and EBITDA margins of 85%+ and 30%+, respectively. Prior to joining Paycom, Craig spent nine years at Deloitte. Craig has 30 years of experience in the workforce management and HR industry.

Holly Faurot, Chief Sales Officer:

Holly was named Chief Sales Officer in 2021 succeeding Jeff York who has been named Paycom's leadership strategist. Holly has been with Paycom for 14 years serving as the Senior Executive Vice President of Sales and Client Relations, VP of Client Relations, Regional VP of Sales, and as a Sales Manager.

Incentives:

Paycom utilizes a strong incentive plan that incentivizes best-in-class operating performance. Over 99% and 85% of Chad Richison's and other named executives' pay packages includes long-term equity compensation, respectively. Annual compensation bonuses are awarded based on the achievement of revenue growth, revenue retention, and Adjusted EBITDA targets. These targets set a high bar and in 2020 executives received only 15% of target bonus thresholds and less than 2% of maximum bonus thresholds despite robust performance results. As the holder of close to 15% of Paycom's shares, Chad Richison is heavily incentivized to efficiently grow the business and the long-run earnings power of the company.

Key Risks:

1. A cyclical downturn could accelerate unemployment rates and slow client growth:

Paycom generates a majority of its revenue using a PEPY fee structure. A cyclical downturn and increased unemployment could lead to a HSD decline in revenue. Furthermore, a cyclical downturn would lead to a decrease in sales leads.

2. Payroll software competition could intensify:

There are several competitors seeking to disrupt the payroll software space. Competition could intensify which could lead to accelerated price competition, increased SG&A spend, and declining customer growth.

3. C-Suite and Management turnover:

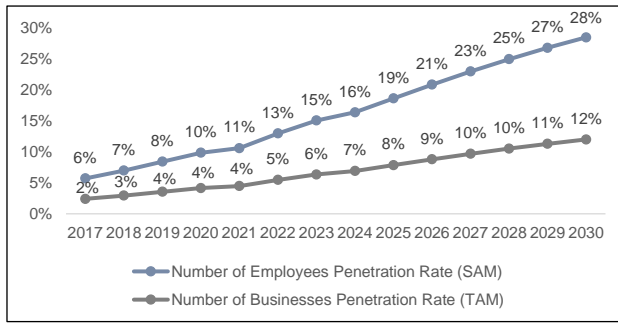
Chad Richison is an integral part of Paycom's success story. If anything was to happen that resulted in Chad no longer serving as the firm's CEO, Paycom's long-term growth trajectory could become impaired.

AV, EPV, and Franchise Value (Reference Exhibits 13,14, and 15):

- **Asset Value (AV):** After adjusting for goodwill / intangibles, taking a haircut to accounts receivable, inventory, and other assets as well as adding in the brand value and the workforce replacement cost, Paycom's Asset Value = \$1.42B.
- **Earnings Power Value (EPV):** In order to calculate EPV, I calculated the normalized EBIT margin (28.1%) which I found was 3.3% higher than current margins due to a COVID-related margin headwind. I then added back 20% of S&M (brand building marketing spend) and 70% of R&D (attributable to growth CapEx). This resulted in an EPV of \$4.4B. This suggests that Paycom has a durable competitive advantage. At Paycom's current market cap, the market has factored in growth equating to 3x current sustainable earnings, and my estimates suggest Paycom is worth 7x this EPV.
- **Franchise Value (FV):** Using the initial EPV of \$4.4B, a 30% ROIC estimate, 36% annual earnings growth over the next five years, and 46% multiple compression, I found that Paycom will yield a 5-year holding period return of 20% and a 2026 Franchise Value of \$11B. Looking ahead from 2026-2031, earnings will grow at a 23% CAGR, and the EPS multiple will compress by 41%. This will lead to a 17% annualized holding period return and a 2031 Franchise Value of \$24.4B.

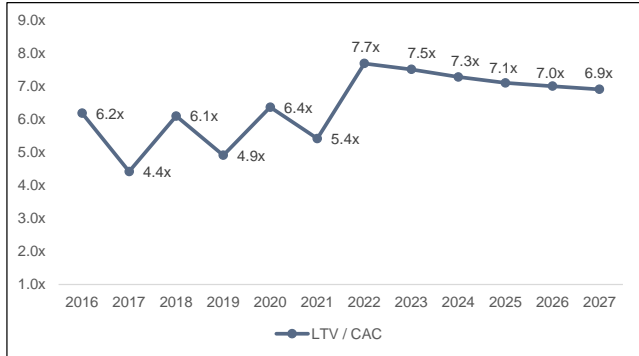
Appendix

Exhibit 1: SAM / TAM Penetration Rate



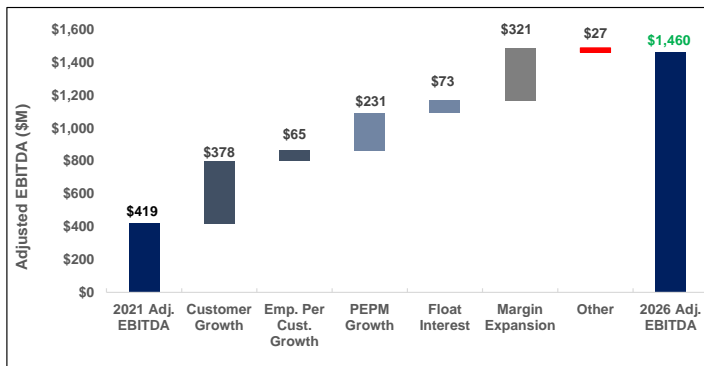
Source: Company Filings, U.S. Bureau of Labor

Exhibit 3: LTV / CAC



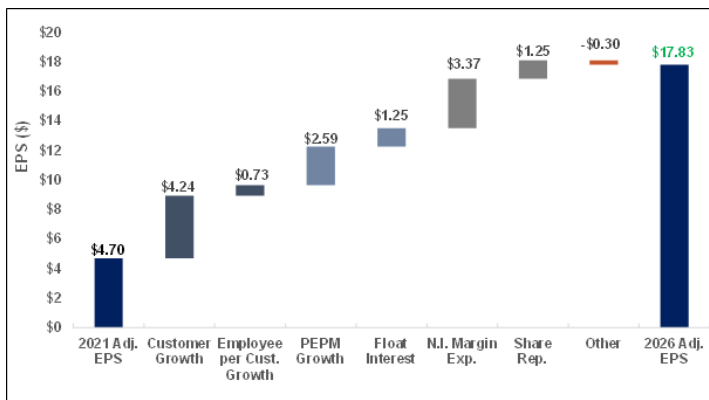
Source: Company Filings, Estimates

Exhibit 5: 2021 – 2026 EBITDA Bridge



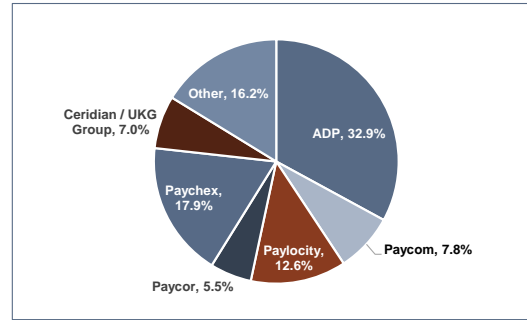
Source: Company Filings, Estimates

Exhibit 6: 2021 – 2026 EPS Bridge



Source: FactSet, Estimates

Exhibit 2: Mid-Market Payroll Client Market Share



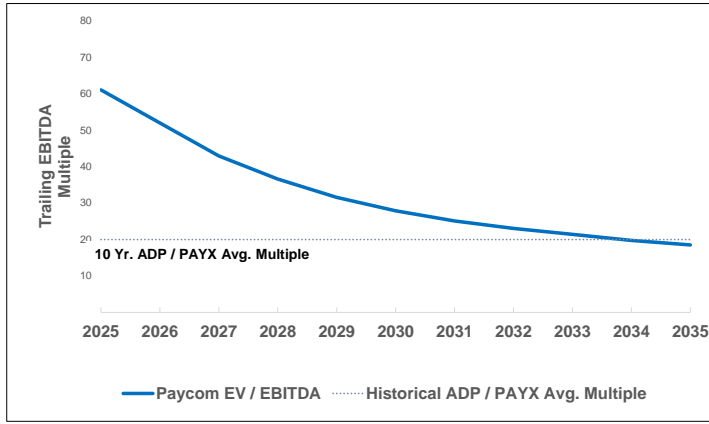
Source: Company Filings, U.S. Bureau of Labor

Exhibit 4: Base Case Vs. Consensus Estimates

	Base Case	Consensus	% Difference
Current Price Target	\$666 (Implied)	\$404.75	39.2%
Revenue			
Total Revenue(M) ('22)	\$1,336	\$1,319	1.3%
Total Revenue(M) ('23)	\$1,564	\$1,625	(3.8%)
Revenue Growth CAGR ('21-'23)	21.7%	23.7%	(2.0%)
Gross Margin (avg. '22 - '23)	85.6%	85.5%	0.2%
Non-GAAP EBITDA			
Non-GAAP EBITDA(M) ('22)	\$585	\$527	11.0%
Non-GAAP EBITDA(M) ('23)	\$729	\$658	10.8%
Non-GAAP EBITDA Margin (avg. '22 - '23)	45.2%	40.3%	12.2%
Non-GAAP EPS			
Non-GAAP EPS ('22)	\$6.84	\$5.45	25.4%
Non-GAAP EPS ('23)	\$8.66	\$6.88	25.9%

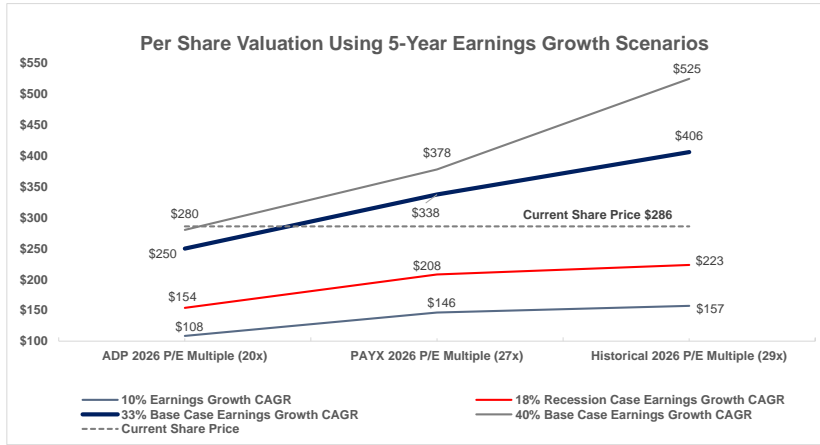
Source: Capital IQ, Estimates

Exhibit 7: EBITDA Multiple Compression



Source: FactSet, Estimates

Exhibit 8: Price Estimates Based on 5 Yr. Earnings CAGR



Source: Estimates

Exhibit 9: Illustrative Breakout of the Type of Customers Paycom is Acquiring

Illustrative Paycom Customer Acquisition Breakout	2022	2023	2024	2025	2026
Total Customers	20801	23921	26971	29871	32559
% Change	17.5%	15.0%	12.8%	10.8%	9.0%
Number of Total Customers Added	5045	5387	5633	5785	5855
Customers Acquired from ADP	1575	1738	1873	1854	1798
% of Net Adds	31.2%	32.3%	33.2%	32.0%	30.7%
ADP Mid-Market Customers	75000	77250	78023	77242	74925
Estimated Involuntary Churn	5250	5794	6242	6179	5994
Estimated Customers Acquired by Paycom (30% of ADP Involuntary Churn)	1575	1738	1873	1854	1798
Customers Acquired from Regional / In-House Payroll Providers	1261	1455	1634	1562	1464
% of Net Adds	25.0%	27.0%	29.0%	27.0%	25.0%
Other Customer Growth	2209	2195	2127	2369	2593
% of Net Adds	43.8%	40.7%	37.8%	41.0%	44.3%

Source: Company Filings, Estimates

Exhibit 10: Bear / Recession Case DCF

DCF Valuation	2021(A)	2022(E)	2023(E)	2024(E)	2025(E)	2026(E)	2027(E)	2028(E)	2029(E)	2030(E)	2031(E)
Revenue	1,055.5	1,207.5	1,316.7	1,540.0	1,785.5	1,989.8	2,197.0	2,406.6	2,612.6	2,812.1	2,989.3
% Growth	25.4%	14.4%	9.0%	17.0%	15.9%	11.4%	10.4%	9.5%	8.6%	7.6%	6.3%
EBIT	285.0	312.2	378.6	453.7	558.1	651.0	750.6	857.5	965.9	1,076.2	1,150.9
Margin	27.0%	25.9%	28.8%	29.5%	31.3%	32.7%	34.2%	35.6%	37.0%	38.3%	38.5%
Net Operating Profit After Tax	225.0	248.1	300.8	360.5	443.4	517.2	596.5	681.7	768.2	856.3	909.2
(-) Capex	(120.7)	(140.7)	(147.7)	(155.7)	(164.7)	(174.7)	(185.7)	(197.7)	(210.7)	(224.7)	(239.0)
(+/-) Net Change in WC	(73.6)	(75.8)	(74.4)	(78.3)	(81.7)	(81.9)	(81.4)	(80.3)	(78.4)	(76.0)	(70.2)
(+) Depreciation	67.2	82.2	97.7	113.7	130.2	147.2	164.7	182.7	201.2	220.2	231.8
Free Cash Flow	98	114	176	240	327	408	494	586	680	776	832
Growth		16.3%	55.0%	36.1%	36.2%	24.6%	21.2%	18.7%	16.0%	14.1%	7.2%
WACC		7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%	7.8%
Period		0.75	1.75	2.75	3.75	4.75	5.75	6.75	7.75	8.75	9.75
Discount factor		0.95	0.88	0.81	0.76	0.70	0.65	0.60	0.56	0.52	0.48
Discounted FCF		108	155	195	247	286	321	354	381	403	401
Implied EV		13,584	14,517	15,456	16,400	17,323	18,231	19,116	19,971	20,791	21,572
Implied EV to Revenue		11.2	11.0	10.0	9.2	8.7	8.3	7.9	7.6	7.4	7.2
Implied EV to EBITDA		34.4	30.5	27.2	23.8	21.7	19.9	18.4	17.1	16.0	15.6

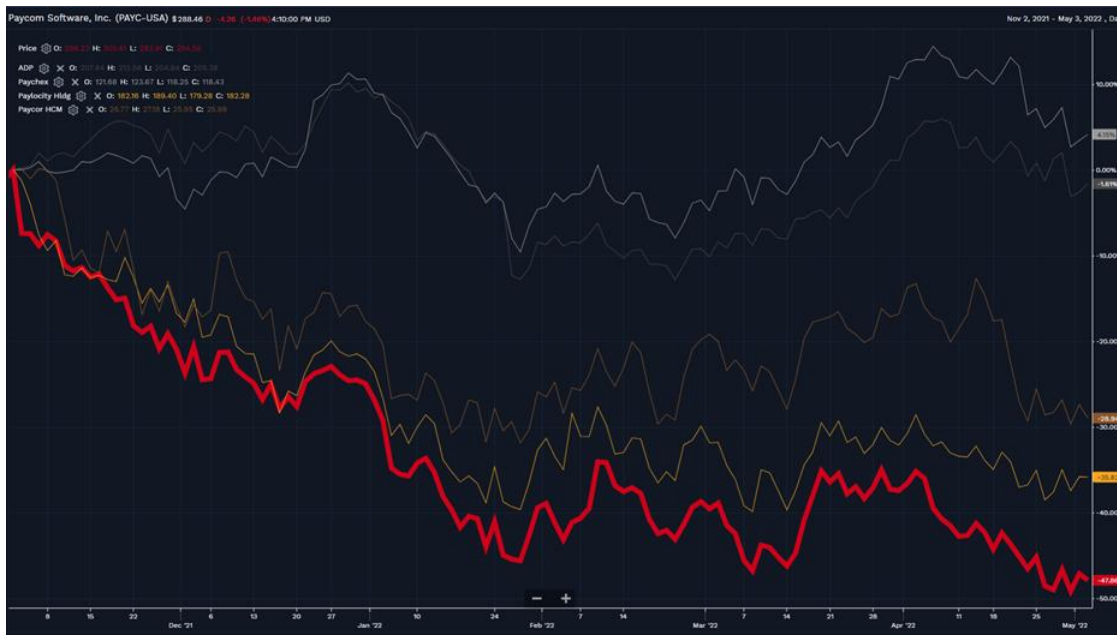
WACC Calculation	
Tax Rate	21.0%
After Tax Cost of Debt	2.8%
Risk Free Rate	2.0%
Debt Premium	1.5%
Debt / (Debt+Equity+Float)	15.0%
Cost of Equity	10.1%
Market Risk Premium	5.5%
Beta	1.47
Equity / (Debt+Equity+Float)	75.0%
Float Benefit	-2.0%
Sustainable Float Interest Rate	2.0%
Float / (Debt+Equity+Float)	10.0%
WACC	7.8%

Valuation		
	2022	2026
PV of Forecasted Values (M)	\$2,948	\$3,061
Discounted Terminal Value (M)	\$9,992	\$14,261
Total Enterprise Value (M)	\$12,939	\$17,323
- Net Debt (M)	\$470	\$1,841
Total Equity Value (M)	\$13,409	\$19,164
Shares Outstanding (M)	58.2	57.8
Implied Share Price	\$230.29	\$331.41
Implied Upside	(16%)	20%

Terminal Value: 15x EV / EBITDA	
FCF	\$20,741
WACC	7.8%
Discounted FCF	\$9,992

Source: Company Filings, Estimates

Exhibit 11: Paycom Share Price Contraction Relative to Competitors



Source: FactSet

Exhibit 12: Key Shareholders

Top 15 Institutions / Top 5 Insiders/Stakeholders

Rank	Type	%OS	Position (000)	Pos Chg (000) [Recent]	Mkt Val (MM)
-	Total	53.01	31,920	-119	9,344
-	Institutions	37.53	22,597	-117	6,615
1	The Vanguard Group, Inc.	8.73	5,258	26	1,539
2	BlackRock Fund Advisors	4.54	2,731	51	799
3	T. Rowe Price Associates, Inc. (Investment Management)	3.49	2,104	-127	616
4	Capital Research & Management Co. (Global Investors)	3.30	1,989	357	582
5	SSgA Funds Management, Inc.	3.22	1,939	34	568
6	BlackRock Advisors LLC	2.25	1,358	-31	397
7	Brown Capital Management LLC	2.20	1,323	-74	387
8	Wellington Management Co. LLP	2.08	1,251	-228	366
9	Geode Capital Management LLC	1.63	979	25	287
10	Loring, Wolcott & Coolidge Fiduciary Advisors LLP	1.19	715	-7	209
11	BlackRock Investment Management (UK) Ltd.	1.03	618	-49	181
12	Eaton Vance Management	1.02	612	19	179
13	Congress Asset Management Co. LLP	0.97	587	20	172
14	Fred Alger Management LLC	0.97	583	-35	171
15	Goldman Sachs Asset Management LP	0.92	552	-97	162
-	Insiders / Stakeholders	15.48	9,323	-2	2,729
1	Richison Chad R	13.96	8,408	0	2,461
2	York Jeffrey D	0.96	576	0	169
3	Boelte Craig E	0.44	263	-1	77
4	Faurot Holly	0.08	46	0	14
5	Smith Brad /Paycom/	0.05	28	-1	8

Source: FactSet

Exhibit 13: Asset Value (AV) Calculation

Balance Sheet (\$M)	Actual	Adjustment	Adjusted Value		
Current Assets	2,252		2,250	Brand Value	\$592
Cash and cash equivalents	278		278	3 Yr. Avg. Marketing Expense	\$46
Accounts Receivable	9	80%	8	(Assume 20% of S&M is	
Prepaid Expenses	24		24	Discount Rate	8%
Inventory	1	80%	1		
Income Tax Receivable	16		16	Workforce Value	\$41
Deferred Contract Costs	77		77	Total Number of Employees	5,385
Funds Held for Clients	1,847		1,847	Sales and Marketing	958
Non-Current Assets	\$963		\$849	Engineering	872
PP&E	349		349	HR	568
Intangible Assets	58	0%	-	Business Development	708
Goodwill	52	0%	-	Product Management	217
Long Term Deferred Contract Costs	462		462	Finance	100
Other Assets	42	90%	38	Operations	1,482
Total Assets	\$3,215		\$3,099	Other	480
				Total Salary (\$M)	\$410
Current Liabilities	\$1,990		\$1,990	Headhunter Fee	10%
Accounts Payable	6		6		
Accrued Commissions and Bonuses	22		22		
Accrued Payroll and Vacation	34		34		
Deferred Revenue	16		16		
Current Portion of LTD	2		2		
Accrued Expenses and Other Current Lial	63		63		
Client Fund Obligations	1,847		1,847		
Non-Current Liabilities	\$331		\$331		
Deferred Income Tax Liabilities	146		146		
Long-Term Deferred Revenue	85		85		
Net Long Term Debt	27		27		
Other	73		73		
Net Asset Value of Equity	\$894		\$777		
Adjustments					
Brand			\$592		
Workforce			\$46		
Adjusted Asset Value of Equity			\$1,416		

Source: Company Filings, Estimates

Exhibit 14: Earnings Power Value (EPV) Calculation

Earnings Power Value (EPV) Calculation

Normalized Revenue	\$1,056
Normalized EBIT Margin	28.1%
Normalized EBIT	\$297
S&M Add Back (20 % of S&M)	\$55
R&D Add Back (70% of R&D)	\$83
Amortization of Intangible Assets	\$3
Adjusted Normalized EBIT	\$437
Tax Rate	21%
Adjusted NOPAT	\$346
Discount Rate	7.8%
EPV	\$4,430

Growth / Return on Incremental Invested Capital Calculation

	2017	2018	2019	2020	2021
Operating Income (M)	\$139	\$188	\$246	\$212	\$285
Implied Adjusted Op Income - Organic	\$127	\$179	\$231	\$200	\$269
% Change		41%	29%	-14%	35%
Adjusted Op Income - Investments	\$12	\$9	\$15	\$12	\$16

Cummulative 4 year Op Income Growth

Adjusted Op Income - Organic	183
Industry Growth	7%
Op Income Growth - Organic	43
Implied Op Income - Investments	102
Taxes	21%
NOPAT - Investments	\$81

Capex	\$59	\$60	\$93	\$94	\$121
Depreciation	\$19	\$30	\$42	\$53	\$67
Growth Capex	\$40	\$30	\$51	\$41	\$53

Tangible Investment	215
Intangible Investment	58
5-yr Growth Capex	273
ROIC	29.6%

Source: Company Filings, Estimates

Exhibit 15: Franchise Value (EPV) Calculation

Franchise Value Framework	
Initial EPV	\$4.43B
Cost of Capital	8.1%
Current EPS Multiple	85x
Growth CAPEX / NOPAT	.13%
Annual ROIC	29.6%
Annual Rate of Growth of Earnings	36%
Growth After 5 Years	4.61
EPS After 5 Years	\$15.52
Multiple After 5 Years	46x
Multiple Compression	-46%
Holding Period Return	149%
Annualized Return	20.0%
2026 Franchise Value	\$11.0B
2026 – 2031 Annual Rate of Growth of Earnings (Assume same ROIC)	23%
Growth from 2026-2031	2.76
2031 Diluted EPS	\$53.15
2031 Multiple	27x
Multiple Compression	-41%
Holding Period Return	122%
Annualized Return	17.3%
2031 Franchise Value	\$24.4B

Source: Estimates

Exhibit 16: Valued Added Research Sources

Value Added Research Sources	
<ul style="list-style-type: none">• CEO of Paycor• IR of Paycor• IR of Paylocity• IR of Paycom• Customer of Paycom Competitor (x3)• Sell-Side Analyst (x2)	<ul style="list-style-type: none">• Sell-Side Analyst Covering Paycom Competitors (x2)• Buy-Side Analyst Owning Paycom (x2)• Buy-Side Analyst Owning a Paycom Competitor (x2)• Former Product Manager at Payroll Competitor (x1)• Former Product Manager (x2)