

# RESEARCH REPORT

## PayGroup (ASX: PYG)

Record contract wins continuing

**BUY**

12 Month Target	\$1.24
Price	\$0.745
Implied Return	66.5%

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### Company Data

Recommendation:	BUY
Price (Date 01-02)	\$0.745
ASX Code:	PYG
Shares on Issue:	51.67m
Market capitalisation	\$38.49m
Enterprise Value	\$36.28m
12 month price range	\$0.58-\$0.95

### Board Structure

Mark Samlal	Managing Director
Ian Bassar	Non-Executive Chairman
David Fagan	Non-Executive Director
Franck Neron-Bancel	Executive Director

### Major Shareholders

Samantha Samlal*	42.73%
Lawrence Pushpam*	13.65%
Macquarie Investment Management Ltd.	9.38%
Simon Forrester	4.70%
National Nominees	4.64%

\* Escrowed for 24 months from IPO date

### Financial Highlights

AS\$'000,000	FY18A*	FY19E*	FY20E	FY21E
<b>Total Revenue</b>	7.3	7.6	9.4	11.0
<b>Operating Expenses</b>	(4.4)	(5.1)	(6.0)	(6.8)
<b>EBITDA</b>	2.8	2.5	3.4	4.2
<b>NPAT</b>	2.6	2.3	3.3	4.1
<b>Dividend yield</b>	3.8%	1.9%	4.2%	5.2%
<b>PE</b>	12.3	16.9	11.5	9.4

\* Normalised Pro Forma results



Source: Iress

## Quarterly Report

Multi-Country BPO (Business Process Outsourcing) Payroll and cloud-based Software as a Service (SaaS) Human Resource Outsourcing Solutions provider PayGroup Limited (ASX: PYG), has released its quarterly results yesterday for the period ended 31 December 2018 (Q3 FY19). PayGroup operates as Pay Asia Pte Ltd (PayAsia), which it formally acquired on 29 May 2018, in conjunction with its listing on the ASX.

### Results Summary

The strong contract wins we saw in the interim results to 31 December 2018, have continued with an additional \$1.68m in new contract signings in Q3 (FY19). This represents an increase of 29% on Q1 and 9.8% on Q2. We expect this trend of new contract wins to continue into the current quarter, with the full revenue impact to flow through in FY20. Furthermore, PayGroup has a strong pipeline of leads from its main referral partner in the USA, and has made further progress with its new referral partners in the UK and Japan.

During the quarter PayGroup partnered with Frontierpay, a UK based specialised currency exchange provider, to facilitate the group's treasury functions. This partnership provides customers with access to an efficient platform for cross-border payments, and is expected to generate both efficiencies and additional revenue for the group.

### Recommendation

We were pleased to note the continued strong level of new contract wins recorded by PayGroup in Q3, and anticipate this trend to continue. The resulting full revenue impact from record new contract wins to occur next financial year, together with a strong sales pipeline and client retention record, supports our **BUY recommendation** and 12-month price target of \$1.24, providing a return of 66% from current levels.

### Q3 FY19 Results Commentary

The Company reported customer receipts of \$1.43m for the three-month period, steady from Q2. Net cash outflows from operating activities were \$0.73m, reflecting the group's investment in the partner referral program and expansion into additional territories. PayGroup reported year-to-date customer receipts of \$4.1m, representing the period from 29 May 2018 to 31 December 2018.

### Operating Highlights:

- Partnered with Frontierpay to provide customers access to an efficient platform for cross-border payments.
- No material client losses recorded over the period and a low client churn <10%.
- Secured \$1.68 million in new contract wins, expressed as total contract value (TCV), a historical high and based on average 3-year contract terms.
- Total cash holding of \$6.08m which includes \$3.87m relating to balances held on behalf of clients for settlement of their payroll obligations.
- Added 847 new client employees which is an increase of 337% from Q2.
- Upgrade of HROnline user interface is on track and the renewed product should be available for release in Q4 FY19.

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## Valuation Ratios (A\$'000's) Proforma

Year ending Mar	2018A	2019E	2020E	2021E	2022E
Proforma profit	2,611	2,280	3,355	4,116	4,901
<b>EPS<sub>adj</sub> (¢)</b>	<b>0.05</b>	<b>0.04</b>	<b>0.06</b>	<b>0.08</b>	<b>0.09</b>
<b>EPS growth</b>	<b>nmf</b>	<b>(12.7%)</b>	<b>47.1%</b>	<b>22.7%</b>	<b>19.1%</b>
<b>P/E ratio</b>	<b>14.7 x</b>	<b>16.9 x</b>	<b>11.5 x</b>	<b>9.4 x</b>	<b>7.9 x</b>
Enterprise Value (m)	39,257	29,511	26,297	22,276	16,917
EV/Sales (x)	5.36 x	3.87 x	2.81 x	2.02 x	1.32 x
EV / EBIT (x)	14.6 x	12.9 x	8.3 x	5.8 x	3.7 x
EV / EBITDA (x)	14.1 x	12.0 x	7.7 x	5.4 x	3.5 x
DPS (¢)	0.0	1.5	3.1	3.9	4.8
<b>Dividend Yield</b>	<b>0.0%</b>	<b>1.9%</b>	<b>4.2%</b>	<b>5.2%</b>	<b>6.5%</b>
Payout Ratio	57.4%	32.9%	22.3%	38.9%	40.8%
Franking	0.0%	0.0%	0.0%	0.0%	0.0%
FCFPS	(0.06)	(0.01)	0.03	0.06	0.10
P/FCFPS	12.16	13.21	10.45	8.74	8.37

## Cashflow (A\$'000's)

Year ending Mar	2018A	2019E	2020E	2021E	2022E
EBIT	(752)	2,280	3,166	3,854	4,543
Dep'n and amort'n	257	176	241	293	334
Deferred tax benefit	0	(34)	(104)	(127)	(152)
Share option expenses	0	0	0	0	0
Change in Work cap	41	118	113	124	150
<b>Operating cashflow</b>	<b>(319)</b>	<b>2,463</b>	<b>3,713</b>	<b>4,522</b>	<b>5,359</b>
<b>Investing cashflows</b>					
Capex	(322)	(500)	(500)	(500)	0
Acquisitions/Divestments	0	0	0	0	0
Other	0	0	0	0	0
<b>Free Cash Flow</b>	<b>(641)</b>	<b>1,963</b>	<b>3,213</b>	<b>4,022</b>	<b>5,359</b>
Equity	0	7,760	0	0	0
Other	221	0	0	0	0
Dividends paid	0	(750)	(1,600)	(2,000)	(2,500)
<b>Net cashflow</b>	<b>(420)</b>	<b>8,973</b>	<b>1,613</b>	<b>2,022</b>	<b>2,859</b>
Cash at beginning 01/04	455	36	9,759	12,973	16,994
<b>Cash at end 31/03</b>	<b>36</b>	<b>9,759</b>	<b>12,973</b>	<b>16,994</b>	<b>22,353</b>

## Revenue Split (A\$'000's)

Year ending Mar	2018A	2019E	2020E	2021E	2022E
Payroll Services	6,581	7,304	9,030	10,686	12,501
Other	377	320	320	320	320
<b>Group Revenue</b>	<b>7,318</b>	<b>7,624</b>	<b>9,350</b>	<b>11,006</b>	<b>12,821</b>

## Profit and loss (A\$'000's) Proforma

Year ending Mar	2018A	2019E	2020E	2021E	2022E
Operating revenue	7,318	7,624	9,350	11,006	12,821
EBITDA	2,779	2,456	3,407	4,147	4,877
D&A	(95)	(176)	(241)	(293)	(334)
<b>EBIT</b>	<b>2,684</b>	<b>2,280</b>	<b>3,166</b>	<b>3,854</b>	<b>4,543</b>
Net interest income	0	0	293	389	510
NPBT	2,684	2,280	3,459	4,243	5,052
Tax Expense (benefit)	(73)	0	(104)	(127)	(152)
<b>NPAT</b>	<b>2,611</b>	<b>2,280</b>	<b>3,355</b>	<b>4,116</b>	<b>4,901</b>
Significant Items	0	0	0	0	0
<b>NPAT (Proforma)</b>	<b>2,611</b>	<b>2,280</b>	<b>3,355</b>	<b>4,116</b>	<b>4,901</b>
EBITDA Margin	38.0%	32.2%	36.4%	37.7%	38.0%
EBIT Margin	36.7%	29.9%	33.9%	35.0%	35.4%
NPAT Margin	35.7%	29.9%	35.9%	37.4%	38.2%

## Balance sheet (A\$'000's)

Year ending Mar	2018A	2019E	2020E	2021E	2022E
Bank Balance	2,334	9,759	12,973	16,994	22,353
Receivables	2,501	1,700	2,085	2,454	2,859
Prepayments	8	0	0	0	0
Other	182	3,150	3,150	3,150	3,150
<b>Current assets</b>	<b>5,026</b>	<b>14,609</b>	<b>18,207</b>	<b>22,598</b>	<b>28,361</b>
Net PPE	85	85	85	85	85
Intangibles	884	1,204	1,463	1,671	1,336
Deferred Tax Assets	0	0	0	0	0
Other	0	0	0	0	0
<b>Non-current assets</b>	<b>969</b>	<b>1,289</b>	<b>1,548</b>	<b>1,756</b>	<b>1,421</b>
<b>Total assets</b>	<b>5,995</b>	<b>15,898</b>	<b>19,755</b>	<b>24,354</b>	<b>29,783</b>
Trade payables	2,220	2,722	3,205	3,733	4,371
Borrowings	606	0	0	0	0
Employee entitlements	0	0	0	0	0
Deferred Revenue	0	0	0	0	0
<b>Total liabilities</b>	<b>5,622</b>	<b>5,520</b>	<b>6,022</b>	<b>6,505</b>	<b>7,033</b>
<b>NET ASSETS</b>	<b>373</b>	<b>10,378</b>	<b>13,733</b>	<b>17,849</b>	<b>22,750</b>

## Balance Sheet Ratios

Year ending Mar	2018A	2019E	2020E	2021E	2022E
Net Debt	(2,334)	(9,759)	(12,973)	(16,994)	(22,353)
NTA	-0.01	0.18	0.24	0.31	0.41
Price / NTA (x)	-75.3 x	4.2 x	3.1 x	2.4 x	1.8 x
Return on assets	-28.9%	16.4%	5.6%	13.8%	13.8%
Return on equity	-464.4%	12.0%	26.6%	24.6%	22.7%

## Valuation

Year ending Mar	2018A	2019E	2020E	2021E	2022E
Discounted Cash Flow			WACC		11.01%
Beta	0.9		Discount Period		9 years
Cost of Equity	11.01%		DCF/Price Target		\$1.24

Table 1: Lodge estimates

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### Comparable analysis

PayGroup trades at a deep discount relative to its domestic listed peers.

A comparable analysis is detailed in Table 2 opposite, which illustrates PYG's PE discount relative to the various domestic (AU) solution providers and the ASX Small Ords Index.

A summary of 12 domestic and international listed comparable listed companies and multiple analysis is detailed in Table 3 below.

**Table 2: Comparable Relative Analysis**

	Forecast PE (Average)	Forecast PE Relative (+/-)
Listed BPO Payroll and HCM Software Providers	40.70 X	- 58.5%
Listed HCM Software Providers	85.26 X	- 80.2%
Listed Software Providers	17.05 X	1%
ASX Small Ords Index	17.39 X	11.4%

Source: Thomson Reuters Consensus and Lodge Research, 1 February 2019

**Table 3: Comparable Company Analysis**

Code	Company	Stock Exchange	Pricing	Market Cap	Price	P/E	EV/EBITDA	EV/Rev	Solution
ADP	Automatic Data Processing	U.S.	USD\$	60.89B	139.84	26.01	17.08	4.18	BPO Payroll and HCM Software
WDAY	Workday	U.S.	USD\$	37.6B	181.53	143.30	75.75	12.32	HCM Software
PAYX	Paychex	U.S.	USD\$	25.55B	70.8	24.84	14.78	5.95	BPO Payroll and HCM Software
PAYC	Payce	U.S.	USD\$	8.4B	148.24	56.83	31.99	13.37	BPO Payroll and HCM Software
PCTY	Paylocity	U.S.	USD\$	3.64B	71.03	55.12	25.53	7.18	BPO Payroll and HCM Software
CSOD	Cornerstone OnDemand	U.S.	USD\$	3.3B	57.34	78.80	30.95	5.62	HCM Software
ULTI	Ultimate Software	U.S.	USD\$	8.4B	273.07	50.61	30.52	7.34	HCM Software
ZAL	Zalaris	OSL (Norway)	NOK	538m	26	68.31	10.30	1.00	HCM Software
IHR	IntelliHR Holdings	ASX	AUD\$	11m	0.18	N/A	N/A	N/A	HCM Software
SIQ	Smartgroup	ASX	AUD\$	1.37B	10.46	17.05	10.93	4.99	Software
ELO	Elmo Software	ASX	AUD\$	121m	5.22	N/A	10.93	7.69	HCM Software
LVH	LiveHire	ASX	AUD\$	140m	0.52	N/A	N/A	25.81	HCM Software
PYG	Paygroup	ASX	AUD\$	38.5m	0.745	16.9	14.51	4.77	BPO Payroll and Software

Source: Thomson Reuters Consensus and Lodge Research, 1 February 2019

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Recommendations are assessments of each Lodge Partners Analyst's view of potential total returns over a 1 year period.

Expected total Return is measured as (capital gain (or loss) + dividend)/purchase price

We have divided our recommendations into three main categories:

**Buy:** Expected Total Return in excess of 15% over a 1 year period.

**Speculative Buy:** Expected Total Return in excess of 15% over a 1 year period, with apparent risk.

**Hold:** Expected Total Return between 0% and 15% over a 1 year period.

**Sell:** Expected Total Return less than 0% over a 1 year period.

### Analyst Verification

I verify that I, Sven Restel, have prepared this research report accurately and that any financial forecasts and recommendations that are expressed are solely my own personal opinions. In addition, I certify that no part of my compensation is or will be directly or indirectly tied to the specific recommendation or financial forecasts expressed in this report.

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