

# RESEARCH REPORT

## PayGroup (ASX: PYG)

Growth accelerating

**BUY**

12 Month Target	\$1.24
Price	\$0.73
Implied Return	70%

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### Company Data

Recommendation:	BUY
Price (Date 02-05)	\$0.73
ASX Code:	PYG
Shares on Issue:	51.67m
Market capitalisation	\$37.71m
Enterprise Value	\$34.8m
12 month price range	\$0.58-\$0.95

### Board Structure

Mark Samlal	Managing Director
Ian Basser	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	16.54	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 March 2019 (Q4 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

PYG added \$0.41m in new contracts signings in Q4 (expressed as total contract value (TCV)), taking total contract wins for FY19 to \$4.93m TCV (versus pcp of \$2.5m TCV). Total implemented client employees (under contract) at the end of the quarter totalled 37,053 which includes 11,226 for SaaS modules. We expect this trend of new contract wins and client implementations to continue into the current quarter, with the full revenue impact to occur in FY20. The record level of new contract activity in FY19 will see a further 7,877 client employees scheduled to be implemented in FY20. This would take total client employees under contract to 44,930, which is in line with our FY20 estimates.

PayGroup also signed a new contract during Q4 to be an Asian payroll Partner to UK based Cloudpay. Subsequent to the end of the quarter, the Company was awarded a new contract valued at \$0.45m TCV under this agreement, which will be implemented in Q1 FY20. This adds to momentum gained with the Company's existing US and Japanese referral partnership agreements (noting first contract revenues recorded in Japan subsequent to end of quarter), all of which are positive indicators for sales activity in FY20.

PYG completed the Workforce Management acquisition in India on 28 February 2019, and accordingly the results include a one-month contribution.

### Recommendation

We were pleased to note the continued strong level of new contract wins recorded by PayGroup in FY19 and anticipate this trend to continue. The resulting full revenue impact from record new contract wins to occur in FY20, together with a strong sales pipeline and client retention record, supports our **BUY recommendation** and 12-month price target of \$1.24 (representing 70% upside from current levels). We note that a continued trend in contract wins is likely to see PYG exceed our forecasted figures for FY21 and beyond, and as such represents upside risk to our current valuation and price target.

### Q4 FY19 Results Commentary

The Company reported customer receipts of \$4.3m for the three-month period. PYG's cash balance is currently at \$6.3m of which \$3.4m relates on balances held on behalf of clients for settlement of their payroll obligations.

#### Operating Highlights:

- New referral partnership with UK based Cloudpay, and \$0.45m TCV contract win post end of quarter;
- No client losses recorded over the period, and client churn <10% for the year.
- Secured \$0.41 million in new contract wins in Q4 (up 5.7% on pcp), in what is traditionally a slower period of sales activity in APAC region (holiday period and Chinese new-year)

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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				
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.

	Forecast PE (Average)	Forecast PE Relative (+/-)
Listed BPO Payroll and HCM Software Providers	50.78 X	- 67.4%
Listed HCM Software Providers	62.55 X	- 73.6%
Listed Software Providers	17.05 X	3%
ASX Small Ords Index	17.39 X	4.9%

Source: Thomson Reuters Consensus and Lodge Research, 2 May 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\$	68.6B	157.48	37.20	20.29	4.85	BPO Payroll and HCM Software
WDAY	Workday	U.S.	USD\$	45.34B	201.18	121.34	66.03	12.60	HCM Software
PAYX	Paychex	U.S.	USD\$	29.58B	81.97	29.69	19.34	7.84	BPO Payroll and HCM Software
PAYC	Payce	U.S.	USD\$	11.78B	201.46	61.29	39.50	16.29	BPO Payroll and HCM Software
PCTY	Paylocity	U.S.	USD\$	5.03B	95.05	74.95	37.92	10.71	BPO Payroll and HCM Software
CSOD	Cornerstone OnDemand	U.S.	USD\$	3.2B	53.92	55.33	25.32	5.61	HCM Software
ULTI	Ultimate Software	U.S.	USD\$	9.7B	331.27	52.69	29.37	7.12	HCM Software
ZAL	Zalaris	OSL (Norway)	NOK	495m	25	20.83	10.14	0.95	HCM Software
IHR	IntelliHR Holdings	ASX	AUD\$	9m	0.092	N/A	N/A	N/A	HCM Software
SIQ	Smartgroup	ASX	AUD\$	1.12B	8.51	17.05	13.34	4.58	Software
ELO	Elmo Software	ASX	AUD\$	370m	5.86	N/A	N/A	4.54	HCM Software
LVH	LiveHire	ASX	AUD\$	149m	0.50	N/A	N/A	43.01	HCM Software
PYG	Paygroup	ASX	AUD\$	37.7m	0.73	16.54	10.23	4.57	BPO Payroll and Software

Source: Thomson Reuters Consensus and Lodge Research, 2 May 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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