

RESEARCH REPORT

PayGroup (ASX: PYG)

Valuation upgrade

BUY

12 Month Target	\$1.52
Price	\$0.87
Implied Return	74%

Sven Restel
+61 2 9137 1068
s.restel@lodgepartners.com.au

Company Data

Recommendation:	BUY
Price (Date 04-06)	\$0.87
ASX Code:	PYG
Shares on Issue:	51.67m
Market capitalisation	\$44.95m
Enterprise Value	\$43.55m
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.	11.77%
Simon Forrester	4.10%
HSBC Custody Nominees	3.20%

* Escrowed for 24 months from IPO date

Financial Highlights

AS\$'000,000	FY19A*	FY20E	FY21E	FY22E
Total Revenue	8.4	10.2	12.2	14.6
Operating Expenses	(5.7)	(6.6)	(7.45)	(8.7)
EBITDA	2.7	3.6	4.75	5.9
NPAT	2.3	3.3	4.3	5.4
Dividend yield	N/A	3.7%	4.8%	6.0%
PE	19.6	13.7	10.4	8.3

* Normalised Pro Forma results



Source: Iress

Full Year 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 full year unaudited results on Friday for the year ended 31 March 2019 (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 \$4.93m (+96% YoY) in new contracts signings in FY19 (expressed as total contract value (TCV)). Total implemented client employees (under contract) at the end of the year totalled 48,279 which includes 11,226 for SaaS modules. PYG has seen a strong start to the current financial period with \$1.1m (TCV) in new contract wins. The record level of new contract activity in FY19 will see a minimum of 7,877 client employees implemented in FY20.

Other drivers of revenue for the period included growing contribution of SaaS HROnline module solutions (SaaS module unique billings have grown by 23% YoY) and continued contribution to revenue from the Global Partners Program.

PYG completed the Workforce Management acquisition in India on 29 February 2019, and accordingly the statutory results include a one-month contribution. The business services over 93 clients and 4,500 contractors in 300 cities in India.

Recommendation

We were pleased to note that total implemented client employees matched our forecast for FY19 and are on track to meet our FY20 number. We also note that a record contract year together with a strong sales pipeline and client retention has PYG's client employee number currently tracking above our FY21 estimates. We maintain our **buy recommendation** and have increased our growth forecast for FY21 and beyond and **upgraded our valuation to \$1.52** (representing 74% upside from current levels).

FY19 Results Commentary

The Company reported pro forma revenue of \$8.4m, an increase of 15.1% and NPAT of \$2.3m, down 11.5% YoY. PYG's cash balance is currently at \$6.3m of which \$4.9m relates on balances held on behalf of clients for settlement of their payroll obligations.

Operating Highlights:

- A strong start to FY20 with \$1.1m in new contract wins (TCV) in the current financial year;
- No client losses recorded in Q4 19, and client churn <5% for the year.
- 13% increase in client employee numbers to 48,279 and scheduled to increase to a minimum of 56,156 in FY20.
- Transition of payroll technology partner provides material improvement in payroll processing times.
- Increase in headcount in Account Management in Singapore.

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

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Proforma profit	2,293	3,288	4,324	5,428	6,958
EPS_{adj} (¢)	0.044	0.064	0.084	0.105	0.135
EPS growth	N/A	43.4%	31.5%	25.5%	28.2%
P/E ratio	19.6 x	13.7 x	10.4 x	8.3 x	6.5 x
Enterprise Value (m)	32,904	32,854	32,732	32,054	39,270
EV/Sales (x)	3.92 x	3.23 x	2.68 x	2.20 x	2.25 x
EV / EBIT (x)	14.3 x	10.3 x	7.7 x	5.9 x	5.6 x
EV / EBITDA (x)	12.3 x	9.0 x	6.9 x	5.4 x	5.3 x
DPS (¢)	0.00	3.2	4.2	5.3	6.7
Dividend Yield	0.0%	3.7%	4.8%	6.0%	7.7%
Payout Ratio	0.0%	50.0%	50.0%	50.0%	50.0%
Franking	0.0%	0.0%	0.0%	0.0%	0.0%
FCFPS	0.06	0.08	0.10	0.11	0.14
P/FCFPS	14.37	11.45	9.00	8.00	6.39

Cashflow (A\$'000's)

Year ending Mar	2019A	2020E	2021E	2022E	2023E
EBIT	2,293	3,198	4,265	5,399	6,957
Dep'n and amort'n	376	441	493	534	467
Deferred tax benefit	(41)	(102)	(134)	(168)	(215)
Share option expenses	0	0	0	0	1
Change in Work cap	110	129	144	178	0
Operating cashflow	2,670	3,838	4,945	6,106	7,603
Investing cashflows					
Capex	(500)	(500)	(500)	0	0
Acquisitions/Divestments	0	0	0	0	0
Other	0	0	0	0	0
Free Cash Flow	2,170	3,338	4,445	6,106	7,603
Equity	7,760	0	0	0	0
Other	(2,100)	0	0	0	0
Dividends paid	(750)	(1,644)	(2,162)	(2,714)	(3,479)
Net cashflow	7,080	1,694	2,283	3,392	4,124
Cash at beginning 01/04	5	6,366	6,416	6,538	7,216
Cash at end 31/03	6,366	6,416	6,538	7,216	7,862

Revenue Split (A\$'000's)

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Payroll Services	8,067	9,838	11,916	14,242	17,112
Other	320	320	320	320	320
Group Revenue	8,387	10,158	12,236	14,562	17,432

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

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Operating revenue	8,387	10,158	12,236	14,562	17,432
EBITDA	2,669	3,639	4,758	5,933	7,424
D&A	(376)	(441)	(493)	(534)	(467)
EBIT	2,293	3,198	4,265	5,399	6,957
Net interest income	0	191	192	196	216
NPBT	2,293	3,389	4,458	5,595	7,173
Tax Expense (benefit)	0	(102)	(134)	(168)	(215)
NPAT	2,293	3,288	4,324	5,428	6,958
Significant Items	0	0	0	0	1
NPAT (Proforma)	2,293	3,288	4,324	5,428	6,958
EBITDA Margin	31.8%	35.8%	38.9%	40.7%	42.6%
EBIT Margin	27.3%	31.5%	34.9%	37.1%	39.9%
NPAT Margin	27.3%	32.4%	35.3%	37.3%	39.9%

Balance sheet (A\$'000's)

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Bank Balance	6,366	6,416	6,538	7,216	7,862
Receivables	1,700	2,059	2,480	2,952	3,533
Prepayments	0	0	0	0	0
Other	3,150	3,150	3,150	3,150	3,150
Current assets	11,216	11,625	12,168	13,318	14,545
Net PPE	85	85	85	85	85
Intangibles	1,204	1,463	1,671	1,336	1,069
Deferred Tax Assets	0	0	0	0	0
Other	0	0	0	0	0
Non-current assets	1,289	1,548	1,756	1,421	1,154
Total assets	12,505	13,174	13,924	14,739	15,699
Trade payables	2,689	3,239	3,854	4,614	0
Borrowings	0	0	0	0	0
Employee entitlements	0	0	0	0	0
Deferred Revenue	0	0	0	0	0
Total liabilities	5,520	5,989	6,539	7,154	7,914
NET ASSETS	6,985	7,185	7,385	7,585	7,785

Balance Sheet Ratios

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Net Debt	(6,366)	(6,416)	(6,538)	(7,216)	(7,862)
NTA	0.11	0.11	0.11	0.12	0.13
Price / NTA (x)	7.8 x	7.9 x	7.9 x	7.2 x	6.7 x
Return on assets	20.9%	9.9%	23.6%	29.3%	34.6%
Return on equity	13.9%	25.8%	25.4%	24.1%	23.6%

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	\$1.52

Table 1: Lodge estimates

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Comparable analysis

PayGroup trades at a deep discount relative to its listed international peers and a comparable analysis is detailed in Table 2 below. Comparable valuation analysis does not presently form part of our valuation model for PayGroup, however we believe it is import to note the material discount which the company trades relative to listed international BPO Payroll and HCM Software providers. On a forecast PE basis, PayGroup currently trades at a 72.9% to listed international BPO Payroll and HCM Software providers (50.51 times average) and a 85.8% discount to HCM Software provider (95.55 times average).

We would also note that in 2018 NASDAQ listed Ultimate Software Group, Inc. was acquired by a private equity group led by Hellman & Friedman for US\$11 billion, representing a 32% premium to its then 30-day VWAP and 52.69 times net earnings.

A summary of 11 domestic and international listed comparable listed companies and multiple analysis is detailed in Table 2 below.

Table 2: Listed 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\$	67.9B	156.00	29.44	20.61	4.93	BPO Payroll and HCM Software
WDAY	Workday	U.S.	USD\$	43.25B	191.88	121.44	65.00	12.74	HCM Software
PAYX	Paychex	U.S.	USD\$	30.34B	84.43	30.02	20.24	8.20	BPO Payroll and HCM Software
PAYC	Payce	U.S.	USD\$	11.55B	197.34	64.52	41.52	17.16	BPO Payroll and HCM Software
PCTY	Paylocity	U.S.	USD\$	4.76B	89.87	78.07	39.12	11.12	BPO Payroll and HCM Software
CSOD	Cornerstone OnDemand	U.S.	USD\$	2.98B	50.01	51.29	25.07	5.41	HCM Software
ZAL	Zalaris	OSL (Norway)	NOK	499m	24.80	115.24	10.27	1.05	HCM Software
PYG	Paygroup	ASX	AUD\$	44.95m	0.87	13.7	12.1	4.26	BPO Payroll and Software

Source: Thomson Reuters Consensus and Lodge Research, 4 June 2019

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Explanation of Lodge Partners Recommendation System:

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.

Contact Lodge Partners

Lodge Partners Pty Ltd
ABN: 25 053 432 769 AFSL: 246271
Level 6, 90 Collins Street, Melbourne VIC 3000
T +61 3 9200 7000
lodgepartners.com.au

Lodge Partners Pty Ltd
ABN: 25 053 432 769 AFSL: 246271
Level 22, 227 Elizabeth Street
T +61 2 9225 4433