PayGroup Limited
Software and Services

Initiation of Coverage

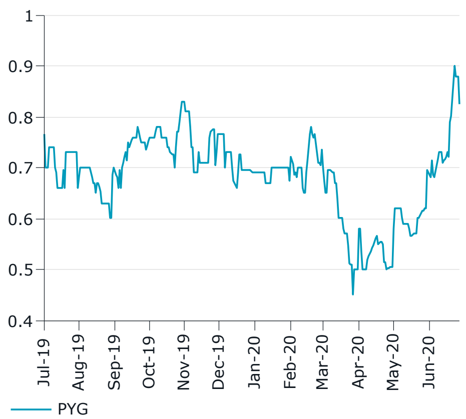
30 June 2020

Rating	Price Target
BUY	A$1.05
PYG-ASX	Price A$0.82

Market Data

52-Week Range (A$) :	0.40 - 0.91
Avg Daily Vol (M) :	0.02
Market Cap (A$M) :	56.7
Shares Out. (M) :	68.7
Dividend /Shr (A$) :	0.00
Dividend Yield (%) :	0.0
Enterprise Value (A$M) :	54.7

FYE Mar	2019A	2020A	2021E	2022E
Sales (A$M)	5.0	10.5	18.5	22.0
EBITDA (A$M)	(1.4)	(0.9)	4.0	5.5
EBIT (A$M)	(1.7)	(2.3)	2.5	4.0
Net Income (A$M)	(2.0)	(1.9)	1.9	2.8
EPS (A$)	(0.05)	(0.03)	0.03	0.04
EPS Adj&Dil (A$)	(0.04)	(0.03)	0.03	0.04
EV/Sales (x)	11.1	5.2	2.9	2.3



Source: FactSet

Priced as of close of business 29 June 2020

PayGroup engages in the provision of business process outsourcing solutions for payroll-related tasks, cloud based human capital management software, and workforce management services.

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Solving a pain point for multinational corporations

Investment Recommendation

PayGroup was formed in 2006 to provide BPO payroll services for multinational corporations (MNCs) that have regional operations in Asia. It began operations in Singapore and has since expanded across Asia Pacific and the Middle East, listing on the ASX in April 2018. Last year, PayGroup acquired Astute One, a SaaS-based provider of payroll and invoicing services to workforce management and recruitment firms across Australia and New Zealand. The combined businesses service nearly 900 clients across 33 countries and are expected to generate ARR of $18.5m.

What we like most about the company is that both of its businesses focus on a narrow subset of outsourced payroll solutions that are complex for its clients and where it can be competitive alongside the major global providers. Consolidation is a common theme in this industry, and we believe PayGroup is well-positioned to participate. **We initiate coverage with a BUY recommendation and $1.05/share price target.**

Key features of the investment thesis

- **Solving a pain point for multinational corporations...** Payroll becomes complex and costly to administer when organisations have small numbers of staff in several countries. Tax laws, reporting obligations, languages, currencies, time zones, and banking cutoff times differ between countries, making it hard to streamline processes and manage them accurately. PayGroup's *PayAsia* business offers outsourced payroll solutions in 33 countries in the Asia Pacific region; around 30% of its ~545 clients are MNC's headquartered in Asia, and another 30% are the Asian operations of US firms.
- **...as well as global payroll firms.** PayGroup has a global partner program with seven large multinational payroll businesses that sees it handle payroll work for partner clients across Asia and the Middle East. These partnerships currently represent around 10% of BPO revenue. Not only is this testament to the value that specialist regional players can offer, but is frequently a driver of industry consolidation as more global businesses set up operations across the region.
- **Generating SaaS revenues in Australia.** Astute is an ANZ-based payroll SaaS technology provider that specializes in workforce management companies, with 330 clients (9% market share) and ARR of $8.8m at 31 March. It operates as a cloud-based SaaS platform that connects with front-end applicant tracking systems and back-end general ledger accounting platforms, pulling timesheet data to calculate the contractor payroll requirement as well as capturing the relevant on-hire margins and creating the invoice for the workforce management firm to send to the client. This is a specialized, industry-specific task, as Astute has to monitor and reference thousands of EBAs and employee awards to ensure wages and invoices are accurate.

Valuation

We value PayGroup at $1.05/share using a 3x FY22e EV/sales multiple - consistent with industry commentary from global payroll companies regarding acquisition multiples for regional businesses, and a significant discount to larger peers. As a cross-check, our DCF valuation is $1.02/share (WACC: 10%).

For important information, please see the Important Disclosures beginning on page 15 of this document.

Figure 1: PayGroup Limited (PYG-ASX); Canaccord Genuity forecasts

PayGroup Limited (PYG)				$0.83					Year end 31 March
Profit & Loss ($m)	**FY19**	**FY20**	**FY21E**	**FY22E**	**Ratios**	**FY19**	**FY20**	**FY21E**	**FY22E**
Sales revenue	**5.0**	**10.5**	**18.5**	**22.0**	**Valuation**				
EBITDA	**-1.4**	**-0.9**	**4.0**	**5.5**	EPS (norm.)	-4.1	-2.6	2.9	4.2
Depreciation	-0.3	-1.1	-1.2	-1.2	P/E (x) (norm.)	-20.2	-32.0	28.9	19.5
EBITA	**-1.7**	**-2.0**	**2.8**	**4.3**	PE Rel - XAO			1.8	
Amortisation	0.0	-0.3	-0.3	-0.3	PE Rel - XSO			1.9	
EBIT	**-1.7**	**-2.3**	**2.5**	**4.0**	EV/EBITDA (x)	-28.6	-61.1	13.6	9.4
Net interest	0.0	-0.1	0.0	0.0	EV/EBIT (x)	-23.8	-23.8	22.1	12.9
Pre-tax profit	**-1.7**	**-2.4**	**2.5**	**4.0**	DPS (cps)	0.0	0.0	0.0	0.0
Tax expense	0.0	0.1	-0.6	-1.2	Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%
NPAT (pre-ISIs)	**-1.8**	**-2.3**	**1.9**	**2.8**	Franking (%)	0%	0%	0%	0%
Significant items	-0.2	0.4	0.0	0.0	CFPS (cps)	-11.0	-0.2	3.4	6.5
NPAT (reported)	**-2.0**	**-1.9**	**1.9**	**2.8**	P/CFPS (x)	nmf	nmf	24.0	12.7
NPAT (normalised)	**-1.8**	**-1.5**	**2.0**	**2.9**	**Profitability**				
					EBITDA margin (%)	nmf	nmf	21.5%	24.8%
Cash Flow ($m)	**FY19**	**FY20**	**FY21E**	**FY22E**	EBIT margin (%)	nmf	nmf	13.3%	18.1%
Operating EBITDA	**-1.4**	**-0.9**	**4.0**	**5.5**	ROE (%)	nmf	nmf	13.6%	17.8%
Interest and tax	0.0	-0.1	-0.2	-0.9	ROA (%)	nmf	nmf	8.4%	13.2%
Working capital	-4.7	-8.1	-1.4	-0.1	**Capital structure**				
Other	1.4	9.0	0.0	0.0	Enterprise Value ($m)	41	55	54	51
Operating Cashflow	**-4.8**	**-0.1**	**2.4**	**4.5**	Net Debt (cash)	-1	-2	-2	-5
Capex	0.0	-0.1	-1.8	-1.5	Gearing (%)	cash	cash	cash	cash
Net acquisitions	0.5	-1.9	0.0	0.0	EFPOWA (m)	44	57	69	69
Free Cashflow	**-4.4**	**-2.1**	**0.5**	**2.9**	**Growth**				
Dividends	-1.0	-0.3	0.0	0.0	Sales revenue (%)	nmf	111.4%	76.1%	19.2%
Net equity issued	7.6	2.9	0.0	0.0	EBITDA (%)	nmf	nmf	-543.7%	37.4%
Net Cashflow	**2.2**	**0.4**	**0.5**	**2.9**	EBIT (%)	nmf	nmf	-206.9%	62.3%
Opening cash	0.0	1.4	2.0	2.5	NPAT (norm.) (%)	nmf	-18.2%	-234.3%	48.1%
Borrowings/other	-0.7	0.1	0.0	0.0	EPS (norm.) (%)	0.0%	-36.8%	-210.7%	48.1%
Closing cash	**1.4**	**2.0**	**2.5**	**5.4**	DPS (%)	nmf	nmf	nmf	nmf
Balance Sheet	**FY19**	**FY20**	**FY21E**	**FY22E**				**FY21e**	**FY22e**
Cash	1.4	2.0	2.5	5.4	**Target sales multiple**				
Receivables	5.3	4.5	2.2	2.6	Sales revenue ($m)			18.5	22.0
PPE	0.1	0.2	0.8	1.2	Multiple (x)			3	3
Intangibles	1.3	10.3	10.0	9.7	Enterprise Value ($m)			55.5	66.1
Other assets	6.5	13.0	13.0	13.0	**Less: net debt ($m)**			2.5	5.4
Total Assets	**14.6**	**29.9**	**28.5**	**31.9**	**Equity value per share ($)**			**$ 0.84**	**$ 1.05**
Borrowings	0.0	0.0	0.0	0.0					
Payables	10.0	12.6	8.9	9.3	**Discounted Cash Flow**				
Other Liabilities	0.7	3.4	3.8	4.0	Cost of equity	10.0%	WACC		10.0%
Total Liabilities	**10.8**	**16.0**	**12.7**	**13.3**	Cost of debt	4.2%	TGR		3.0%
NET ASSETS	**3.9**	**13.9**	**15.8**	**18.6**	Debt weighting	0.0%	**Per Share**		**$ 1.02**
Board and shareholders			**(m)**	**%**	**Substantial Shareholders**			**(m)**	**(%)**
Ian Basser, Non-Executive Chairman			0.6	0.8	Michele Samlal			22.1	32.1
Mark Samlal, Managing Director			22.1	32.1	Lawrence Pushpam			7.1	10.2
Franck Neron-Bancel, Executive Director			1.0	1.4	Buttonwood Nominees			6.4	9.4
David Fagan, Non-Executive Director			0.3	0.4	SG Hiscock & Company			3.5	5.1
					Top 20 shareholders			**46.3**	**67.3**

Description

PayGroup engages in the provision of business process outsourcing solutions for payroll-related tasks, cloud based human capital management software, and workforce management services.

Source: Company Reports, Canaccord Genuity estimates

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Key features of investment thesis

Solving a pain point for multinational corporations

What we like most about PayGroup is that both of its businesses (PayAsia and Astute) focus on a narrow subset of outsourced payroll solutions that are complex for its clients and where it can be competitive alongside the major global providers. Specifically, the typical client for PayAsia is a mid-sized multinational corporation with employees in multiple Asia-Pacific regions, and PayAsia handles payroll and reporting requirements for them in these regions. Astute is similarly niche, servicing ANZ workforce management companies that need to accurately apply thousands of employee awards and EBAs (enterprise bargaining agreements) to weekly timesheet data, and then on-charge these at a margin to their clients.

A likely participant in industry consolidation

Localised players and regional specialists flourish in smaller markets. Our research suggests that global payroll providers frequently partner with businesses like PayGroup to provide them with niche geographic coverage.

Further, globalisation and the growth of mid-sized firms is increasing the number of MNCs operating from some of these smaller countries across Asia and the Middle East. As demand for outsourced payroll increases in a country, it becomes a strategic option for a larger global provider to acquire an established partner in one of these growing countries and build market share organically from there. In this regard, we see the potential for PayGroup to be acquired or to be an acquirer itself.

Astute acquisition offers scope for further expansion in Asia

PYG's acquisition of Astute represents another play in a niche space, namely servicing workforce management companies in Australia and New Zealand where it has roughly 9% market share. There are opportunities to increase market share in Australia, and we like the fact that the contractor market tends to hold up well in economic downturns. However, the biggest upside that Astute offers is to integrate its timesheeting and invoicing capabilities with the company's Asia-centric payroll engine and win workforce management clients in English-speaking companies through Asia, leveraging its existing reputation in the region and its strong client base in Australia.

Experienced board and management team

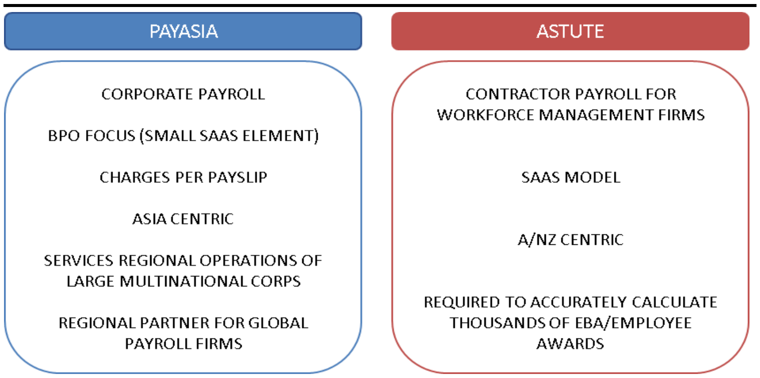
PayGroup is a founder-led business, complemented by a board that has considerable executive experience in global HR and payroll businesses. The executive team has long relationships with key clients and service partners and demonstrates a strong understanding of the industry and opportunities, which we feel is evidenced by the specific areas that PayGroup focuses on.

Company overview

PYG's predecessor company, PayAsia, was formed in 2006 to provide BPO payroll services. It began operations in Singapore and has since expanded across the Asia Pacific and Middle East, listing on the ASX in April 2018 with 410 clients and forecast revenues of $7.5m. The company's IPO raised $8.5m at $0.50/share to fund further geographic expansion. At IPO, the company was valued at $25m, compared to its market cap today of $57m.

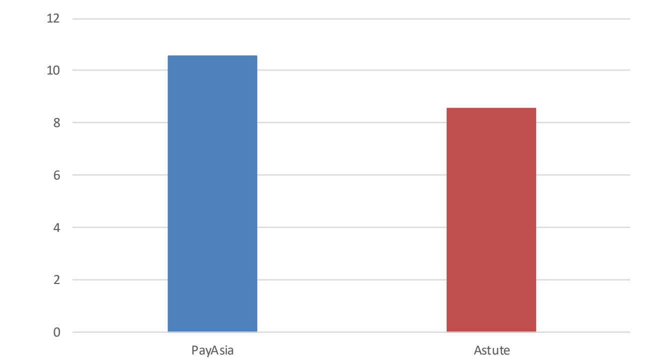
In October 2019, PYG acquired Astute One, a SaaS-based HCM provider in Australia, for $11m (issued in scrip at $0.85/share). The combined businesses service nearly 900 clients across 33 countries and are expected to generate ARR of $18.5m on a proforma basis.

Figure 2: PayGroup has two business lines: a BPO payroll business with a regional niche, and a SaaS payroll business focusing on a niche industry.



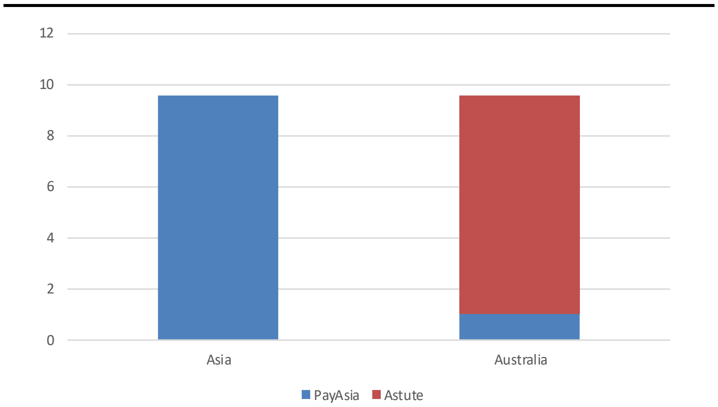
Source: Canaccord Genuity estimates

Figure 3: Revenues are split almost equally between PayAsia and Astute…



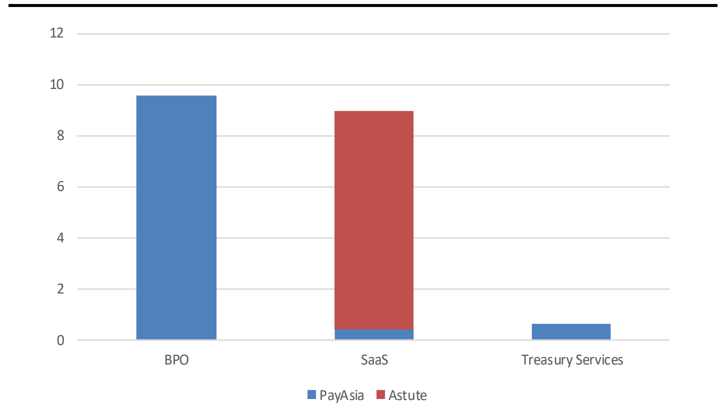
Source: Canaccord Genuity estimates

Figure 4: …across Asia/Middle East and Australia…



Source: Company Reports

Figure 5: …and BPO and SaaS, with some Treasury Services in PayAsia.



Source: Company Reports

Payroll is a complex task that makes it difficult to provide a single 'best' solution

A company's payroll obligations are, at a minimum, to correctly calculate 'gross-to-net' obligations to its employees (referencing applicable tax legislation), make the appropriate payments (excluding any relevant deductions), and keep records of these transactions for reporting purposes. If a company has a large number of employees and it operates within one tax jurisdiction, then the most effective approach to meet these obligations is to run an in-house payroll function, utilizing one of the major payroll administration software providers like SAP or Oracle.

Multinational corporations (MNCs) face the most complexity in meeting payroll obligations

Payroll becomes more complex and/or costly to administer internally if one or more of the following are applicable:

- an organization does not have a large number of staff;
- staff numbers fluctuate considerably, or
- it operates in a number of countries.

The latter creates the most complexity because tax laws, reporting obligations, languages, currencies, time zones, and banking cutoff times differ between countries, which makes it hard to streamline processes and manage them accurately. For these reasons, many multinational corporations (MNCs) will consider some form of an outsourced payroll solution, ranging from basic payroll tasks (printing cheques, filing local tax documents and disbursing funds to client employees) to a full end-to-end service which includes the calculation of wages, pensions, and taxes, monitoring leave balances and leave applications, and handling employee expense and medical claims.

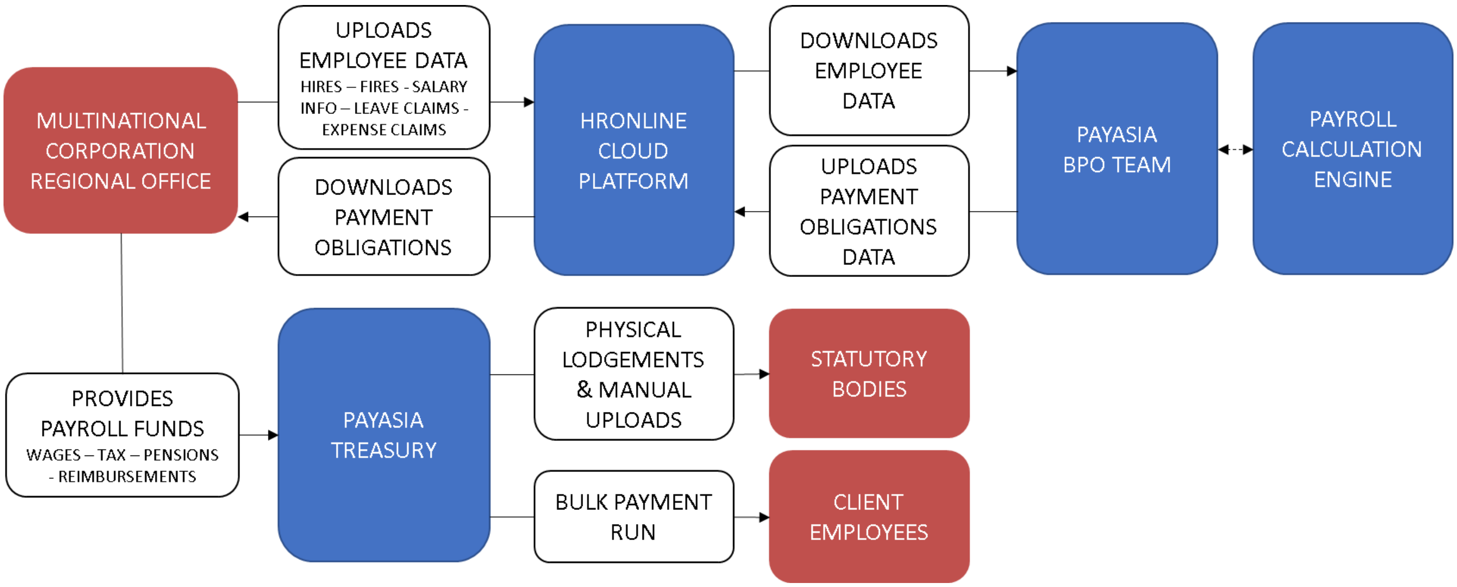
PayGroup's BPO payroll business (PayAsia) provides an outsourced solution for these obligations, and client employees can access their payslips via HROnline, its cloud-based platform. From a revenue perspective, the company is primarily paid on a 'per payslip' basis for this work. However, HROnline can also be used by clients as a portal for employees to apply for annual leave or enter expense claims, for which PayAsia receives a SaaS-based subscription fee. Around a third of PayAsia's clients use this solution.

Figure 6: PayGroup's BPO payroll business processes payslips for more than 40,000 employees, with nearly a third of these including a SaaS revenue component

	2H18	1H19	2H19	1H20	2H20
MONTH-END PAYSLIPS PROCESSED	32241	33299	37053	38913	42403
- GROWTH (%, HOH)		3.3%	11.3%	5.0%	9.0%
PAYSLIPS GENERATING SAAS REVENUE (%)	na	na	23%	32%	31%

Source: Company Reports

Figure 7: PayAsia's payroll operations have a strong BPO element because it is providing a multi-country solution that includes physical document lodgment and some manual uploads between systems. However, the company integrates all this data to provide one report to the client via its HROnline cloud platform, which also acts as a hub for collecting employment data and delivering payslips to employees.



Source: Canaccord Genuity estimates

PayGroup offers a range of modularized service options which enables flexibility for the client, given their differing sizes as well as the extent to which they have administrative functions in the region. Contracts typically run for three years, with 95% retention rates.

PayGroup has developed a niche in the Asia Pacific region

PayGroup's headquarters are in Singapore, which is an attractive regional hub for MNC's because of a longstanding tax incentive for businesses conducting activities that are deemed beneficial to Singapore's economic development. E&Y estimates that around 4,200 of 7,000 MNC's operating in Asia have their regional headquarters in Singapore. Around 30% of PayGroup's ~545 BPO payroll clients are Asian MNC's, and another 30% are US firms with Asian operations (likely using a separate payroll provider for operations in their home country).

PayGroup offers outsourced payroll solutions in 33 countries in the Asia Pacific region, relying on partnerships to provide services in 22 of these countries, which represent less than 10% of its client volume (again highlighting the usefulness of this strategy).

Global players are often reliant on local providers to give them geographic coverage...

The multinational payroll solutions market is estimated at around US$3bn, and companies like **ADP** (ADP-US: US$144.72 | Not Rated), **NGA Human Resources** (a subsidiary of the Blackstone Group-owned Alight Solutions), and **TMF Group** (owned by CVC Capital Partners) dominate these services in the relatively mature markets that they are headquartered in (the US, the UK, and Europe, respectively).

The market for outsourced providers is much more fragmented outside of these regions (we will focus on Asia-Pacific in this report), owing to the complexities described above. In particular, the heavy reliance on physical lodgment and manual uploading of documents makes it difficult for a pure SaaS solution to be effective.

Figure 8: PYG provides service coverage of 30+ countries through the Asia-Pacific region

Country	Service Method
Australia	Office Location
Bahrain	Service Partner
Bangladesh	Service Partner
Brunei	Service Partner
Cambodia	Service Partner
China	Service Partner
Egypt	Service Partner
Hong Kong	Office Location
India	Office Location
Indonesia	Office Location
Iraq	Service Partner
Japan	Service Partner
Jordan	Service Partner
Kuwait	Service Partner
Lebanon	Service Partner
Malaysia	Office Location
Morocco	Service Partner
Myanmar	Office Location
Nepal	Office Location
New Zealand	Service Partner
Oman	Service Partner
Pakistan	Service Partner
Philippines	Office Location
Qatar	Service Partner
Saudi Arabia (KSA)	Service Partner
Singapore	Office Location
South Korea	Service Partner
Sri Lanka	Service Partner
Taiwan	Service Partner
Thailand	Office Location
Turkey	Service Partner
UAE	Service Partner
Vietnam	Office Location

Source: Company Reports

Local providers flourish in smaller markets, where they build up a client base of businesses headquartered in their country, and act as a supplementary partner to global providers looking to offer their clients broad geographic coverage for payroll services (but the volumes are too small to justify developing the resources internally).

A good example of this is Thailand-based **Humanica** (HUMAN-TH:BT7.85, Not Rated), which was spun out of PwC in 2003. It leads the market for payroll outsourcing in Thailand and acts as a partner for many larger outsourcing companies looking to provide coverage of Thailand to its MNC clients.

...and PayGroup acts as one of these providers, with the distinct advantage of being able to cover 33 countries in the region.

PayGroup has a global partner program with seven large multinational payroll businesses that sees it handle BPO payroll work for partner clients across Asia and the Middle East. These partnerships currently represent around 10% of BPO revenue. Not only are such programs a source of revenue growth at a low cost of customer acquisition, but typically PayGroup can charge its partners according to its standard rate card. Margins can also be enhanced to the extent that PayGroup can leverage the geographic spread of its existing office infrastructure (refer Figure 8) to take on work outside peak hours.

Figure 9: PayGroup has partnered with a variety of larger payroll companies that leverage its local expertise

Global partner	HQ	Service line
Ultimate Software	US	BPO Payroll
Payroll Inc	Japan	BPO Payroll
CloudPay	UK	BPO Payroll
People First	UK	BPO Payroll
Immedis	Ireland	BPO Payroll
PayrollHQ	Australia	BPO Payroll
FlareHR	Australia	Treasury Services

Source: Company Reports

Consolidation (in both directions) could be a catalyst for PayGroup

Globalisation and the growth of mid-sized firms are increasing the number of MNCs operating from some of these smaller countries. As demand for outsourced payroll increases in a country, it becomes a strategic option for a larger global provider to acquire an established partner in one of these growing countries and build market share organically from there.

While the largest companies in the industry already offer both HCM and outsourced payroll in their software, in the last few years we have seen smaller HCM and payroll companies acquire their way to having a combined offering.

Figure 10: Consolidation of niche players is occurring rapidly across Asia Pacific, as well as broader M&A activity in the sector

Year	Acquirer	Target	Industry	Region	Info
2019	ReadyTech	WageLink	Payroll	Australia	$1.6m purchase price - 7x EBITDA (combined)
2019	ReadyTech	Zambian	HCM	Australia	$10.5m purchase price - 7x EBITDA (combined)
2019	ADP	Softcom	HCM/payroll	Ireland	Long-standing regional partner
2019	Humanica	Tiger Soft	HCM/payroll	Thailand	
2019	Ceridian	RITEQ	HCM	Australia	
2019	Hellman & Friedman	Ultimate Software (UltiPro)	HCM	various	US$11bn transaction - 11x revenue
2018	Ascender	PeopleStreme	HCM	Australia	
2018	ADP	Celergo	Payroll	various	Expat administration software
2018	Paychex	Lessor Group	HCM/payroll	Nth Europe	SaaS and on-premise software
2017	Tricor	Orisoft	HCM/payroll	Malaysia	Multi-country Asian payroll
2016	ELMO Software	Sky Payroll	Payroll	Australia	$1.8m purchase price - 12x revenue
2016	Everstone Capital	AON Hewitt (Excelity)	Payroll	various	$60m transaction - India/China centric

Source: Company Reports, Canaccord Genuity estimates

The strategy is perhaps best summarised by the **Ceridian HCM** [CDAY-US: US$79.91 | Not Rated] CEO at a recent technology conference: *"From a global expansion perspective…we believe that there are opportunities to…identify incumbents in local markets that understand the demand very well that have a market presence…it's an opportunity for us to acquire it at about a 3x [sales] multiple."*

Treasury Services is a small but growing service offering

PayGroup recently launched a Treasury Services offering, which allows clients to remit funds to the company in bulk and rely on it to make wage payments to employees and remit local taxes. This was originally launched as a cross-border solution, but really started to ramp up when PayGroup offered localized solutions, with a little over 100 clients using the service.

In the medium term there should be opportunities to add complementary services like flexible wage access (i.e., outside of traditional pay cycles), which is more common in Western countries but increasingly becoming accepted across Asia. The company also intends to launch a debit card offering that facilitates payments to employees that do not have bank accounts, and a 'financial wellbeing' product that enables contractors to choose their superannuation provider.

The acquisition of Astute One is consistent with PayGroup's 'niche' strategy…

Astute One (Astute) is an ANZ-based payroll services provider that specializes in workforce management companies. It operates as a cloud-based SaaS platform that connects with front-end applicant tracking systems and back-end general ledger accounting platforms, effectively digitizing the back-office components of contractor records administration, tax and payment processing of contractors that these companies on-hire to their clients, and the creation of invoices.

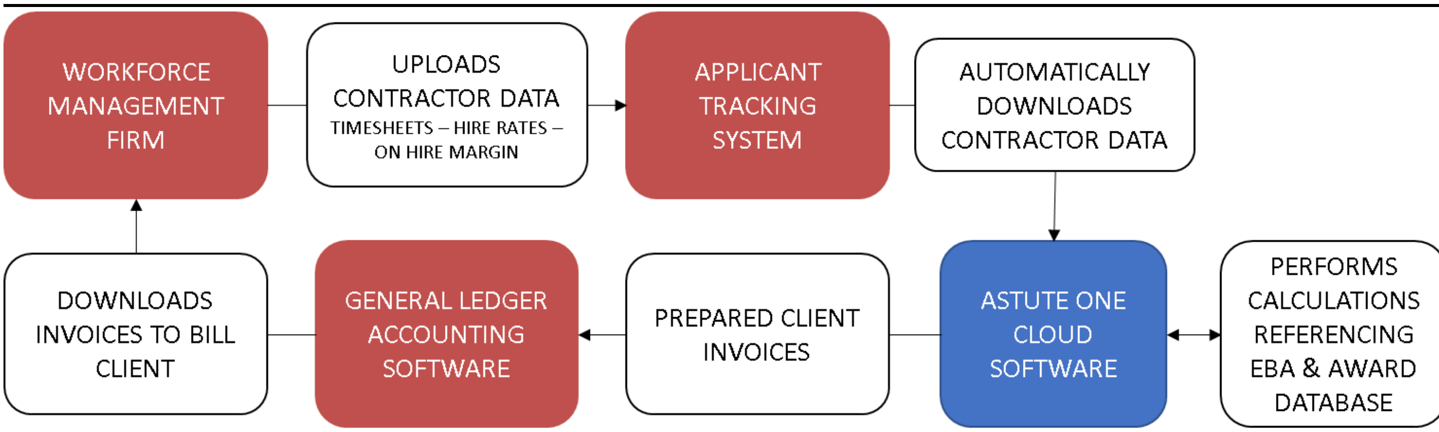
The business has 330 clients with an ARR of $8.8m at 31 March. With approximately 4,200 workforce management firms in Australia, this would give Astute around 9% market share.

…with a specific focus on the complex requirements of workforce management and recruitment firms.

Where most businesses are concerned with "corporate payroll", i.e., paying their salaried employees, the primary payroll burden of workforce management firms involves paying contractors and then on-charging their clients at a margin. Astute specializes in "pay-to-bill" which pulls timesheet data to calculate the contractor payroll requirement as well as capturing the relevant on-hire margins and creating the invoice for the workforce management firm to send to the client.

Because workforce management firms hire contractors across a multitude of businesses and industries, there are literally thousands of employee awards and EBAs (enterprise bargaining agreements) that have to be monitored and accurately applied to weekly timesheet data. Underpayment of employees is a reputational hazard to be avoided, as recent media coverage attests. In addition, there is often a schedule of on-hire margins that are agreed between the workforce management firm and the client, and it is important to marry these items up correctly in order to ensure that the invoice prepared on behalf of the workforce management firm is accurate. Astute's payroll engine is specifically designed for these tasks, which makes it distinct from the more homogenous nature of corporate payroll.

Figure 11: Astute services a niche industry, where it sits as a middle-office software layer between applicant tracking systems and accounting software, to perform the calculations required to ensure that contractor rates are calculated accurately and the client is billed correctly. In contrast to PayAsia, this process is largely automated.



Source: Canaccord Genuity estimates

These factors influence implementation times (months compared to weeks for corporate payroll) as well as customer stickiness. Contract length is typically three years, and firms buy 'blocks' of subscriptions to cover anticipated monthly users (with agreed minimums) This feature is reflective of the underlying industry, which sees cyclical demand for contractors through the year (rising toward December) and through a business cycle (rising through economic troughs as companies 'variabilise' their cost base). Churn runs at around 6%, which is a mixture of business closures (recruitment is a fragmented, SME-heavy industry) and occasional in-sourcing.

Other potential synergies between Astute and PayAsia

As we have discussed, PayAsia specializes in corporate payroll for MNCs with operations in Asia, and Astute specializes in 'pay to bill' for workforce management companies across Australia and New Zealand. The imminent opportunity is to integrate the capabilities of both businesses so that PayAsia can market to recruitment firms in the region or to businesses that have a significant component of temporary, fluctuating labour requirements. From a technical perspective, this would require disaggregating the timesheeting and invoicing capabilities of Astute from its contractor-centric payroll engine, so that it can be linked to the payroll engines that PayAsia uses across the countries it operates in.

Once this is achieved, there may also be the opportunity for Astute to provide corporate payroll services in Australia and New Zealand. However, we are mindful that there are a variety of firms already operating in this space such as **Payroll Metrics** (private), **Key Pay** (private), **Definitiv** (private), and **Sky Payroll** (recently acquired by Elmo Software).

Earnings overview

PayGroup has a March year end, and recently reported an FY20 EBITDA loss of $0.9m on revenue of $10.9m. The result includes a five-month contribution from Astute. There were a number of cash costs relating to the acquisition/integration of Astute and non-cash adjustments relating to the acquisition accounting that point to a normalised FY20 EBITDA of circa $1.2m.

Figure 12: On our estimates PayGroup reported normalised FY20 EBITDA of $1.2m on $10.5m of revenue

FY20 statutory revenue	**10.9**
Less: forex gains	-0.4
FY20 normalised revenue	**10.5**
Comprised of…	
BPO payroll & treasury services	*7.6*
Astute (five months)	*2.9*
FY20 statutory EBITDA	**-0.9**
Add: Astute acquisition/integration costs	1.1
Add: other one-off costs	0.7
Add: non-cash adjustments relating to acq'n	0.7
Less: forex gains	-0.4
FY20 normalised EBITDA	**1.2**

Source: Company Reports, Canaccord Genuity estimates

The company had $2m in cash at 31 March and no debt. It also holds an additional $7m in restricted cash which relates to client balances that are held for employee and statutory obligations.

Forecasts and assumptions

From our normalised FY20 calculation of $10.5m revenue and $1.2m EBITDA, we add in a full year contribution from Astute and PayAsia's balance date payslip numbers to arrive at an exit rate of $17.8m revenue and $1.9m EBITDA for the business.

From this starting point, we make the following assumptions:

PayAsia - increase in payslips under management from new partnerships and contract wins

At the FY20 result, PayGroup announced a new partnership agreement that is expected to generate 10k payslips (+24%) across a base of 100 clients in the first year. This work will be fulfilled by PayGroup's Indian operations, increasing utilization, which suggests that margins across this business will improve.

Subsequent to balance date, the company announced $2.7m in new contract wins (pointing to a record Q1) which would work out to $0.9m in annual revenue, assuming a three-year contract life.

Astute – potential Covid-19-related impacts to impact revenue in the near term

We assume the Astute business has seen a drop off in weekly timesheets and new contractor jobs to the tune of 15-20%, which would be consistent with industry commentary. This figure looks to have stabilized in recent weeks.

Figure 13: Global payroll/HCM peers point to the critical nature of the services that they provide, while acknowledging that the pipeline of new work has temporarily slowed. Astute's local competitor, FastTrack, has quantified a 15-20% drop in volumes.

ADP Q3 analyst call (March 2020)	"As with prior uncertain economic environments, our clients and prospects have become time and resource-constrained and are faced with reassessing their own operations to best ride out the impact of this health crisis. And although our products support mission-critical functions, making decisions about additional HCM services or making the decision to switch from another vendor to ADP can get put off to a later time. Even in circumstances where decisions have already been made, **clients are understandably delaying implementation,** which can also cause us to adjust down the bookings we record."
Paychex Q3 analyst call (March 2020)	"...**we've seen leads drop off on the front end**, but then there's been other pieces that have picked up. So they're definitely down, but they're not like shut down. **They're down double-digits**, but not as much as you might have even thought. So people are still looking for, and maybe because of this, looking for payroll support, HR support, insurance, those kind of things."
Paychex industry conference (June 2020)	"...mid to late-April we saw kind of a bottom, the lowest number; and then since the beginning, probably... **late-April, the beginning of May things have started to come back** and improve each week and we've seen that improvement."
Ceridian industry conference (June 2020)	"In terms of head count...we had seen **employment levels begin to stabilize in the middle of April**."
FastTrack CEO blog (May 2020)	"...the last three weeks since COVID-19 took hold in ANZ the number of worked hours started to see a gradual decline. Not unexpectedly, new jobs created took a significant dive in the week ending March 22 as governments stated to ramp up their concerns and implement restrictions on movement... ...following the drop in both the leading indicator of new jobs created and the lag indicator of timesheet hours in April, **we are now seeing this start to flatten out around 15-20% above the early April drop** (made worse with the short Easter weeks). While still early days, there does seem to be consistency here, with a slight underlying upwards trend, particularly in timesheet hours."

Source: Company Reports, FastTrack

Overhead cost reductions

Management has identified $1.5m in annualised cost savings that should be realized in FY21e. In addition, there is a small amount of carry-forward tax losses that we assume are absorbed in 1H21.

We outline our FY21e forecasts overleaf.

Figure 14: FY21 should be a year of solid EBITDA growth given a full year contribution from Astute, new BPO payroll client wins and cost-outs.

	FY20	1H21E	2H21E	FY21E
PayAsia	7.6	4.3	5.7	9.9
Astute	2.9	4.1	4.5	8.6
Revenue ($m)	**10.5**	**8.3**	**10.2**	**18.5**
PayAsia	-2.4	0.5	0.7	1.2
Astute	1.5	1.2	1.4	2.8
EBITDA ($m)	**-0.9**	**1.8**	**2.2**	**4.0**
EBITDA margin	-8.5%	21.5%	21.5%	21.5%
Dep'n and amort'n ($m)	-1.4	-0.8	-0.8	-1.5
EBIT ($m)	-2.3	1.0	1.4	2.5
Net interest ($m)	-0.1	0.0	0.0	0.0
PBT ($m)	-2.4	1.0	1.4	2.5
Tax expense ($m)	0.1	-0.2	-0.4	-0.6
NPAT pre-ISIs ($m)	-2.3	0.9	1.0	1.9
Significant items ($m)	0.4	0.0	0.0	0.0
Reported NPAT ($m)	**-1.9**	**0.9**	**1.0**	**1.9**
Normalised NPAT ($m)	**-1.5**	**0.9**	**1.1**	**2.0**
Dividend (cents)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Normalised EPS (cents)	-2.6	1.3	1.5	2.9

Source: Company Reports, Canaccord Genuity estimates

Valuation

We value PayGroup at $1.05/share using a 3x FY22e EV/sales multiple - consistent with industry commentary from global HCM/payroll companies that smaller regional businesses can be acquired on 3x sales, or a peer like ReadyTech (RDY-ASX: $1.39 | Not Rated), and at a significant discount to Humanica (HUMAN-TH: BT7.85 | Not Rated). As a cross-check, our DCF valuation is $1.02/share (WACC: 10%).

Figure 15: COMPS TABLE

COMPANY	TICKER	M/CAP (A$M)	EV (A$M)	SALES (A$M)	EBITDA (A$M)	EV/SALES (X)	EV/EBITDA (X)
Global HCM/outsourced payroll							
Automatic Data Processing, Inc.	ADP-USA	92383	93920	21140	5159	4.4	18.2
Paychex, Inc.	PAYX-USA	38201	38558	5686	2246	6.8	17.2
Workday, Inc.	WDAY-USA	47247	62515	7195	1518	8.7	41.2
Ceridian HCM Holding, Inc.	CDAY-USA	16587	18248	1425	289	12.8	63.1
Humanica Public Co. Ltd.	HUMAN-TH	248	238	37	13	6.5	18.1
Australian HCM/outsourced payroll							
ReadyTech Holdings Ltd.	RDY-AU	112	134	67	27	2.0	4.9
ELMO Software Ltd.	ELO-AU	617	431	92	-2	4.7	na
PayGroup Ltd.	PYG-AU	61	44	19	4	2.3	10.8

Source: Canaccord Genuity estimates

Risks

We see the key risks to our investment thesis as follows:

Key man risk – PayGroup is a small organization from an executive headcount standpoint, and we believe it is particularly reliant on founder Mark Samlal (who indirectly owns ~32% of the business) and Executive Director Franck Neron-Bancel (2% shareholder).

Systems risk – PayGroup handles confidential information for its clients and performs time-sensitive tasks that require continuity and accuracy in its systems and software. Any interruption to its processes could impact its ability to deliver its services and/or its reputation with clients.

Competition – PayGroup faces competition from large global payroll outsourcing companies as well as local providers which could impact its growth, client retention rates or the revenue it generates from clients.

Covid-19 impacts - Because PayAsia's client base has moderate concentration in Singapore, Malaysia and Bangalore, it has increased exposure to any prolonged business restrictions relating to Covid-19. These may delay new business wins and implementations or see clients reduce activities in the region.

Board and management

Figure 16: Key management personnel

	Role	Detail
Ian Basser	Non-Executive Chairman	Appointed in November 2017. Ian has nearly 30 years' experience in professional service industries, with Managing Director roles at Chandler Macleod and Harvey Nash and having served on the global management team of Michael Page.
Mark Samlal	Managing Director	Mark co-founded PayAsia and has acted in a Managing Director role since 2015. He has over 20 years' experience in executive roles across Australia and Singapore, having been CEO at Singapore-listed VicPlas and GM of ADP in Asia-Pac.
Franck Neron-Bancel	Executive Director	Appointed in July 2017. Franck has over 20 years' experience in Human Capital Management and payroll services, having been a Senior VP at Automatic Data Processing.
David Fagan	Non-Executive Director	Appointed in November 2017. David has nearly 40 years' experience in law practice including 30 years with Clayton Utz where he was National Chief Executive Partner from 2001-2010.

Source: Company Reports

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Investment Recommendation

Date and time of first dissemination: June 29, 2020, 16:29 ET

Date and time of production: June 29, 2020, 16:07 ET

Target Price / Valuation Methodology:

PayGroup Limited - PYG

We value PayGroup at $1.05/share using a 3x FY22e EV/sales multiple. As a cross-check, our DCF valuation is $1.02/share (WACC: 10%).

Risks to achieving Target Price / Valuation:

PayGroup Limited - PYG

We see the key risks to our investment thesis as follows:

Key man risk – PayGroup is a small organization from an executive headcount standpoint, and we believe it is particularly reliant on founder Mark Samlal (who indirectly owns ~32% of the business) and Executive Director Franck Neron-Bancel (2% shareholder).

Systems risk – PayGroup handles confidential information for its clients and performs time-sensitive tasks that require continuity and accuracy in its systems and software. Any interruption to its processes could impact its ability to deliver its services and/or its reputation with clients.

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Covid-19 impacts - Because PayAsia's client base has moderate concentration in Singapore, Malaysia and Bangalore, it has increased exposure to any prolonged business restrictions relating to Covid-19. These may delay new business wins and implementations or see clients reduce activities in the region.

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Rating	Coverage Universe		IB Clients
	#	%	%
Buy	483	60.53%	54.66%
Hold	182	22.81%	38.46%
Sell	18	2.26%	38.89%
Speculative Buy	115	14.41%	70.43%
	798*	100.0%	

*Total includes stocks that are Under Review

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