



Research Report

PayGroup Limited

Buy

Price: \$0.78 | 12 Month Target: \$1.94 | Implied Return: 148% | 06 November, 2019

Quarterly Update

Multi-Country Software with a Service (SaaS) Payroll Solutions and APP enabled Cloud Software as a Service (SaaS) Human Capital Management (HCM) provider PayGroup Limited (ASX: PYG), released its quarterly results on Thursday for the period ending 30 September 2019 (Q2 FY20). Key highlights for the period included the acquisition of SaaS HCM provider Astute One Limited (Astute), and company guidance for pro-forma FY20 annual revenue to exceed \$17.5m, in line with Lodge's estimate.

Results Summary

PYG added \$1.5m (+14.5% on previous quarter) in new contracts signings in Q2 (expressed as total contract value (TCV)). 2,455 new client employees were added during the quarter with a pipeline of 3,338 additional client employees to be implemented during FY20. Total implemented client employees sit at 57,048 with PYG well on track to meet our forecasts. New client employees were slightly lower than the previous quarter, however Q1 implementations are often higher than the rest of the financial year so a slight drop off is not unusual. Cash receipts for the quarter were down slightly on previous quarter (\$2.059m vs \$2.114m) however shows a 320% increase on pcp. Q1 included the impact of 13th month invoicing.

Additionally, during the quarter PYG finalised the acquisition of Astute for a total consideration of \$11m, wholly funded via the issue of PYG shares at \$0.85 per share. The combined entity is on track to deliver pro-forma annual revenue in excess of \$17.5m in FY20. The acquisition of Astute will provide immediate scale in the Australian market as well as cross-selling opportunities of PYG's services (such as BPO payroll) to Astute's clients. The addition of Astute will increase the contribution of SaaS revenue from the current level of 6% to more than 40%.

Recommendation

Astute is currently in the process of being integrated into the wider business, with contributions expected to be seen from this point forward. Astute is a highly synergistic business with PYG and as such, we maintain our **buy recommendation** with a **valuation of \$1.94**, representing 148% upside from current levels. We also note, that on a P/E basis, PYG continues to trade well below its international peers.

Q2 FY20 Results Commentary

The company reported quarterly receipts of \$2.06m, an increase of 320% on the previous corresponding period and a negative cash flow of \$818,000. PYG's cash balance is currently \$4.8m, of which \$3.9m relates on balances held on behalf of clients for settlement of their payroll obligations.

Operational Highlights:

- Continued strong growth in new contract wins recording \$1.5m (TCV) for Q2 FY20.
- No material client losses recorded in Q2 FY20.
- 2,455 new client employees added, with an additional minimum of 3,338 new clients scheduled to be implemented in FY20.
- Cash flow negative in Q2 due to negative movement of client money for temp staff payrolls, higher admin costs and costs associated with the Astute acquisition.
- Continued investment in its SaaS HROnline technology (\$322,000 for the quarter).

Company Data

Recommendation: BUY
Price (Date 06 November): \$0.78
ASX Code: PYG
Shares on Issue: 64.57m (with Astute)
Market capitalization: \$50.3m
Enterprise Value: \$49.5m

Board Structure

Ian Basser: Non-Exec Chairman
Mark Samlal: Managing Director
Franck Neron-Bancel: Exec Director
David Fagan: Non-Exec Director

Major Shareholders

Samantha Samlal*: 42.73%
Lawrence Pushpam*: 13.65%
Newgate Capital Partners: 12.4%
Simon Forrester: 4.10%
HSBC Custody Nominees: 3.20%
 *escrowed for 24 months from IPO date

Financial Highlights (with Astute)

\$m	FY19A*	FY20E*	FY21E*	FY22E*
Total Revenue	8.4	17.5	20.7	24.2
Operating Expenses	(5.7)	(12.1)	(13.4)	(15.5)
EBITDA	2.7	5.4	7.3	9.4
NPAT	2.3	4.98	6.76	8.8
Dividend yield	N/A	3.7%	4.8%	6.0%
DF	15.4	10.5	7.7	6.0

*Normalised Pro Forma results



Source: Iress

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

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Proforma profit	2,293	4,981	6,769	8,732	10,830
EPS_{adj} (¢)	0.044	0.077	0.105	0.135	0.168
EPS growth	N/A	73.7%	35.9%	29.0%	24.0%
P/E ratio	18.3 x	10.5 x	7.7 x	6.0 x	4.8 x
Enterprise Value (m)	32,904	33,835	33,647	32,895	39,270
EV/Sales (x)	3.92 x	1.93 x	1.62 x	1.36 x	1.40 x
EV / EBIT (x)	14.3 x	6.8 x	4.9 x	3.7 x	3.6 x
EV / EBITDA (x)	12.3 x	6.3 x	4.6 x	3.5 x	3.4 x
DPS (¢)	0.00	3.9	5.2	6.8	8.4
Dividend Yield	0.0%	4.8%	6.5%	8.3%	10.3%
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	0.11	0.14	0.17
P/FCFPS	13.38	10.14	7.07	5.89	4.81

Cashflow (A\$'000's)

Year ending Mar	2019A	2020E	2021E	2022E	2023E
EBIT	2,293	4,944	6,815	8,833	10,974
Dep'n and amort'n	376	441	493	534	467
Deferred tax benefit	(41)	(154)	(209)	(270)	(335)
Share option expenses	0	0	0	0	1
Change in Work cap	568	196	217	233	0
Operating cashflow	2,670	5,990	7,457	9,483	11,530
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	5,490	6,957	9,483	11,530
Equity	7,760	0	0	0	0
Other	(2,100)	0	0	0	0
Dividends paid	(750)	(2,491)	(3,384)	(4,366)	(5,415)
Net cashflow	7,080	2,999	3,573	5,117	6,115
Cash at beginning 01/04	5	6,366	5,435	5,623	6,375
Cash at end 31/03	6,366	5,435	5,623	6,375	7,075

Revenue Split (A\$'000's)

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Payroll Services	8,067	9,811	12,105	14,737	18,036
Other	320	320	320	320	320
Group Revenue	8,387	17,547	20,707	24,208	27,965

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

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Operating revenue	8,387	17,547	20,707	24,208	27,965
EBITDA	2,669	5,385	7,308	9,367	11,441
D&A	(376)	(441)	(493)	(534)	(467)
EBIT	2,293	4,944	6,815	8,833	10,974
Net interest income	0	191	163	169	191
NPBT	2,293	5,135	6,978	9,002	11,165
Tax Expense (benefit)	0	(154)	(209)	(270)	(335)
NPAT	2,293	4,981	6,769	8,732	10,830
Significant Items	0	0	0	0	1
NPAT (Proforma)	2,293	4,981	6,769	8,732	10,830
EBITDA Margin	31.8%	30.7%	35.3%	38.7%	40.9%
EBIT Margin	27.3%	28.2%	32.9%	36.5%	39.2%
NPAT Margin	27.3%	28.4%	32.7%	36.1%	38.7%

Balance sheet (A\$'000's)

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Bank Balance	6,366	5,435	5,623	6,375	7,075
Receivables	1,700	3,556	4,197	4,907	5,668
Prepayments	0	0	0	0	0
Other	3,150	3,150	3,150	3,150	3,150
Current assets	11,216	12,141	12,970	14,431	15,893
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	13,690	14,726	15,853	17,047
Trade payables	4,644	5,481	6,408	7,402	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	7,944	8,781	9,708	10,702
NET ASSETS	6,985	5,745	5,945	6,145	6,345

Balance Sheet Ratios

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Net Debt	(6,366)	(5,435)	(5,623)	(6,375)	(7,075)
NTA	0.11	0.07	0.07	0.07	0.08
Price / NTA (x)	7.2 x	12.2 x	12.2 x	10.9 x	9.9 x
Return on assets	20.9%	9.6%	33.8%	42.7%	51.2%
Return on equity	13.9%	34.5%	31.9%	29.2%	26.6%

Valuation

Year ending Mar	2019A	2020E	2021E	2022E	2023E
Discounted Cash Flow				WACC	9.84%
Beta	0.9			Discount Period	9 years
Cost of Equity	9.84%			DCF/Price Target	\$1.94

Table 1: Earnings estimates. Source: Lodge

Comparable analysis

PayGroup trades at a deep discount relative to its listed international peers with a comparable analysis detailed in Table 4 below. Comparable valuation analysis does not presently form part of our valuation model for PayGroup, however we believe it is important to note the material discount which the company trades at relative to listed international BPO Payroll and HCM Software providers. On a forecast PE basis, PayGroup currently trades at a 76.1% discount relative to other listed international BPO Payroll and HCM Software providers (43.9 times average) and a 79.6% discount to HCM Software providers (51.5 times average).

We would also note that in 2018, the 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 8 domestic and internationally listed comparable companies and multiple analysis is detailed in Table 2 below.

CODE	COMPANY	STOCK EXCHANGE	PRICING	MARKET CAP	PRICE	P/E	EV/EBITDA	EV/REV	SOLUTION
ADP	Automatic Data Processing	U.S.	USD\$	70.6B	162.98	26.44	19.92	5.20	BPO Payroll and HCM Software
WDAY	Workday	U.S.	USD\$	27.1B	165.33	97.73	61.55	12.28	HCM Software
PAYX	Paychex	U.S.	USD\$	30.1B	83.89	27.05	16.75	6.92	BPO Payroll and HCM Software
PAYC	Paycom	U.S.	USD\$	12.36B	214.31	62.75	38.64	16.46	BPO Payroll and HCM Software
PCTY	Paylocity	U.S.	USD\$	5.5B	102.63	59.59	39.12	11.12	BPO Payroll and HCM Software
CSOD	Cornerstone OnDemand	U.S.	USD\$	3.6B	59.55	39.92	25.07	5.41	HCM Software
ZAL	Zalaris	OSL (Norway)	NOK	495m	21.2	16.86	6.98	0.97	HCM Software
ELO	Elmo Software	ASX	AUD\$	495m	6.62	N/A	N/A	7.6	BPO Payroll and Software
PYG	Paygroup*	ASX	AUD\$	52.3m	0.81	10.5	9.5	2.9	BPO Payroll and Software

Table 2: Market comparables Source: Thomson Reuters Consensus and Lodge Research, 4 November 2019. *Forward P/E, EV/EBITDA and EV/Revenue based on FY20 pro-forma forecasts including Astute

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Analyst Verification

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