

Initiation of Coverage

US Software

SaaS payroll/HCM vendors racing in to take share

Equities

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Pure Cloud disrupting large legacy vendors

The industry is shifting from legacy payroll providers – ADP, Paychex, Ceridian – to a new generation of Cloud-based software vendors – Ultimate, Paycom, Paylocity. We like the fundamental prospects of next-gen vendors for three reasons: 1) A very large total addressable market (TAM) (~7m firms, >130m employees, revenue TAM of \$23-52bn+) that is only 1-3% penetrated and gives them many years of future share gains. 2) Top-line growth that is 3-7x faster than legacy providers in the past four years, combined with rapidly expanding margins (e.g., PAYC +580bp last FY). 3) A potential repeat of the disruptive stories we've already seen in CRM vs. ORCL/Siebel, WDAY/N vs. ORCL/PSFT/SAP and NOW vs. BMC.

Stock set-up still attractive for next-gen vendors

ULTI, PAYC, and PCTY are trailing the S&P 500 and legacy vendors YTD: -0.6%, -5.6%, -7.3%, respectively vs. S&P 500 +2.5%, ADP +7.1%, PAYX +1.0%. While EV/S multiples look healthy (6-8x NTM), the companies' superior prospects for revenue growth & margin expansion could drive stock outperformance. The next-gen trio's combined market cap is <\$10bn, which leaves plenty of room to catch up to ADP + PAYX's >\$60bn.

Thesis supported by dozens of interviews + multi-pronged TAM analysis

Our due diligence involved dozens of conversations with company and industry contacts and supports our disruptive thesis that next-gen vendors will not only take share in core payroll processing but also innovate faster in the overall HCM suite. Our TAM analysis suggests an annual vendor revenue potential of up to \$52bn+ in NA, based on current employment levels and available products.

Our rank order: PAYC (Buy, \$50 PT), ULTI (Buy, \$226 PT), PCTY (Neutral, \$38 PT)

PAYC is our favorite stock idea due its combination of 40% revenue growth, healthy 17% operating margin, three-year EPS CAGR (UBS FY15A-18E) of nearly 40%, yet lowest multiple. We view ULTI as the reliable core holding, with a 10-year track record of 20%+ recurring revenue growth, balanced with the highest margin of the trio, at 20%+, and expanding. PCTY is the high-beta, exciting grower (revenue +61% last quarter and UBSe +49% for FY16-June), but with only roughly break-even operating margin for the past 3 FYs and a 7.7x NTM EV/S multiple higher than PAYC's 6.6x.

Figure 1: ULTI, PAYC, PCTY valuation multiples

Ticker	Company	Market	Revenues		EPS		Valuation		last qtr		EV/S	
		Cap	EV	NTM	% growth	NTM	% growth	EV/S (ntm)	PE (ntm)	PF op mgn	CY16E	CY17E
ULTI	Ultimate Software Group, Inc.	5,803	5,692	772	25%	3.24	22%	7.4x	60x	21.8%	7.4x	6.1x
PAYC	Paycom Software, Inc.	2,074	2,049	311	38%	0.53	33%	6.6x	67x	11.6%	6.6x	5.1x
PCTY	Paylocity Holding Corp.	2,018	1,939	253	35%	0.15	-17%	7.7x	NM	7.2%	7.7x	6.0x

Source: FactSet consensus estimates, UBS

PAYROLL/HCM SOFTWARE

UBS Research

MOST FAVORED

LEAST FAVORED

Paycom, Ultimate Software

Paylocity

PIVOTAL QUESTIONS

Q: Is there a technology shift in payroll software & services?

Yes. The industry is shifting from legacy payroll providers (including BPOs and service bureaus) to a new generation of Cloud-based software vendors, similar to the shift in front-office (e.g., from on-premise-based Siebel CRM software to SaaS-based Salesforce.com) and back-office software (e.g., from ERP software by Oracle/PeopleSoft/SAP to SaaS-based Workday/NetSuite). With the shift to Software as a Service (SaaS), the scope of payroll providers is widening – from a black-box service focused on payroll check processing to a full suite of HCM solutions spanning the entire employee lifecycle (including recruiting, onboarding, core HR, payroll, performance, succession, etc.). In addition, the scope of expansion is leading to more employees becoming users of the payroll/HR systems.

Q: What is the true TAM for the three next-gen vendors?

We believe the market opportunity in North America alone is vast – encompassing ~7m firms that employ over 130M workers, representing a revenue TAM of \$23-52bn+. Each of the three next-gen vendors (ULTI, PAYC, PCTY) has only single-digit revenue penetration.

WHAT'S PRICED IN?

Only partial credit for sustained growth potential. Next-generation payroll-centric HCM vendors are enjoying premium EV/S multiples over many SaaS peers. However, they are trading below recent (2-4 year) historical peaks and averages. Valuations embed some concerns about sustainability of recent growth rates and potential overt contribution from ACA creating tough future comps.

UBS VIEW

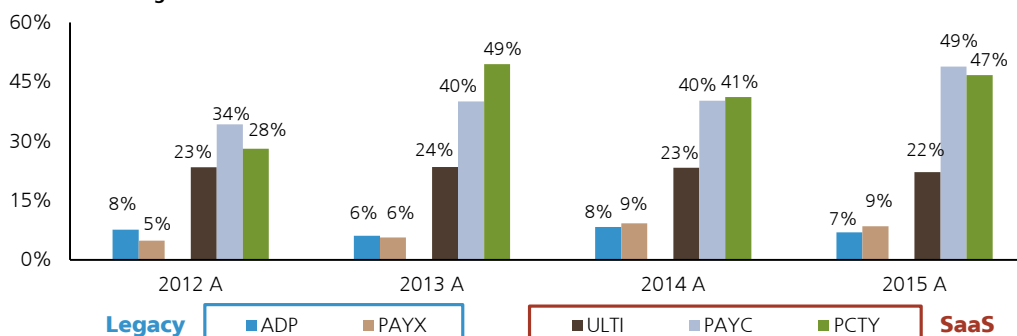
Large payroll market transitioning to SaaS and broadening to HCM: A new generation of pure SaaS-based vendors is disrupting legacy providers in the large payroll solutions market. At the same time, new Cloud architecture is accelerating innovation and expanding the TAM beyond simple payroll check processing to a more strategic full suite of HCM solutions.

EVIDENCE

Next-gen vendors growing 3-7x faster: Our analysis of industry growth trends, supported by dozens of conversations with industry contacts, shows next-generation, payroll-centric HCM vendors are growing 3-7x faster than legacy providers. Our multi-pronged analysis suggests a vast TAM in North America, estimated at ~7m firms, 131m workers, and annual revenue of \$23-52bn.

Next-gen SaaS vendors growing revenue 3-7x faster than legacy vendors

Annual revenue growth rate



Note: For ADP, reporting is based on FY numbers, with year ending on June 30. Others are on a CY basis. UBS for PCTY 2012.
Source: UBS estimates, Company data

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EVIDENCE

Our analysis of industry growth trends, supported by dozens of conversations with industry contacts, shows next-generation payroll-centric HCM vendors are growing 3-7x faster than legacy providers.

WHAT'S PRICED IN

Next-generation payroll-centric HCM vendors are enjoying premium valuation multiples over their legacy peers. However, the spread does not seem to fully reflect the significantly faster revenue growth rate, the potential for outsized share gains, and the possibility of long-term operating margins approaching that of legacy vendors.

SaaS vendors growing 3-7x faster than legacy vendors

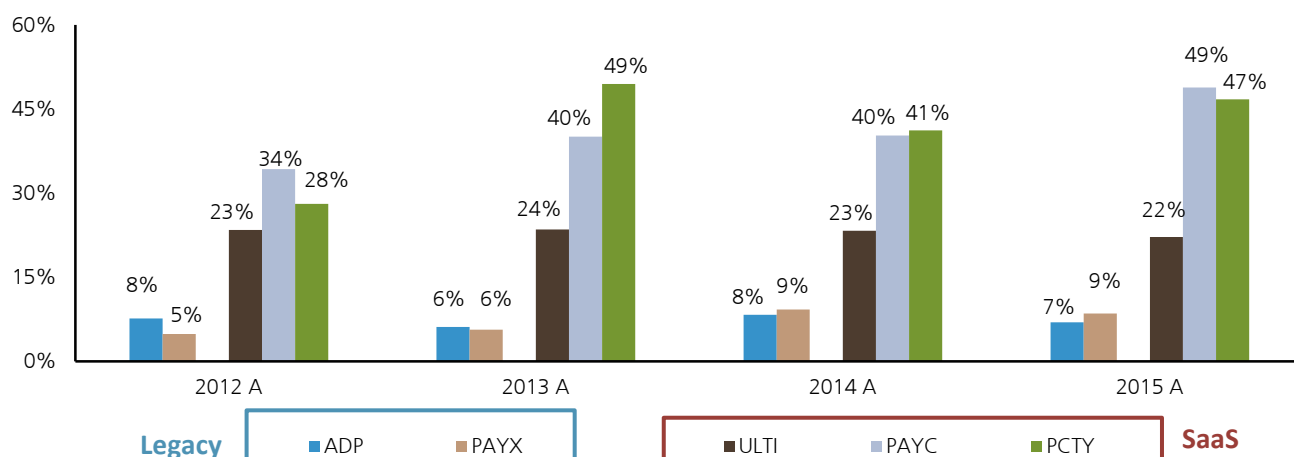
We divide the payroll vendor landscape into two groups: 1) Legacy, including ADP and Paychex, which have traditionally used a BPO model or a labor-intensive black-box service but increasingly offer BPaaS and even SaaS. 2) Next-gen SaaS, which includes Ultimate, Paycom and Paylocity, which offer a pure SaaS or BPaaS model based on an internally developed, single-platform, SaaS software.

Notably, there is a fine line between BPaaS and SaaS based on how much responsibility is shared between the vendor and the customer (the former is more services, the latter is more software).

In 2015, the new generation of SaaS vendors grew revenue at 3-7x the rate of legacy vendors – ranging from 22-49% vs. 7-9%. This spread has been consistent for several years (at least going back to 2012, when revenue became significant for some of the younger SaaS vendors).

Figure 2: Next-gen SaaS vendors growing revenue 3-7x faster than legacy vendors

Annual revenue growth rate



Note: For ADP, reporting is based on FY numbers, with year ending on June 30. Others are on a CY basis. UBSe for PCTY 2012.
Source: UBS estimates, company data

Next-gen vendors have multi-year head start

Part of the appeal of the new breed of SaaS vendors is that they developed their SaaS applications much earlier and focused their efforts on a single, unified platform. In contrast, legacy vendors began to shift later; have a mix of acquired, homegrown, or OEMd software; and are dealing with customer migration issues.

Figure 3: Pure SaaS payroll vendors have multi-year head start

Vendor	Legacy product	SaaS product	SaaS development
Ultimate Software	Discontinued (in 2014)	Yes (since 2002)	Own
Paycom	-	Yes (since 1999)	Own
Paylocity	Discontinued	Yes (since 2006)	Own
Workday	-	Yes (since 2009)	Own
ADP	Yes	Yes (since 2007)	Own + acquisition
Paychex	Yes	Yes (since 2011*)	Acquisition: SurePayroll
Intuit	Yes	Yes (since 2005)	Own + PayCycle acquisition
Ceridian	Yes	Yes (since 2012)	Acquisition: Dayforce

* Paychex's acquisition of SurePayroll, a provider of online payroll processing for small businesses, was announced in Dec. 2010 and closed in Feb. 2011 for \$115m in cash. Source: UBS, company data, Gartner

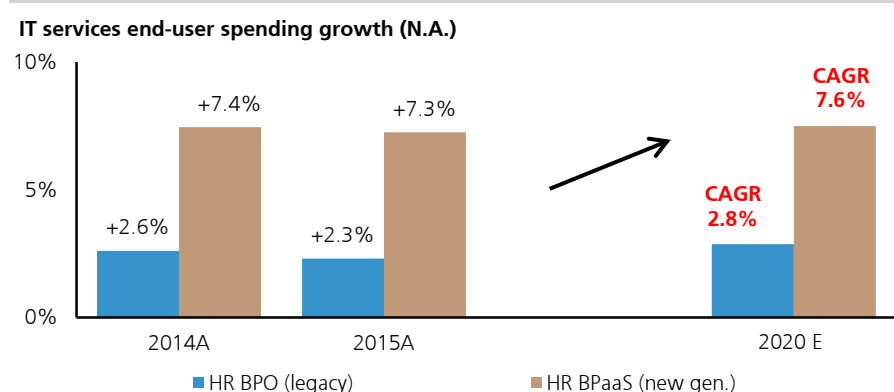
Industry IT service spending on BPaaS growing at ~3x of legacy BPO

Legacy payroll providers often offer business processing outsourcing (BPO) services using black-box software where the customer has little direct interaction with the software and the model is labor-intensive. The newer Business Process as a Service (BPaaS) offering uses multi-tenant, Cloud-based HCM apps where the customer can make direct configuration changes and employees can make self-service modifications.

According to Gartner, IT services end-user spending in North America (where most US vendors are focused) increased 7.3% in 2015 for HR BPaaS, or more than triple the 2.3% growth of traditional HR BPO. Gartner forecasts the relative growth to

roughly sustain through 2020: a 5-year CAGR (2015-20) of 7.6% for HR BPaaS or 2.7x the 2.8% CAGR for traditional HR BPO.

Figure 4: IT spend on new gen. BPaaS growing ~3x faster than legacy BPO



Source: UBS, Gartner Forecast: IT Services, Worldwide, 2014-2020, 1Q16 Update

History suggests long runway for next-gen payroll SaaS vendors

Looking back at high-profile SaaS disruptors CRM and WDAY, they have demonstrated that revenue growth can sustain above 20% for 5-10+ years. Even as of FY16-end (Jan. '16), with revenues above \$1bn (above \$6bn for CRM), penetration remains low for WDAY (2-4% of TAM) and CRM (12% or 27% depending on how narrowly the TAM is defined). We would expect next-gen payroll SaaS vendors to show more consistent, albeit milder, growth for a longer period given: 1) the nature of their product (customers don't change their payroll solutions frequently, but on a more measured pace, usually around calendar year-end), and 2) their target customer size being the mid-market (no mega-deals, but a high volume of small to mid-size deals).

Figure 5: CRM and WDAY revenue/growth vs. TAM

(FY-Jan.; \$m)	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	% of TAM	% of TAM
													Gartner-based	co-defined
CRM	176	310	497	749	1,077	1,306	1,657	2,267	3,050	4,071	5,374	6,667	27%	12%
YoY growth	84%	76%	60%	51%	44%	21%	27%	37%	35%	33%	32%	24%		
WDAY						25	68	134	274	469	788	1,162	4%	2%
YoY growth							170%	98%	104%	71%	68%	48%		

Note: Based on TAM for CY2015. Source: Company data, Gartner, UBS

For every 1% increase in penetration (or ~\$230m-520m of a \$23-52bn TAM in 2016), PAYC and PCTY's revenues would increase more than 100% from current levels, while it would drive roughly 50% growth for ULTI. Our current FY20 estimates only imply a LT penetration of 3-6% for ULTI, 1-3% for PAYC, and 1-2% for PCTY based on a FY20 TAM of \$29-50bn+, which conservatively leave plenty of room for further upside, despite our being above consensus for periods where data is available.

Q: What is the true TAM for the three next-gen vendors?

UBS VIEW

We believe the market opportunity in North America alone is vast – encompassing ~7m firms that employ over 130m workers, representing a revenue TAM of \$23-52bn+. Each of the three next-gen vendors (ULTI, PAYC, PCTY) has only single-digit revenue penetration.

EVIDENCE

It can be difficult for investors to size up the payroll/HCM opportunity, with the industry being well established and the majority of businesses using legacy payroll providers. However, next-gen vendors are outgrowing the industry by 3-7x. We have tried to quantify the TAM from multiple angles, which confirms there is a long runway ahead for next-gen vendors. Qualitatively, the shift is being fuelled by the consumerization of tech and the adoption of Cloud platforms, which are driving a refresh of payroll/HCM systems and reaching a much broader base of users (i.e., all employees instead of just the payroll/HR department).

WHAT'S PRICED IN

Next-generation payroll-centric HCM vendors are enjoying premium EV/S multiples over many SaaS peers, but only getting partial credit for sustained growth potential in a very large TAM. They are trading below recent (2-4 year) historical peaks and averages. Valuations embed some concerns about sustainability of recent growth rates and potential overt contribution from ACA creating tough future comps.

High level TAM summary: 7m firms, 131m workers, annual revenue of \$23-52bn

We estimate a large TAM, although with a wide range of \$23-52bn for the payroll/HCM industry. Our focus is on North America, where ULTI, PAYC and PCTY operate. (PAYC and PCTY are entirely in the US, while ULTI has a small and immaterial revenue base in Canada.) Our analysis is as follows:

- (1) **\$23bn** based on Gartner market data: Here, we combine Gartner's market forecasts (2016E) for enterprise software spending on HCM apps (SaaS and on-premise), IT services spending on HR BPO, and IT services spending on HR BPaaS.
- (2) **7m firms and 131m employees.** These represent the potential population that can be reached by payroll solutions providers.
- (3) **\$52bn** based on bottom-up analysis. We multiply the number of employed workers in the US and Canada by a per-employee, per-year monetization amount of \$400.

Figure 6: High level TAM summary

TAM type	Size	Source
HCM software + HR BPO + HR BPaaS (2016E, \$bn)	23.4	Gartner
# of firms (2012)	6,833,700	US & Canadian stats
# of employees (m)	131	US & Canadian stats
x revenue opportunity per employee per year (PEPY)	400	Paycom
= TAM (bottom up based on PEPY; in \$bn)	52.4	UBS-e

Source: Gartner Forecast: Enterprise Software Markets, Worldwide, 2013-2020, 1Q16 Update; Gartner Forecast: IT Services, Worldwide, 2014-2020, 1Q16; US Census Bureau, 2012 Statistics of US Businesses; Statistics Canada, Business Register, December 2012; UBS

\$23bn on visible software & services spending

Businesses can generate employee paychecks using a variety of methods, which can be grouped into 2 major categories: 1) in-house, using internally developed or acquired software, installed on-premises or running in the Cloud; and 2) outsourced to an external vendor, which handles parts of or the entire payroll process. In addition to payroll, vendors also sell a variety of HCM solutions, ranging from core HR to onboarding and performance management. Our analysis tries to capture the various ways businesses procure these payroll and HCM solutions.

Figure 7 combines software spending with services spending (BPO and BPaaS) for North America. Although BPO is the largest segment, it is growing the slowest and is on pace to be surpassed by BPaaS in 2021. Software spending is growing at a similar rate as BPaaS.

Figure 7: TAM sizing for HCM and payroll market in North America (Gartner)

TAM Sizing (in million \$)	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	CAGR (2015-20)
Enterprise Software Revenue for HCM Solution	4,330	4,995	5,590	6,072	6,463	6,863	7,272	7,719	6.7%
HR BPaaS	6,362	6,836	7,332	7,905	8,519	9,158	9,845	10,583	7.6%
HR BPO	8,783	9,012	9,219	9,462	9,736	10,017	10,303	10,599	2.8%
Total	19,474	20,843	22,141	23,439	24,718	26,038	27,420	28,901	5.5%

Source: UBS; Gartner Forecast: Enterprise Software Markets, Worldwide, 2013-2020, 1Q16 Update; Gartner Forecast: IT Services, Worldwide, 2014-2020, 1Q16 Update

7m firms employing 131m workers

There are 6.8m firms in North America that may require some sort of payroll services (i.e., at least one employee during part of the year). That is based on data from 2012, when the US Census Bureau ran its last survey of businesses (done every 5 years), and similar data from Canada. The US represented 84% (5.7m) of total firms.

There were 131m workers employed by the 6.8m firms. The US represented 89% (116M) of total employees in North America.

Figure 8: Number of firms & employees in US and Canada

Company size	Firm Size by # of EEs	# of firms			# of employees		
		US	Canada	Total	US	Canada	Total
Very small	0-19 EEs	5,130,348	967,980	6,098,328	20,408,789	3,043,596	23,452,385
Small	20 - 99 EEs	494,170	119,823	613,993	19,387,249	2,846,865	22,234,114
Medium	100 - 499 EEs	83,423	18,169	101,592	16,266,855	2,237,501	18,504,356
Large	500+ EEs	18,219	1,568	19,787	59,875,575	6,828,913	66,704,488
TOTAL		5,726,160	1,107,540	6,833,700	115,938,468	14,956,875	130,895,343

Source: US Census Bureau, 2012 Statistics of US Businesses; Statistics Canada, Business Register, Dec.2012; UBS

Notably, very small firms (fewer than 20 employees) represented 89% (6.1m) of all firms but employed only 18% (23m) of all employees. Clearly, the pool of firms is much larger at the low end, although with much smaller average selling prices.

Figure 9: Nearly 90% of all firms in NA are very small (<20 employees)



Source: US Census Bureau, 2012 Statistics of US Businesses; Statistics Canada, Business Register, December 2012; UBS

The global market is much larger, at 1.5bn workers (according to an ADP white paper – "Payroll at the heart of HR Outsourcing", dated 2013 – using data from the International Labour Organization). Of that 1.5bn, ADP estimates around 10%, or 150m employees, is handled by payroll outsourcing. In North America, the payroll outsourcing adoption rate is higher, although still low, at 20-30%.

\$52bn+ potential at 100% penetration

We multiply the number of employed workers in the US and Canada by a per-employee, per-year (PEPY) monetization amount. In this case, we use \$400, which is the amount Paycom can collect if a customer buys Paycom's entire portfolio of products. Similar figures are \$360 for Ultimate and \$250 for Paylocity. (ADP estimates an industry payroll cost of \$250 PEPY). The \$52bn TAM is an optimistic scenario based on 100% penetration of the worker population.

Notably, PEPY figures are based on the current product portfolio. All vendors continue to push this figure higher by expanding their portfolios. ULTI has set a goal of \$480 PEPY (\$40 PEPM) by 2018, while PCTY is aiming for \$300 over the long term.

In Figure 10, we show the math behind the \$52bn overall TAM and for each next-gen vendor based on the stated target segment by client size. Addressing larger businesses amplifies the dollar opportunity, as seen in ULTI's \$26bn TAM (target 300-25K EEs) vs. PCTY's \$10bn TAM (target 20-1000 EEs).

Figure 10: Bottom-up \$ TAM sizing for overall market and by vendor

Vendor	Firm Sweet Spot	# of firms	Total employees	\$ PEPPY	TAM (\$ bn)
overall	all in NA	6,833,700	130,895,343	400	52.4
PAYC	50 - 2000 EEs	215,240	36,877,650	400	14.8
PCTY	20 - 1000 EEs	586,654	41,920,743	250	10.5
ULTI *	300 - 25000+ EEs	34,251	72,061,849	360	25.9

Source: US Census Bureau, 2012 Statistics of US Businesses; Statistics Canada, Business Register, December 2012; company data; UBS

Next-gen vendors only 2% penetrated

While each next-gen vendor enjoys a sizable TAM, penetration rates are still low for all three vendors – around 2% when measured on CY15 revenue vs. their respective dollar TAM and less than 10% when comparing the number of customers vs. the number of firms in their target segments.

Figure 11: Penetration rates of each vendor

Vendor	# of Clients	% of TAM	CY15 revs (\$M)	% of TAM
PAYC	8,906	4%	\$225	2%
PCTY	10,350	2%	\$188	2%
ULTI	3,200	9%	\$618	2%

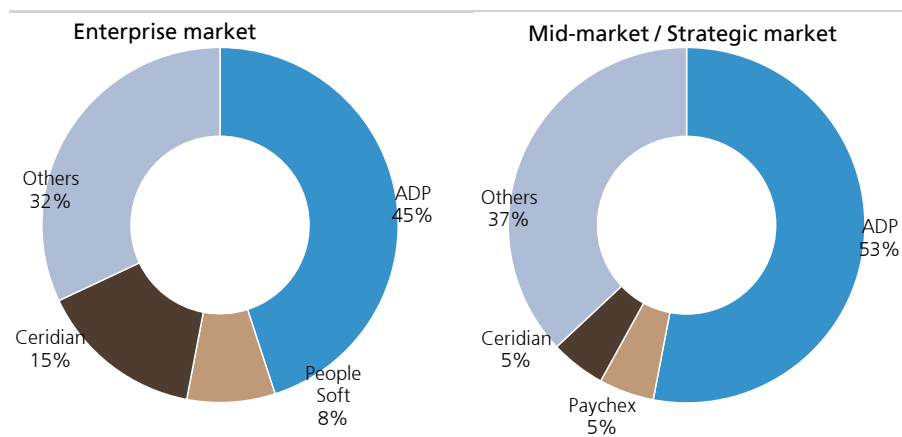
Note: PAYC is based on parent company grouping; the reported count for contracted clients is 15,004. Source: Company data, UBS

Legacy vendors provide fertile hunting ground

The payroll market has traditionally been highly concentrated and legacy vendors have become a large feeder source of new customers for next-gen vendors. Roughly two-thirds of ULTI's new customers come from traditional payroll service bureaus, including about 50% of total additions from ADP. PCTY has said 50% of its customers come from ADP and Paychex, with the remainder coming from regional/local payroll providers and in-house solutions.

ADP is in the midst of a multi-year transition, trying to migrate clients to newer SaaS solutions. However, the migration has been challenging – in the Dec. 2015 quarter, the retention rate worsened 120 bps from the Sept quarter. In the mid-market segment alone, ADP has ~30k out of 75k clients that are still on legacy systems and have not yet migrated. Significant progress is not expected until the end of FY17 (ending June 2017).

Figure 12: Majority of ULTI's wins come from ADP, Paychex, Ceridian



Source: UBS, Company data (Jan. 1, 2015 to June 30, 2015)

We believe this share shift can continue for many years. As seen in Figure 13, six of the largest traditional payroll providers have a combined 2.7m customers, serving nearly 40% of all employers in North America. In contrast, the three next-gen vendors combined have ~22k clients, or less than 1% the size of the legacy base.

Figure 13: Top legacy vendors have >100x as many clients as next-gen vendors

Legacy vendors	# clients in NA	Next-gen	# clients in NA
ADP	543,000	PAYC	8,906
PAYX	584,000	PCTY	10,350
Ceridian	67,000	ULTI	3,200
Intuit	1,424,000		
Paycor	30,000		
CGI	29,000		
TOTAL	2,677,000	TOTAL	22,456

Notes: ADP, PAYX, Ceridian clients estimated by applying NA % of revenue to global client base. Intuit payroll customers for QuickBooks Desktop has been flat at ~1.0m for 4+ years. PAYC is based on parent company grouping; the reported count for contracted clients is 15,004.
Source: Company data, UBS

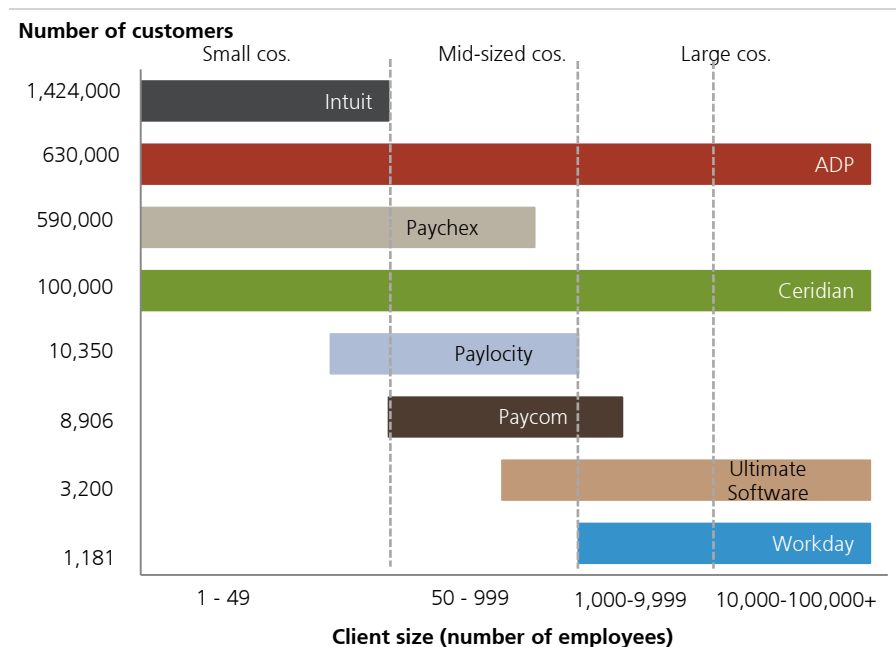
Next-gen vendors do not compete against each other often

Large legacy players such as ADP and Ceridian provide solutions across all client sizes, given their long history (ADP since 1949) and ever-expanding scope. However, most other vendors have picked a certain customer size segment to pursue, which has resulted in limited overlap. Therefore, our analysis shows ULTI, PAYC, and PCTY should have plenty of runway left before they start competing against each other often.

- **ULTI:** While the company is often perceived to be a mid-market vendor, its customers can fall below the formal low-end target of 300 employees (EEs) and can exceed 100K EEs at the high end (the largest customer has 185K+ EEs). ULTI's typical customer is significantly larger than that of PAYC or PCTY. Average annual revenue per customer (UBS calculation based on average customer count) in FY15 was \$206k for ULTI vs. \$27k for PAYC and \$16k for PCTY.
- **PAYC:** Its target customer has 50-2,000 employees, although it is winning larger clients with 4-5K+ EEs on a regular basis.

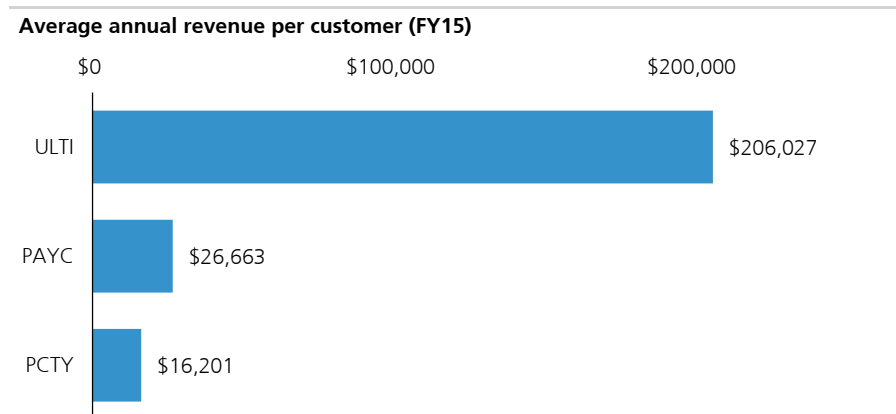
- **PCTY:** PCTY's target customer has 20-1,000 EEs, slightly smaller than PAYC. The average customer has more than 100 EEs. PAYC and PCTY are still relatively small, with annual revenue below \$300m, and do not yet have a fully built-out national sales presence. As a result, they do not compete often.

Figure 14: Mapping payroll vendors to target client size



Source: Company data, UBS

Figure 15: ULTI's average client is larger than PAYC/PCTY



Source: Company data, UBS

Figure 16: Competitive landscape – overview

Competitive study	Paycom	Paylocity	Ultimate Software	ADP	Paychex	Ceridian
Inception year, HQ	Since 1998, IPO in 2014; HQ in Oklahoma	Since 1997, IPO in 2014; HQ in Illinois	Since 1990, IPO in 1998; HQ in Florida	Since 1949, IPO in 1961; HQ in New Jersey	Since 1971, IPO in 1983; HQ in New York	Founded in 1992; public until 2007, then acq./private; HQ in Minnesota
Geography	US only	US only	US, Canada	83% US, 10% Europe, 3% Canada, 4% others	US, Germany	Ceridian: > 50 countries; Dayforce: mostly in the US & Canada, > 20 countries
Employees (latest filing)	1,461 as of Dec. '15	1,500 as of Dec. '15	2,880 as of Dec. '15	55,000 as of June '15	13,400 as of Feb. '16	4,500 (2014)
Products	Cloud-based unified solution	Cloud-based WebPay platform	Cloud-based unified solution	Cloud-based payroll service	Cloud-based solutions: SurePayroll & Paychex Flex for small firms; Paychex Flex Enterprise for mid-market	Cloud-based Ceridian Dayforce HCM (CDHCM; acq. in Mar '12); >2K solutions sold (as of Mar. '15). Legacy payroll services.
	Payroll, HCM, talent, time & labor management	Payroll, HCM, onboarding, performance	Payroll, HCM, talent, compensation, time & labor management	Payroll, HCM	Payroll, HCM	Global solutions, small business payroll, LifeWorks employee assistance & wellness
Pricing - subscription for current portfolio	Fixed amount + variable per EE or trans. (max \$400 / EE / yr)	Max \$250 / EE / year	Max \$30 / EE / mo. (= \$360/year) + \$4 / EE / mo. for global tracking	N/A	N/A	N/A
Customer count	15,004 a/o FY15, +17% y/y; 8,906 with parent co. grouping, +12% y/y	~10,350 as of FY15 end (each >100 EEs on avg.), up 22% y/y	~3,200 as of FY15, up ~14% y/y	>630k total, 500k in Cloud (i.e., ~80% of total) as of FY15	590k as of FY15 end (average 17 EEs), up 2% y/y	Ceridian: >100k (>25m users); Dayforce: 300 ('12) to 1,700 ('14)
Target segment by company size	Mid-sized firms (50-2,000 EEs)	Mid-sized firms (20-1,000 EEs)	Enterprise (1,501-100,000+ EEs); mid-market (501-1,500 EEs); strategic (300-500 EEs)	Small business, RUN >440k clients (avg. ~10 EEs); mid-market, Workforce Now ~60k clients (avg. ~200 EEs); large ent., Vantage >200 clients (avg. ~4k EEs); large multinational ent., >11m EEs served (104 countries); PEO, TotalSource ~8,700 clients (worksites EEs 403k)	TAM: 10m businesses, 80M employees. Small-sized firms (1-50 EEs); mid-sized firms (50-500 EEs)	Small (1-100 EE): Ceridian HR / Payroll, powered by CDHCM. Mid-sized (100-500 EEs): Dayforce Go (launch Feb '15), CDHCM scaled for mid-size. Large enterp. (500+ EEs): CDHCM avail. Mar. '15. MNCs: Dayforce ConnectedPay (launched 10-23-14).
Market penetration	1% penetration	<2% penetration out of 565k mid-sized firms in US	Enterprise ~9% Mid-market ~7% Strategic ~3%	N/A	6% penetration out of 10m businesses	N/A

Source: UBS, Company Data

Figure 17: Competitive landscape – financials

Competitive study	Paycom	Paylocity	Ultimate Software	ADP	Paychex	Ceridian
Financials (all figures in \$m except per share values):						
Latest FY end	FY15 (Dec)	FY15 (Jun)	FY15 (Dec)	FY15 (Jun)	FY15 (May)	N/A
Annual revenue	\$225	\$153	\$618	\$10,938	\$2,740	\$900 M (2014)
Revenue growth (y/y)	49%	40%	22%	7%	9%	N/A
Billings	\$234	\$153	\$654	N/A	N/A	N/A
Deferred revenue	\$29	N/A	\$146	\$591	N/A	N/A
EBIT	\$37	\$0	\$127	\$2,077	\$1,054	N/A
EBIT margin (%)	17%	0%	21%	19%	38%	N/A
Shares o/s (per latest filing)	58	54	30	460	362	N/A
Market cap	\$2,074	\$2,019	\$5,803	\$41,749	\$19,349	N/A
Prices per share	\$35.53	\$37.58	\$194.27	\$90.70	\$53.42	N/A
EPS	\$0.40	\$0.01	\$2.65	\$2.89	\$1.85	N/A
EV	\$2,049	\$1,940	\$5,682	\$40,901	\$18,593	N/A
Valuation metrics (CY16)						
EV/EBIT	40.4 x	NM	35.1 x	17.8 x	15.6 x	N/A
P/E	66.5 x	NM	60.1 x	26.3 x	26.1 x	N/A
EV/Sales	6.6 x	7.7 x	7.4 x	3.4 x	6.1 x	N/A
Metrics:						
Latest FY end	FY15 (Dec)	FY15 (Jun)	FY15 (Dec)	FY15 (Jun)	FY15 (May)	N/A
Avg. rev. / customer (\$k)	\$26.663	\$15.286	\$206.027	\$17.266	\$4.683	N/A
Avg. rev / employee (\$k)	\$153.767	\$115.680	\$214.611	\$198.873	\$210.738	N/A
Recurring fees from new clients	N/A	45.0%	N/A	N/A	N/A	N/A
Retention rate	91%+	>92%	97%+	91%	82%	N/A
Annualized new recurring rev (\$m)	\$109	N/A	N/A	N/A	N/A	N/A

Source: UBS, company data

Companies

Ultimate Software Group Inc

A Turbine-Like Fundamental Engine

Initiating coverage with a Buy rating and \$226 price target

We view ULTI as the reliable core holding among the 3 next-gen SaaS payroll/human capital management (HCM) vendors, with a 10+ year track record of 20%+ recurring revenue growth, balanced with the highest margin at 20%+. Since moving early to a multi-tenant SaaS platform in 2002, ULTI has had remarkably consistent, predictable growth – recurring revenue grew 23-28% annually in the past 10 years, except for 2007, at 36%. We believe the right culture, which prioritizes customers and employees, combined with a wide open total addressable market (TAM), are fuelling sustainable execution. Conversations with dozens of industry contacts have increased our confidence that ULTI can deliver many more years of 20%+ top-line growth, even as it passes the \$1bn mark (expected in FY18), with a steadily expanding 20%+ op. margin.

The right fuel formulation, starting with a winning team culture...

We believe ULTI has the right elements for consistent, profitable growth, starting with: a deeply embedded culture that is customer- (97%+ retention) and employee-centric (94%+ retention); superior execution that is produced by this culture (97%+ visibility into next-12-month recurring revenue); a large, still under-penetrated TAM (<3% of >\$20Bn); and continued share gains from legacy providers (~50% from ADP).

... boosted by prescient technology innovation and a detailed sales manual

The company recognized technology shifts and moved to Cloud early (in 2002). It boasts a rich product suite that scales across the entire range of customers (monetization potential per employee of \$360/year, rising to \$480 by 2018) and a detailed sales playbook proactively designed to minimize disruptions (finely slicing go-to-market segments with additional sales teams).

Valuation: trades at EV/S 7.4x CY16e, 6.1x CY17e

Our 12-month \$226 price target is based on EV/S 7.0x applied to UBS revenue estimates in 5-8 quarters. The multiple is at a slight discount to current NTM EV/S and to the historical average over the past four years when recurring revenues exceeded 80% of total. The multiple is at a premium to the SaaS comparison group mean EV/S, which we believe is justified given ULTI's above-average revenue and earnings growth (+ predictability) and superior margins. There are no other companies in the comparison group of 30 stocks with >20% NTM revenue and EPS growth, and trailing quarter operating margin of >20%.

Equities

Americas
Software

12-month rating **Buy**
Prior: Not Rated

12m price target **US\$226.00**
Prior: -

Price **US\$194.27**
RIC: ULTI.O **BBG:** ULTI US

Trading data and key metrics

52-wk range US\$210.94-152.42

Market cap. US\$5.55bn

Shares o/s 28.6m (COM)

Free float 94%

Avg. daily volume ('000) 338

Avg. daily value (m) US\$58.7

Common s/h equity (12/16E) US\$0.43bn

P/BV (12/16E) 13.2x

Net debt / EBITDA (12/16E) NM

EPS (UBS, diluted) (US\$)

	12/16E			
	From	To	% ch	Cons.
Q1E	-	0.65	-	0.66
Q2E	-	0.77	-	0.77
Q3E	-	0.85	-	0.85
Q4E	-	0.96	-	0.96
12/16E	-	3.24	-	3.23
12/17E	-	4.04	-	4.01
12/18E	-	5.01	-	5.36

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Highlights (US\$K)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	410,397	505,936	618,081	772,435	945,093	1,148,581	1,387,604	1,667,860
EBIT (UBS)	76,263	101,670	126,768	162,581	205,525	258,374	322,583	400,244
Net earnings (UBS)	46,486	61,805	78,804	97,884	124,577	157,680	197,953	246,723
EPS (UBS, diluted) (US\$)	1.60	2.11	2.65	3.24	4.04	5.01	6.16	7.53
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	74,605	101,284	101,172	165,580	244,405	349,272	485,372	660,004
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	18.6	20.1	20.5	21.0	21.7	22.5	23.2	24.0
ROIC (EBIT) %	88.8	72.6	64.7	67.6	73.4	78.5	83.4	88.2
EV/EBITDA (core) x	36.6	32.5	33.2	27.9	21.6	16.8	13.1	10.5
P/E (UBS, diluted) x	77.6	67.5	66.3	60.0	48.1	38.8	31.5	25.8
Equity FCF (UBS) yield %	1.3	1.1	1.2	1.2	1.4	1.9	2.5	3.1
Net dividend yield %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$194.27 on 18 Apr 2016 18:41 EDT

[Ultimate Software Group Inc](#)

Paycom Software Inc

More Than OK With Stealthy, Understated Power

Initiating coverage with a Buy rating and \$50 price target

PAYC is our favorite stock among the 3 next-gen payroll/HCM vendors due its combination of 40% rev growth, healthy 17% op. mgn, 3-year EPS CAGR (UBSe FY15A-18E) of ~40%, yet lowest multiple. Since moving first to a multi-tenant SaaS platform in 1999, it has quietly earned the trust of ~9,000 clients with an integrated pdt suite that is robust, secure, reliable, and user-friendly. Conversations with dozens of industry contacts suggest there is much unrealized potential, as brand awareness is still low. Starting from its Oklahoma City HQ, PAYC has expanded its sales coverage methodically using a proven, metrics-driven approach. With rapid increases in sales productivity, client net adds, and monetizable products, we believe PAYC could hit \$1bn in revs by 2021. For FY16, we forecast a 4th year of 40%+ rev growth despite a tough 49% comp.

Many engines to drive above-market growth

Growth drivers include: 1) low penetration of a large TAM (<2% of \$15-21bn in the US); 2) share gains from a very large pool of clients still using legacy vendors (ADP has >500k clients in NA vs. PAYC's ~9k); 3) expanding sales presence (from 42 sales teams to 120+ LT); 4) broadening product portfolio (26 modules and growing); and 5) increasing sales productivity (some offices selling >\$8m/yr vs. <\$4m 3-4 years ago).

Concerns over low R&D and tough comps created by ACA seem overdone

R&D is lower than peers', but this is partly explained by: 1) accounting choices; and 2) efficient IT architecture from a first-mover advantage to SaaS. Evidence contradicts this concern, as R&D has been highly productive – 26 modules that could sell for \$400 PEPPY (per employee per year), higher than its peers'. 2016 revenue guidance at the mid-point, adjusted to exclude the ACA (Affordable Care Act) product, implies only 34% growth – which is significantly below the ~40%+ trend line of the last 3 years.

Valuation: Trading at EV/S 6.6x CY16E, 5.1x CY17E

Our 12-month \$50 price target is based on EV/S 7.0x applied to UBS estimated revenue in 5-8 quarters. The multiple is at a slight discount to the historical average. The multiple is at a premium to the SaaS comparison group mean EV/S, which we believe is justified given above average revenue and earnings growth and superior margins. There are no other companies in the comparison group of 30 with >30% NTM revenue and EPS growth, and trailing quarter operating margin >10%. We think the implied PEG of 1.6x is undemanding.

Equities

Americas
Software

12-month rating **Buy**
Prior: Not Rated
12m price target **US\$50.00**
Prior: -
Price **US\$35.53**
RIC: PAYC.N **BBG:** PAYC US

Trading data and key metrics

52-wk range US\$45.73-22.50

Market cap. US\$2.01bn

Shares o/s 56.5m (COM)

Free float 71%

Avg. daily volume ('000) 152

Avg. daily value (m) US\$4.5

Common s/h equity (12/16E) US\$0.13bn

P/BV (12/16E) 15.7x

Net debt / EBITDA (12/16E) NM

EPS (UBS, diluted) (US\$)

	12/16E			
	From	To	% ch	Cons.
Q1E	-	0.22	-	0.19
Q2E	-	0.12	-	0.12
Q3E	-	0.11	-	0.11
Q4E	-	0.12	-	0.12
12/16E	-	0.57	-	0.53
12/17E	-	0.79	-	0.73
12/18E	-	1.08	-	1.07

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Highlights (US\$K)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	107,601	150,929	224,653	314,994	410,258	522,071	653,838	805,663
EBIT (UBS)	10,406	16,412	37,445	53,471	76,004	104,517	140,288	185,543
Net earnings (UBS)	2,689	9,628	23,449	33,409	47,837	66,151	89,178	118,350
EPS (UBS, diluted) (US\$)	0.06	0.19	0.40	0.57	0.79	1.08	1.42	1.85
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	(68,603)	(1,834)	24,854	67,970	123,293	194,592	287,270	407,009
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	9.7	10.9	16.7	17.0	18.5	20.0	21.5	23.0
ROIC (EBIT) %	14.5	21.9	50.1	77.9	126.7	194.7	284.2	395.4
EV/EBITDA (core) x	-	39.5	44.1	29.8	21.1	15.2	11.0	8.4
P/E (UBS, diluted) x	-	94.4	87.0	62.8	44.8	33.0	25.0	19.2
Equity FCF (UBS) yield %	-	0.9	1.3	2.1	2.8	3.6	4.6	6.0
Net dividend yield %	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$35.53 on 18 Apr 2016 18:41 EDT

[Paycom Software Inc](#)

Paylocity Holding Corp

Pedal to the Metal, with a Flaming Exhaust

Initiating coverage with a Neutral rating and \$38 price target

PCTY is the high-beta, Silicon Valley-like start-up among next-gen payroll-centric HCM vendors – with exciting growth, but only roughly break-even op. mgn during the past 3 FYs, and a 7.7x NTM EV/S multiple that is higher than PAYC's 6.6x. Compared to ULTI and PAYC, PCTY had the highest rev growth in the Dec. 2015 qtr (+61% YoY, +22% QoQ), biggest growth in customer net adds in FY15 (+22%), and lowest op. mgn in CY15 (4.9%). Its sales force is singularly focused on "hunting" new clients, with the exception of the ACA product, where existing clients had a time-sensitive need. Rapid client growth is hurting margins, as implementation gross profit margin is running at a negative 170-200%. While new client hypergrowth and low margins are concerns, they also set up a future monetization pool that could sustain 20%+ growth at 20-25%+ EBITDA margins. Cross-selling the current base is a ~\$100m rev. opportunity, and EBITDA already improved in CY15 by ~600bps to ~10%, but execution is paramount.

Multiple growth drivers to sustain 25-30% growth through FY18

While FY16's expected rev acceleration (UBS-e +49% YoY vs. FY15 +40%) is unlikely to repeat, we believe Paylocity can sustain 25-30% growth thanks to: 1) the mid-market being ripe for a new generation of Cloud-based payroll/HR apps; 2) low penetration of a large TAM; 3) share gains from a very large pool of clients still using legacy vendors; 4) growing referral network; 5) expanding pdt portfolio; and 6) future x-sell potential.

Tough comps from ACA, but embedded in expectations; margins low but rising

We est. ACA accounts for 8-11% of total rev during its first full yr. With ACA excluded, current guide for F3Q16 and implied guide for F4Q16 imply rev growth only in the high 20s% – below the ~40% trend line of FY12-15. Although there are many reasons for low mgns, we see potential for improvement twd LT goals of 20-25% EBITDA mgns.

Valuation: Trades at EV/S 7.7x CY16E, 6.0x CY17E

Our 12-month \$38 price target is based on EV/S 6.0x applied to UBS estimated revenue in 5-8 quarters. We think a modest haircut to the historical average and to the 7.0x multiple used for PAYC and ULTI is reasonable given a slightly higher risk profile, due to a heavier focus on top-line growth, low profitability, and relatively short history. We believe the multiple premium to the SaaS comp group mean is justified given above average revenue growth and positive/improving margins.

Equities

Americas
Software

12-month rating **Neutral**
Prior: Not Rated
12m price target **US\$38.00**
Prior: -
Price **US\$37.58**
RIC: PCTY.O **BBG:** PCTY US

Trading data and key metrics

52-wk range	US\$46.23-25.17
Market cap.	US\$1.90bn
Shares o/s	50.7m (COM)
Free float	53%
Avg. daily volume ('000)	374
Avg. daily value (m)	US\$11.5
Common s/h equity (06/16E)	US\$0.12bn
P/BV (06/16E)	16.6x
Net debt / EBITDA (06/16E)	NM

EPS (UBS, diluted) (US\$)

	06/16E			
	From	To	% ch	Cons.
Q1	-	0.02	-	0.02
Q2	-	0.08	-	0.08
Q3E	-	0.16	-	0.14
Q4E	-	(0.05)	-	(0.04)
06/16E	-	0.21	-	0.19
06/17E	-	0.30	-	0.28
06/18E	-	0.40	-	0.36

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Highlights (US\$K)	06/13	06/14	06/15	06/16E	06/17E	06/18E	06/19E	06/20E
Revenues	77,294	108,687	152,698	227,017	295,055	372,300	455,413	548,152
EBIT (UBS)	554	(1,038)	494	10,814	16,287	25,363	37,943	54,496
Net earnings (UBS)	936	(1,130)	443	11,210	16,633	22,575	31,544	42,313
EPS (UBS, diluted) (US\$)	0.02	(0.02)	0.01	0.21	0.30	0.40	0.55	0.73
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	6,969	78,848	81,258	85,009	100,986	120,473	147,366	183,889
Profitability/valuation	06/13	06/14	06/15	06/16E	06/17E	06/18E	06/19E	06/20E
EBIT margin %	0.7	-1.0	0.3	4.8	5.5	6.8	8.3	9.9
ROIC (EBIT) %	-	(13.6)	2.6	37.7	51.9	76.3	102.2	128.7
EV/EBITDA (core) x	-	>100	>100	76.0	60.6	43.8	31.8	23.4
P/E (UBS, diluted) x	-	NM	NM	NM	NM	93.3	68.1	51.8
Equity FCF (UBS) yield %	-	(0.4)	(0.2)	0.3	0.8	1.0	1.4	1.9
Net dividend yield %	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$37.58 on 18 Apr 2016 18:41 EDT

[Paylocity Holding Corp](#)

Figure 18: SaaS valuation comp sheet + ADP/PAYX

Ticker	Company	Price 4/18/16	Market Cap	EV	Revenues NTM	LTM	% growth	EPS NTM	LTM	% growth	Valuation EV/S (ntm)	PE (ntm)	last qtr PF op mgn	EV/S CY17E
WDAY	Workday, Inc. Class A	77.66	16,648	15,279	1,549	1,162	33%	0.02	(0.01)	NM	9.9x	NM	-0.2%	7.6x
NOW	ServiceNow, Inc.	64.47	11,009	10,683	1,360	1,005	35%	0.64	0.39	64%	7.9x	NM	14.1%	6.0x
PCTY	Paycom Software, Inc.	37.58	2,018	1,939	253	188	35%	0.15	0.18	-17%	7.7x	NM	7.2%	6.0x
ULTI	Ultimate Software Group, Inc.	194.27	5,803	5,692	772	618	25%	3.24	2.66	22%	7.4x	60x	21.8%	6.1x
VEEV	Veeva Systems Inc Class A	25.70	3,731	3,385	512	409	25%	0.55	0.52	6%	6.6x	47x	22.1%	5.4x
PAYC	Paycom Software, Inc.	35.53	2,074	2,049	311	225	38%	0.53	0.40	33%	6.6x	67x	11.6%	5.1x
CRM	salesforce.com, inc.	77.27	52,773	51,397	8,121	6,667	22%	1.01	0.75	35%	6.3x	77x	12.1%	5.3x
PFPT	Proofpoint, Inc.	53.69	2,176	2,116	348	265	31%	(0.22)	(0.35)	NM	6.1x	NM	-4.0%	4.7x
HUBS	HubSpot, Inc.	43.52	1,658	1,513	251	182	38%	(0.72)	(0.74)	NM	6.0x	NM	-8.3%	4.6x
N	NetSuite Inc.	72.12	5,817	5,736	961	741	30%	0.42	0.21	100%	6.0x	NM	2.8%	4.7x
ZEN	Zendesk, Inc.	21.99	1,959	1,713	297	209	42%	(0.33)	(0.30)	NM	5.8x	NM	-10.5%	4.3x
MDSO	Medidata Solutions, Inc.	41.35	2,347	2,330	461	393	17%	1.01	0.91	11%	5.1x	41x	23.9%	4.2x
ATHN	athenahealth, Inc.	136.75	5,444	5,600	1,107	925	20%	1.75	1.37	28%	5.1x	78x	12.1%	4.2x
NEWR	New Relic, Inc.	24.60	1,303	1,112	227	162	40%	(0.76)	(0.82)	NM	4.9x	NM	-22.4%	3.8x
DWRE	Demandware, Inc.	42.95	1,624	1,427	301	237	27%	0.16	0.43	-63%	4.7x	NM	19.0%	3.7x
CSOD	Cornerstone OnDemand, Inc.	34.13	1,994	1,982	430	341	26%	0.01	(0.40)	NM	4.6x	NM	0.4%	3.7x
MB	MINDBODY, Inc. Class A	14.01	608	515	135	101	33%	(0.63)	NM	NM	3.8x	NM	-21.9%	3.0x
LOGM	LogMeIn, Inc.	49.82	1,293	1,145	325	272	20%	1.74	1.65	5%	3.5x	29x	24.2%	3.0x
MKTO	Marketo, Inc.	21.82	1,057	952	273	210	30%	(0.50)	(0.61)	NM	3.5x	NM	-9.5%	2.8x
SPSC	SPS Commerce, Inc.	44.58	763	634	192	159	21%	0.94	0.84	12%	3.3x	47x	12.4%	2.8x
RP	RealPage, Inc.	20.66	1,592	1,522	570	467	22%	0.71	0.54	31%	2.7x	29x	17.5%	2.3x
SNCR	Synchronoss Technologies, Inc.	32.74	1,567	1,596	664	580	15%	2.35	2.23	5%	2.4x	14x	28.1%	2.1x
SQI	SciQuest, Inc.	14.32	400	257	110	105	5%	0.33	0.29	14%	2.3x	43x	14.7%	2.1x
XTLY	Xactly Corp	7.54	251	219	95	76	25%	(0.59)	NM	NM	2.3x	NM	-20.6%	1.9x
IL	IntraLinks Holdings, Inc.	8.70	503	525	300	276	9%	0.15	0.06	150%	1.8x	58x	5.5%	1.6x
TNGO	Tango, Inc.	8.68	357	326	230	219	5%	0.32	0.51	-37%	1.4x	27x	4.0%	1.3x
BCOV	Brightcove Inc.	6.18	208	181	146	135	8%	0.06	0.02	NM	1.2x	NM	6.6%	1.1x
JIVE	Jive Software, Inc.	4.13	344	235	204	196	4%	(0.13)	(0.13)	NM	1.2x	NM	-5.9%	1.1x
BV	Bazaarvoice, Inc.	3.48	282	230	205	197	4%	(0.06)	(0.10)	NM	1.1x	NM	3.9%	1.1x
MRIN	Marin Software, Inc.	2.88	110	76	111	109	3%	(0.22)	(0.44)	NM	0.7x	NM	5.7%	0.6x
Total			\$127,714	\$122,367	\$20,822	\$16,831								
Mean			\$4,257	\$4,079	\$694	\$561	23%			23%	4.4x	47x	5.5%	3.5x
Median			\$1,608	\$1,518	\$301	\$231	25%			14%	4.7x	47x	6.1%	3.7x
ADP	Automatic Data Processing, Inc.	90.70	41,749	40,901	12,188	11,247	8%	3.45	2.99	15%	3.4x	26x	18.0%	3.1x
PAYX	Paychex, Inc.	53.42	19,349	18,593	3,120	2,890	8%	2.17	1.90	14%	6.0x	25x	37.2%	5.7x

Source: Company data, FactSet consensus estimates, UBS

We would like to thank Namrata Agarwal, an employee of Evalueserve, for her assistance in preparing this research report. Evalueserve staff provide research support services to UBS.

Ultimate Software Group Inc Investment case

We view ULTI as the reliable core holding among the 3 next-gen SaaS payroll/human capital management (HCM) vendors, with a 10+ year track record of 20%+ recurring revenue growth, balanced with the highest margins at 20%+. Since moving early to a multi-tenant SaaS platform in 2002, ULTI has had remarkably consistent, predictable growth – recurring revenue grew 23-28% annually in the past 10 years, except for 2007, at 36%. We believe the right culture, which prioritizes customers and employees, combined with a wide open total addressable market (TAM), are fuelling sustainable execution. Conversations with dozens of industry contacts have increased our confidence that ULTI can deliver many more years of 20%+ top-line growth, even as it passes the \$1bn mark (expected in FY18), with a steadily expanding 20%+ operating margin..

Paycom Software Inc Investment case

PAYC is our favorite stock idea of the 3 next-gen payroll/HCM vendors we cover due its combination of 40% revenue growth, healthy 17% operating margin, three-year EPS CAGR (UBSe FY15A-18E) of nearly 40%, yet lowest multiple. Since moving first to a multi-tenant SaaS platform in 1999, it has quietly earned the trust of ~9,000 clients with an integrated product suite that is robust, secure, reliable, and user-friendly. Conversations with dozens of industry contacts suggest there is much unrealized potential, as brand awareness is still low. Starting from its Oklahoma City HQ, PAYC has expanded its sales coverage methodically using a proven, metrics-driven approach. The number of sales teams has more than doubled to 42 in the last 5 years, and we see potential to add another 80+ in the top 50 metro areas alone. With rapid growth in sales productivity, client net adds, and monetizable products, PAYC could hit \$1bn in revenues by 2021. For FY16, we forecast a 4th year of 40%+ revenue growth despite a tough 49% comp.

Paylocity Holding Corp Investment case

PCTY is the high-beta, Silicon Valley-like start-up among the next-gen payroll-centric HCM (human capital management) vendors – with exciting growth, but only roughly break-even operating margin during the past 3 FYs, and a NTM EV/S multiple that is higher than PAYC's. Compared to ULTI and PAYC, PCTY had the highest revenue growth in the December 2015 quarter (+61% YoY, +22% QoQ), biggest growth in customer net adds in FY15 (+22%), and lowest operating margins in CY15 (4.9%). Its sales force is singularly focused on "hunting" new clients, with the recent exception of the ACA product, where existing clients had a time-sensitive need. Rapid client growth is hurting margins, as implementation gross profit margin is running at a negative 170-200%. While new client hypergrowth and low margins are concerns, they also set up a future monetization pool that could sustain 20%+ growth at 20-25%+ EBITDA margins. We believe cross-selling the current base alone is a ~\$100m revenue opportunity, and EBITDA already improved in CY15 by ~600bps to ~10%, but execution is paramount.

Valuation Method and Risk Statement

Our price targets are based on an EV/S multiple applied to UBS-e revenue in 5-8 quarters.

Investing in the software sector entails above-average risk, given low sales visibility, operational gearing and a tendency for a substantial proportion of sales to be closed at the end of the period. The presence of large, well-funded competitors also creates challenges. Technology obsolescence is also a risk.

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12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	49%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	26%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

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UBS Securities LLC: John Byun; Brent Thill.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Paycom Software Inc ¹⁶	PAYC.N	Not Rated	N/A	US\$35.53	18 Apr 2016
Paylocity Holding Corp ¹⁶	PCTY.O	Not Rated	N/A	US\$37.58	18 Apr 2016
Ultimate Software Group Inc ¹⁶	ULTI.O	Not Rated	N/A	US\$194.27	18 Apr 2016

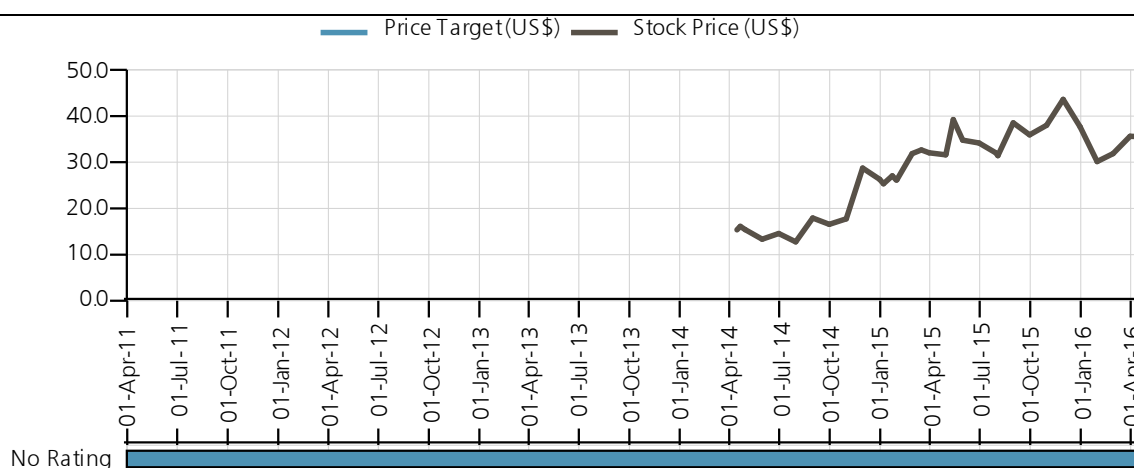
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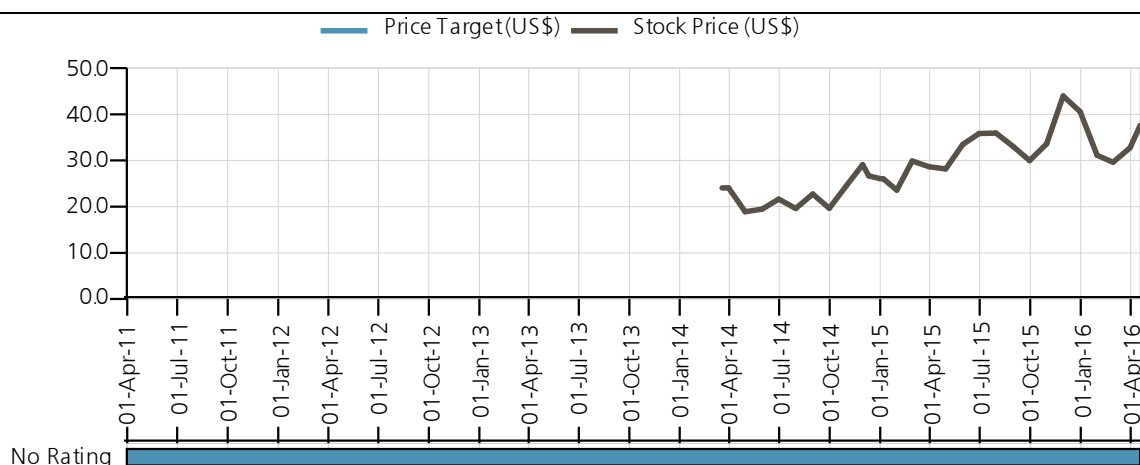
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Paycom Software Inc (US\$)



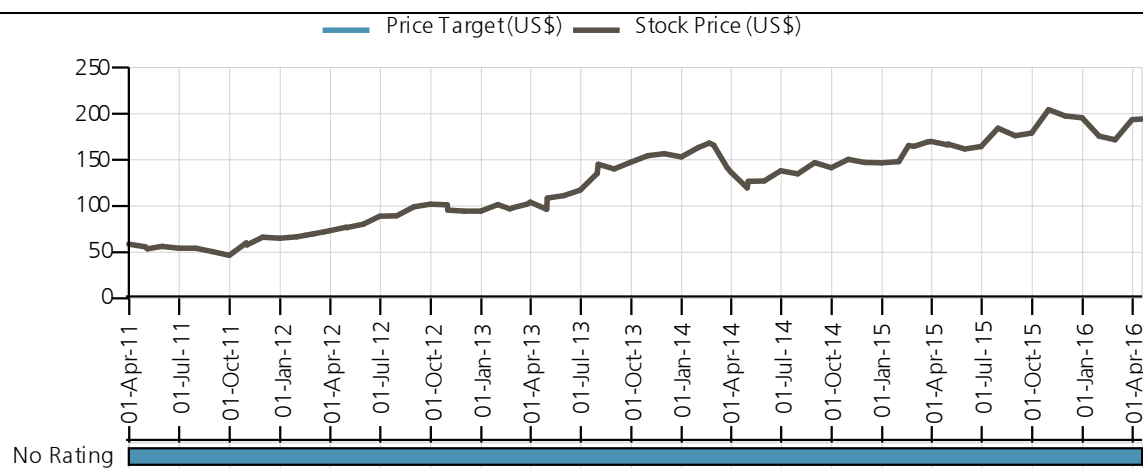
Source: UBS; as of 18 Apr 2016

Paylocity Holding Corp (US\$)



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Ultimate Software Group Inc (US\$)



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