

Paylocity Holding Corp
Form 10-K
August 11, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended June 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period from to

Commission File Number 001- 36348

PAYLOCITY HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	46-4066644
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification Number)

3850 N. Wilke Road

Arlington Heights, Illinois 60004

(Address of principal executive offices and zip code)

(847) 463-3200

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.001 per share	The NASDAQ Global Select Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of voting stock held by non-affiliates of the registrant as of December 31, 2016, the last day of registrant's most recently completed second fiscal quarter, was \$774.8 million (based on the closing price for shares of the registrant's common stock as reported by the NASDAQ Global Select Market for the last business day prior to that date).

As of August 4, 2017, there were 51,750,086 shares of the registrant's common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE:

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the Proxy Statement relating to the registrant's 2018 annual meeting of stockholders, which shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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Form 10-K

For the Year Ended June 30, 2017

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PART 1

Forward Looking Statements

Except for the historical financial information contained herein, the matters discussed in this report on Form 10-K (as well as documents incorporated herein by reference) may be considered “forward-looking” statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including, but not limited to, statements regarding our future financial position, business strategy and plans and objectives of management for future operations. When used in this Annual Report, the words “believe,” “may,” “could,” “will,” “estimate,” “continue,” “intend,” “expect,” “anticipate,” “plan,” “project” and similar expressions are intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives, and financial needs. These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this report, and in particular, the risks discussed under Part 1, Item 1A: “Risk Factors” and those discussed in other documents we file with the Securities and Exchange Commission. Except as required by law, we do not intend to update these forward-looking statements publicly or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report and in the documents incorporated in this report may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. Accordingly, readers are cautioned not to place undue reliance on such forward-looking statements.

Item 1. Business.

Overview

We are a cloud-based provider of payroll and human capital management, or HCM, software solutions for medium-sized organizations, which we define as those having between 20 and 1,000 employees. Our comprehensive

and easy-to-use solutions enable our clients to manage their workforces more effectively. As of June 30, 2017, we served approximately 14,550 clients across the U.S., which on average had over 100 employees. Our solutions help drive strategic human capital decision-making and improve employee engagement by enhancing the human resource, payroll and finance capabilities of our clients.

Our multi-tenant software platform is highly configurable and includes a unified suite of payroll and HCM applications, such as time and labor tracking, benefits and talent management. Our solutions have been organically developed from our core payroll solution, which we believe is the most critical system of record for medium-sized organizations and an essential gateway to other HCM functionality. Our payroll and HCM applications use a unified database and provide robust on-demand reporting and analytics. Our platform provides intuitive self-service functionality for employees and managers combined with seamless integration across all our solutions. We supplement our comprehensive software platform with an integrated implementation and client service organization, all of which are designed to meet the needs of medium-sized organizations.

Effective management of human capital is a core function in all organizations and requires a significant commitment of resources. Organizations are faced with complex and ever-changing requirements, including diverse federal, state and local regulations across multiple jurisdictions. In addition, the workplace operating environment is rapidly changing as employees increasingly become mobile, work remotely and expect an end user experience similar to that of consumer-oriented Internet applications. Medium-sized organizations operating without the infrastructure,

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expertise or personnel of larger enterprises are uniquely pressured in this complex and dynamic environment. Existing solutions offered by third-party payroll service providers can have limited capabilities and configurability while enterprise-focused software vendors can be expensive and time-consuming to implement and manage. We believe that medium-sized organizations are better served by solutions designed to meet their unique needs.

Our solutions provide the following key benefits to our clients:

- Comprehensive cloud-based platform optimized to meet the payroll and HCM needs of medium-sized organizations;
- Modern, intuitive user experience and self-service capabilities that significantly increase employee engagement;
- Flexible and configurable platform that aligns with business processes and centralizes payroll and HCM data;
- Software as a service, or SaaS, delivery model that reduces total cost of ownership for our clients; and
 - Seamless data integration with our extensive partner ecosystem that saves time and expense and reduces the risk of errors.

We market and sell our products primarily through our direct sales force. We generate sales leads through a variety of focused marketing initiatives and from our extensive referral network of 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants. We derive revenue from a client based on the solutions purchased by the client, the number of client employees and the amount, type and timing of services provided with respect to those client employees. Our annual revenue retention rate was greater than 92% in each of the fiscal years 2015, 2016 and 2017. Our total revenues increased from \$152.7 million in fiscal 2015 to \$230.7 million in fiscal 2016, representing a 51% year-over-year increase and to \$300.0 million in fiscal 2017, representing a 30% year-over-year increase. Our recurring revenues increased from \$144.1 million in fiscal 2015 to \$220.1 million in fiscal 2016, representing a 53% year-over-year increase, and to \$288.4 million in fiscal 2017, representing a 31% year-over-year increase. Although we do not have long-term contracts with our clients and our agreements with clients are generally terminable on 60 days' or less notice, our recurring revenue model provides significant visibility into our future operating results.

Industry Background

Effective management of human capital is a core function for all organizations and requires a significant commitment of resources. Identifying, acquiring and retaining talent is a priority at all levels of an organization. In today's increasingly complex business and regulatory environment, organizations are being pressured to manage critical payroll and HCM functions more effectively, automate manual processes and decrease their operating costs.

Complex and Dynamic Tax and Regulatory Environment

The tax and regulatory environment in the United States is complex and dynamic. Organizations are subject to a myriad of tax, benefit, workers compensation, healthcare and other rules, regulations and reporting obligations. In addition to U.S. federal taxing and regulatory authorities, there are more than 10,000 state and local tax codes in the United States. Further, federal, state and local government agencies continually enact and amend the rules, regulations and reporting requirements with which organizations must comply.

Growing Demand for Mobility and Enhanced User Experience

Connectivity and mobility are enabling employees to spend less time in traditional office environments and more time working remotely. This trend increases the demand for advanced and intuitive solutions that improve collaboration and foster employee engagement, such as remote self-service access to payroll and timesheet reporting, HR

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and benefits portals and other talent management applications. Given the prominence of consumer-oriented Internet applications, employees expect the user experience and accessibility of internal systems to be similar to those of the latest Internet applications, such as LinkedIn, Amazon and Facebook.

Medium-Sized Organizations Face Unique Challenges

Medium-sized organizations functioning without the infrastructure, expertise or personnel of larger enterprises are uniquely pressured in the current complex and dynamic environment. Employees in these medium-sized organizations often perform multiple job functions, and many medium-sized organizations have limited financial, technical and other resources needed to effectively manage their critical business requirements and to build and maintain the systems required to do so.

Large Market Opportunity for Payroll and HCM Solutions

According to market analyses published by International Data Corporation, or IDC, titled Worldwide and U.S. Human Capital Management Applications 2015-2019 Forecast (June 2015) and U.S. Payroll Outsourcing Services Forecast, 2015-2019 (November 2015), the U.S. market for HCM applications and payroll outsourcing services is estimated to be \$26 billion in 2017. The market opportunity is driven by the importance of payroll and HCM solutions to the successful management of organizations.

To estimate our addressable market, we focus our analysis on the number of U.S. medium-sized organizations and the number of their employees. According to the U.S. Census Bureau, there were over 610,000 firms with 20 to 999 employees in the U.S. in 2014, employing over 43 million persons. We estimate that if clients were to buy our entire suite of existing solutions at list prices, they would spend approximately \$285 per employee annually. Based on this analysis, we believe our current target addressable market is approximately \$12 billion. Our existing clients do not typically buy our entire suite of solutions, and as we continue to expand our product offerings, we believe that we have an opportunity to increase the amount clients spend on payroll and HCM solutions per employee and to expand our addressable market.

Organizations Are Increasingly Transitioning to SaaS Solutions

SaaS solutions are easier and more affordable to implement and operate than those offered by traditional software providers. SaaS solutions also enable software updates with greater frequency and without new hardware investments, enabling organizations to better react to changes in their environments. Many organizations are transitioning to SaaS solutions for front-office business applications such as salesforce management. Similarly, we believe organizations are

adopting back-office SaaS applications, such as payroll and HCM, with increasing frequency. According to a market analysis published by IDC, titled Worldwide SaaS and Cloud Software 2015-2019 Forecast and 2014 Vendor Shares (August 2015), the U.S. SaaS market is estimated to be \$54 billion in 2017 and is projected to grow at a 17% compound annual growth rate from 2014 to 2019.

Limitations of Existing Solutions

We believe that existing payroll and HCM solutions have limitations that cause them to underserve the unique needs of medium-sized organizations. Existing payroll and HCM solutions include:

- Traditional Payroll Service Providers. Traditional payroll service providers are primarily focused on delivery of a variety of payroll processing services, insurance products and HR business process outsourcing solutions. Many of these solutions offer limited capabilities and integration beyond traditional payroll processing. The lack of a unified and configurable payroll and HCM suite can diminish the effectiveness of a system, detract from user experience and limit integration with other solutions. In addition, we believe that certain traditional payroll service providers often do not provide a high-quality client service experience.

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- Enterprise-Focused Payroll and HCM Software Vendors. Enterprise-focused software vendors offer solutions and services that are designed for the complex needs and structures of large enterprises. As a result, their solutions can be expensive, complex and time-consuming to implement, operate and maintain.
- HCM Point Solution Providers. Many HCM point solutions lack integrated payroll functionality. The implementation and management of multiple point solutions and the reliance on multiple service organizations can be challenging and expensive for medium-sized organizations.
- Manual Processes for Payroll and HCM Functions. Manual payroll and HCM processes require increased HR, payroll and finance personnel involvement, resulting in higher costs, slower processing and greater risks of data entry errors.

Given the challenges medium-sized organizations face operating in complex and dynamic environments and the limited ability of traditional offerings to address these challenges, we believe there is a significant market opportunity for a comprehensive, unified SaaS solution designed to serve the payroll and HCM needs of medium-sized organizations.

Segment Information

Our chief operating decision maker reviews our financial results in total when evaluating financial performance and for purposes of allocating resources. We have thus determined that we operate in a single cloud-based software solution reporting segment.

Our Solution

We are a cloud-based provider of payroll and HCM software solutions for medium-sized organizations. Our solutions enable medium-sized organizations to more efficiently manage payroll and human capital in their complex and dynamic operating environments. As of June 30, 2017, we served approximately 14,550 clients across the U.S., which on average had over 100 employees.

The key benefits of our solution include the following:

- Comprehensive Platform Optimized for Medium-Sized Organizations. Our solutions empower finance and HR professionals in medium-sized organizations to drive strategic human capital decisions by providing enterprise-grade

payroll and HCM applications, including robust reporting and analytics. Our unified platform fully automates payroll and HCM processes, enabling our clients to focus on core business activities. Our solutions help our clients attract, retain and manage their employees within a single, comprehensive system.

- **Modern, Intuitive User Experience.** Our intuitive, easy-to-use interface is based on current technology and automatically adapts to users' devices, including mobile platforms, thereby significantly increasing accessibility of our solutions and decreasing the need for training. Our platform's self-service functionality and performance management applications provide employees with an engaging experience. Our performance management applications include peer-to-peer employee recognition and social employee profiles that create a reward and recognition environment resulting in greater employee engagement.
- **Flexible and Configurable Platform.** We design our solutions to be flexible and configurable, allowing our clients to match their use of our software with their specific business processes and workflows. Our platform has been organically developed from a common code base, data structure and user interface, providing a consistent user experience with powerful features that are easily adaptable to our clients' needs. Our systems centralize payroll and HCM data, minimizing inconsistent and incomplete information that can be produced when using multiple databases.
- **Highly-Attractive SaaS Solution for Medium-Sized Organizations.** Our solutions are cloud-based and offered on a subscription basis, making them easier and more affordable to implement, operate and update

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and enabling our clients to focus less on their IT infrastructure and more on their core businesses. Our cloud-based software can be operated by a single administrator without the support of an in-house information technology department. Our multi-tenant and modern architecture allows for frequent software enhancements thereby enabling our clients to react to a rapidly changing and complex operating environment. Our cloud-based platform enables our clients to scale their businesses without having to acquire additional hardware or to resolve the integration challenges that often result from traditional outsourcing solutions.

- **Seamless Integration with Extensive Ecosystem of Partners.** Our platform offers our clients automated data integration with over 200 related third-party partner systems, such as 401(k), benefits and insurance provider systems. This integration reduces the complexity and risk of error of manual data transfers and saves time for our clients and their employees. We integrate data with these related systems through a secure connection, which significantly decreases the risk of unauthorized third-party access and other security breaches. Our direct and automated data transmission improves the accuracy of data and facilitates data collection in our partners' systems. We believe having automated data integration with a payroll and HCM provider like us differentiates our partners' product offerings, strengthening their competitive positioning in their own markets.

Our Strategy

We intend to strengthen and extend our position as a provider of cloud-based payroll and HCM software solutions to medium-sized organizations. Key elements of our strategy include:

- **Grow Our Client Base.** We believe that our current client base represents only a small portion of the medium-sized organizations that could benefit from our solutions. While we served approximately 14,550 clients across the U.S. as of June 30, 2017, there were over 610,000 firms with 20 to 999 employees in the U.S., employing more than 43 million persons, according to the U.S. Census Bureau in 2014. In order to acquire new clients, we plan to continue to grow our sales organization aggressively across all U.S. geographies.
- **Expand Our Product Offerings.** We believe that our leadership position is in significant part the result of our investment and innovation in our product offerings designed for medium-sized organizations. Therefore, we plan to increase investment in software development to continue to advance our platform and expand our product offerings. For example, in fiscal 2017, we released Web Expense and Paylocity Recruiting, which simplify and automate employee expense management and recruitment tasks.
- **Increase Average Revenue Per Client.** Our average revenue per client has consistently increased in each of the last three years as we have broadened our product offerings. We plan to further grow average revenue per client by selling a broader selection of products to new and existing clients.
- **Extend Technological Leadership.** We believe that our organically developed cloud-based multi-tenant software platform, combined with our unified database architecture, enhances the experience and usability of our products, providing what we believe to be a competitive advantage over alternative solutions. Our modern, intuitive user

interface utilizes features found on many popular consumer Internet sites, enabling users to use our solutions with limited training. We plan to continue our technology innovation, as we have done with our mobile applications, social features and analytics capabilities.

- Further Develop Our Referral Network. We have developed a strong network of referral participants, such as 401(k) advisors, benefits administrators, insurance brokers, third-party administrators and HR consultants that recommend our solutions and provide referrals. We believe that our platform's automated data integration with over 200 related third-party partner systems is valuable to our referral participants, as they are able to access payroll and HR data through a single system which decreases complexity and cost and complements their own product offerings. We plan to increase integration with third-party providers and expand our referral network to grow our client base and lower our client acquisition costs.

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Our Products

Our cloud-based platform features a suite of unified payroll and HCM applications. Our solutions are highly configurable and easy to use, implement, update and maintain.

Payroll (Web Pay)

Paylocity Web Pay is designed to provide enterprise-grade payroll processing and administration from a convenient cloud-based platform. Key features of Web Pay include:

Feature	Functionality
Configurable Templates	Combination of standard and modifiable templates powered by highly-flexible drag-and-drop technology Standard templates such as new hire, job change, leave of absence and termination templates Enables users to configure user interface to efficiently align to organizations' business processes Ability to require additional data, add default values and insert new custom fields increases accuracy and consistency of data across the platform
Custom Checklists	Allows users to track critical steps in hiring and other processes Triggers reports and notification emails to track critical steps and informs users when tasks are complete
Advanced Reporting	Easy-to-use, powerful reporting dashboard enables users to design and create ad-hoc reports or rely on over 100 standard reports Ability to generate a variety of pre-process reports via report library and report writer