Paylocity Holding Corp
Form 10-Q
February 09, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 31, 2017

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 incorporation or organization)	(IRS Employer Identification No.)

3850 N. Wilke Road

Arlington Heights, Illinois	60004
(Address of principal executive offices)	(Zip Code)

(847) 463-3200

(Registrant's telephone number, including area code)

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth 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. (Check one):

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 Exchange Act). Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 52,603,746 shares of Common Stock, $0.001 par value per share, as of February 2, 2018.

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Paylocity Holding Corporation

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For the Quarterly Period Ended December 31, 2017

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Balance Sheets

(in thousands, except per share data)

	June 30, 2017	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 103,468	$ 111,027
Accounts receivable, net	2,040	2,739
Prepaid expenses and other	14,879	7,456
Total current assets before funds held for clients	120,387	121,222
Funds held for clients	942,459	1,345,702
Total current assets	1,062,846	1,466,924
Long-term prepaid expenses	1,535	1,072
Capitalized internal-use software, net	17,394	18,786
Property and equipment, net	40,756	48,354
Intangible assets, net	8,907	8,189
Goodwill	6,003	6,003
Total assets	$ 1,137,441	$ 1,549,328
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 2,046	$ 1,794
Accrued expenses	30,301	29,128
Total current liabilities before client fund obligations	32,347	30,922
Client fund obligations	942,459	1,345,702

Total current liabilities	974,806	1,376,624
Deferred rent	14,621	14,243
Deferred income tax liabilities, net	401	308
Total liabilities	$ 989,828	$ 1,391,175
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000 authorized, no shares issued and outstanding at June 30, 2017 and December 31, 2017	$ —	$ —
Common stock, $0.001 par value, 155,000 shares authorized at June 30, 2017 and December 31, 2017; 51,738 shares issued and outstanding at June 30, 2017 and 52,590 shares issued and outstanding at December 31, 2017	52	53
Additional paid-in capital	192,837	202,512
Accumulated deficit	(45,276)	(44,302)
Accumulated other comprehensive loss	—	(110)
Total stockholders' equity	$ 147,613	$ 158,153
Total liabilities and stockholders' equity	$ 1,137,441	$ 1,549,328

See accompanying notes to unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Statements of Operations and Comprehensive Income (Loss)

(in thousands, except per share data)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2016	2017	2016	2017
Revenues:				
Recurring fees	$ 65,347	$ 81,292	$ 127,267	$ 158,586
Interest income on funds held for clients	731	1,783	1,448	3,400
Total recurring revenues	66,078	83,075	128,715	161,986
Implementation services and other	2,576	2,929	4,961	5,518
Total revenues	68,654	86,004	133,676	167,504
Cost of revenues:				
Recurring revenues	20,716	25,638	39,819	49,729
Implementation services and other	9,667	11,202	18,923	22,070
Total cost of revenues	30,383	36,840	58,742	71,799
Gross profit	38,271	49,164	74,934	95,705
Operating expenses:				
Sales and marketing	17,735	21,598	35,746	42,778
Research and development	7,222	9,274	14,523	18,169
General and administrative	14,957	18,159	28,815	34,110
Total operating expenses	39,914	49,031	79,084	95,057
Operating income (loss)	(1,643)	133	(4,150)	648
Other income	4	141	43	250
Income (loss) before income taxes	(1,639)	274	(4,107)	898
Income tax expense (benefit)	32	(157)	132	(76)
Net income (loss)	$ (1,671)	$ 431	$ (4,239)	$ 974
Other comprehensive loss, net of tax				
Unrealized losses on securities, net of tax	—	(105)	—	(110)
Total other comprehensive loss, net of tax	—	(105)	—	(110)
Comprehensive income (loss)	$ (1,671)	$ 326	$ (4,239)	$ 864

Net income (loss) per share:

Basic	$ (0.03)	$ 0.01	$ (0.08)	$ 0.02
Diluted	$ (0.03)	$ 0.01	$ (0.08)	$ 0.02
Weighted-average shares used in computing net income (loss) per share:				
Basic	51,384	52,502	51,308	52,197
Diluted	51,384	54,818	51,308	54,639

See accompanying notes to unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Statement of Changes in Stockholders' Equity

(in thousands)

	Stockholders' Equity					
	Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	Total Stockholders'
	Shares	Amount	Capital	Deficit	Loss	Equity
Balances at June 30, 2017	51,738	$ 52	$ 192,837	$ (45,276)	$ —	$ 147,613
Stock-based compensation	—	—	15,328	—	—	15,328
Stock options exercised	669	1	5,739	—	—	5,740
Issuance of common stock upon vesting of restricted stock units	414	—	—	—	—	—
Issuance of common stock under employee stock purchase plan	53	—	2,045	—	—	2,045
Net settlement for taxes and/or exercise price related to equity awards	(284)	—	(13,437)	—	—	(13,437)
Unrealized losses on securities, net of tax	—	—	—	—	(110)	(110)
Net income	—	—	—	974	—	974
Balances at December 31, 2017	52,590	$ 53	$ 202,512	$ (44,302)	$ (110)	$ 158,153

See accompanying notes to the unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Statements of Cash Flows

(in thousands)

	Six Months Ended December 31, 2016	2017
Cash flows from operating activities:		
Net income (loss)	$ (4,239)	$ 974
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Stock-based compensation expense	12,448	14,424
Depreciation and amortization expense	9,103	13,438
Deferred income tax expense (benefit)	102	(93)
Provision for doubtful accounts	60	76
Net accretion of discounts and amortization of premiums on available-for-sale securities	—	(141)
Net realized losses on sales of available-for-sale securities	—	2
Loss on disposal of equipment	97	106
Changes in operating assets and liabilities:		
Accounts receivable	(446)	(775)
Prepaid expenses and other	845	1,583
Accounts payable	46	(88)
Accrued expenses	(2,626)	(1,290)
Tenant improvement allowance	—	5,952
Net cash provided by operating activities	15,390	34,168
Cash flows from investing activities:		
Purchases of available-for-sale securities from funds held for clients	—	(95,207)
Proceeds from sales and maturities of available-for-sale securities from funds held for clients	—	23,181
Net change in funds held for clients' cash and cash equivalents	147,151	(331,078)
Capitalized internal-use software costs	(6,279)	(7,146)
Purchases of property and equipment	(10,038)	(7,998)
Lease allowances used for tenant improvements	—	(5,952)
Net cash provided by (used in) investing activities	130,834	(424,200)
Cash flows from financing activities:		
Net change in client fund obligations	(147,151)	403,243
Proceeds from employee stock purchase plan	1,823	2,045

Taxes paid related to net share settlement of equity awards	(5,135)	(7,697)
Net cash provided by (used in) financing activities	(150,463)	397,591
Net Change in Cash and Cash Equivalents	(4,239)	7,559
Cash and Cash Equivalents—Beginning of Period	86,496	103,468
Cash and Cash Equivalents—End of Period	$ 82,257	$ 111,027
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Purchase of property and equipment and internal-use software, accrued but not paid	$ 2,172	$ 482
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes, net of refunds	$ 26	$ 60

See accompanying notes to unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Notes to the Unaudited Consolidated Financial Statements

(all amounts in thousands, except per share data)

(1) Organization and Description of Business

Paylocity Holding Corporation (the “Company”), through its wholly owned subsidiary, Paylocity Corporation, is a cloud-based provider of payroll and human capital management software solutions for medium-sized organizations. Services are provided in a Software-as-a-Service (“SaaS”) delivery model utilizing the Company’s cloud-based platform. Payroll services include collection, remittance and reporting of payroll liabilities to the appropriate federal, state and local authorities.

(2) Summary of Significant Accounting Policies

(a) Consolidation and Use of Estimates

These unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany accounts and transactions have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the allowance for doubtful accounts, internal-use software, valuation and useful lives of long-lived assets, definite-lived intangibles, goodwill, incurred but not reported medical and dental claims, stock-based compensation, valuation of deferred income tax assets and liabilities and the best estimate of selling price for revenue recognition purposes. Future events and their effects cannot be predicted with certainty; accordingly, accounting estimates require the exercise of judgment. Accounting estimates used in the preparation of these consolidated financial statements change as new events occur, as more experience is acquired, as additional information is obtained and as the operating environment changes.

(b) Interim Unaudited Consolidated Financial Information

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with GAAP and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of the Company's financial position, results of operations, changes in stockholders' equity and cash flows. The results of operations for the three and six months ended December 31, 2017 are not necessarily indicative of the results for the full year or the results for any future periods. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the year ended June 30, 2017 included in the Company's Annual Report on Form 10-K filed with the SEC on August 11, 2017.

(c) Funds Held For Clients and Corporate Investments

Funds held for clients is primarily comprised of cash and cash equivalents invested in demand deposit accounts. Starting in July 2017, the Company also invested a portion of its funds held for clients in marketable securities.

Marketable securities classified as available-for-sale are recorded at fair value on the consolidated balance sheets. Unrealized gains and losses, net of applicable income taxes, are reported as other comprehensive income (loss) in the consolidated statements of operations and comprehensive income (loss). Interest on marketable securities included in

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funds held for clients is reported as interest income on funds held for clients on the consolidated statements of operations and comprehensive income (loss).

The Company reviews the composition of its portfolio for any available-for-sale security that has a fair value that falls below its amortized cost. If any security fits this criterion, the Company further evaluates whether other-than-temporary impairment exists by considering whether the Company has the intent and ability to retain the security for a period of time sufficient enough to allow for anticipated fair value recovery. The Company did not record any other-than-temporary impairment charges during the three or six months ended December 31, 2017.

(d) Income Taxes

Income taxes are accounted for in accordance with ASC 740, Income Taxes, using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company recognizes deferred tax assets to the extent that it believes that these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If the Company determines that it would be able to realize its deferred tax assets in the future in excess of their net recorded amount, it would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

(e) Stock-Based Compensation

The Company recognizes all employee stock-based compensation as a cost in the financial statements. Equity-classified awards, including those under the 2014 Employee Stock Purchase Plan (“ESPP”), are measured at the grant date fair value of the award and expense is recognized, net of assumed forfeitures, on a straight-line basis over the requisite service period for each separately vesting portion of the award. The Company estimates grant date fair value using the Black-Scholes option-pricing model and periodically updates the assumed forfeiture rates for actual experience over the option vesting term or the term of the ESPP purchase period.

(f) Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). ASU 2014-09 supersedes a majority of existing revenue recognition guidance under US GAAP, and requires companies to recognize revenue when it transfers goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled. Companies may need to apply more judgment and estimation techniques or methods while recognizing revenue, which could result in additional disclosures to the financial statements. In addition, in March 2016, April 2016, May 2016 and December 2016 the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) ("ASU 2016-08"), ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing ("ASU 2016-10"), ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients ("ASU 2016-12") and ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers ("ASU 2016-20"), respectively, to amend certain guidance in ASU 2014-09. Topic 606 allows for either a retrospective or cumulative effect transition method. ASU 2014-09 was originally effective for fiscal years beginning after December 15, 2016. In July 2015, the FASB approved a one-year deferral of ASU 2014-09 and all amendments to it, with a new effective date for fiscal years beginning after December 15, 2017 with early adoption permitted as of the original effective date.

The Company currently expects to adopt the new standard in its fiscal year beginning July 1, 2018 using the full retrospective method. While the impact the new revenue recognition standard will have on its consolidated financial statements and disclosures has not yet been fully assessed, the Company currently expects that there will be a material impact in the manner in which it treats certain costs of obtaining new contracts (i.e., selling and commission costs). The

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new standard will require the Company to defer these costs and amortize them versus current treatment of expensing these costs as incurred. The Company is continuing to evaluate all potential impacts as well as the changes required for systems, processes and internal controls to meet the new standard's reporting and disclosure requirements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02") which amends various aspects of existing guidance for leases. ASU 2016-02 requires an entity to recognize assets and liabilities arising from a lease with terms greater than twelve months, along with additional qualitative and quantitative disclosures. ASU 2016-02 also requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently assessing the potential effects of these changes to its consolidated financial statements and expects to adopt this new standard in its fiscal year beginning July 1, 2019.

In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718) ("ASU 2016-09") which modifies accounting for excess tax benefits and tax deficiencies, forfeitures, and employer tax withholding requirements. ASU 2016-09 also clarifies certain classifications on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, with early adoption permitted. The Company adopted this standard effective July 1, 2017. Due to the Company's tax valuation allowance, the adoption of this standard did not have a material impact on its consolidated financial statements and disclosures. The Company will continue to estimate forfeitures at each reporting period, rather than electing an accounting policy change to record the impact of such forfeitures as they occur.

From time to time, new accounting pronouncements are issued by the FASB or other standard setting bodies that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of other recently issued standards that are not yet effective will not have a material impact on the Company's consolidated financial statements upon adoption.

(3) Balance Sheet Information

The following tables provide details of selected consolidated balance sheet items:

Activity in the allowance for doubtful accounts was as follows:

Balance at June 30, 2017	$ 266
Charged to expense	76

Write-offs	(85)
Balance at December 31, 2017	$ 257

Capitalized internal-use software and accumulated amortization were as follows:

	June 30, 2017	December 31, 2017
Capitalized internal-use software	$ 49,663	$ 57,758
Accumulated amortization	(32,269)	(38,972)
Capitalized internal-use software, net	$ 17,394	$ 18,786

Amortization of capitalized internal-use software costs is included in Cost of Revenues-Recurring Revenues and amounted to $1,950 and $3,314 for the three months ended December 31, 2016 and 2017, respectively, and $3,634 and $6,703 for the six months ended December 31, 2016 and 2017, respectively.

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Property and equipment, net consist of the following:

	June 30, 2017	December 31, 2017
Office equipment	$ 3,591	$ 3,797
Computer equipment	24,411	27,567
Furniture and fixtures	7,547	8,821
Software	4,954	5,008
Leasehold improvements	21,426	29,324
Time clocks rented by clients	4,240	4,489
Total	66,169	79,006
Accumulated depreciation	(25,413)	(30,652)
Property and equipment, net	$ 40,756	$ 48,354

Depreciation expense amounted to $2,504 and $3,092 for the three months ended December 31, 2016 and 2017, respectively, and $4,707 and $6,017 for the six months ended December 31, 2016 and 2017, respectively.

Intangible assets, net consist of the following:

	June 30, 2017	December 31, 2017	Weighted Average Useful Life
Client relationships	$ 12,580	$ 12,580	9 years
Non-solicitation agreements	360	360	2 - 3 years
Total	12,940	12,940	
Accumulated amortization	(4,033)	(4,751)	
Intangible assets, net	$ 8,907	$ 8,189	

Amortization expense for acquired intangible assets was $381 and $359 for the three months ended December 31, 2016 and 2017, respectively, and $762 and $718 for the six months ended December 31, 2016 and 2017, respectively.

Future amortization expense for acquired intangible assets is as follows, as of December 31, 2017: