

Paycom Software, Inc.  
Form 10-K  
February 14, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 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: 001-36393

Paycom Software, Inc.

(Exact name of registrant as specified in its charter)

Delaware 80-0957485  
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification Number)

7501 W. Memorial Road

Edgar Filing: Paycom Software, Inc. - Form 10-K

Oklahoma City, Oklahoma 73142

(Address of registrant's principal executive offices)

Registrant's telephone number, including area code: (405) 722-6900

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

Title of each class	Name of each exchange on which registered
Common Stock, \$0.01 par value	New York Stock Exchange

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

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 a 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" and "smaller reporting 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. [ ]

Edgar Filing: Paycom Software, Inc. - Form 10-K

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

As of February 5, 2018, 59,182,715 shares of the registrant's common stock, \$0.01 par value per share, were outstanding, including 1,381,416 shares of restricted stock. The aggregate market value of voting stock held by non-affiliates of the registrant, as of June 30, 2017, the last day of registrant's most recently completed second fiscal quarter, was approximately \$3.3 billion (based on the closing price for shares of the registrant's common stock as reported by the New York Stock Exchange on that date).

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement on Schedule 14A to be furnished to stockholders in connection with its 2018 Annual Meeting of Stockholders are incorporated by reference in Part III, Items 10-14 of this Annual Report on Form 10-K.

---

PAYCOM SOFTWARE, INC.

2017 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

	Page No.
PART I	
Item 1. <u>Business</u>	1
Item 1A. <u>Risk Factors</u>	11
Item 1B. <u>Unresolved Staff Comments</u>	22
Item 2. <u>Properties</u>	22
Item 3. <u>Legal Proceedings</u>	22
Item 4. <u>Mine Safety Disclosures</u>	22
PART II	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities</u>	23
Item 6. <u>Selected Financial Data</u>	25
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	39
Item 8. <u>Financial Statements and Supplementary Data</u>	40
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	62
Item 9A. <u>Controls and Procedures</u>	62
PART III	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	64
Item 11. <u>Executive Compensation</u>	64
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	64
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	64

Item 14. <u>Principal Accounting Fees and Services</u>	64
PART IV	
Item 15. <u>Exhibits, Financial Statement Schedules</u>	65
<u>Signatures</u>	70

---

## PART I

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Form 10-K”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Forward-looking statements are any statements that look to future events and include, but are not limited to, statements regarding our business strategy; anticipated future operating results and operating expenses, cash flows, capital resources, dividends and liquidity; trends, opportunities and risks affecting our business, industry and financial results; future expansion or growth plans and potential for future growth; our ability to attract new clients to purchase our solution; our ability to retain clients and induce them to purchase additional applications; our ability to accurately forecast future revenues and appropriately plan our expenses; market acceptance of our solution and applications; our expectations regarding future revenues generated by certain applications, including Enhanced ACA; continued acceptance of Software-as-a-Service (“SaaS”) as an effective method for delivering human capital management (“HCM”) solutions and other business management applications; our ability to attract and retain qualified employees and key personnel; future regulatory, judicial and legislative changes; how certain factors affecting our performance correlate to improvement or deterioration in the labor market; our plan to open additional sales offices and our ability to effectively execute such plan; the sufficiency of our existing cash and cash equivalents to meet our working capital and capital expenditure needs over the next 12 months; our ability to expand our corporate headquarters within an expected timeframe; our plans regarding our capital expenditures and investment activity as our business grows, including with respect to research and development; the expected impact on our consolidated financial statements of new accounting pronouncements; the expected impact of the Tax Cuts and Jobs Act of 2017; and our plans to repurchase shares of our common stock through a stock repurchase plan. In addition, forward-looking statements also consist of statements involving trend analyses and statements including such words as “anticipate,” “believe,” “could,” “expect,” “may,” “might,” “plan,” “would,” and similar expressions or the negative of such terms or other comparable terminology. These forward-looking statements speak only as of the date of this Form 10-K and are subject to business and economic risks. As such, our actual results could differ materially from those set forth in the forward-looking statements as a result of the factors set forth below in Part I, Item 1A, “Risk Factors,” and in our other reports filed with the Securities and Exchange Commission (the “SEC”). We do not undertake any obligation to update or revise the forward-looking statements to reflect events that occur or circumstances that exist after the date on which such statements were made, except to the extent required by law.

#### Item 1. Business

Unless we state otherwise or the context otherwise requires, the terms “Paycom,” “we,” “us,” “our” and the “Company” refer to Paycom Software, Inc., a Delaware corporation, and its consolidated subsidiaries.

#### Overview

We are a leading provider of a comprehensive, cloud-based HCM software solution delivered as SaaS. We provide functionality and data analytics that businesses need to manage the complete employment life cycle from recruitment to retirement. Our solution requires virtually no customization and is based on a core system of record maintained in a single database for all HCM functions, including talent acquisition, time and labor management, payroll, talent management and human resources (“HR”) management applications. Our user-friendly software allows for easy adoption of our solution by employees, enabling self-management of their HCM activities in the cloud, which reduces the administrative burden on employers and increases employee productivity.

Organizations need sophisticated, flexible and intuitive applications that can quickly adapt to their evolving HCM requirements, streamline their HR processes and systems and enable them to control costs. We believe that the HCM needs of most organizations are currently served either by multiple providers in an attempt to replicate a comprehensive SaaS product or, to a lesser extent, by legacy providers offering outdated on-premise products. These approaches often result in challenges with system integration and data integrity, low scalability, high costs, extended delivery times and large up-front capital requirements.

Because our solution was developed in-house and is based on a single platform, there is no need to integrate, update or access multiple databases, which are common issues with competitor offerings that use multiple third-party systems in order to link together their HCM offerings. Additionally, our solution maintains data integrity for accurate, actionable and real-time analytics and business intelligence and helps clients minimize the risk of compliance errors due to inaccurate or missing information. We deliver feature-rich applications while maintaining excellence in information security and quality management standards as evidenced by our International Organization for Standardization (“ISO”) certifications.

We sell our solution directly through our internally trained, client-focused and highly skilled sales force based in offices across the United States. As a part of our client retention effort, a specialist within a dedicated team is assigned to each client to provide industry-leading, personalized service. We have over 20,000 clients, none of which constituted more than one-half of one percent of our revenues for the year ended December 31, 2017. We believe that as a result of our focus on client retention, we enjoy high client satisfaction as evidenced by an annual revenue retention rate of 91% from existing clients for each of the three years ended December 31, 2017, 2016 and 2015. We believe our revenue retention rate understates our client loyalty because this rate also includes former clients that were acquired or otherwise ceased operations.

We were founded in 1998. Since our founding, we have focused on providing an innovative SaaS HCM solution. As of December 31, 2017, we had 2,548 employees across the United States. For the years ended December 31, 2017, 2016 and 2015, our revenues were \$433.0 million, \$329.1 million and \$224.7 million, respectively, representing year-over-year growth in revenues of approximately 32% and 47%, respectively. We currently derive the majority of our revenues from payroll processing. We are able to determine revenues from payroll processing because all of our clients are required to utilize our payroll application in order to access our other applications. We generally do not separately track our revenues across our other applications because we often sell applications in various groupings and configurations for a single price. We realized net income of \$66.8 million, \$43.8 million and \$20.9 million for the years ended December 31, 2017, 2016 and 2015, respectively.

### The Paycom Solution

We offer an end-to-end SaaS HCM solution that provides our clients and their employees with immediate access to accurate and secure information and analytics at any time from any location where internet is available. We believe that our solution delivers the following benefits:

#### Comprehensive HCM Solution

Our solution offers functionality that manages the entire employment life cycle for employers and employees, from recruitment to retirement. Our user-friendly applications streamline client processes and provide clients and their employees with the ability to directly access and manage administrative processes, including applications that identify candidates, on-board employees, manage time and labor, administer payroll deductions and benefits, manage performance, terminate employees and administer post-termination health benefits such as COBRA. The widespread employee usage of our applications helps further integrate our solution into the administrative processes of our clients. Our solution also has the advantage of being built in-house by our highly trained and skilled team of software developers, thereby minimizing data integrity issues across applications.

#### Core System of Record

Our solution is based on a core system of record that contains payroll and HR information in one convenient database, thereby reducing costs and eliminating the need for multiple software products and vendors and the maintenance of employee data in numerous databases. This core system of record enables our clients to input employee data one time and enjoy seamless functionality across our applications. When a revision is made to the file of an employee, all appropriate personnel have access to the change in real time. In addition, our core system of record helps clients minimize the risk of compliance errors due to inaccurate or missing information that results from maintaining multiple databases. Through accurate tracking and management of employee payroll and other HR data, such information can be compiled for comprehensive and consistent reporting for our clients.

#### Data Analytics and Business Intelligence

Our solution's core system of record allows clients to strategically analyze comprehensive and accurate employee information to make informed business decisions based upon actionable, real-time analytics provided through our client dashboard. This functionality helps our clients operate with a more complete and accurate picture of their organization, as our solution's embedded analytics capture the content and context of everyday business events, facilitating fast and informed decision-making from any location. These tools help clients reduce administrative and operational costs and better manage talent.



### Enhanced Employee Experience

The employees of our clients also benefit from our HCM applications. As workforces transition from technology-savvy to technology-dependent, employees expect mobile technology and the resources necessary to readily access information and control their professional development. Through our employee self-service technology, employees can view real-time HR information, including pay stubs, W-2s and benefits information, as well as manage their schedules and vacation time and update W-4 contact information. Our mobile apps – available on both the App Store and Google Play – make it easier for employees to access their self-service information. Our apps have fingerprint and facial recognition capabilities, aiding employers in their efforts to engage technology-savvy workers. Our system also allows employers to engage their workforce through learning management courses and training paths, surveys and performance goals and reviews.

### Personalized Support Provided by Trained Personnel

Our applications are supported by one-on-one personal assistance from trained specialists. Service specialists are assigned to specific clients and are trained across all of our applications, ensuring they provide comprehensive, expert-level service. Our client service is ISO 9001:2008 certified on the basis of its quality and consistency. We strive to provide our clients with high levels of service and support to ensure their continued use of our solution for all of their HCM needs. We have maintained high client satisfaction, as evidenced by an annual revenue retention rate of 91% from existing clients for each of the three years ended December 31, 2017, 2016 and 2015.

### Software-as-a-Service Delivery Model

Our SaaS delivery model allows clients with geographically dispersed and mobile workforces to operate more efficiently, and allows these clients to implement, access and use our client-oriented internet solution on demand and remotely through standard web browsers, smart phones, tablets and other web-enabled devices. Our SaaS solution reduces the time, risk, headcount and costs associated with installing and maintaining applications for on-premise products within the information technology (“IT”) infrastructure of our clients.

### Secure Cloud-Based Architecture

Our cloud-based architecture allows our solution to be implemented remotely with minimal client interaction. Updates such as software enhancements and newly developed applications can be deployed without client interaction, disruption or involvement, allowing our clients to make a smaller investment in hardware, personnel, implementation time and consulting. Additionally, we own and maintain all of the infrastructure technology to host our solution and to maximize system availability for clients. Our focus and investment in technology and data security has been recognized with ISO/IEC 27001:2013 certified security standards that provide our clients with a “best-in-class” level of data security.

### Scalability to Grow with our Clients

Our solution is highly scalable. We serve a diversified client base ranging in size from one employee to many thousands of employees, although our target client size range is 50 to 2,000 employees. We calculate the number of clients’ employees based on parent company grouping. Our clients are able to use the same solution while their businesses grow by deploying applications as-needed in real-time. Pricing is determined by employee headcount and the number of applications utilized, enabling our clients to align HCM spending with their evolving HCM needs as compared to traditional HCM products that require clients to migrate to new software as they grow but retain fixed costs even if the client shrinks in size.

### Efficient and Productive Research and Development

We believe that we benefit from a competitive advantage with our research and development investments, people and processes. Early investments in our proprietary, cloud-based architecture enable us to develop and deploy applications in a timely and cost-effective manner. We have also chosen to base our research and development team in Oklahoma and Texas, which we believe provides us with high-quality talent at a lower cost compared to other locations in the United States where there is more competition for technology talent. These strategic decisions have enabled us to have a highly productive research and development function.

### Our Strategy for Growth

Our strategy is to continue to establish our solution as the HCM industry standard by increasing our presence in existing markets and expanding into additional markets. We intend to open 10 to 14 new sales offices over the next two years as well as potentially expand over the longer term into international markets. We will also execute our strategy for growth by targeting larger clients, as well as strengthening and extending our solution.

### Increase Our Presence in Existing Markets

We believe a significant market opportunity exists to increase our presence within markets where we currently have a sales office. Each sales office is typically staffed with one sales team, with each team comprised of a sales manager and approximately six to eight other sales professionals. Although we have a sales office in 35 of the 50 largest metropolitan statistical areas (“MSAs”) in the United States based on July 2016 U.S. Census Bureau estimates, only five of these MSAs are currently served by multiple Paycom sales teams. In addition to expanding into new markets, we plan to further penetrate and more effectively capture existing markets by adding sales offices and increasing the number of sales teams in such markets. Since our initial public offering (“IPO”) in April 2014, we have expanded our presence within three MSAs that were already served by at least one Paycom sales team by opening new sales offices in Brooklyn, Chicago, Long Island and Pasadena.

#### Expand Into Additional Markets

We plan to continue expanding our sales capability by opening sales offices in certain metropolitan areas where we currently have no sales teams. Since our IPO in April 2014, we have expanded into eleven new markets by opening new sales offices in Cincinnati, Cleveland, Kansas City, Milwaukee, Nashville, Pittsburgh, Richmond, Sacramento, Salt Lake City, San Antonio, and Stamford.

We have historically selected new locations based on potential client and employee demographics as well as business density. When opening a new sales office, we typically relocate a proven sales manager from an existing territory who then recruits a team of high performing sales representatives. It typically takes a new sales office 24 months to reach maturity.

### Enlarge our Existing Client Relationships

We dedicate our resources to helping our clients facilitate their goals, whether through helping them execute better hiring decisions, manage compensation more effectively or simply operate more efficiently. We believe a significant growth opportunity exists in selling additional applications to our current clients. Many clients have subsequently deployed additional applications as they recognize the benefits of our comprehensive solution. As we extend and enhance the functionality of our solution, we will continue to invest in initiatives to increase the adoption of our solution and maintain our high levels of client satisfaction.

### Target Larger Clients

The average size of our clients has grown significantly as we have organically grown our operations and increased the number of applications we offer. Based on our total revenues, we have grown at an approximately 42% CAGR from January 1, 2013 through December 31, 2017. Our solution requires no adjustment to serve larger clients. We believe larger employers represent a substantial opportunity to increase the number of clients and to increase our revenues per client, with limited incremental cost to us. To further capitalize on this opportunity, we intend to continue targeting larger businesses opportunistically where our current sales model is effective.

### Maintain Our Leadership in Innovation by Strengthening and Extending our Solution

Our ability to develop and deploy new applications and updates rapidly and cost-effectively has been integral to the results that we have achieved to date. We intend to continue extending the functionality and range of our solution in the future. Our development efforts are performed exclusively in-house and are heavily based upon proactive research and client input. We are focusing our investments on the development of new applications, enhancements and learning courses that are responsive to the needs of our clients, which are garnered through ongoing client interaction and collaboration.

### Our Applications

Our HCM solution offers a full suite of applications that generally fall within the following categories: talent acquisition, time and labor management, payroll, talent management and HR management.

#### Talent Acquisition

**Applicant Tracking.** Our applicant tracking application simplifies the recruiting processes needed to hire the most qualified employees. By using our all-in-one system, our clients can move candidates from the application process through new employee on-boarding without re-keying data.

**Candidate Tracker.** Our candidate tracker application enables recruiters to track and stay connected to potential talent through an online database of top candidates. This application helps clients fill future positions faster without the cost of professional recruiting firms.

**Background Checks.** Our background check application helps to ensure that prospective new hires are qualified candidates. We provide clients with the tools for authorizing background checks, creating pre-adverse and adverse action letters and securely store results as required by the Fair Credit Reporting Act.

**On-Boarding.** Our on-boarding application streamlines the hiring and termination processes for employees of our clients by creating online checklists of tasks to be assigned to an employee or group of employees.

**E-Verify ®.** Our E-Verify ® application automates employment verification and reduces our clients' exposure to audits and penalties that could result from I-9 violations.

**Tax Credit Services.** Our tax credit services application helps employers process and calculate the available federal tax credits associated with hiring employees who meet various qualifications.

4

---

## Time and Labor Management

**Time and Attendance.** Our time and attendance application allows our clients to accurately and efficiently manage when, where and how employees report their hours worked. Clients can apply customized rules, use batch editing and use timecard management tools to manage complex time and attendance needs. Our Web Time Clock feature allows employees to clock in and out online, which automatically updates the payroll application when approved, eliminating the need to manually calculate timesheets and re-key information into payroll systems. We also offer several different types of hardware that are ideal for single or multi-terminal environments.

**Scheduling/Schedule Exchange.** Our scheduling application helps managers with employee scheduling through automated functionality that provides for a seamless workflow with the payroll and time and attendance applications. Our schedule exchange application allows employees and managers access to their schedules at any time and employees can approve, decline or swap their schedules and see what shifts are available for pickup.

**Time-Off Requests.** Our time-off requests application automates and standardizes the time-off request procedure and helps employers remain effectively staffed. Managers can view an online time-off calendar to easily monitor and approve or deny time-off requests. Our employee self-service tool allows employees to view the time-off they have available, submit requests and view blackout dates, the status of requests and any manager comments.

**Labor Allocation.** Our labor allocation application simplifies the process of setting up and tracking employee hours based on the job the employee is working.

**Labor Management Reports/Push Reporting.** Our labor management reports application provides clients with access to up-to-the-minute reports on the information they need to better manage their labor force, such as overtime and labor distribution. Our push reporting application also gives clients the ability to set up recurring reports and to schedule them to be run automatically and sent to users on a daily, weekly, monthly, quarterly or yearly basis.

**Geofencing/Geotracking.** Enhancing our time and attendance solution, Paycom's geofencing and geotracking location-based technology assist our clients in managing the whereabouts of employees while on the job. Geofencing allows employers to establish geographical boundaries within which their employees are authorized to clock in and out when using our Web Time Clock on smartphones, tablets or other electronic devices. Once enabled, this time-theft-combatting tool supersedes IP address restrictions, meaning the system first checks for authorized geographical locations, rather than authorized IP addresses. In addition, the geotracking tool empowers clients to track employees' geographical locations upon clocking in and out. The coordinates collected by the application can be entered into and viewed on a Google® display map.

## Payroll

**Payroll and Tax Management.** Our payroll application is the foundation of our solution and all of our clients are required to utilize this application in order to access our other applications. Our payroll application is automatically updated with changes in employee information and offers other time saving functionality such as batch editing and effective dating. Enhanced payroll grid functionality allows clients to automate and delegate payroll functions to accelerate the processes and build additional controls. The application can be accessed at any time to make changes, run payroll and generate custom reports. We also help our clients by handling their payroll taxes and deposits, regulatory correspondence and amendments as well as assisting with penalty and interest disputes.

**Paycom Pay.** Our Paycom Pay application eliminates the tedious job of check reconciliation by issuing checks to our clients' employees that clear from a Paycom bank account, which helps clients eliminate potential liability and simplifies the reconciliation process.

**Expense Management.** Our expense management application eliminates the manual, paper-based processes associated with employee expense reimbursement and allows employers to control and monitor expenses by setting clearly defined rules and parameters for employee reimbursement. Employees can upload receipts when submitting their expenses and access an expense dashboard where they can view the status of their submitted expenses. Our native mobile app includes mileage tracker capability, allowing employers to more accurately track and manage employees' mileage reimbursements that are then automatically updated within our expense management application.

**Garnishment Management.** Our garnishment management application allows clients to handle communications with garnishment payees and agencies and to calculate and track garnishment payments.

**GL Concierge.** Our GL Concierge application offers organizations more control and transparency into their payroll general ledger and gives finance professionals intuitive reporting, enriched audit trails, customizable file layouts and real-time alerts. Clients of all sizes can utilize a wide variety of general ledger maps along with an action-item alert system that improves the dynamics of their daily operations.

## Talent Management

**Employee Self-Service.** Our employee self-service application improves employee engagement by empowering employees to self-manage certain transactions, obtain quick answers to frequent payroll and HR questions, access their pay history and view performance goals and reviews and total compensation reports to review their compensation and benefits package. Benefits information and paid time-off accruals also give employees the ability to make informed decisions regarding their benefit selections and time-off requests.

**Compensation Budgeting.** Our compensation budgeting application provides compensation and performance information in one system, providing clients valuable workforce insight to help manage and formulate salary budgets and establish merit-based compensation increases.

**Performance Management.** Our performance management application allows employees to set standardized pay grades and performance goals for positions across an organization. It also helps streamline the performance review process with online facilitation of the review process.

Executive Dashboard. Our executive dashboard offers powerful workforce insight for executives to access information on demand in a variety of report formats. Because we offer an all-in-one solution in a single database, the comprehensive report data provides the workforce intelligence needed to drive human capital decisions at an executive level.

Paycom Learning and Course Content. Our learning management application formalizes and standardizes our clients' training processes. Employers can create customized content utilizing videos, presentations, quizzes and surveys. It provides employees with "anytime, anywhere" access to a central knowledge base where the employee can access content, share expertise and measure his or her professional development progress. In addition to providing the ability to create and upload custom content, we created and launched our own proprietary eLearning content. Paycom Learning clients have immediate access to a library of Paycom-created learning courses, which allow employers to educate their managers and employees quickly and consistently on foundational topics such as workplace violence, discrimination and harassment prevention.

6

---



## HR Management

**Document and Task Management.** Our document and task management application is designed to manage employee files and allows employees to digitally sign and view company documents. We securely store client records to meet retention requirements and protect documents from unauthorized access and other disasters that can threaten businesses. In addition, clients can assign checklists to employees for the completion of certain tasks associated with processes such as on-boarding and off-boarding.

**Government and Compliance.** Our government and compliance application helps clients reduce exposure to violations, audits and penalties with respect to the employment laws impacting their business, such as the Family Medical Leave Act, Equal Employment Opportunity Commission and other state and federal regulations. A single database keeps our clients' employee data consistent and enhances reporting capabilities by providing better accuracy and real-time insight.

**Benefits Administration/Benefits to Carrier.** Our benefits administration application allows clients to customize benefit plan setup, deduction amounts, enrollment dates and new-hire waiting periods. Employers are provided census and reconciliation reports to ensure they do not overpay for benefits. Employers can also update deduction amounts for all employees or groups of employees at once and automatically updates all insurance carriers for any changes. This application also provides employees with online enrollment and helps educate them and drive informed enrollment decisions for greater employee satisfaction.

**COBRA Administration.** Our COBRA administration application protects employers from COBRA violations and the associated fines and penalties by automatically initiating compliance measures upon entry of qualifying events into the application. This application also tracks important dates, collects and remits premiums and reports on all COBRA activity.

**Personnel Action Forms.** Our personnel action forms application helps our clients reduce the amount of time and paperwork required with employee changes such as pay rate, position and title changes by allowing managers to complete and approve online personnel action forms.

**Surveys.** Our surveys application allows clients to create employee surveys to help identify and resolve workplace matters that otherwise may remain undisclosed. Clients can analyze results by the demographics of the workforce and compare how results change over time.

**Enhanced ACA.** Our Affordable Care Act ("ACA") application provides clients with access to a dashboard that tracks employee count, employee status, health care plan affordability and ACA periods all from one convenient location and enables Paycom to file IRS Forms 1094/1095-B or -C. Clients utilizing this application also have access to additional real-time compliance reports and alerts.

## Our Clients

We serve a diverse client base in terms of size and industry. We have over 20,000 clients, or approximately 11,000 clients based on parent company grouping, none of which constituted more than one-half of one percent of our revenues for the year ended December 31, 2017. We stored data for nearly 3.3 million persons employed by our clients during the year ended December 31, 2017.

Many small to mid-sized companies can typically make the decision to adopt our solution more quickly than larger companies, which we believe results in a shorter sales cycle and more closely corresponds to our target sales cycle of 30 to 90 days. As a result of the nature and size of our clientele, we maintain a diversified client base and very low revenue concentration among our clients. We believe, however, that larger employers represent a substantial opportunity to increase the number of clients and to increase our revenues per client with limited incremental cost. As we attract clients at the higher end of our target client size range, we may face longer sales cycles and less predictability in completing some of our sales.

#### Competition

The market for HCM solutions is rapidly evolving, highly competitive and subject to changing technology, shifting client needs and frequent introduction of new products and services. Our competitors range from small, regional firms to large, well-established international firms with multiple product offerings.

We compete with firms that provide HCM solutions by various means. Many providers continue to deliver legacy enterprise software, but as demand for greater flexibility and access to information grows, we believe there will be increased competition in the delivery of HCM cloud-based solutions by other SaaS providers. Our competitors offer HCM solutions that may overlap with one,

several or all categories of applications offered by our solution. Our talent acquisition and talent management applications compete primarily with Cornerstone OnDemand, Inc., Oracle Corporation, SAP SE and Workday, Inc. Our payroll applications, including payroll processing, compete primarily with Automatic Data Processing, Inc. (“ADP”), Ceridian HCM, Inc. (“Ceridian”), Concur Technologies, Inc., Intuit Inc., Paychex, Inc., Paylocity Holding Corporation and The Ultimate Software Group, Inc. Our HR management applications compete primarily with ADP, Ceridian, Oracle Corporation, Paychex, Inc., Paylocity Holding Corporation, SAP SE and Workday, Inc. Our time and labor management applications compete primarily with ADP, Ceridian, Kronos Incorporated, Paylocity Holding Corporation and The Ultimate Software Group, Inc. Our larger competitors compete with us across multiple segments. In addition, our HCM solution continues to face competition from in-house payroll and HR systems and departments as well as HR systems and software sold by third-party vendors.

Competition in the HCM solutions market is primarily based on service responsiveness, product quality and reputation, breadth of service, application offering and price. The importance of these factors depends on the size of the business. Price tends to be the most important factor of competition for smaller businesses with fewer employees, while the scope of features and customization is more important to larger businesses. Regardless of a company’s size, another important factor is the implementation experience, as all organizations are seeking a streamlined and simplified process.

#### Sales and Marketing

We sell our solution exclusively through our captive sales force, substantially all of whom have a four-year college degree. We typically recruit sales candidates who have sales experience in non-HCM industries or, with respect to candidates recruited directly from colleges and universities, who have demonstrated an aptitude for sales. Our sales force is comprised of inside sales and field sales personnel, who are organized geographically, and client relations representatives (“CRRs”), who sell additional applications to existing clients. As of the filing of this Form 10-K, we have 46 sales teams located in 26 states and plan to open additional sales offices to further expand our presence in the U.S. market.

We provide our sales force with an intensive six-week training course that includes at least one week of training at our headquarters in Oklahoma City. Our unique training program includes instruction in accounting, business metrics, application features and tax matters relevant to our target market and we believe it fosters loyalty and helps maintain our corporate culture. Our training continues for our sales force through weekly in-office strategy sessions and leadership development training. Executive sales representatives are also required to attend in-person quarterly conferences to share best practices and receive legal and business updates.

When a new client processes payroll with us for an entire month, or an existing client purchases and then utilizes a new application for one month, our sales representative or CRR receives a one-time commission based upon an estimate of future annual revenues from such client. Executive sales representatives receive a higher commission rate and base salary based upon both current year and life-to-date realized sales, respectively.

We generate client leads, accelerate sales opportunities and build brand awareness through our marketing programs that target senior finance and HR executives, technology professionals and senior business leaders of companies that perform HCM functions in-house or outsource these functions to one of our competitors. Our marketing programs include:

- Podcasts, webinars, white papers and infographics;

National and local television commercial campaigns, personalized direct mail campaigns, email campaigns, social and digital media campaigns, industry-specific advertising and tradeshow exhibiting; and Search engine marketing methods that include site optimization and pay-per-click searches.

In addition to managing client relationships, our CRRs are focused on expanding the number of applications our clients purchase from us by introducing them to additional applications. Our CRRs call upon select clients periodically and are paid a non-recurring commission on any additional sales they generate.

## Technology, Operations and Security

### Technology

Our multi-tenant architecture enables us to deliver our solution across our client base with a single instance of our solution, while securely partitioning access to our clients' respective application data. Because a single version of our solution is developed, supported and deployed across all of our clients, updates are delivered to all of our clients at the same time, making it easier to scale our solution as our number of clients and their respective employee headcounts increase.

We maintain multiple load-balanced internet lines serviced by multiple networks to provide our clients continuous access to our solution and their stored data. We back up our client data at regular intervals utilizing live replication, snapshots and cold archive methods of backup and manually monitor backup success and failure regularly. Our server cluster and database servers have redundant "hot swappable" disks to ensure continuous service in the event of a disk failure.

## Operations

We physically host our solution for our clients in two secure data center facilities located in Oklahoma and Texas. All of our critical systems are fully redundant and backed-up in real-time to these facilities. Physical security includes ID-oriented access control, alarm systems and manned 24-hour-a-day camera monitoring by our security guards. Server facilities also have environmental monitoring and extensive environmental controls such as heat and fire protection, moisture, temperature, and humidity sensors, backup power supply and exterior reinforced concrete walls.

## Security

We maintain a formal and comprehensive security program designed to ensure the confidentiality, integrity and availability of our clients' data. During the regular course of business, we receive client data through our online system that we in turn process, record and store following ISO/IEC 27001:2013 certified controls and procedures. All communications with our servers that might contain sensitive information are encrypted before they leave the network and our servers are configured to only allow high-grade encryption algorithms.

We strictly regulate and limit all access to servers and networks at each of our facilities. Local network access is restricted by our authenticated server, using access control lists and remote network access is restricted by a firewall, which provides no accessible route from external networks to systems within our local network. We also employ network and host intrusion detection and prevention sensors throughout our infrastructure, systems that monitor that infrastructure and alert our security department of cybersecurity issues, a system for managing and installing patches for unsecure third-party applications and highly restricted access to the internet for anyone who has access to client data. Our information security department regularly performs penetration testing and we retain a third-party penetration testing company to conduct penetration tests and periodic audits to identify and remediate any issues.

Our applications are secured using multiple libraries and secure coding practices. Our IT infrastructure is secured and monitored using a number of best practices and tools at multiple layers of the physical and logical network. This security is also continually monitored by our information security department. All of our operations employees work in either our Oklahoma or Texas locations and, with the exception of certain IT personnel, are not permitted to work remotely.

## Software Development

Our application development team works closely with our clients to enhance our existing application offerings and develop new applications. This process is led by experienced product managers who oversee the evolution of their respective applications within a focused timeframe of innovation and cultivation in order to deliver the well-developed applications and enhancements desired by our clients. Our product managers, many of whom are former HR executives, are proactive in their approach to assigning development requests based on research, trends and user feedback. A key element of our development process is the one-on-one personal interaction between clients and our CRRs, through whom our clients personally suggest new applications and features.

We develop our solution from the "ground up" with our internal development and engineering teams. Our development and engineering teams and our employees conceive new applications and enhancements, review requests, schedule development in order of priority and subsequently develop the applications or enhancements. Our new applications and enhancements are independently reviewed by the quality assurance team, in accordance with our software development process, before being fully implemented. Any enhancements to our applications are released on a monthly scheduled release date to coordinate the communication and release to our clients.

Capitalized software development expenses, which include compensation for employees directly associated with development projects, were \$15.8 million, \$8.8 million and \$4.3 million for the years ended December 31, 2017, 2016 and 2015, respectively.

#### Client Service

We are committed to providing industry-leading, client-centered service. For this reason, we assign each client a specialist within a dedicated team. This one-on-one service is a key part of our client service model and helps to ensure that we are delivering an industry-leading solution and maintaining high client satisfaction. The primary elements of our client service model include the following:

##### Streamlined Setup and On-Boarding

After electing to deploy our solution, a new client begins our on-boarding process with assistance from a team of new client setup specialists and the sales professional responsible for obtaining the client's business. In addition, we also have a team of transition specialists whose job it is to ensure that the process is performed smoothly, data is collected properly and all relevant employees are fully trained on the system. This team works closely with the client until the client is capable of managing our solution independently, at which time responsibility for the client relationship is transferred to our dedicated CRRs and service specialists. Unlike certain of our competitors, we do not outsource any of our on-boarding efforts.

### Dedicated Service Specialists

After completing the on-boarding process, each client is assigned to a services specialist within a dedicated team. Clients can then contact their dedicated services specialist or a team member if any issues or questions arise. These specialists provide personalized service with actual knowledge of the clients' business needs. When appropriate, client questions can be elevated to the specialists with the appropriate application, regulatory or tax expertise. In addition, our CRRs proactively contact our clients to ensure satisfaction with our solution and introduce additional applications.

### Expert Level Service

Our client specialists are trained across all of our applications to ensure that they can provide comprehensive, expert-level service. Our client service is ISO 9001:2008 certified and helps support a high client retention rate.

### Regulatory and Certifications

We are subject to varying degrees of regulations in each of the jurisdictions in which we provide services. Local laws and regulations, and their interpretation and enforcement, differ significantly among those jurisdictions. These regulations and laws cover, among others, information privacy.

Data privacy has become a significant issue in the United States and in other countries. The regulatory framework for privacy issues worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. Many federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations affecting or regarding the collection, use and disclosure of personal information. In the United States, these include, for example, rules and regulations promulgated under the authority of the Federal Trade Commission, the Health Insurance Portability and Accountability Act of 1996, the Family Medical Leave Act of 1993, the ACA and state breach notification laws.

We voluntarily obtain third-party security examinations relating to security and data privacy in accordance with Statement on Standards for Attestation Engagements ("SSAE"), No. 16, Reporting on Controls at a Service Organization. Our SSAE examination is conducted every six months by one of the four largest independent international auditing firms, and addresses, among other areas, our physical and environmental safeguards for production data centers, data availability and integrity procedures, change management procedures and logical security procedures.

In October 2016, we renewed a certification based on ISO/IEC 27001:2013 criteria, a security standard for Information Security Management Systems published by ISO covering our production, quality assurance and implementation environments. This independent assessment of our conformity to the ISO 27001 standard includes assessing security risks, designing and implementing comprehensive security controls and adopting an information security management process to meet security needs on an ongoing basis. The certification is valid until December 2019, with continuing assessments taking place annually.

In April 2017, we renewed a certification based on ISO 9001:2008 criteria, a standard for the implementation of quality management processes published by ISO, covering our activities required to create and deliver our solution. This independent assessment of our conformity to the ISO 9001:2008 standard includes assessing the design and implementation of quality objectives to meet delivery standards on an ongoing basis. The certification is valid until September 2018, with continuing assessments taking place annually.

## Intellectual Property

We rely on a combination of copyrights, trademarks, service marks, trade secret laws and contractual restrictions to establish and protect our intellectual property rights. We also have a number of registered and unregistered trademarks and will continue to evaluate the registration of additional trademarks as appropriate. We do not have any patents or patent applications pending.

## Seasonality

Our revenues are seasonal in nature. Recurring revenues include revenues relating to the annual processing of payroll forms, such as Form W-2 and Form 1099, and revenues from processing unscheduled payroll runs (such as bonuses) for our clients. Because payroll forms are typically processed in the first quarter of the year, first quarter revenues and margins are generally higher than in subsequent quarters. Further, beginning in the first quarter of 2016, we began generating additional revenues as a result of the enactment of the ACA, as many clients began complying with filing requirements for Forms 1094 and 1095. We anticipate that our revenues will continue to exhibit this seasonal pattern related to ACA form filings for so long as the ACA (or replacement legislation) includes employer reporting requirements. In addition, we often experience increased revenues during the fourth quarter due to unscheduled payroll runs for our clients that occur before the end of the year. Therefore, we expect the seasonality of our revenue cycle to decrease to the extent clients utilize more of our non-payroll applications.



## Employees

Our ability to recruit and retain qualified employees is critical to our continued success. We invest heavily in our training and leadership development programs to encourage the development and promotion of our employees. As of December 31, 2017, we employed 2,548 people. None of our employees were covered by collective bargaining agreements.

## Facilities

Our corporate headquarters is an approximately 250,000-square-foot campus located on over 30 acres of Company-owned property in Oklahoma City, Oklahoma. In addition to housing a fully redundant data center at our corporate headquarters, we operate another fully redundant data center at a leased property near Dallas, Texas. We also lease a disaster recovery site in downtown Oklahoma City.

We also lease offices in Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Tennessee, Texas, Utah, Virginia, Washington and Wisconsin. We believe that these facilities are suitable for our current operations and upon the expiration of the terms of the leases we believe we could renew these leases or find suitable space elsewhere on acceptable terms.

## Segment Information

We operate in a single operating segment and a single reporting segment. Operating segments are defined as components of an enterprise about which separate financial information is regularly evaluated by the chief operating decision maker function (which is fulfilled by our chief executive officer) in deciding how to allocate resources and in assessing performance. Our chief executive officer allocates resources and assesses performance based upon financial information at the consolidated level. Since we operate in one operating segment, all required financial segment information is presented in the consolidated financial statements.

## Available Information

Our internet address is [www.paycom.com](http://www.paycom.com) and our investor relations website is located at [investors.paycom.com](http://investors.paycom.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports can be found on our Investor Relations website, free of charge. These reports are also electronically filed with (or furnished to) the SEC. Information contained on our website is not incorporated by reference into this Form 10-K. The SEC maintains a public website, [www.sec.gov](http://www.sec.gov), which includes information about and the filings of issuers that file electronically with the SEC.

Additionally, the information that we file with the SEC may be read at the SEC's Public Reference Room at 100 F Street NE, Washington, DC 20549. Information about the SEC's Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

## Item 1A. Risk Factors

The risk factors noted in this section and other factors noted throughout this Form 10-K, including those risks identified in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," describe examples of risks, uncertainties and events that may cause our actual results to differ materially from those contained in any forward-looking statement. If one or more of these risks or uncertainties materialize, or if underlying

assumptions prove incorrect, actual outcomes may vary materially from those included in this Form 10-K.

Changes in laws, government regulations and policies could have a material adverse effect on our business and results of operations.

Many of our applications are designed to assist our clients in complying with government regulations that continually change. The introduction of new regulatory or licensing requirements, or new interpretations of existing laws or regulations, could increase our cost of doing business, and changing regulatory requirements may make the introduction of new applications and enhancements more costly or more time-consuming than we currently anticipate or could prevent the introduction of new applications and enhancements by us altogether. Changes in laws, regulations or policies could also affect the extent and type of benefits employers are required, or may choose, to provide employees or the amount and type of taxes employers and employees are required to pay. Such changes could reduce or eliminate the need for certain of our existing applications, which would result in decreased revenues. Further, we may spend time and money developing new applications and enhancements that, due to regulatory changes, become unnecessary prior to being released. In addition, any failure to educate and assist our clients with respect to new or revised legislation that impacts them could have an adverse effect on our reputation, and any failure to modify our applications or develop new applications in a timely fashion in response to regulatory changes could have an adverse effect on our business and results of operations.

In addition, the future success of our business depends upon the continued use of the internet as a primary medium for commerce, communication and business. Federal, state and foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting the use of the internet as a commercial medium. Changes in these laws or regulations could require us to modify our applications in order to comply with these changes. In addition, government agencies or private organizations may impose taxes, fees or other charges for accessing the internet or commerce conducted via the internet. These laws or charges could limit the growth of internet-related commerce or communications generally or could result in reductions in the demand for internet-based applications such as ours.

If our security measures are breached, or unauthorized access to our clients' or their employees' sensitive data is otherwise obtained, our solution may not be perceived as being secure, clients may reduce the use of or stop using our solution, our ability to attract new clients may be harmed and we may incur significant liabilities.

Our solution involves the collection, storage and transmission of clients' and their employees' confidential and proprietary information, including personal identifying information, as well as financial and payroll data. HCM software is often targeted in cyber-attacks, including computer viruses, worms, phishing attacks, malicious software programs and other information security breaches, which could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of our clients' sensitive data or otherwise disrupt our clients' or other third parties' business operations. If cybercriminals are able to circumvent our security measures, or if we are unable to detect an intrusion into our systems and contain such intrusion in a reasonable amount of time, our clients' sensitive data may be compromised.

Certain of our employees have access to sensitive information about our clients' employees. While we conduct background checks of our employees and limit access to systems and data, it is possible that one or more of these individuals may circumvent these controls, resulting in a security breach.

Although we have security measures in place to protect client information and prevent data loss and other security breaches, these measures could be breached as a result of third-party action, employee error, malfeasance or otherwise. Because the techniques used to obtain unauthorized access or to sabotage systems change frequently, we may not be able to anticipate these techniques and implement adequate preventative or protective measures. While we currently maintain a cyber liability insurance policy, cyber liability insurance may be inadequate or may not be available in the future on acceptable terms, or at all. In addition, our cyber liability insurance policy may not cover all claims made against us, and defending a suit, regardless of its merit, could be costly and divert management's attention from our business and operations.

Any actual or perceived breach of our security could damage our reputation, cause existing clients to discontinue the use of our solution, prevent us from attracting new clients, or subject us to third-party lawsuits, regulatory fines or other actions or liabilities, which could adversely affect our business, operating results or financial condition.

Any damage, failure or disruption of our SaaS network infrastructure or data centers could impair our ability to effectively provide our solution, harm our reputation and adversely affect our business.

Our SaaS network infrastructure is a critical part of our business operations. Our clients access our solution through standard web browsers, smart phones, tablets and other web-enabled devices and depend on us for fast and reliable access to our solution. We serve all of our clients from our two fully redundant data centers located in Oklahoma and Texas. Our SaaS network infrastructure and data centers are vulnerable to damage, failure and disruption.

In the future, we may experience issues with our computing and communications infrastructure or data centers caused by the following factors:

- human error;
- telecommunications failures or outages from third-party providers;
- computer viruses or cyber-attacks;
- break-ins or other security breaches;
- acts of terrorism, sabotage, intentional acts of vandalism or other misconduct;
- tornadoes, fires, earthquakes, hurricanes, floods and other natural disasters;
- power loss; and
  - other unforeseen interruptions or damages.

If our SaaS network infrastructure or our clients' ability to access our solution is interrupted, client and employee data from recent transactions may be permanently lost, and we could be exposed to significant claims by clients, particularly if the access interruption is associated with problems in the timely delivery of funds payable to employees. Further, any adverse changes in service

levels at our data centers resulting from damage to or failure of our data centers could result in disruptions in our services. Any significant instances of system downtime or performance problems at our data centers could negatively affect our reputation and ability to attract new clients, prevent us from gaining new or additional business from our current clients, or cause our current clients to terminate their use of our solution, which would adversely impact our revenues. In addition, if our network infrastructure and data centers fail to support increased capacity due to growth in our business, our clients may experience interruptions in the availability of our solution. This might reduce our revenues, cause us to issue refunds to clients or adversely affect our retention of existing clients, which could have a negative impact on our business, operating results or financial condition.

Privacy concerns and laws or other regulations may reduce the effectiveness of our applications.

Our applications are subject to various complex government laws and regulations on the federal, state and local levels, including those governing data privacy, which has become a significant issue globally. The regulatory framework for privacy issues is rapidly evolving and is likely to remain uncertain for the foreseeable future. Many federal, state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations regarding the collection, use and disclosure of personal information. In the United States, these include rules and regulations promulgated under the authority of the Federal Trade Commission, the Health Insurance Portability and Accountability Act of 1996, the Family Medical Leave Act of 1993, the ACA, federal and state labor and employment laws and state data breach notification laws. Failure to comply with such laws and regulations could result in the imposition of consent orders or civil and criminal penalties, including fines, which could damage our reputation and have an adverse effect on our results of operations or financial condition.

In addition to government regulation, privacy advocates and industry groups may propose new and different self-regulatory standards. Because the interpretation and application of privacy and data protection laws are still uncertain, it is possible that these laws may be interpreted and applied in a manner that is inconsistent with our existing data management practices or the features of our solution. Any failure to comply with government regulations that apply to our applications, including privacy and data protection laws, could subject us to liability. In addition to the possibility of fines, lawsuits and other claims, we could be required to fundamentally change our business activities and practices or modify our solution, which could have an adverse effect on our business, operating results or financial condition. Any inability to adequately address privacy concerns, even if unfounded, or comply with applicable privacy or data protection laws, regulations and policies, could result in additional cost and liability to us, damage our reputation, inhibit sales and adversely affect our business, operating results or financial condition.

Furthermore, privacy concerns may cause our clients' employees to resist providing the personal data necessary to allow our clients and their employees to use our applications effectively. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption of our applications in certain industries. All of these legislative and regulatory initiatives may adversely affect the ability of our clients to process, handle, store, use and transmit demographic and personal information from their employees, which could reduce demand for our applications.

The market in which we participate is highly competitive, and if we do not compete effectively, our business, operating results or financial condition could be adversely affected.

The market for HCM software is highly competitive, rapidly evolving and fragmented. We expect competition to intensify in the future with the introduction of new technologies and market entrants. Many of our current and potential competitors are larger and have greater brand name recognition, longer operating histories, more established relationships in the industry and significantly greater financial, technical and marketing resources than we do. As a result, some of these competitors may be able to:

- adapt more rapidly to new or emerging technologies and changes in client requirements;
- develop superior products or services, gain greater market acceptance and expand their product and service offerings more efficiently or rapidly;
- bundle products and services that we may not offer or in a manner that provides our competitors with a price advantage;
- take advantage of acquisition and other opportunities for expansion more readily;
- maintain a lower cost basis;
- adopt more aggressive pricing policies and devote greater resources to the promotion, marketing and sales of their products and services; and
- devote greater resources to the research and development of their products and services.

13

---

Some of our principal competitors offer their products or services at a lower price, which has resulted in pricing pressures. Similarly, some competitors offer different billing terms, which has resulted in pressures on our billing terms. If we are unable to maintain our pricing levels and our billing terms, our operating results would be negatively impacted. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses or the failure of our solution to maintain widespread market acceptance, any of which could adversely affect our business, operating results or financial condition.

We compete with firms that provide HCM solutions by various means. Many providers continue to deliver legacy enterprise software, but as demand for greater flexibility and access to information grows, we believe there will be increased competition in the delivery of HCM cloud-based solutions by other SaaS providers. Our competitors offer HCM solutions that overlap with one, several or all categories of applications that we offer. Our talent acquisition and talent management applications compete primarily with Cornerstone OnDemand, Inc., Oracle Corporation, SAP SE and Workday, Inc. Our payroll applications, including payroll processing, compete primarily with ADP, Ceridian, Concur Technologies, Inc., Intuit Inc., Paychex, Inc., Paylocity Holding Corporation and The Ultimate Software Group, Inc. Our HR management applications compete primarily with ADP, Ceridian, Oracle Corporation, Paychex, Inc., Paylocity Holding Corporation, SAP SE, and Workday, Inc. Our time and labor management applications compete primarily with ADP, Ceridian, Kronos Incorporated, Paylocity Holding Corporation and The Ultimate Software Group, Inc. Most of our larger competitors compete with us across multiple application categories. In addition, our HCM solution continues to face competition from in-house payroll and HR systems as well as HR systems and software sold by third-party vendors.

Competition in the HCM solutions market is primarily based on service responsiveness, application quality and reputation, breadth of service and product offering and price. Many of our competitors have established marketing relationships, access to larger client bases and major distribution agreements with consultants, software vendors and distributors. In addition, some competitors may offer software that addresses one or a limited number of HCM functions at a lower price point or with greater depth than our solution. Further, some potential clients, particularly large enterprises, may elect to develop their own internal solutions. If we are unable to compete effectively, our business, operating results or financial condition could be adversely affected.

Our financial results may fluctuate due to many factors, some of which may be beyond our control.

Our results of operations, including the levels of our revenues, costs of revenues, administrative expenses, operating income, cash flow and deferred revenue, may vary significantly in the future, and the results of any one period should not be relied upon as an indication of future performance. Fluctuations in our financial results may negatively impact the value of our common stock. Our financial results may fluctuate as a result of a variety of factors, many of which are outside of our control, and as a result, may not fully reflect the underlying performance of our business. Factors that may cause our financial results to fluctuate from period to period include, without limitation:

- our ability to attract new clients or sell additional applications to our existing clients;
- the number of new clients and their employees, as compared to the number of existing clients and their employees in a particular period;
- the mix of clients between small, mid-sized and large organizations;
- the extent to which we retain existing clients and the expansion or contraction of our relationships with them;
- the mix of applications sold during a period;
- changes in our pricing policies or those of our competitors;
- seasonal factors affecting payroll processing, demand for our applications or potential clients' purchasing decisions;
-

the amount and timing of operating expenses, including those related to the maintenance and expansion of our business, operations and infrastructure;

- the timing and success of new applications introduced by us and the timing of expenses related to the development of new applications and technologies;
- the timing and success of current and new competitive products and services by our competitors;
- economic conditions affecting our clients, including their ability to outsource HCM solutions and hire employees;
- changes in laws, regulations or policies affecting our clients' legal obligations and, as a result, demand for certain applications;
- changes in the competitive dynamics of our industry, including consolidation among competitors or clients;
- our ability to manage our existing business and future growth, including expenses related to our data centers and the expansion of such data centers and the addition of new offices;

14

---



- the effects and expenses of acquisition of third-party technologies or businesses and any potential future charges for impairment of goodwill resulting from those acquisitions;
- inclement weather or natural disasters, including but not limited to tornadoes, hurricanes, fires, earthquakes and floods;
- network outages or security breaches; and
- general economic, industry and market conditions.

Our business and operations are experiencing rapid growth and organizational change. If we fail to manage such growth and change effectively, we may be unable to execute our business plan, maintain high levels of service or adequately address competitive challenges.

We have experienced, and may continue to experience, rapid growth in our headcount and operations, which has placed, and may continue to place, significant demands on our management, operational and financial resources. For example, our headcount has grown from 523 employees as of December 31, 2011 to 2,548 employees as of December 31, 2017, and we have expanded from 20 sales teams as of December 31, 2011 to 46 sales teams as of the filing of this Form 10-K. We have also experienced significant growth in the number of clients and transactions and the amount of client and employee data that our infrastructure supports. Finally, our organizational structure and recording systems and procedures are becoming more complex as we improve our operational, financial and management controls. Our success will depend, in part, on our ability to manage this growth and organizational change effectively. To manage the expected growth of our headcount and operations, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. The failure to effectively manage growth could result in difficulties or delays in obtaining clients, selling additional applications to our clients, declines in quality or client satisfaction of our applications, increases in costs, difficulties in introducing new applications or other operational difficulties, any of which could adversely affect our business by impairing our ability to retain and attract clients or sell additional applications to our existing clients.

Further, we need to continue to expand our sales force and support team members in order to grow our client base and increase our revenues, but our ability to add additional offices may be constrained by the willingness and availability of qualified personnel to staff and manage any new offices and our success in recruiting and training sales personnel in those new offices. If our expansion efforts are unsuccessful, our business, operating results or financial condition could be adversely affected.

Our business, operating results or financial condition could be adversely affected if our clients are not satisfied with our deployment or technical support services, or if our solution fails to perform properly.

Our business depends on our ability to satisfy our clients, both with respect to our applications and the technical support provided to help our clients use the applications that address the needs of their businesses. We use our in-house deployment personnel to implement and configure our solution and provide support to our clients. If a client is not satisfied with the quality of our solution or the applications delivered or the support provided, we could incur additional costs to address the situation, our profitability might be negatively affected, and the client's dissatisfaction with our deployment service could damage our ability to sell additional applications to that client. In addition, our sales process is highly dependent on the reputation of our solution and applications and on positive recommendations from our existing clients. Our clients have no obligation to continue to use our applications, and may choose not to continue to use our applications at the same or higher level of service, if at all. In the past, some of our clients have elected not to continue to use our applications. Moreover, our clients generally have the right to cancel their agreements with us for any or no reason by providing 30 days' prior written notice. Any failure to maintain high-quality technical support, or a market perception that we do not maintain high-quality technical support, could adversely affect client retention, our reputation, our ability to sell our applications to existing and prospective clients,

and, as a result, our business, operating results or financial condition.

Further, our solution is inherently complex and may in the future contain, or develop, undetected defects or errors. Any defects in our applications could adversely affect our reputation, impair our ability to sell our applications in the future and result in significant costs to us. The costs incurred in correcting any application defects may be substantial and could adversely affect our business, operating results or financial condition. Any defects in functionality or that cause interruptions in the availability of our applications could result in:

- loss or delayed market acceptance and sales of our applications;
- termination of service agreements or loss of clients;
- credits or refunds to clients, including reimbursements for any fees or penalties assessed by regulatory agencies;
- breach of contract, breach of warranty or indemnification claims against us, which may result in litigation;
- diversion of development and service resources; and
- injury to our reputation.

15

---

Because of the large amount of data that we collect and manage, it is possible that hardware failures or errors in our applications could result in data loss or corruption or cause the information that we collect to be incomplete or contain inaccuracies that our clients regard as significant. Our clients might assert claims against us in the future alleging that they suffered damages due to a defect, error, or other failure of our solution. Our errors and omissions insurance may be inadequate or may not be available in the future on acceptable terms, or at all. In addition, our policy may not cover all claims made against us, and defending a suit, regardless of its merit, could be costly and divert management's attention. Any failures in the performance of our solution could harm our reputation and our ability to retain existing clients and attract new clients, which would have an adverse impact on our business, operating results or financial condition.

If we are not able to develop enhancements and new applications, keep pace with technological developments or respond to future disruptive technologies, we might not remain competitive and our business could be adversely affected.

Our continued success will depend on our ability to adapt and innovate. In order to attract new clients and increase revenues from existing clients, we need to enhance, add new features to and improve our existing applications and introduce new applications. The success of any enhancements or new features and applications depends on several factors, including timely completion, introduction and market acceptance. We may expend significant time and resources developing and pursuing sales of a particular enhancement or application that may not result in revenues in the anticipated time frame or at all, or may not result in revenue growth sufficient to offset increased expenses. Further, changing legal and regulatory requirements may delay the development or introduction of enhancements or new applications or render certain of our applications obsolete. If we are unable to successfully develop enhancements, new features or new applications to meet client needs, our business and operating results could be adversely affected.

In addition, because our applications are designed to operate on a variety of network, hardware and software platforms using internet tools and protocols, we will need to continuously modify and enhance our applications to keep pace with changes in internet-related hardware, software, communication, browser and database technologies. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments, our current and future applications may become less marketable and less competitive or even obsolete.

Our success is also subject to the risk of future disruptive technologies. If new technologies emerge that are able to deliver HCM solutions at lower prices, more efficiently or more conveniently, such technologies could adversely impact our ability to compete.

The market for our solution among large companies may be limited if these companies demand customized features and functions that we do not offer.

Prospective clients, especially larger companies, may require customized features and functions unique to their business processes that we do not offer. In order to ensure we meet these requirements, we may devote a significant amount of support and service resources to larger prospective clients, increasing the cost and time required to complete sales with no guarantee that these prospective clients will adopt our solution. Further, we may not be successful in implementing any customized features or functions. If prospective clients require customized features or functions that we do not offer, or that would be difficult for them to deploy themselves, the market for our solution will be more limited and our business could be adversely affected.

We are dependent on the continued service of our key executives and, if we fail to retain such key executives, our business could be adversely affected.

We believe that our success depends in part on the continued services of our senior management team, consisting of Chad Richison, Craig E. Boelte, Jeffrey D. York and Stacey Pezold. Our business could be adversely affected if we fail to retain these key executives. Although the employment arrangements with each of our key executives contain non-competition restrictions, our business could nonetheless be adversely affected if a key executive leaves Paycom and attempts to compete with us. In addition, we have not purchased key person life insurance on any members of our senior management team.

If we are unable to attract and retain qualified personnel, including software developers and skilled IT, sales and marketing personnel, our ability to develop and market new and existing products and, in turn, increase our revenue and profitability could be adversely affected.

Our future success is dependent on our ability to continue to enhance and introduce new applications. As a result, we are heavily dependent on our ability to attract and retain qualified software developers and IT personnel with the requisite education, background and industry experience. In addition, to continue to execute our growth strategy, we must also attract and retain qualified sales, marketing and operational personnel capable of supporting a larger and more diverse client base. The software industry is characterized by a high level of employee mobility and aggressive recruiting among competitors. This competition for qualified personnel may be amplified by new immigration laws or policies that could limit software companies' ability to recruit internationally. Although such changes in immigration laws or policies would not have a significant direct impact on our workforce, the ensuing increase in demand for software developers and IT personnel could impair our ability to attract or retain skilled employees and/or significantly increase our costs to do so. Furthermore, identifying and recruiting qualified personnel and training them in the use of our

applications requires significant time, expense and attention, and it can take a substantial amount of time before our employees are fully trained and productive. The loss of the services of a significant number of employees could be disruptive to our development efforts, which may adversely affect our business by causing us to lose clients, increase operating expenses or divert management's attention to recruit replacements for the departed employees.

Certain of our operating results and financial metrics may be difficult to predict as a result of seasonality.

We have historically experienced seasonality in our revenues because a significant portion of our recurring revenues relate to the annual processing of payroll forms such as Form W-2 and Form 1099 and, beginning in 2016, the annual processing and filing of ACA-related forms. Because these forms are typically processed in the first quarter of the year, first quarter revenues are generally higher than subsequent quarters. In addition, unscheduled payroll runs at the end of the year (such as bonuses) often result in increased revenues in the fourth quarter. We expect this seasonality to continue in the future, although the repeal or modification of the ACA could have an impact on the seasonality of our revenues. Nonetheless, the seasonal fluctuations in certain of our operating results and financial metrics may make such results and metrics difficult to predict.

The modification or repeal of certain provisions of the ACA could have an adverse effect on our business, financial condition and results of operations.

We generate ACA-related revenues (i) on an annual basis in connection with processing and filing Forms 1094 and 1095 on behalf of clients and (ii) from clients who have purchased our Enhanced ACA application as part of the fixed, bundled price charged per billing period. On January 20, 2017, President Donald J. Trump issued an executive order stating that it is the policy of the new administration to seek the prompt repeal of the ACA. Despite multiple efforts, Congress was unable to pass legislation significantly repealing or replacing the ACA in 2017, but many uncertainties remain regarding its future. The Trump Administration took additional action in October 2017 that may weaken the ACA's public health insurance marketplace, and the Tax Cuts and Jobs Act of 2017, enacted December 22, 2017, eliminates the ACA's individual mandate penalty beginning January 1, 2019. Both events suggest additional action to further weaken, repeal or replace the ACA may occur. The modification or repeal of certain provisions of the ACA could harm our business, operating results and financial condition. If the ACA is modified to eliminate the employer reporting requirements, or if the ACA is repealed and replaced with new legislation that does not include similar employer reporting requirements, we will no longer generate revenues in connection with processing and filing Forms 1094 and 1095 on behalf of clients. While we generally do not track our revenues on an application-by-application basis (because applications are often sold in various groupings and configurations for a single price), we estimate that, if the ACA is not modified or repealed, revenues from our Enhanced ACA application and ACA forms filings business will represent approximately 5% of total projected revenues for the year ending December 31, 2018. Further, uncertainty regarding the potential future modification, repeal or replacement of the ACA could adversely affect our ability to sell our Enhanced ACA application to new clients.

If we fail to adequately protect our proprietary rights, our competitive advantage could be impaired and we may lose valuable assets, generate reduced revenues or incur costly litigation to protect our rights.

Our success is dependent in part upon our intellectual property. We rely on a combination of copyrights, trademarks, service marks, trade secret laws and contractual restrictions to establish and to protect our intellectual property rights. However, the steps we take to protect our intellectual property may be inadequate. We will not be able to protect our intellectual property if we are unable to enforce our rights or if we do not detect unauthorized use of our intellectual property. Despite our precautions, it may be possible for unauthorized third parties to copy our applications and use information that we regard as proprietary to create products or services that compete with ours.

We may be required to spend significant resources to monitor and protect our intellectual property. We have been involved in litigation in the past and litigation may be necessary in the future to protect and enforce our intellectual property rights and to protect our trade secrets. Such litigation could be costly, time-consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property rights. We may not be able to secure, protect and enforce our intellectual property rights or control access to, and the distribution of, our solution and proprietary information, which could affect our business.

We may be sued by third parties for alleged infringement of their proprietary rights.

Considerable intellectual property development activity exists in our industry, and we expect that software developers will increasingly be subject to infringement claims as the number of applications and competitors grows and the functionality of applications in different industry segments overlaps. Our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property in technology areas relating to our solution or applications. In addition, we may increasingly be subject to trademark infringement claims as our presence grows in the marketplace. From time to time, third parties have asserted and may in the future assert that we are infringing on their intellectual property rights, and we may be found to be infringing upon such rights. A claim of infringement may also be made relating to technology that we acquire or license from third parties. However, we may be unaware of the intellectual property rights of others that may cover, or may be alleged to cover, some or all of our solution, applications or brands.

The outcome of litigation is inherently unpredictable and, as a result, any future litigation or claim of infringement could (i) cause us to enter into an unfavorable royalty or license agreement, pay ongoing royalties or require that we comply with other unfavorable terms, (ii) require us to discontinue the sale of our solution or applications, (iii) require us to indemnify our clients or third-party service providers or (iv) require us to expend additional development resources to redesign our solution or applications. Any of these outcomes could harm our business. Even if we were to prevail, any litigation regarding our intellectual property could be costly and time consuming and divert the attention of our management and key personnel from our business and operations.

The use of open source software in our applications may expose us to additional risks and harm our intellectual property rights.

Some of our applications use software covered by open source licenses. From time to time, there have been claims challenging the ownership of open source software against companies that incorporate such software into their products or applications. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Litigation could be costly for us to defend, have a negative effect on our operating results and financial condition or require us to devote additional development resources to change our applications. In addition, if we were to combine our applications with open source software in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our applications. If we inappropriately use open source software, we may be required to redesign our applications, discontinue the sale of our applications or take other remedial actions, which could adversely impact our business, operating results or financial condition.

We employ third-party licensed software for use in our applications and the inability to maintain these licenses or errors in the software we license could result in increased costs or reduced service levels, which could adversely affect our business.

Our applications incorporate certain third-party software obtained under licenses from other companies. We anticipate that we will continue to rely on such third-party software and development tools from third parties in the future. Although we believe that there are commercially reasonable alternatives to the third-party software we currently license, this may not always be the case, or it may be difficult or costly to replace. In addition, incorporating the software used in our applications with new third-party software may require significant work and substantial investment of our time and resources. Also, to the extent that our applications depend upon the successful operation of third-party software in conjunction with our software, any undetected errors or defects in this third-party software could prevent the deployment or impair the functionality of our applications, delay new application introductions, result in a failure of our applications and harm our reputation.

The failure to develop and maintain our brand cost-effectively could have an adverse effect on our business.

We believe that developing and maintaining widespread awareness of our brand in a cost-effective manner is critical to achieving the widespread acceptance of our solution and is an important element in attracting new clients and retaining existing clients. Successful promotion of our brand depends largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful applications at competitive prices. Brand promotion activities may not yield increased revenues, and even if they do, any increased revenues may not offset the expenses incurred in building our brand. If we fail to successfully promote and maintain our brand, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, we may fail to attract enough new clients or retain our existing clients to the extent necessary to realize a sufficient return on our brand-building efforts, which could have an adverse effect on our business.

## Edgar Filing: Paycom Software, Inc. - Form 10-K

Our outstanding indebtedness is subject to certain operating and financial covenants that may restrict our business and financing activities and may adversely affect our cash flow and our ability to operate our business.

We have incurred indebtedness to fund certain construction projects at our corporate headquarters. Pursuant to the terms of our outstanding indebtedness, we may not, subject to certain exceptions:

- incur additional debt;
- create or permit the existence of additional liens on our assets;
- permit certain fundamental changes, including a merger with any persons;
- make investments in and acquisitions of (or acquisitions of substantially all of the assets of) any person;
- enter into transactions with affiliates other than in the ordinary course of business on an arm's-length basis;
- make any distributions during an event of default, or any other distributions in excess of \$50 million prior to demonstrating pro forma compliance with certain financial covenants;
- make any change in the basis upon which our financial statements are prepared;
- enter into any sale and leaseback transaction; or
- amend, modify, or waive any of our organizational documents in a manner that would be adverse to our lenders.

18

---



In addition, we are required to maintain a fixed charge coverage ratio of earnings before interest, taxes, depreciation and amortization (“EBITDA”) to fixed charges (defined as current maturities of long-term debt, interest expense, rent expense and distributions) of greater than 1.25 to 1.0 and a funded indebtedness (defined as total indebtedness less accounts payable, accrued expenses and deferred revenues) to EBITDA of no greater than 2.0 to 1.0. Both of which are measured on a quarterly basis. The operating and financial covenants in the loan agreements relating to our outstanding indebtedness, as well as any future financing agreements that we may enter into, may restrict our ability to finance our operations, engage in business activities or expand or fully pursue our business strategies. We may also be required to use a substantial portion of our cash flows to pay principal and interest on our debt, which would reduce the amount of money we have for operations, working capital, expansion, or other general corporate purposes.

Our ability to meet our expenses and debt obligations and comply with the operating and financial covenants may be affected by financial, business, economic, regulatory and other factors beyond our control. We may be unable to control many of these factors and comply with these covenants. A breach of any of the covenants under our loan agreements could result in an event of default, which could cause all of our outstanding indebtedness to become immediately due and payable.

We may acquire other businesses, applications or technologies, which could divert our management’s attention, result in additional dilution to our stockholders and otherwise disrupt our operations and harm our operating results.

In the future, we may seek to acquire or invest in businesses, applications or technologies that we believe complement or expand our applications, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential acquisitions may divert the attention of management and cause us to incur expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are ultimately consummated.

We do not have any experience in acquiring other businesses. If we acquire additional businesses, we may not be able to integrate the acquired personnel, operations and technologies successfully or to effectively manage the combined business following the acquisition. We also may not achieve the anticipated benefits from the acquired business due to a number of factors, including:

- the inability to integrate or benefit from acquired applications or services in a profitable manner;
- unanticipated costs or liabilities associated with the acquisition;
- the incurrence of acquisition-related costs;
- difficulty integrating the accounting systems, operations and personnel of the acquired business;
- difficulty and additional expenses associated with supporting legacy products and hosting infrastructure of the acquired business;
- difficulty converting the clients of the acquired business onto our solution, including disparities in the revenues, licensing, support or services of the acquired company;
- diversion of management’s attention from other business concerns;
- harm to our existing relationships with clients as a result of the acquisition;
- the potential loss of key employees;
- the use of resources that are needed in other parts of our business; and
- the use of substantial portions of our available cash to consummate the acquisition.

In addition, a significant portion of the purchase price of any companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process, which could harm our results of operations. Acquisitions could also result in issuances of equity securities or the incurrence of debt, which would result in dilution to our stockholders.

Our growth depends in part on the success of our relationships with third parties.

We rely on third-party financial and accounting processing systems, as well as various financial institutions, to perform financial services in connection with our applications, such as providing automated clearing house (“ACH”) and wire transfers as part of our payroll and expense reimbursement services and to provide technology and content support, manufacture time clocks and process background checks. We anticipate that we will continue to depend on various third-party relationships in order to grow our business, provide technology and content support, manufacture time clocks and process background checks. Identifying, negotiating and documenting relationships with these third parties and integrating third-party content and technology requires significant time and resources. Our agreements with third parties typically are non-exclusive and do not prohibit them from working with our competitors.

In addition, these third parties may not perform as expected under our agreements, and we may have disagreements or disputes with such third parties, which could negatively affect our brand and reputation. A global economic slowdown could also adversely affect the businesses of our third-party providers, particularly those financial institutions that process transactions through the ACH network, and it is possible that they may not be able to devote the resources we expect to our relationship.

If we are unsuccessful in establishing or maintaining our relationships with these third parties, our ability to compete in the marketplace or to grow our revenues could be impaired and our business, operating results or financial condition could be adversely affected. Even if we are successful, these relationships may not result in improved operating results.

Adverse economic conditions could affect our business, operating results or financial condition.

Our business depends on the overall demand for HCM applications and on the economic health of our current and prospective clients. If economic conditions in the United States or in global markets deteriorate, clients may cease their operations, delay or reduce their spending on HCM and other outsourcing services or attempt to renegotiate their contracts with us. This could result in reductions in sales of our applications, longer sales cycles, slower adoption of new technologies and increased price competition, any of which could adversely affect our business, operating results or financial condition. In addition, HCM spending levels may not increase following any recovery.

Further, as part of our payroll and tax filing application, we collect and then remit client funds to taxing authorities and accounts designated by our clients. During the interval between receipt and disbursement, we may invest such funds in money market funds, demand deposit accounts, certificates of deposit and commercial paper. These investments are subject to general market, interest rate, credit and liquidity risks, and such risks may be exacerbated during periods of unusual financial market volatility. Any loss of or inability to access such funds could have an adverse impact on our cash position and results of operations and could require us to obtain additional sources of liquidity, which may not be available on reasonable terms, if at all.

If our goodwill or other intangible assets become impaired, we may be required to record a significant charge to earnings.

We are required to test goodwill for impairment at least annually or earlier if events or changes in circumstances indicate the carrying value may not be recoverable. As of December 31, 2017, we had recorded a total of \$51.9 million of goodwill and \$1.0 million of other intangible assets. An adverse change in domestic or global market conditions, particularly if such change has the effect of changing one of our critical assumptions or estimates made in connection with the impairment testing of goodwill or intangible assets, could result in a change to the estimation of fair value that could result in an impairment charge to our goodwill or other intangible assets. Any such material charges may have a negative impact on our operating results.

We typically pay employees and may pay taxing authorities amounts due for a payroll period before a client's electronic funds transfers are finally settled to our account. If client payments are rejected by banking institutions or otherwise fail to clear into our accounts, we may require additional sources of short-term liquidity and our operating results could be adversely affected.

Our payroll processing application moves significant funds from the account of a client to employees and relevant taxing authorities. For larger funding amounts, we require clients to transfer the funds to us via fed wire. For smaller funding amounts, we debit a client's account prior to any disbursement on its behalf, and due to ACH banking

regulations, funds previously credited could be reversed under certain circumstances and time frames after our payment of amounts due to employees and taxing and other regulatory authorities. There is therefore a risk that the employer's funds will be insufficient to cover the amounts we have already paid on its behalf. While such shortage and accompanying financial exposure has only occurred in very limited circumstances in the past, should clients default on their payment obligations in the future, we might be required to advance substantial funds to cover such obligations. In such an event, we may be required to seek additional sources of short-term liquidity, which may not be available on reasonable terms, if at all, and our operating results and our liquidity could be adversely affected and our banking relationships could be harmed.

Because our long-term success may depend, in part, on our ability to expand the sales of our solution to clients located outside of the United States, our business could be subject to risks associated with international operations.

An element of our growth strategy is to expand our operations and client base. To date, we have not engaged in any operations outside of the United States. If we decide to expand our operations into international markets, it will require significant resources and management attention and will subject us to regulatory, economic and political risks that are different from those in the United States. Because of our lack of experience with international operations, we cannot ensure that our international expansion efforts will be successful, and the impact of such expansion efforts may adversely affect our business, operating results or financial condition.

If we are unable to maintain effective internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may be negatively affected.

As a public company, we are required to maintain internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements. Management must evaluate and furnish a report on the effectiveness of our internal control over financial reporting as of the end of each fiscal year, and our auditors must attest to the effectiveness of our internal control over financial reporting.

If we have a material weakness in our internal control over financial reporting, we may not detect errors on a timely basis and our financial statements may be materially misstated. Compliance with the public company requirements has made some activities more time-consuming, costly and complicated. If we identify material weaknesses in our internal control over financial reporting or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and/or we could become subject to investigations by the New York Stock Exchange (the “NYSE”), the SEC, or other regulatory authorities and the market price of our common stock could be negatively affected.

Adverse tax laws or regulations could be enacted or existing laws could be applied to us or our clients, which could increase the costs of our solution and applications and could adversely affect our business, operating results or financial condition.

As a vendor of services, we are ordinarily held responsible by taxing authorities for collecting and paying any applicable sales or other similar taxes. Additionally, the application of federal, state and local tax laws to services provided electronically like ours is evolving. New income, sales, use or other tax laws, statutes, rules, regulations or ordinances could be enacted at any time (possibly with retroactive effect), and could be applied solely or disproportionately to services and applications provided over the internet. These enactments could adversely affect our sales activity, due to the inherent cost increase the taxes would represent, and ultimately could adversely affect our business, operating results or financial condition.

Each state has different rules and regulations governing sales and use taxes, and these rules and regulations are subject to varying interpretations that change over time. We review these rules and regulations periodically and, when we believe we are subject to sales and use taxes in a particular state, we may voluntarily engage state tax authorities in order to determine how to comply with that state’s rules and regulations. We cannot ensure that we will not be subject to sales and use taxes or related penalties for past sales in states where we currently believe no such taxes are required.

In addition, existing tax laws, statutes, rules, regulations or ordinances could be interpreted, changed, modified or applied adversely to us (possibly with retroactive effect), which could require us or our clients to pay additional tax amounts, as well as require us or our clients to pay fines or penalties and substantial interest for past amounts. If we are unsuccessful in collecting such taxes from our clients, we could be held liable for such costs, thereby adversely affecting our business, operating results or financial condition. Additionally, the imposition of such taxes on us would effectively increase the cost of our software and services we provide to clients and would likely have a negative impact on our ability to retain existing clients or to gain new clients in the jurisdictions in which such taxes are imposed.

Our actual operating results may differ significantly from our guidance.

From time to time, we have released, and may continue to release, guidance in our earnings conference calls, earnings releases, or otherwise, regarding our future performance, which represents our estimates as of the date of release. This guidance, which includes forward-looking statements, has been and will be based on projections prepared by our management. These projections are not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our registered public accountants nor any other independent expert or outside party compiles or examines the projections. Accordingly, no such person expresses any opinion or any other form of assurance with respect to the projections.

Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic, and competitive uncertainties and contingencies, many of which are beyond our control. Projections are also based upon specific assumptions with respect to future business decisions, some of which will change. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any third parties.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the guidance furnished by us will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results may vary from our guidance and the variations may be material. In light of the foregoing, investors are urged not to rely upon our guidance in making an investment decision regarding our common stock.

Any failure to successfully implement our operating strategy or the occurrence of any of the events or circumstances set forth in this "Risk Factors" section in this Form 10-K could result in the actual operating results being different from our guidance, and the differences may be adverse and material.

The issuance of additional stock in connection with acquisitions, our stock incentive plans, warrants or otherwise will dilute all other stockholders.

Our certificate of incorporation authorizes us to issue up to one hundred million shares of common stock and up to ten million shares of preferred stock with such rights and preferences as may be determined by our board of directors. Subject to compliance with applicable rules and regulations, we may issue all of these shares that are not already outstanding without any action or approval by our stockholders. We intend to continue to evaluate strategic acquisitions in the future. We may pay for such acquisitions, partly or in full, through the issuance of additional equity securities.

Any issuance of shares in connection with an acquisition, the exercise of stock options or warrants, the award of shares of restricted stock or otherwise would dilute the percentage ownership held by our existing stockholders.

Anti-takeover provisions in our charter documents and Delaware law may delay or prevent an acquisition of our company.

Our certificate of incorporation, bylaws and Delaware law contain provisions that may have the effect of delaying or preventing a change in control of us or changes in our management. These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

Any provision of our certificate of incorporation, bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could affect the price that some investors are willing to pay for our common stock.

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.

Generally accepted accounting principles in the United States are subject to interpretation by the Financial Accounting Standards Board (“FASB”), the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results and could affect the reporting of transactions completed before the announcement of a change.

Our certificate of incorporation contains an exclusive forum provision that may discourage lawsuits against us and our directors and officers.

Our certificate of incorporation provides that, unless we consent in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware (or if no Court of Chancery located within the State of Delaware has jurisdiction, the Federal District Court for the District of Delaware) will be the sole and exclusive forum any derivative action or proceeding brought on our behalf, any action asserting a claim of breach of fiduciary duty owed by any of our directors, officers or other employees to us or our stockholders, any action asserting a claim against us or any of our directors, officers or other employees arising pursuant to any provision of Delaware law or our certificate of incorporation or our bylaws (as either may be amended from time to time) or any action asserting a claim against us or any of our directors, officers or other employees governed by the internal affairs doctrine. This exclusive forum provision may limit the ability of our stockholders to bring a claim in a judicial forum that such stockholders find favorable for disputes with us or our directors or officers, which may discourage such lawsuits against us and our directors and officers. Alternatively, if a court outside of Delaware were to find this exclusive forum provision inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings described above, we may incur additional costs associated with resolving such matters in multiple jurisdictions, which could materially and adversely affect our financial results.

#### Item 1B. Unresolved Staff Comments

None.

#### Item 2. Properties

Our corporate headquarters is an approximately 250,000-square-foot campus located on over 30 acres of Company-owned property in Oklahoma City, Oklahoma. In addition to housing a fully redundant data center at our corporate headquarters, we operate another fully redundant data center at a leased property near Dallas, Texas. We

also lease a disaster recovery site in downtown Oklahoma City.

We also lease offices in Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Tennessee, Texas, Utah, Virginia, Washington and Wisconsin. We believe that these facilities are suitable for our current operations and upon the expiration of the terms of the leases we believe we could renew these leases or find suitable space elsewhere on acceptable terms.

#### Item 3. Legal Proceedings

From time to time, we are involved in various disputes, claims, suits, investigations and legal proceedings arising in the ordinary course of business. We believe that the resolution of current pending legal matters will not have a material adverse effect on our business, financial condition, results of operations or cash flows. Nonetheless, we cannot predict the outcome of these proceedings, as legal matters are subject to inherent uncertainties, and there exists the possibility that the ultimate resolution of these matters could have a material adverse effect on our business, financial condition, results of operations or cash flows.

#### Item 4. Mine Safety Disclosures

None.



## PART II

## Item 5. Market for Registrants Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

## Price Range of Common Stock

Our common stock is traded on the NYSE under the symbol “PAYC.” The following table sets forth for the periods indicated the high and low sale prices per share of our common stock as reported on the NYSE:

	High	Low
Fiscal Year 2016:		
First Quarter	\$37.74	\$22.42
Second Quarter	\$43.25	\$32.42
Third Quarter	\$52.93	\$42.73
Fourth Quarter	\$52.80	\$39.15
Fiscal Year 2017:		
First Quarter	\$57.72	\$42.52
Second Quarter	\$73.61	\$57.09
Third Quarter	\$76.75	\$64.50
Fourth Quarter	\$86.10	\$73.61

As of February 5, 2018, there were approximately 911 holders of record of our common stock. This number is based on the actual number of holders registered at such date and does not include holders whose shares are held in “street name” by brokers and other nominees.

## Dividends

We did not pay any cash dividends on our common stock in 2017, 2016 or 2015. The declaration, amount and payment of any future dividends on shares of common stock will be at the sole discretion of our board of directors and we may reduce or discontinue entirely the payment of such dividends at any time. Our board of directors may take into account general and economic conditions, our financial condition and operating results, our available cash and current and anticipated cash needs, capital requirements, contractual, legal, tax and regulatory restrictions and implications of the payment of dividends by us to our stockholders or by our subsidiaries to us, and such other factors as our board of directors may deem relevant. While there are no restrictions that currently apply under our existing loan agreements, such agreements prohibit the payment of dividends if an event of default exists. In addition, any financing arrangements that we enter into in the future may include restrictive covenants that limit our or our subsidiaries’ ability to pay dividends.

We are a holding company that has no material assets other than our ownership of all of the outstanding Series B Preferred Units of Paycom Payroll Holdings, LLC (“Holdings”) and the outstanding capital stock of WCAS Paycom

Holdings, Inc. (“WCAS Holdings”) and WCAS CP IV Blocker, Inc. In the event that we decide to pay dividends in the future, we intend to cause Holdings to make distributions to us in an amount sufficient to cover cash dividends, if any, declared by us.

#### Performance Graph

Notwithstanding any statement to the contrary in any of our filings with the SEC, the following performance graph shall not be deemed “filed” with the SEC for purposes of Section 18 of the Exchange Act or “soliciting material” under the Exchange Act and shall not be incorporated by reference into any such filings irrespective of any general incorporation language contained in such filing.

23

---

The following graph compares the total cumulative stockholder return on our common stock with the total cumulative return of the S&P 500 Index and the S&P 1500 Application Software Index during the period commencing on April 15, 2014, the initial trading day of our common stock, and ending on December 31, 2017. The graph assumes that \$100 was invested at the beginning of the period in our common stock and in each of the comparative indices, and assumes the reinvestment of any dividends. Historical stock price performance should not be relied upon as an indication of future stock price performance.

### Purchases of Equity Securities

The number of shares of common stock repurchased by us during the three months ended December 31, 2017 is set forth below:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup>
October 1 - 31, 2017 <sup>(2)</sup>	57,916	\$ 78.89	—	\$ 75,000,000
November 1 - 30, 2017 <sup>(3)</sup>	82,658	\$ 78.75	82,658	\$ 68,500,000
December 1 - 31, 2017	397,938	\$ 78.15	397,938	\$ 37,400,000
Total	538,512		480,596	

(1) Under a stock repurchase plan announced on October 31, 2017, we were authorized to purchase (in the aggregate) up to \$75.0 million of our common stock in open market purchases, privately negotiated transactions or by other means. The stock repurchase plan was scheduled to expire on October 30, 2019 but, as announced on February 13, 2018, the stock repurchase plan was subsequently amended to add \$100.0 million of availability and extend the expiration date to February 12, 2020.

(2) Consists of shares withheld to satisfy tax withholding obligations for certain employees upon the vesting of restricted stock.

(3) Includes 1,491 shares withheld to satisfy tax withholding obligations for certain employees upon the vesting of restricted stock.



## Item 6. Selected Financial Data

Our selected consolidated financial data set forth below should be read together with Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes thereto, which are included elsewhere in this Form 10-K. Selected consolidated financial data for the year ended December 31, 2013 is that of Holdings and its consolidated subsidiaries and WCAS Holdings.

	Year Ended December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands, except share and per share data)				
Consolidated statements of income data:					
Total revenues	\$433,047	\$329,141	\$224,653	\$150,929	\$107,601
Operating income	\$78,625	\$57,971	\$34,435	\$15,700	\$9,472
Net income	\$66,807	\$43,840	\$20,945	\$5,663	\$607
Earnings per share, basic	\$1.15	\$0.76	\$0.37	\$0.11	\$0.01
Earnings per share, diluted	\$1.13	\$0.74	\$0.36	\$0.11	\$0.01
Weighted average shares outstanding:					
Basic	57,839,155	57,550,204	56,495,170	49,784,154	45,476,895
Diluted	58,790,019	58,968,099	57,919,700	51,857,309	48,062,075

	As of December 31,				
	2017	2016	2015	2014	2013
	(dollars in thousands)				
Consolidated balance sheets data:					
Cash and cash equivalents	\$46,077	\$60,158	\$50,714	\$25,144	\$13,362
Working capital (deficit) <sup>1</sup>	\$16,692	\$31,919	\$37,330	\$15,340	\$(7,694 )
Property and equipment, net	\$147,705	\$96,848	\$58,858	\$47,919	\$38,671
Total assets	\$1,355,164	\$1,078,613	\$876,655	\$797,497	\$575,478
Deferred revenue	\$51,624	\$39,711	\$29,036	\$19,337	\$12,572
Net long-term debt, less current portion	\$34,414	\$28,711	\$24,856	\$26,123	\$11,545
Long-term debt to related parties	\$—	\$—	\$—	\$—	\$60,875
Additional paid in capital	\$137,234	\$95,452	\$71,135	\$67,937	\$33,978
Retained earnings (accumulated deficit)	\$137,255	\$70,448	\$26,608	\$5,663	\$(29,349 )
Total stockholder's equity	\$135,402	\$116,527	\$98,314	\$74,138	\$5,083

(1) Working capital (deficit) is defined as current assets, excluding restricted cash, less current liabilities, excluding the current portion of deferred revenue.



## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with the audited and unaudited consolidated financial statements (prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP")) and related notes included elsewhere in this Annual Report on Form 10-K (this "Form 10-K"). The following discussion contains forward-looking statements that are subject to risks and uncertainties. See Part I "Special Note Regarding Forward-Looking Statements" for a discussion of the uncertainties, risks, and assumptions associated with those statements. Actual results could differ materially from those discussed in or implied by forward-looking statements as a result of various factors, including those discussed below and elsewhere in this Form 10-K, particularly in the section entitled "Risk Factors." Unless we state otherwise or the context otherwise requires, the terms "we," "us," "our" and the "Company" refer to Paycom Software, Inc. and its consolidated subsidiaries.

### Overview

We are a leading provider of comprehensive, cloud-based human capital management ("HCM") software delivered as Software-as-a-Service. We provide functionality and data analytics that businesses need to manage the complete employment life cycle from recruitment to retirement. Our solution requires virtually no customization and is based on a core system of record maintained in a single database for all HCM functions, including talent acquisition, time and labor management, payroll, talent management and human resources ("HR") management applications. Our user-friendly software allows for easy adoption of our solution by employees, enabling self-management of their HCM activities in the cloud, which reduces the administrative burden on employers and increases employee productivity.

We serve a diverse client base in terms of size and industry. We have over 20,000 clients, none of which constituted more than one-half of one percent of our revenues for the year ended December 31, 2017. We stored data for nearly 3.3 million persons employed by our clients during the year ended December 31, 2017.

Our revenues are primarily generated through our sales force that solicits new clients and our client relations representatives who sell additional applications to existing clients. As of the filing of this Form 10-K, we have 46 sales teams located in 26 states and plan to open additional sales offices to further expand our presence in the U.S. market. During the year ended December 31, 2017, we opened three new sales offices, with one new sales office located in each of Milwaukee, Richmond and Long Island. On February 6, 2018, we announced the opening of our Salt Lake City office. Our continued growth depends on attracting new clients through further penetration of our existing markets, geographic expansion and the introduction of new applications to our existing client base. We also expect that changes in certain factors affecting our performance will correlate with improvement or deterioration in the labor market. Our principal marketing programs include national and local television commercials, email campaigns, social and digital media campaigns, tradeshows and search engine marketing methods that include website optimization and pay-per-click searches. In addition, we generate awareness and build recognition of our brand and thought leadership with relevant and informative content through podcasts, white papers, infographics and webinars.

During the last three years, we have developed several new applications. We believe our ability to continue to develop new applications and to improve existing applications will enable us to increase revenues in the future, and the number of our new applications adopted by our clients has been a significant factor in our revenue growth over the last three years.

### Trends, Opportunities and Challenges

Our payroll application is the foundation of our solution and all of our clients are required to utilize this application in order to access our other applications. As a result of our significant revenue growth and geographic expansion since our initial public offering in April 2014, we are presented with a variety of opportunities and challenges. Our payroll application is the foundation of our solution and all of our clients are required to utilize this application in order to access our other applications. Consequently, we have historically generated the majority of our revenues from payroll processing, although our revenue mix has evolved and will continue to evolve as we develop and add new non-payroll applications to our solution. Client adoption of new applications has been a significant factor in our revenue growth over the last three years and we expect that the continuation of this trajectory will depend, in part, on the introduction of new applications to our existing client base. Moreover, in order to increase revenues and continue to improve our operating results, we must also attract new clients. We intend to obtain new clients by (i) opening sales offices in new metropolitan areas and (ii) continuing to expand our presence in metropolitan areas where we currently have an existing sales office through adding sales teams or offices, thereby increasing the number of sales professionals within such markets.

For the years ended December 31, 2017, 2016 and 2015, our gross margins were approximately 83%, 84% and 84%, respectively. Although our gross margins may fluctuate from quarter to quarter due to seasonality and hiring trends, we expect that our gross margins will remain relatively consistent in future periods.



Growing our business has also resulted in, and will continue to result in, substantial investment in sales professionals, operating expenses, systems development and programming costs and general and administrative expenses, which has and will continue to increase our expenses. Specifically, our revenue growth and geographic expansion drive increases in our employee headcount, which in turn precipitates increases in (i) salaries and benefits, (ii) stock-based compensation expense and (iii) costs related to the expansion of our corporate headquarters. While we expect our growth to continue to drive increases in headcount, personnel costs and general operating expenses for the foreseeable future, we also expect to continue our practice of driving efficiencies across our organization. We anticipate leveraging our size and benefiting from economies of scale, and believe these efficiencies will allow for ongoing realization of competitive operating margins and cash flows. We intend to obtain new clients by (i) continuing to expand our presence in metropolitan areas where we currently have an existing sales office through adding sales teams or offices and increasing the number of our sales professionals and (ii) opening sales offices in new metropolitan areas. Our ability to increase revenues and improve operating results depends on our ability to add new clients.

The average size of our clients has grown significantly as we have organically grown our operations and increased the number of applications we offer. Based on our total revenues, we have grown at an approximately 42% CAGR from January 1, 2013 through December 31, 2017. Because we charge our clients on a per employee basis for certain services we provide, any increase or decrease in the number of employees that our clients have will have a positive or negative impact, respectively, on our results of operations. Our solution requires no adjustment to serve larger clients. We believe larger employers represent a substantial opportunity to increase the number of potential clients and to increase our revenues per client, with limited incremental cost to us. Moreover, we believe we are well-positioned to take full advantage of improved economic and hiring trends that result from changes in the regulatory environment, including but not limited to the enactment of the Tax Cuts and Jobs Act of 2017 (the "Tax Act") in December 2017. While the impact of the Tax Act on our current and prospective clients and their hiring decisions is still yet to be fully understood, we anticipate wage increases and higher employee counts resulting from improved economic and hiring trends could have a net positive impact on our results in 2018 and beyond. We also expect the lower federal corporate tax rate under the Tax Act to result in a reduction to our future overall effective tax rate and to have a net positive effect on our net earnings and operating cash flows.

We believe the challenges of managing the ever-changing complexity of payroll and human resources will continue to drive companies to turn to outsourced providers for help with their HCM needs. The HCM industry historically has been driven, in part, by legislation and regulatory action, including COBRA, changes to the minimum wage laws or overtime rules, and legislation from federal, state or municipal taxation authorities. The implementation of the Affordable Care Act (the "ACA") is the most recent example of legislation that has created demand in the HCM industry. We generate ACA-related revenues (i) on an annual basis in connection with processing and filing Forms 1094 and 1095 on behalf of clients and (ii) from clients who have purchased our Enhanced ACA application as part of the fixed, bundled price charged per billing period. While we generally do not track our revenues on an application-by-application basis (because applications are often sold in various groupings and configurations for a single price), we estimate that, if the ACA is not modified or repealed, revenues from our Enhanced ACA application and ACA forms filings business will represent approximately 5% of total projected revenues for the year ending December 31, 2018.

Throughout our history, we have built strong relationships with our clients. As the HCM needs of our clients evolve, we believe that we are well-positioned to gain additional share of the HCM spending of our clients, and we believe this opportunity is significant. To be successful, we must continue to demonstrate the operational and economic benefits of our solution, as well as effectively hire, train, motivate and retain qualified personnel.

## Key Metrics

## Edgar Filing: Paycom Software, Inc. - Form 10-K

In addition to the U.S. GAAP and non-GAAP metrics discussed elsewhere in this Form 10-K, we also monitor the following metrics to evaluate our business, measure our performance and identify trends affecting our business:

	Year Ended December 31,					
	2017		2016		2015	
Key performance indicators:						
Clients	20,591		17,817		15,004	
Clients (based on parent company grouping)	11,111		10,464		8,906	
Sales teams	45		42		36	
Annual revenue retention rate	91	%	91	%	91	%

**C**lients. When we calculate the number of clients at period end, we treat client accounts with separate taxpayer identification numbers as separate clients, which often separates client accounts that are affiliated with the same parent organization. We track the number of our clients to provide an accurate gauge of the size of our business. Unless we state otherwise or the context otherwise requires, references to clients throughout this Form 10-K refer to this metric.

27

---

Clients (based on parent company grouping). When we calculate the number of clients based on parent company grouping at period end, we combine client accounts that have identified the same person(s) as their decision-maker regardless of whether the client accounts have separate taxpayer identification numbers, which often combines client accounts that are affiliated with the same parent organization. We track the number of our clients based on parent company grouping to provide an alternate measure of the size of our business and clients.

Sales Teams. We monitor our sales professionals by the number of sales teams at period end. Each team consists of a sales manager and approximately six to eight sales professionals. Certain larger metropolitan areas can support more than one sales team. We believe that the number of sales teams is an indicator of potential revenues for future periods.

Annual Revenue Retention Rate. Our annual revenue retention rate tracks the percentage of revenues that we retain from our existing clients. We monitor this metric because it is an indicator of client satisfaction and revenues for future periods.

#### Components of Results of Operations

##### Sources of Revenues

Revenues are comprised of recurring revenues, and implementation and other revenues. We expect our revenues to increase as we introduce new applications, expand our client base and renew and expand relationships with existing clients. As a percentage of total revenues, we expect our mix of recurring revenues, and implementation and other revenues to remain relatively constant.

Recurring. Recurring revenues include fees for our talent acquisition, time and labor management, payroll, talent management and HR management applications as well as fees charged for form filings and delivery of client payroll checks and reports. These revenues are derived from (i) fixed amounts charged per billing period plus a fee per employee or transaction processed or (ii) fixed amounts charged per billing period. We do not require clients to enter into long-term contractual commitments with us. Our billing period varies by client based on when they pay their employees, which is done either weekly, bi-weekly, semi-monthly or monthly. Because recurring revenues are based, in part, on fees for use of our applications and the delivery of checks and reports that are levied on a per-employee basis, our recurring revenues increase as our clients hire more employees. Recurring revenues are recognized in the period services are rendered. Beginning April 1, 2016, recurring revenues also include interest earned on funds held for clients. We collect funds from clients in advance of either the applicable due date for payroll tax submissions or the applicable disbursement date for employee payment services. These collections from clients are typically disbursed from one to 30 days after receipt, with some funds being held for up to 120 days. We typically invest funds held for clients in money market funds, demand deposit accounts, commercial paper and certificates of deposit until they are paid to the applicable tax or regulatory agencies or to client employees. We expect that interest earned on funds held for clients will increase as we introduce new applications, expand our client base and renew and expand relationships with existing clients. The amount of interest we earn from the investment of client funds is also impacted by changes in interest rates. Recurring revenues include revenues relating to the annual processing of payroll forms, such as Form W-2 and Form 1099, and revenues from processing unscheduled payroll runs (such as bonuses) for our clients. Because payroll forms are typically processed in the first quarter of the year, first quarter revenues and margins are generally higher than in subsequent quarters. Further, beginning in the first quarter of 2016, we began generating additional revenues as a result of the enactment of the ACA, as many clients began complying with filing requirements for Forms 1094 and 1095. We anticipate that our revenues will continue to exhibit this seasonal pattern related to ACA form filings for so long as the ACA (or replacement legislation) includes employer reporting requirements. In addition, we often experience increased revenues during the fourth quarter due to unscheduled payroll runs for our clients that occur before the end of the year. Therefore, we expect the seasonality of our revenue cycle to decrease to the extent clients utilize more of our non-payroll applications.

Implementation and Other. Implementation and other revenues are comprised of implementation fees for the deployment of our solution and other revenues from sales of time clocks as part of our time and attendance services. Non-refundable implementation fees are charged to new clients at inception and upon the addition of certain incremental applications for existing clients. These fees range from 10% to 30% of the annualized value of the transaction. Implementation revenues are recorded as deferred revenue and recognized over the life of the client, which is estimated to be ten years, and other revenues are recognized upon shipment of time clocks. Implementation and other revenues comprised approximately 1.8% of our total revenues for the year ended December 31, 2017.

#### Cost of Revenues

Cost of revenues consists of expenses related to hosting and supporting our applications, hardware costs, systems support and technology and depreciation and amortization. These costs include employee-related expenses (including non-cash stock-based compensation expenses) and other expenses related to client support, bank charges for processing ACH transactions, certain implementation expenses, delivery charges and paper costs. They also include our cost for time clocks sold and ongoing technology and support costs related to our systems. The amount of depreciation and amortization of property and equipment allocated to cost of revenues is determined based upon an estimate of assets used to support our operations.

### Administrative Expenses

Administrative expenses consist of sales and marketing, research and development, general and administrative and depreciation and amortization. Sales and marketing expenses consist primarily of employee-related expenses for our direct sales and marketing staff (such as commissions and bonuses and non-cash stock-based compensation expenses), marketing expenses and other related costs. Research and development expenses consist primarily of employee-related expenses (including non-cash stock-based compensation expenses) for our development staff, net of capitalized software costs for internally developed software. We expect to grow our research and development efforts as we continue to broaden our payroll and HR solution offerings and extend our technological solutions by investing in the development of new applications and introducing them to new and existing clients. General and administrative expenses consist of employee-related expenses for finance and accounting, legal, human resources and management information systems personnel (including non-cash stock-based compensation expenses), legal costs, professional fees and other corporate expenses. Depreciation and amortization expenses consist of (i) the amount of depreciation and amortization of property and equipment allocated to administrative expenses (based upon an estimate of assets used to support our selling, general and administrative functions) and (ii) amortization of intangible assets.

### Interest Expense

Interest expense includes interest on debt related to our corporate headquarters, and settlements related to an interest rate swap that we entered into in connection with our new senior secured term credit agreement.

### Other Income, net

Other income, net includes interest earned on our own funds, any gain or loss on the sale or disposal of fixed assets, costs associated with the early repayment of debt and any unrealized gain or loss related to our interest rate swap. Prior to April 1, 2016, other income, net also included interest earned on funds held for clients.

### Provision for Income Taxes

Our consolidated financial statements include a provision for income taxes incurred for the anticipated tax consequences of the reported results of operations using the asset and liability method. Under this method, we recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities, as well as for any operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the tax rates that are expected to apply to taxable income for the years in which those tax assets and liabilities are expected to be realized or settled. We record a valuation allowance to reduce our deferred tax assets to the net amount that we believe is more likely than not to be realized.

## Results of Operations

The following table sets forth selected consolidated statements of income data and such data as a percentage of total revenues for each of the periods indicated, as well as year-over-year changes with respect to each line item:

	Year Ended December 31,				% change		% change	
	2017		2016		2017 to	2016	2017 to	2016 to
	(dollars in thousands)							
<b>Revenues</b>								
Recurring	\$425,424	98.2%	\$323,548	98.3%	31%	\$219,987	97.9%	47%
Implementation and other	7,623	1.8%	5,593	1.7%	36%	4,666	2.1%	20%
Total revenues	433,047	100.0%	329,141	100.0%	32%	224,653	100.0%	47%
<b>Cost of revenues</b>								
Operating expenses	62,438	14.4%	48,268	14.6%	29%	31,790	14.2%	52%
Depreciation and amortization	9,590	2.2%	5,798	1.8%	65%	3,683	1.6%	57%
Total cost of revenues	72,028	16.6%	54,066	16.4%	33%	35,473	15.8%	52%
<b>Administrative expenses</b>								
Sales and marketing	150,512	34.8%	119,258	36.2%	26%	92,554	41.2%	29%
Research and development	30,430	7.0%	20,966	6.4%	45%	8,627	3.8%	143%
General and administrative	91,647	21.2%	69,046	21.0%	33%	47,826	21.3%	44%
Depreciation and amortization	9,805	2.2%	7,834	2.4%	25%	5,738	2.6%	37%
Total administrative expenses	282,394	65.2%	217,104	66.0%	30%	154,745	68.9%	40%
Total operating expenses	354,422	81.8%	271,170	82.4%	31%	190,218	84.7%	43%
Operating income	78,625	18.2%	57,971	17.6%	36%	34,435	15.3%	68%
Interest expense	(911)	(0.2%)	(1,036)	(0.3%)	(12%)	(1,427)	(0.6%)	(27%)
Other income, net	(1,067)	(0.3%)	308	0.1%	(446%)	517	0.2%	(40%)
Income before income taxes	76,647	17.7%	57,243	17.4%	34%	33,525	14.9%	71%
Provision for income taxes	9,840	2.3%	13,403	4.1%	(27%)	12,580	5.6%	7%
Net income	\$66,807	15.4%	\$43,840	13.3%	52%	\$20,945	9.3%	109%

## Revenues

The increase in total revenues for the year ended December 31, 2017 from the year ended December 31, 2016 was due to several factors, including (i) the addition of new clients in mature sales offices, which are offices that have been open for at least 24 months, and in sales offices that reached maturity during 2017, (ii) contributions from the six new sales offices opened in 2016 that are progressing to maturity, (iii) the sale of additional applications to our existing clients, (iv) the strong performance of our tax forms filing business and (v) growth in our clients' employee headcounts as a result of favorable economic conditions. Nonetheless, the magnitude of the increases in revenues for the year ended December 31, 2017 was tempered as a result of the hurricanes that hit Texas and Florida in August and September. In particular, we experienced some disruption to our prospecting and conversion efforts in the affected

areas and we noted certain newly signed clients delayed implementation of our solution.

The increase in total revenues for the year ended December 31, 2016 from the year ended December 31, 2015 was due to several factors, including (i) the addition of clients in mature sales offices, as well as contributions from sales offices that were reaching maturity in 2016, (ii) the addition of new clients in the sales offices opened in 2016, (iii) the sale of additional applications to our existing clients, (iv) additional revenues in the first quarter attributable to the strong performance of our tax form filing business (including additional revenues from the first year of ACA-related filings), (v) an increase in average revenues per client as we continued to sell our applications to larger clients and (vi) growth in the number of employees of our clients. In addition, during the second quarter of 2016, we elected to change our accounting policy for recording interest income earned on funds held for clients, such that beginning April 1, 2016, interest earned in the period between receipt and disbursement of client funds is recorded as recurring revenue. Prior to April 1, 2016, this interest income was recorded as other income, net.

## Expenses

### Cost of Revenues

The increase in cost of revenues for the year ended December 31, 2017 from the year ended December 31, 2016 was primarily due to a \$12.2 million increase in employee-related expenses, which consisted of a \$10.5 million increase in expenses attributable to growth in the number of operating personnel and a \$1.7 million increase in non-cash stock-based compensation expense. Additionally, shipping fees and ACH fees increased \$1.1 million and \$0.9 million, respectively, in connection with increased sales. Depreciation and amortization expense increased \$3.8 million, or 65%, primarily due to the development of additional technology and purchases of other assets, particularly with respect to the new headquarters building that was not in service for the entire prior year period.

The increase in cost of revenues for the year ended December 31, 2016 from the year ended December 31, 2015 was primarily due to a \$12.3 million increase in employee-related expenses, which consisted of a \$10.3 million increase in expenses related to an increase in the number of operating personnel and a \$2.0 million increase in non-cash stock-based compensation expense. Additionally, shipping fees and ACH fees each increased \$1.3 million in connection with increased sales. Depreciation and amortization expense increased \$2.1 million, or 57%, primarily due to the development of technology, purchases of other assets and the construction of assets in connection with the expansion of our headquarters.

### Administrative Expenses

#### Sales and marketing

During the year ended December 31, 2017, sales and marketing expenses increased from the comparable prior year period due to a \$24.7 million increase in employee-related expenses, including commissions and bonuses, a \$4.2 increase in marketing and advertising expense and a \$2.4 million increase in non-cash stock-based compensation expense.

During the year ended December 31, 2016, sales and marketing expenses increased from the comparable prior year period primarily due to a \$22.1 million increase in employee-related expenses, including commissions and bonuses, and a \$3.1 million increase in non-cash stock-based compensation expense.

#### Research and development

During the year ended December 31, 2017, research and development expenses increased from the comparable prior year period due to an \$8.4 million increase in expenses related to growth in the number of research and development personnel and a \$1.1 million increase in non-cash stock-based compensation expense.

During the year ended December 31, 2016, research and development expenses increased from the comparable prior year period due to an \$11.6 million increase in expenses related to an increase in the number of research and development personnel and a \$0.7 million increase in non-cash stock-based compensation expense.

As we continue the ongoing development of our platform and product offerings, we generally expect research and development expenses (exclusive of stock-based compensation) to continue to increase, particularly as we hire more personnel to support our growth. While we expect this trend to continue on an absolute dollar basis and as a percentage of total revenues, we also anticipate the rate of increase to decline over time as we leverage our growth and



realize additional economies of scale. As is customary for our business, we also expect fluctuations in research and development expense as a percentage of revenue on a quarter-to-quarter basis due to seasonal revenue trends, the amount and timing of research and development costs that may be capitalized and the timing of onboarding new hires and restricted stock vesting events.

Expenditures for software developed or obtained for internal use are capitalized and amortized over a three-year period on a straight-line basis. The nature of the development projects underway during a particular period directly impacts the timing and extent of these capitalized expenditures, and can affect the amount of research and development expenses in such period. The table below sets forth the amounts of capitalized and expensed research and development costs for the years ended December 31, 2017, 2016 and 2015:

	Year Ended December 31,			% Change	
	2017	2016	2015	2017 vs 2016	2016 vs 2015
	(in thousands)				
Capitalized portion of research and development	\$15,821	\$8,817	\$4,317	79%	104%
Expensed portion of research and development	30,430	20,966	8,627	45%	143%
Total research and development costs	\$46,251	\$29,783	\$12,944	55%	130%

### General and administrative

During the year ended December 31, 2017, general and administrative expenses increased from the comparable prior year period due to a \$13.4 million increase in employee-related expenses and a \$10.7 million increase in non-cash stock-based compensation expense, which were partially offset by a \$1.6 million decrease in accounting and legal costs.

During the year ended December 31, 2016, general and administrative expenses increased from the comparable prior year period primarily due to a \$13.7 million increase in non-cash stock-based compensation expense and a \$7.5 million increase in employee-related expenses.

### Non-Cash Stock-Based Compensation Expense

	Year Ended December 31,			% Change	
	2017	2016	2015	2017 vs 2016	2016 vs 2015
	(in thousands)				
Non-cash stock-based compensation expense:					
Operating expenses	\$3,950	\$2,217	\$235	78%	843%
Sales and marketing	6,086	3,656	559	66%	554%
Research and development	1,912	836	104	129%	704%
General and administrative	26,565	15,837	2,112	68%	650%
Total non-cash stock-based compensation expense	\$38,513	\$22,546	\$3,010	71%	649%

During the year ended December 31, 2017, our non-cash stock-based compensation expense increased \$16.0 million, primarily due to the vesting of restricted stock with market-based vesting conditions and the issuance of restricted stock with a greater grant-date fair value than shares issued in the prior year. During the year ended December 31, 2016, our non-cash stock-based compensation expense increased \$19.5 million, primarily due to the issuance and subsequent vesting of restricted stock with market-based vesting conditions.

### Depreciation and Amortization

During the years ended December 31, 2017 and 2016, depreciation and amortization expense increased from the comparable prior year periods primarily due to the development of additional technology and purchases of other assets, particularly with respect to the timing of new buildings that were placed in service in 2016 and 2017.

### Provision for Income Taxes

For the year ended December 31, 2017, income tax expense decreased compared to the year ended December 31, 2016. The decrease primarily resulted from the recognition of excess tax benefits from share-based payment awards due to the vesting of various market-based awards during 2017. As a result of the Tax Act, we remeasured certain deferred tax assets and liabilities based on expected future rates. This remeasurement resulted in a \$0.4 million charge

to our provision for income taxes for the year ended December 31, 2017.

#### Other Income, net

For the year ended December 31, 2017, other income, net decreased \$1.4 million compared to the year ended December 31, 2016 due to \$0.9 million loss on early repayment of debt and a \$0.6 million unrealized loss recognized on the fair value of an interest rate swap. The early repayment of debt and the interest rate swap related to our entry into a new credit agreement in December 2017, as discussed under “Liquidity and Capital Resources” below. See Note 6 in the notes to the consolidated financial statements for further information on the interest rate swap.

#### Liquidity and Capital Resources

Our principal sources of liquidity are cash and cash equivalents, which totaled \$46.1 million and \$60.2 million as of December 31, 2017 and 2016, respectively. Our cash and cash equivalents are comprised primarily of demand deposit accounts, money market funds and certificates of deposit. We believe our existing cash and cash equivalents will be sufficient to meet our working capital and capital expenditure needs over at least the next 12 months.

We have historically financed our operations from cash flows generated from operations, cash from the sale of debt and equity securities and borrowings under our loans. Since inception, we have raised \$125.1 million of equity capital, \$64.3 million of which was the net proceeds raised in our initial public offering that closed in April 2014. Although we have funded most of the costs for ongoing construction projects at our corporate headquarters from available cash, we have incurred indebtedness for a portion of these

costs and may continue to do so in the future. Further, to date, all purchases under our stock repurchase plan have been paid for from available cash and, to the extent we repurchase additional shares in the future, we expect to continue to use cash.

#### Recent Liquidity Developments

**New Credit Agreement.** On December 7, 2017 (the “Effective Date”), we entered into a senior secured term credit agreement (the “New Credit Agreement”), pursuant to which JPMorgan Chase Bank, N.A., Bank of America, N.A. and Kirkpatrick Bank (collectively, the “Lenders”) have agreed to make certain term loans to us (the “Term Loans”) in an aggregate principal amount of \$60.0 million on or prior to September 7, 2018. As of December 31, 2017, our indebtedness consists solely of Term Loans made under the New Credit Agreement.

On the Effective Date, in connection with our entry into the New Credit Agreement, we terminated and prepaid all obligations outstanding under (i) the Consolidated, Amended and Restated Loan Agreement with Kirkpatrick Bank dated December 15, 2011, as amended from time to time, (ii) the Loan Agreement with Kirkpatrick Bank dated May 13, 2015, as amended from time to time, and (iii) the Loan Agreement with Kirkpatrick Bank dated August 2, 2016 (collectively, the “Existing Credit Agreements”), including applicable interest and prepayment penalties. In conjunction with the termination and prepayment of the Existing Credit Agreements, we incurred a loss on extinguishment of debt of \$0.8 million for the year ended December 31, 2017, which is included in Other income, net in the consolidated statements of income. The principal and accrued interest outstanding, together with remaining borrowing capacity under these terminated agreements, was approximately \$57.6 million in the aggregate as of the Effective Date. Proceeds of the Term Loans made on the Effective Date were used to refinance existing indebtedness associated with these terminated agreements.

After giving effect to the Term Loans made on the Effective Date, and as of December 31, 2017, there was \$24.5 million of borrowing capacity remaining under the New Credit Agreement. Our obligations under the Term Loans are secured by a mortgage and first priority security interest in our headquarters property. Term loans made after the Effective Date may be used to finance hard and soft costs related to the completion of construction of our fourth headquarters building and any landscaping, groundwork, parking lots and roads reasonably incidental thereto. The Term Loans mature on September 7, 2025. The Term Loans bear interest, at our option, at either (a) a prime rate plus 1.0% or (b) an adjusted LIBOR rate for the interest period in effect for such Term Loan plus 1.5%. The adjusted LIBOR rate is equal to (i) the LIBOR rate for the applicable interest period multiplied by (ii) the statutory reserve rate (equal to (x) one divided by (y) one minus the aggregate of the maximum reserve percentage (including any marginal, special, emergency or supplemental reserves) established by the Board of Governors of the Federal Reserve System of the United States).

Under the New Credit Agreement, we are required to comply with certain financial and non-financial covenants, including maintaining a fixed charge coverage ratio of not less than 1.25 to 1.0 and a funded indebtedness to EBITDA ratio of not greater than 2.0 to 1.0. Additionally, the New Credit Agreement contains customary affirmative and negative covenants, including covenants limiting our ability to, among other things, grant liens, incur debt, effect certain mergers, make investments, dispose of assets, enter into certain transactions, including swap agreements and sale and leaseback transactions, pay dividends or distributions on their capital stock, and enter into transactions with affiliates, in each case subject to customary exceptions for a credit agreement of this size and type. As of December 31, 2017, we were in compliance with these covenants.

In connection with entering into the New Credit Agreement, we also entered into a floating-to-fixed interest rate swap agreement to limit the exposure to interest rate risk related to the Term Loans (the “Interest Rate Swap

Agreement”). The Interest Rate Swap Agreement, which has a maturity date of September 7, 2025, provides that we will receive quarterly variable interest payments based on the LIBOR rate and will pay interest at a fixed rate. We have elected not to designate this interest rate swap as a hedge and, as such, changes in the fair value of the derivative instrument are being recognized in earnings in our consolidated statements of income. For the fiscal year ended December 31, 2017, we recorded a loss of \$0.6 million for the change in fair value of the interest rate swap, which is included in Other income, net in the consolidated statements of income.

**Revolving Credit Agreement.** On February 12, 2018, we entered into a senior secured revolving credit agreement (the “Revolving Credit Agreement”) with JPMorgan Chase Bank, N.A. and Bank of America, N.A. that provides for a senior secured revolving credit facility (the “Facility”) in the aggregate principal amount of \$50.0 million, which may be increased to up to \$100.0 million, subject to obtaining additional lender commitments and certain approvals and satisfying certain other conditions. The Facility is scheduled to mature on February 12, 2020. Borrowings under the Facility will generally bear interest at a prime rate plus 1.0% or, at our option, an adjusted LIBOR rate for the interest period in effect for such borrowing plus 1.5%, in each case subject to certain conditions set forth in the Revolving Credit Agreement. The Revolving Credit Agreement also contains financial and non-financial covenants that are substantially similar to the covenants in the New Credit Agreement described above. As of the filing of this Form 10-K, we have not made any draws under the Facility.

**Stock Repurchase Plan.** On February 8, 2017, we announced that our Board of Directors amended and extended our stock repurchase plan originally announced on May 26, 2016, such that we were authorized to purchase (in the aggregate) up to an additional \$50.0 million of common stock through January 2019. On October 30, 2017, our Board of Directors again amended and extended the stock repurchase plan, such that we were authorized to purchase (in the aggregate) up to an additional \$75.0 million of

common stock through October 30, 2019. Additionally, as announced on February 13, 2018, our Board of Directors further amended and extended the stock repurchase plan, such that we are authorized to purchase up to an additional \$100.0 million of common stock. As of the filing of this Form 10-K, there was \$132.4 million available for repurchases. The stock repurchase plan will expire on February 12, 2020. Shares may be repurchased from time-to-time in open market transactions at prevailing market prices, in privately negotiated transactions or by other means in accordance with federal securities laws, including Rule 10b5-1 programs, and the repurchase plan may be suspended or discontinued at any time. The actual timing, number and value of shares repurchased depends on a number of factors, including the market price of our common stock, general market and economic conditions and other corporate considerations.

During the year ended December 31, 2017, we repurchased an aggregate of 1,238,577 shares of common stock for an aggregate cost of \$89.7 million, including 464,302 shares to satisfy tax withholding obligations with respect to the delivery of vested shares of restricted stock to certain employees, as discussed below.

**Withholding Shares to Cover Taxes.** During the year ended December 31, 2017, we withheld 464,302 shares to satisfy tax withholding obligations with respect to the delivery of vested shares of restricted stock to certain employees. Our payment of the taxes on behalf of those employees resulted in an expenditure of \$32.8 million in cash and, as such, we generally subtract the amounts attributable to such withheld shares from the aggregate amount available for future purchases under our stock repurchase plan.

#### Cash Flow Analysis

Our cash flows from operating activities have historically been significantly impacted by profitability, implementation revenues received but deferred, research and development, and our investment in sales and marketing to drive growth. Our ability to meet future liquidity needs will be driven by our operating performance and the extent of continued investment in our operations. Failure to generate sufficient revenues and related cash flows could have a material adverse effect on our ability to meet our liquidity needs and achieve our business objectives.

As our business grows, we expect our capital expenditures and our investment activity to continue to increase. Depending on certain growth opportunities, we may choose to accelerate investments in sales and marketing, acquisitions, technology and services. Actual future capital requirements will depend on many factors, including our future revenues, cash from operating activities and the level of expenditures in all areas of our business, and may use available cash to repurchase shares of our common stock.

As part of our payroll and payroll tax filing services, we collect funds from our clients for federal, state and local employment taxes, which we remit to the appropriate tax agencies. We invest these funds in money market funds, demand deposit accounts, commercial paper and certificates of deposit from which we earn interest income during the period between their receipt and disbursement.

Our cash flows from investing and financing activities are influenced by the amount of funds held for clients, which varies significantly from quarter to quarter. The balance of the funds we hold depends on our clients' payroll calendars, and therefore such balance changes from period to period in accordance with the timing of each payroll cycle.

Our cash flows from financing activities are also affected by the extent to which we use available cash to purchase shares of common stock under our stock repurchase plan as well as restricted stock vesting events that may result in the Company paying withholding taxes on behalf of certain employees.

Edgar Filing: Paycom Software, Inc. - Form 10-K

The following table summarizes the consolidated statements of cash flows for the years ended December 31, 2017, 2016 and 2015:

	Year Ended December 31,			\$ Change 2017 vs 2016	% Change 2017 vs 2016	\$ Change 2016 vs 2015	% Change 2016 vs 2015
	2017	2016	2015				
Net cash provided by (used in):	(in thousands)						
Operating activities	\$130,600	\$98,953	\$42,972	\$ 31,647	32	% \$ 55,981	130 %
Investing activities	(290,346)	(205,051)	(52,324)	(85,295 )	42	% (152,727)	292 %
Financing activities	145,665	115,542	34,922	30,123	26	% 80,620	231 %
Net change in cash and cash equivalents	\$(14,081 )	\$9,444	\$25,570	\$ (23,525 )	(249	%) \$ (16,126	(63 %)

### Operating Activities

Cash flows from operating activities for the year ended December 31, 2017 primarily consisted of payments received from our clients and interest earned on funds held for clients. Cash used in operating activities primarily consisted of cash we invested in personnel and expenditures made to support the growth and infrastructure of our business. These payments included costs of operations, advertising and other sales and marketing efforts, IT infrastructure development, product research and development and security and administrative costs. Compared to the year ended December 31, 2016, our operating cash flows for the year ended December 31, 2017 were positively impacted by the growth of our business.

Cash flows from operating activities for the year ended December 31, 2016 primarily consisted of payments received from our clients and interest earned on funds held for clients. Cash used in operating activities primarily consisted of cash we invested in personnel and expenditures made to support the growth and infrastructure of our business. These payments included costs of operations, sales and marketing efforts, IT infrastructure development and security and administrative costs. Compared to the year ended December 31, 2015, our operating cash flows for the year ended December 31, 2016 were positively impacted by the growth of our business.

#### Investing Activities

Cash flows from investing activities for the year ended December 31, 2017 changed by \$85.3 million due to the impact of changes in funds held for clients and a \$15.6 million increase in cash used for purchases of property and equipment, primarily as a result of the ongoing construction of our fourth headquarters building.

Cash flows from investing activities for the year ended December 31, 2016 changed by \$152.7 million due to the impact of changes in funds held for clients and a \$27.3 million increase in cash used for purchases of property and equipment, primarily as a result of the construction of our third headquarters building.

#### Financing Activities

Cash flows from financing activities for the year ended December 31, 2017 changed by \$30.1 million due to the impact of changes in client funds obligation, which is due to the timing of receipts from our clients and payments to our client's employees. Financing cash flows were also impacted by the \$35.9 million increase in proceeds from the issuance of long-term debt. These cash flows provided by financing activities were partially offset by the \$34.3 million increase in payments on long-term debt related to our previous loan agreements, a \$21.3 million increase in open market purchases of common stock, an \$18.5 million increase in withholding taxes paid related to net share settlements, \$0.8 million in debt extinguishment costs and a \$0.3 million increase in the payment of debt issuance costs.

Cash flows from financing activities for the year ended December 31, 2016 changed by \$80.6 million due to the impact of changes in client funds obligation, which is due to the timing of receipts from our clients and payments to our clients' employees. Financing cash flows were also impacted by the \$5.0 million increase in proceeds from the issuance of long-term debt and a \$0.2 million decrease in principal payments on long-term debt. These cash flows provided by financing activities were partially offset by the \$35.6 million increase in open market purchases of common stock and \$14.4 million increase in withholding taxes paid related to net share settlements.

#### Contractual Obligations

Our principal commitments primarily consist of long-term debt and leases for office space. We disclose our long-term debt in Note 5 and our commitments and contingencies in Note 12 to our audited consolidated financial statements included elsewhere in this Form 10-K.

As of December 31, 2017, the future non-cancelable minimum payments under these commitments were as follows:

Payments Due by Period



Edgar Filing: Paycom Software, Inc. - Form 10-K

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
(in thousands)					
<b>Long-term debt obligations:</b>					
Net term notes to bank due September 7, 2025	\$35,500	\$888	\$3,550	\$3,550	27,512
Interest on net term notes to bank due September 7, 2025	9,055	1,443	2,672	2,375	2,565
<b>Operating lease obligations:</b>					
Facilities space	20,959	6,833	9,499	3,775	852
Total	\$65,514	\$9,164	\$15,721	\$9,700	\$30,929

We may continue to lease additional office space to support our growth. In addition, many of our existing lease agreements provide us with the option to renew. Our future operating lease obligations include payments due during any renewal period provided for in the lease where the lease imposes a penalty for failure to renew.

The contractual commitment amounts in the table above are associated with agreements that are enforceable and legally binding and that specify all significant terms, including fixed or minimum services to be used, fixed minimum or variable price provisions, and the approximate timing of the transaction. Obligations under contracts that we can cancel without a significant penalty are not included in the table above.

#### Off-Balance Sheet Arrangements

As of December 31, 2017, we did not have any off-balance sheet arrangements that have or are reasonably likely to have an effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that may be material to investors.

#### Critical Accounting Policies and Estimates

Our consolidated financial statements and accompanying notes have been prepared in accordance with U.S. GAAP. The preparation of these consolidated financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an ongoing basis, we continually evaluate our estimates and assumptions believed to be reasonable under current facts and circumstances. Actual amounts and results may materially differ from these estimates made by management under different assumptions and conditions.

Certain accounting policies that require significant management estimates, and are deemed critical to our results of operations or financial position, are described below. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our consolidated financial condition and results of operations.

#### Revenue Recognition

Our total revenues are comprised of recurring revenues, and implementation and other revenues. We recognize revenues in accordance with accounting standards for software and service companies when all of the following criteria have been met:

- There is persuasive evidence of an arrangement;
- The service has been or is being provided to the customer;
- Collection of the fees is reasonably assured; and
- The amount of fees to be paid by the customer is fixed or determinable.

Recurring revenues are derived primarily from our talent acquisition, time and labor management, payroll, talent management and HR management applications. These services are rendered during each client's payroll period with the agreed-upon fee being charged and collected as part of the client's payroll. Revenues are recognized at time of billing of each client's payroll period. Collectability is reasonably assured as the fees are collected through ACH as part of the client's payroll cycle or through direct wire transfer, which minimizes the default risk. Our implementation and other revenues represent non-refundable conversion fees which are charged to new clients to offset the expense of new client set-up and revenues from sale of time clocks as part of our employee time and attendance services. Because these conversion fees and sale of time clocks relate to our recurring revenues, we have evaluated such arrangements under the accounting guidance that governs multiple element arrangements.

For arrangements with multiple elements, we evaluate whether each element represents a separate unit of accounting. In order to treat deliverables in a multiple element arrangement as separate units of accounting, the deliverables must have standalone value upon delivery. If the deliverables have standalone value upon delivery, we account for each

deliverable separately and revenue is recognized for the respective deliverables as they are delivered. If one or more of the deliverables does not have standalone value upon delivery, the deliverables that do not have standalone value are generally combined with the final deliverable within the arrangement and treated as a single unit of accounting.

For the years ended December 31, 2017, 2016 and 2015, we determined that there was no standalone value associated with the upfront conversion fees as they did not have value to our clients on a standalone basis nor were they offered as an individual service; therefore, the conversion fees were deferred and are recognized ratably over the estimated life of our clients, based on our historical client attrition rate, which we estimate to be ten years. Revenues from the sale of time clocks are recognized when they are delivered.

#### Goodwill and Other Intangible Assets

Goodwill is not amortized, but we are required to test the carrying value of goodwill for impairment at least annually, or earlier if, at the reporting unit level, an indicator of impairment arises. The estimates and assumptions about future results of operations and cash flows made in connection with the impairment testing could differ from future actual results of operations and cash flows. If impairment exists, a write-down to fair value is recorded. Our business is largely homogeneous and, as a result, goodwill is associated with one reporting unit. We have selected June 30 as our annual goodwill impairment testing date and determined there was no impairment as of June 30, 2017. For the years ended December 31, 2017, 2016 and 2015, there were no indicators of impairment. Intangible assets with finite lives are amortized on a straight-line basis over their estimated useful lives.

### Impairment of Long-Lived Assets

Long-lived assets, including intangible assets with finite lives, are reviewed for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset. We have determined that there is no impairment of long-lived assets for the years ended December 31, 2017, 2016 and 2015.

### Restricted Stock

We measure non-cash stock-based compensation expense based on the fair value of the award on the date of grant. We determine the fair value of stock awards issued by using a Monte Carlo simulation model. This model considers various subjective assumptions as inputs, and represent our best estimates, which involve inherent uncertainties and the application of our judgment as it relates to market volatilities, the historical volatility of our stock price, risk-free rates and expected life. The valuation model also incorporates exercise and forfeiture assumptions based on an analysis of historical data. Determining these assumptions is subjective and complex, and therefore, a change in the assumptions utilized could impact the calculation of the fair value of our stock awards and the associated compensation expense. Refer to Note 10 of the notes to the consolidated financial statements for further information regarding our stock-based compensation awards.

### Recent Accounting Pronouncements

Refer to Note 2 of the notes to the consolidated financial statements for a full description of recent accounting pronouncements.

### Non-GAAP Financial Measures

Management uses Adjusted EBITDA and non-GAAP net income as supplemental measures to review and assess the performance of our core business operations and for planning purposes. We define (i) Adjusted EBITDA as net income plus interest expense, taxes, depreciation and amortization, non-cash stock-based compensation expense, loss on early repayment of debt, certain transaction expenses that are not core to our operations and the change in fair value of our interest rate swap and (ii) non-GAAP net income as net income plus non-cash stock-based compensation expense, certain transaction expenses that are not core to our operations, loss on early repayment of debt and the change in fair value of our interest rate swap, all of which are adjusted for the effect of income taxes. Adjusted EBITDA and non-GAAP net income are metrics that provide investors with greater transparency to the information used by management in its financial and operational decision-making. We believe these metrics are useful to investors because they facilitate comparisons of our core business operations across periods on a consistent basis, as well as comparisons with the results of peer companies, many of which use similar non-GAAP financial measures to supplement results under U.S. GAAP. In addition, Adjusted EBITDA is a measure that provides useful information to management about the amount of cash available for reinvestment in our business, repurchasing common stock and other purposes. Management believes that the non-GAAP measures presented in this Form 10-K, when viewed in combination with our results prepared in accordance with U.S. GAAP, provide a more complete understanding of the factors and trends affecting our business and performance.

Adjusted EBITDA and non-GAAP net income are not measures of financial performance under U.S. GAAP, and should not be considered a substitute for net income, which we consider to be the most directly comparable U.S. GAAP measure. Adjusted EBITDA and non-GAAP net income have limitations as analytical tools, and when assessing our operating performance, you should not consider Adjusted EBITDA or non-GAAP net income in isolation, or as a substitute for net income or other consolidated statements of income data prepared in accordance with U.S. GAAP. Adjusted EBITDA and non-GAAP net income may not be comparable to similar titled measures of other companies and other companies may not calculate such measures in the same manner as we do.

The following tables reconcile net income to Adjusted EBITDA, net income to non-GAAP net income and earnings per share to non-GAAP net income per share on a basic and diluted basis:

	Year Ended December 31,		
	2017	2016	2015
	(in thousands)		
Net Income to Adjusted EBITDA:			
Net income	\$66,807	\$43,840	\$20,945
Interest expense	911	1,036	1,427
Provision for income taxes	9,840	13,403	12,580
Depreciation and amortization	19,395	13,632	9,421
EBITDA	96,953	71,911	44,373
Non-cash stock-based compensation expense	38,513	22,546	3,010
Transaction expenses	—	—	685
Loss on early repayment of debt	923	—	—
Change in fair value of interest rate swap	649	—	—
Adjusted EBITDA	\$137,038	\$94,457	\$48,068
	Year Ended December 31,		
	2017	2016	2015
	(in thousands, except share and per share amounts)		
Net Income to non-GAAP net income:			
Net income	\$66,807	\$43,840	\$20,945
Non-cash stock-based compensation expense	38,513	22,546	3,010
Transaction expenses	—	—	685
Loss on early repayment of debt	923	—	—
Change in fair value of interest rate swap	649	—	—
Income tax effect on non-GAAP adjustments	(30,233 )	(14,790 )	(1,191 )
Non-GAAP net income	\$76,659	\$51,596	\$23,449
Earnings per share, basic	\$1.15	\$0.76	\$0.37
Earnings per share, diluted	\$1.13	\$0.74	\$0.36
Non-GAAP net income per share, basic	\$1.33	\$0.90	\$0.42
Non-GAAP net income per share, diluted	\$1.30	\$0.87	\$0.40
Weighted average shares outstanding:			
Basic	57,839,155	57,550,204	56,495,170
Diluted	58,790,019	58,968,099	57,919,700
	Year Ended December		
	31,		
	2017	2016	2015

Edgar Filing: Paycom Software, Inc. - Form 10-K

Earnings per share to non-GAAP net income per share, basic:

Earnings per share, basic	\$1.15	\$0.76	\$0.37
Non-cash stock-based compensation expense	0.67	0.39	0.06
Transaction expenses	—	—	0.01
Loss on early repayment of debt	0.02	—	—
Change in fair value of interest rate swap	0.01	—	—
Income tax effect on non-GAAP adjustments	(0.52)	(0.25)	(0.02)
Non-GAAP net income per share, basic	\$1.33	\$0.90	\$0.42

38

---

	Year Ended December 31,		
	2017	2016	2015
<b>Earnings per share to non-GAAP net income per share, diluted:</b>			
Earnings per share, diluted	\$1.13	\$0.74	\$0.36
Non-cash stock-based compensation expense	0.66	0.38	0.05
Transaction expenses	—	—	0.01
Loss on early repayment of debt	0.02	—	—
Change in fair value of interest rate swap	0.01	—	—
Income tax effect on non-GAAP adjustments	(0.52)	(0.25)	(0.02)
Non-GAAP net income per share, diluted	\$1.30	\$0.87	\$0.40

#### Item 7A. Quantitative and Qualitative Disclosures about Market Risk

##### Interest rate sensitivity

We had cash and cash equivalents totaling \$46.1 million as of December 31, 2017. We consider all highly liquid instruments purchased with a maturity of three months or less and money market funds to be cash equivalents. These amounts are invested primarily in demand deposit accounts, money market funds and certificates of deposit. We also invest funds held for clients in money market funds, demand deposit accounts, commercial paper and certificates of deposit. The primary objectives of our investing activities are capital preservation, meeting our liquidity needs and, with respect to investing client funds, generating interest income while maintaining the safety of principal. We do not enter into investments for trading or speculative purposes.

Our investments are subject to market risk due to changes in interest rates. The market value of fixed rate securities may be adversely affected due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectation due to changes in interest rates, or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates.

We do not believe that an increase or decrease in interest rates of 100-basis points would have a material effect on our operating results or financial condition with respect to our cash equivalents.

In December 2017, we entered into the New Credit Agreement, pursuant to which the Lenders have agreed to make Term Loans to us in an aggregate principal amount of \$60.0 million, which will mature September 7, 2025. As describe elsewhere in this Form 10-K, the Term Loans bear interest at a variable stated interest rate that is determined based on an adjusted LIBOR rate. As a result, we are exposed to increased interest rate risk. To mitigate the increased interest rate risk, we entered into the Interest Rate Swap Agreement. The interest rate swap has effectively fixed our rate at 4.0%, eliminating a portion of the variable rate and coinciding interest rate risk associated with the new Term Loans.



Item 8. Financial Statements and Supplementary Data  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Paycom Software, Inc.	
Consolidated Annual Financial Statements	
<u>Report of Independent Registered Public Accounting Firm</u>	41
<u>Consolidated Balance Sheets as of December 31, 2017 and 2016</u>	42
<u>Consolidated Statements of Income, Years Ended December 31, 2017, 2016 and 2015</u>	43
<u>Consolidated Statements of Stockholders' Equity, Years Ended December 31, 2017, 2016 and 2015</u>	44
<u>Consolidated Statements of Cash Flows, Years Ended December 31, 2017, 2016 and 2015</u>	45
<u>Notes to Consolidated Financial Statements</u>	46

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Paycom Software, Inc.

Opinion on the financial statements

We have audited the accompanying consolidated balance sheets of Paycom Software, Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2017 and 2016, the related consolidated statements of income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2017, based on criteria established in the 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), and our report dated February 14, 2018 expressed an unqualified opinion.

Basis for opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ GRANT THORNTON LLP

We have served as the Company’s auditor since 2009.

Oklahoma City, Oklahoma

February 14, 2018



Paycom Software, Inc.

## Consolidated Balance Sheets

(in thousands, except share amounts)

	December 31,	
	2017	2016
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$46,077	\$60,158
Accounts receivable	1,576	1,339
Prepaid expenses	4,982	4,475
Inventory	979	675
Income tax receivable	7,047	692
Current assets before funds held for clients	60,661	67,339
Funds held for clients	1,089,201	858,244
Total current assets	1,149,862	925,583
Property and equipment, net	147,705	96,848
Deposits and other assets	1,456	1,215
Goodwill	51,889	51,889
Intangible assets, net	958	1,871
Deferred income tax assets, net	3,294	1,207
Total assets	\$1,355,164	\$1,078,613
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable	\$6,490	\$3,737
Accrued commissions and bonuses	9,585	8,003
Accrued payroll and vacation	7,015	4,769
Deferred revenue	6,982	5,230
Current portion of long-term debt	888	1,113
Accrued expenses and other current liabilities	19,991	17,798
Current liabilities before client funds obligation	50,951	40,650
Client funds obligation	1,089,201	858,244
Total current liabilities	1,140,152	898,894
Long-term derivative liability	554	—
Long-term deferred revenue	44,642	34,481
Net long-term debt, less current portion	34,414	28,711
Total long-term liabilities	79,610	63,192
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.01 par value (100,000,000 shares authorized, 60,149,411 and 58,453,283 shares issued at December 31, 2017 and 2016, respectively; 57,788,573 and 57,331,022 shares outstanding at December 31, 2017 and 2016, respectively)	601	585
Additional paid in capital	137,234	95,452

Edgar Filing: Paycom Software, Inc. - Form 10-K

Retained earnings	137,255	70,448
Treasury stock, at cost (2,360,838 and 1,122,261 shares at December 31, 2017 and 2016, respectively)	(139,688 )	(49,958 )
Total stockholders' equity	135,402	116,527
Total liabilities and stockholders' equity	\$1,355,164	\$1,078,613

See accompanying notes to the consolidated financial statements.

42

---

Paycom Software, Inc.

## Consolidated Statements of Income

(in thousands, except share and per share amounts)

	Year Ended December 31,		
	2017	2016	2015
<b>Revenues</b>			
Recurring	\$425,424	\$323,548	\$219,987
Implementation and other	7,623	5,593	4,666
Total revenues	433,047	329,141	224,653
<b>Cost of revenues</b>			
Operating expenses	62,438	48,268	31,790
Depreciation and amortization	9,590	5,798	3,683
Total cost of revenues	72,028	54,066	35,473
<b>Administrative expenses</b>			
Sales and marketing	150,512	119,258	92,554
Research and development	30,430	20,966	8,627
General and administrative	91,647	69,046	47,826
Depreciation and amortization	9,805	7,834	5,738
Total administrative expenses	282,394	217,104	154,745
Total operating expenses	354,422	271,170	190,218
Operating income	78,625	57,971	34,435
Interest expense	(911 )	(1,036 )	(1,427 )
Other income, net	(1,067 )	308	517
Income before income taxes	76,647	57,243	33,525
Provision for income taxes	9,840	13,403	12,580
Net income	\$66,807	\$43,840	\$20,945
Earnings per share, basic	\$1.15	\$0.76	\$0.37
Earnings per share, diluted	\$1.13	\$0.74	\$0.36
Weighted average shares outstanding:			
Basic	57,839,155	57,550,204	56,495,170
Diluted	58,790,019	58,968,099	57,919,700

See accompanying notes to the consolidated financial statements.

Paycom Software, Inc.

## Consolidated Statements of Stockholders' Equity

(in thousands, except share amounts)

	Common Stock	Additional	Retained	Treasury Stock	Total	
	Shares	Amount	Paid in Capital Earnings	Shares	Amount	Stockholders' Equity
Balances at December 31, 2014	53,832,782	\$ 538	\$ 67,937	\$ 5,663	—	\$ 74,138
Vesting of restricted stock	3,287,091	33	(33 )	—	—	—
Stock-based compensation	—	—	3,231	—	—	3,231
Net income	—	—	—	20,945	—	20,945
Balances at December 31, 2015	57,119,873	\$ 571	\$ 71,135	\$ 26,608	—	\$ 98,314
Vesting of restricted stock	1,333,410	14	(14 )	—	—	—
Stock-based compensation	—	—	24,331	—	—	24,331
Repurchases of common stock	—	—	—	—	1,122,261	(49,958 )
Net income	—	—	—	43,840	—	43,840
Balances at December 31, 2016	58,453,283	\$ 585	\$ 95,452	\$ 70,448	1,122,261	\$(49,958 )
Vesting of restricted stock	1,696,128	16	(16 )	—	—	—
Stock-based compensation	—	—	41,798	—	—	41,798
Repurchases of common stock	—	—	—	—	1,238,577	(89,730 )
Net income	—	—	—	66,807	—	66,807
Balances at December 31, 2017	60,149,411	\$ 601	\$ 137,234	\$ 137,255	2,360,838	\$(139,688)

See accompanying notes to the consolidated financial statements.





Paycom Software, Inc.

## Consolidated Statements of Cash Flows

(in thousands)

	Year Ended December 31,		
	2017	2016	2015
<b>Cash flows from operating activities:</b>			
Net income	\$66,807	\$43,840	\$20,945
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>			
Depreciation and amortization	19,395	13,632	9,421
(Gain)/loss on disposition of property and equipment	21	(64 )	15
Amortization of debt discount and debt issuance costs	117	124	157
Stock-based compensation expense	38,542	22,471	3,219
Loss on early repayment of debt	923	—	—
Cash paid for derivative settlement	(24 )	—	—
Loss on derivative	673	—	—
Deferred income taxes, net	(2,087 )	(1,848 )	(1,021 )
<b>Changes in operating assets and liabilities:</b>			
Accounts receivable	(237 )	1,015	440
Prepaid expenses	(507 )	(944 )	(1,579 )
Inventory	462	418	(224 )
Deposits and other assets	(241 )	71	(810 )
Accounts payable	79	(1,571 )	(431 )
Income taxes, net	(6,355 )	6,051	(5,808 )
Accrued commissions and bonuses	1,582	(684 )	3,607
Accrued payroll and vacation	2,246	1,871	1,316
Deferred revenue	11,913	10,675	9,699
Accrued expenses and other current liabilities	(2,709 )	3,896	4,026
Net cash provided by operating activities	130,600	98,953	42,972
<b>Cash flows from investing activities:</b>			
Net change in funds held for clients	(230,957)	(161,541)	(36,146)
Decrease in restricted cash	—	—	371
Purchases of property and equipment	(59,389 )	(43,805 )	(16,549)
Proceeds from sale of property and equipment	—	295	—
Net cash used in investing activities	(290,346)	(205,051)	(52,324)
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of long-term debt	40,940	5,000	—
Repurchases of common stock	(56,880 )	(35,561 )	—
Withholding taxes paid related to net share settlements	(32,850 )	(14,396 )	—
Principal payments on long-term debt	(35,335 )	(964 )	(1,118 )
Net change in client funds obligation	230,957	161,541	36,146
Debt extinguishment costs	(823 )	—	—
Payment of debt issuance costs	(344 )	(78 )	(106 )

Edgar Filing: Paycom Software, Inc. - Form 10-K

Net cash provided by financing activities	145,665	115,542	34,922
Net change in cash and cash equivalents	(14,081 )	9,444	25,570
Cash and cash equivalents			
Beginning of year	60,158	50,714	25,144
End of year	\$46,077	\$60,158	\$50,714
Supplemental disclosures of cash flow information:			
Cash paid for interest, net of amounts capitalized	\$791	\$938	\$1,271
Cash paid for income taxes	\$18,332	\$9,323	\$19,205
Noncash investing and financing activities:			
Purchases of property and equipment, accrued but not paid	\$6,686	\$4,651	\$1,613
Stock-based compensation for capitalized software	\$3,285	\$1,784	\$220

See accompanying notes to the consolidated financial statements.

Paycom Software, Inc.

Notes to the Consolidated Financial Statements

## 1. ORGANIZATION AND DESCRIPTION OF BUSINESS

### Description of Business

Paycom Software, Inc. (“Software”) and its wholly owned subsidiaries (collectively, the “Company”) is a leading provider of comprehensive, cloud-based human capital management (“HCM”) software delivered as Software-as-a-Service. Unless we state otherwise or the context otherwise requires, the terms “we”, “our”, “us” and the “Company” refer to Software and its consolidated subsidiaries.

We provide functionality and data analytics that businesses need to manage the complete employment life cycle from recruitment to retirement. Our solution requires virtually no customization and is based on a core system of record maintained in a single database for all HCM functions, including talent acquisition, time and labor management, payroll, talent management and human resources (“HR”) management applications.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Basis of Presentation and Principles of Consolidation

Our consolidated financial statements include the financial results of Software and its wholly owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America (“US GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”). Intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, the accompanying consolidated financial statements include all adjustments necessary for the fair presentation for the periods presented. Such adjustments are of a normal recurring nature.

### Adoption of New Pronouncements

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-04, “Simplifying the Test for Goodwill Impairment (Topic 350)” to simplify the subsequent measurement of goodwill. Under this new guidance, Step 2 of the goodwill impairment test is eliminated, including elimination of the requirement to perform Step 2 for any reporting unit with a zero or negative carrying amount that failed a qualitative assessment. This standard should be applied on a prospective basis with the nature of and reason for the change in accounting principle disclosed upon transition. The standard is effective in fiscal years beginning after December 15, 2019, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We adopted this guidance for the annual goodwill impairment test we performed as of June 30, 2017.

### Use of Estimates

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates include income taxes, loss contingencies, the useful life for long-lived and intangible assets, the life of our client relationships, the fair market value of our equity incentive awards and the fair value of our financial

instruments. These estimates are based on historical experience where applicable and other assumptions that management believes are reasonable under circumstances. As such, actual results could materially differ from these estimates.

#### Segment Information

We operate in a single operating segment and a single reporting segment. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker, who is also the chief executive officer in deciding how to allocate resources and assessing performance. Our chief executive officer allocates resources and assesses performance based upon financial information at the consolidated level. As we operate in one operating segment, all required financial segment information is presented in the consolidated financial statements.

#### Cash Equivalents

We consider all highly liquid instruments purchased with a maturity of three months or less and money market funds to be cash equivalents. We maintain cash and cash equivalents in demand deposit accounts, money market funds, and certificates of deposit, which may not be federally insured. The fair value of our cash and cash equivalents approximates carrying value. We have not experienced any losses in such accounts and do not believe there is exposure to any significant credit risk on such accounts.

Paycom Software, Inc.

Notes to the Consolidated Financial Statements

Accounts Receivable

We generally collect revenues from our clients through an automatic deduction