Paycom Software, Inc.
Form 10-Q
May 02, 2019

false Q1 PAYC 0001590955 --12-31 Large Accelerated Filer false false P9M P1Y true us-gaap:OtherNoncurrentAssetsMember us-gaap:AccruedLiabilitiesAndOtherLiabilities us-gaap:OtherLiabilitiesNoncurrent P18Y 0 P3Y3M18D P3Y6M 0001590955 2019-01-01 2019-03-31 xbrli:shares 0001590955 2019-04-25 iso4217:USD 0001590955 2019-03-31 0001590955 2018-12-31 iso4217:USD xbrli:shares 0001590955 payc:RecurringMember 2019-01-01 2019-03-31 0001590955 payc:RecurringMember 2018-01-01 2018-03-31 0001590955 payc:ImplementationAndOtherMember 2019-01-01 2019-03-31 0001590955 payc:ImplementationAndOtherMember 2018-01-01 2018-03-31 0001590955 2018-01-01 2018-03-31 0001590955 us-gaap:CommonStockMember 2017-12-31 0001590955 us-gaap:AdditionalPaidInCapitalMember 2017-12-31 0001590955 us-gaap:RetainedEarningsMember 2017-12-31 0001590955 us-gaap:TreasuryStockMember 2017-12-31 0001590955 2017-12-31 0001590955 us-gaap:CommonStockMember 2018-01-01 2018-03-31 0001590955 us-gaap:AdditionalPaidInCapitalMember 2018-01-01 2018-03-31 0001590955 us-gaap:TreasuryStockMember 2018-01-01 2018-03-31 0001590955 us-gaap:RetainedEarningsMember 2018-01-01 2018-03-31 0001590955 us-gaap:CommonStockMember 2018-03-31 0001590955 us-gaap:AdditionalPaidInCapitalMember 2018-03-31 0001590955 us-gaap:RetainedEarningsMember 2018-03-31 0001590955 us-gaap:TreasuryStockMember 2018-03-31 0001590955 2018-03-31 0001590955 us-gaap:CommonStockMember 2018-12-31 0001590955 us-gaap:AdditionalPaidInCapitalMember 2018-12-31 0001590955 us-gaap:RetainedEarningsMember 2018-12-31 0001590955 us-gaap:TreasuryStockMember 2018-12-31 0001590955 us-gaap:CommonStockMember 2019-01-01 2019-03-31 0001590955 us-gaap:AdditionalPaidInCapitalMember 2019-01-01 2019-03-31 0001590955 us-gaap:TreasuryStockMember 2019-01-01 2019-03-31 0001590955 us-gaap:RetainedEarningsMember 2019-01-01 2019-03-31 0001590955 us-gaap:CommonStockMember 2019-03-31 0001590955 us-gaap:AdditionalPaidInCapitalMember 2019-03-31 0001590955 us-gaap:RetainedEarningsMember 2019-03-31 0001590955 us-gaap:TreasuryStockMember 2019-03-31 0001590955 payc:MarketBasedSharesAwardMember 2019-01-01 2019-03-31 0001590955 us-gaap:AccountingStandardsUpdate201602Member 2019-01-01 0001590955 payc:StockRepurchasePlanMember srt:MaximumMember 2018-02-13 0001590955 payc:StockRepurchasePlanMember srt:MaximumMember 2018-11-20 0001590955 payc:StockRepurchasePlanMember 2019-03-31 0001590955 payc:StockRepurchasePlanMember 2019-01-01 2019-03-31 0001590955 2019-04-01 2019-03-31 0001590955 2020-01-01 2019-03-31 0001590955 2021-01-01 2019-03-31 0001590955 payc:CostsToObtainContractMember 2018-12-31 0001590955 payc:CostsToFulfillContractMember 2018-12-31 0001590955 payc:CostsToObtainContractMember 2019-01-01 2019-03-31 0001590955 payc:CostsToFulfillContractMember 2019-01-01 2019-03-31 0001590955 payc:CostsToObtainContractMember 2019-03-31 0001590955 payc:CostsToFulfillContractMember 2019-03-31 0001590955 payc:CostsToObtainContractMember 2017-12-31 0001590955 payc:CostsToFulfillContractMember 2017-12-31 0001590955 payc:CostsToObtainContractMember 2018-01-01 2018-03-31 0001590955 payc:CostsToFulfillContractMember 2018-01-01 2018-03-31 0001590955 payc:CostsToObtainContractMember 2018-03-31 0001590955 payc:CostsToFulfillContractMember 2018-03-31 0001590955 us-gaap:BuildingMember 2019-03-31 0001590955 us-gaap:BuildingMember 2018-12-31 0001590955 us-gaap:SoftwareAndSoftwareDevelopmentCostsMember 2019-03-31 0001590955 us-gaap:SoftwareAndSoftwareDevelopmentCostsMember 2018-12-31 0001590955 us-gaap:ComputerEquipmentMember 2019-03-31 0001590955 us-gaap:ComputerEquipmentMember 2018-12-31 0001590955 payc:RentalClocksMember 2019-03-31 0001590955 payc:RentalClocksMember 2018-12-31 0001590955 payc:FurnitureFixturesAndEquipmentMember 2019-03-31 0001590955 payc:FurnitureFixturesAndEquipmentMember 2018-12-31 0001590955 us-gaap:LeaseholdImprovementsMember 2019-03-31 0001590955 us-gaap:LeaseholdImprovementsMember 2018-12-31 0001590955 us-gaap:VehiclesMember 2019-03-31 0001590955 us-gaap:VehiclesMember 2018-12-31 0001590955 payc:ExcludedLandAndConstructionInProcessMember 2019-03-31 0001590955 payc:ExcludedLandAndConstructionInProcessMember 2018-12-31 0001590955 us-gaap:ConstructionInProgressMember 2019-03-31 0001590955 us-gaap:ConstructionInProgressMember 2018-12-31 0001590955 us-gaap:LandMember 2019-03-31 0001590955 us-gaap:LandMember 2018-12-31

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us-gaap:SubsequentEventMember us-gaap:RestrictedStockMember 2019-04-28 2019-04-29

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019

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 incorporation or organization) | (I.R.S. Employer Identification Number) |

7501 W. Memorial Road

Oklahoma City, Oklahoma 73142

(Address of principal executive offices, including zip code)

(405) 722-6900

(Registrant’s telephone number, including area code)

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

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---|---|---|

| | | |
|---|---|---|
| Common | PAYC | New York Stock Exchange |

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company
Emerging growth company

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

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

As of April 25, 2019, there were 58,507,395 shares of common stock, par value of $0.01 per share, outstanding, including 996,755 shares of restricted stock.

**Paycom Software, Inc.**

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Paycom Software, Inc.

Consolidated Balance Sheets

(in thousands, except share amounts)

| | March 31, 2019 (unaudited) | December 31, 2018 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $91,307 | $45,718 |
| Accounts receivable | 3,835 | 3,414 |
| Prepaid expenses | 9,156 | 7,658 |
| Inventory | 910 | 797 |
| Income tax receivable | — | 3,962 |
| Deferred contract costs | 38,811 | 35,286 |
| Current assets before funds held for clients | 144,019 | 96,835 |
| Funds held for clients | 1,405,465 | 967,787 |
| Total current assets | 1,549,484 | 1,064,622 |
| Property and equipment, net | 187,511 | 176,962 |
| Goodwill | 51,889 | 51,889 |
| Long-term deferred contract costs | 247,135 | 225,459 |
| Other assets | 26,809 | 2,994 |
| Total assets | $2,062,828 | $1,521,926 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | $4,081 | $6,288 |
| Income tax payable | 3,526 | — |
| Accrued commissions and bonuses | 4,553 | 10,671 |
| Accrued payroll and vacation | 14,506 | 10,741 |
| Deferred revenue | 9,672 | 8,980 |
| Current portion of long-term debt | 1,775 | 1,775 |
| Accrued expenses and other current liabilities | 40,132 | 22,440 |
| Current liabilities before client funds obligation | 78,245 | 60,895 |
| Client funds obligation | 1,405,465 | 967,787 |
| Total current liabilities | 1,483,710 | 1,028,682 |
| Deferred income tax liabilities, net | 73,928 | 70,206 |
| Long-term deferred revenue | 57,839 | 55,671 |
| Net long-term debt, less current portion | 32,179 | 32,614 |
| Other long-term liabilities | 16,619 | — |
| Total long-term liabilities | 180,565 | 158,491 |
| Total liabilities | 1,664,275 | 1,187,173 |
| Commitments and contingencies | | |

| | | |
|---|---|---|
| Stockholders' equity: | | |
| Common stock, $0.01 par value (100,000,000 shares authorized, 61,027,123 and 60,746,715 shares issued at March 31, 2019 and December 31, 2018, respectively; 57,447,346 and 57,276,992 shares outstanding at March 31, 2019 and December 31, 2018, respectively) | 609 | 607 |
| Additional paid-in capital | 239,865 | 203,680 |
| Retained earnings | 442,872 | 395,590 |
| Treasury stock, at cost (3,579,777 and 3,469,723 shares at March 31, 2019 and December 31, 2018, respectively) | (284,793 ) | (265,124 ) |
| Total stockholders' equity | 398,553 | 334,753 |
| Total liabilities and stockholders' equity | $2,062,828 | $1,521,926 |

See accompanying notes to the unaudited consolidated financial statements.

**Paycom Software, Inc.**

Consolidated Statements of Income

(in thousands, except share and per share amounts)

(unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Revenues | | |
| Recurring | $196,864 | $151,885 |
| Implementation and other | 3,079 | 2,031 |
| Total revenues | 199,943 | 153,916 |
| Cost of revenues | | |
| Operating expenses | 24,776 | 20,568 |
| Depreciation and amortization | 4,542 | 3,037 |
| Total cost of revenues | 29,318 | 23,605 |
| Administrative expenses | | |
| Sales and marketing | 39,645 | 32,352 |
| Research and development | 18,489 | 11,250 |
| General and administrative | 45,198 | 32,657 |
| Depreciation and amortization | 4,805 | 3,032 |
| Total administrative expenses | 108,137 | 79,291 |
| Total operating expenses | 137,455 | 102,896 |
| Operating income | 62,488 | 51,020 |
| Interest expense | (276) | — |
| Other income, net | (100) | 1,030 |
| Income before income taxes | 62,112 | 52,050 |
| Provision for income taxes | 14,830 | 10,890 |
| Net income | $47,282 | $41,160 |
| Earnings per share, basic | $0.82 | $0.71 |
| Earnings per share, diluted | $0.81 | $0.70 |
| Weighted average shares outstanding: | | |
| Basic | 57,357,490 | 57,793,023 |
| Diluted | 58,316,154 | 58,738,732 |

See accompanying notes to the unaudited consolidated financial statements.

Paycom Software, Inc.

Consolidated Statements of Stockholders' Equity

(in thousands, except share amounts)

(unaudited)

| | Common Stock | | Additional | Retained | Treasury Stock | | Total |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-in Capital | Earnings | Shares | Amount | Stockholders' Equity |
| Balances at December 31, 2017 | 60,149,411 | $ 601 | $ 161,809 | $ 258,525 | 2,360,838 | $ (139,688 ) | $ 281,247 |
| Vesting of restricted stock | 297,291 | 3 | (3 ) | — | — | — | — |
| Stock-based compensation | — | — | 27,496 | — | — | — | 27,496 |
| Repurchases of common stock | — | — | — | — | 169,146 | (16,870 ) | (16,870 ) |
| Net income | — | — | — | 41,160 | — | — | 41,160 |
| Balances at March 31, 2018 | 60,446,702 | $ 604 | $ 189,302 | $ 299,685 | 2,529,984 | $ (156,558 ) | $ 333,033 |

| | Common Stock | | Additional | Retained | Treasury Stock | | Total |
|---|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-in Capital | Earnings | Shares | Amount | Stockholders' Equity |
| Balances at December 31, 2018 | 60,746,715 | $ 607 | $ 203,680 | $ 395,590 | 3,469,723 | $ (265,124 ) | $ 334,753 |
| Vesting of restricted stock | 280,408 | 2 | (2 ) | — | — | — | — |
| Stock-based compensation | — | — | 36,187 | — | — | — | 36,187 |
| Repurchases of common stock | — | — | — | — | 110,054 | (19,669 ) | (19,669 ) |
| Net income | — | — | — | 47,282 | — | — | 47,282 |
| Balances at March 31, 2019 | 61,027,123 | $ 609 | $ 239,865 | $ 442,872 | 3,579,777 | $ (284,793 ) | $ 398,553 |

See accompanying notes to the unaudited consolidated financial statements.

**Paycom Software, Inc.**

Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Cash flows from operating activities | | |
| Net income | $47,282 | $41,160 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 9,347 | 6,069 |
| Accretion of discounts on available-for-sale securities | (165) | (177) |
| Amortization of debt issuance costs | 9 | 6 |
| Stock-based compensation expense | 31,071 | 23,222 |
| Cash paid for derivative settlement | (1) | (79) |
| (Gain)/loss on derivative | 540 | (738) |
| Deferred income taxes, net | 3,722 | 4,272 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (421) | (774) |
| Prepaid expenses | (1,498) | (2,019) |
| Inventory | (11) | (193) |
| Other assets | (702) | (565) |
| Deferred contract costs | (23,414) | (17,712) |
| Accounts payable | (1,251) | (710) |
| Income taxes, net | 7,488 | 4,013 |
| Accrued commissions and bonuses | (6,118) | (6,980) |
| Accrued payroll and vacation | 3,765 | 4,307 |
| Deferred revenue | 2,860 | 2,153 |
| Accrued expenses and other current liabilities | 7,923 | 2,232 |
| Net cash provided by operating activities | 80,426 | 57,487 |
| Cash flows from investing activities | | |
| Purchase of short-term investments from funds held for clients | (16,800) | (67,632) |
| Proceeds from maturities of short-term investments from funds held for clients | 14,500 | 22,500 |
| Net change in funds held for clients | (435,213) | 39,350 |
| Purchases of property and equipment | (14,889) | (18,708) |
| Net cash used in investing activities | (452,402) | (24,490) |
| Cash flows from financing activities | | |
| Repurchases of common stock | — | (4,999) |
| Withholding taxes paid related to net share settlement | (19,669) | (11,871) |
| Payments on long-term debt | (444) | — |
| Net change in client funds obligation | 437,678 | 5,959 |
| Payment of debt issuance costs | — | (42) |
| Net cash provided by (used in) financing activities | 417,565 | (10,953) |

| | | |
|---|---|---|
| Increase in cash and cash equivalents | 45,589 | 22,044 |
| Cash and cash equivalents | | |
| Beginning of period | 45,718 | 46,077 |
| End of period | $91,307 | $68,121 |

See accompanying notes to the unaudited consolidated financial statements.

**Paycom Software, Inc.**

Notes to the Consolidated Financial Statements

(in thousands, except share and per share amounts)

(unaudited)

**1.** ORGANIZATION AND 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 lifecycle, 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

Our significant accounting policies are discussed in "Note 2. Summary of Significant Accounting Policies" in the notes to our audited consolidated financial statements for the year ended December 31, 2018, included in the Form 10-K.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial statements that permit reduced disclosure for interim periods.  In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments necessary for the fair presentation of our consolidated balance sheets as of March 31, 2019 and December 31, 2018, our consolidated statements of income for the three months ended March 31, 2019 and 2018, our consolidated statements of stockholders' equity for the three months ended March 31, 2019 and 2018 and our consolidated statements of cash flows for the three months ended March 31, 2019 and 2018.  Such adjustments are of a normal recurring nature.  The information in this Quarterly Report on Form 10-Q (this "Form 10-Q") should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2018 that was filed with the SEC on February 14, 2019 (the "Form 10-K").  The results of operations for the three months ended March 31, 2019 are not necessarily indicative of the results expected for the full year.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no impact on reported net income and did not result in any material change to operating cash flows. In addition to these adjustments, in the consolidated balance sheets, we combined the line items “Intangible assets, net” and “Other assets” in the prior period in order to conform to the current period presentation.

Recently Adopted New Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842).” The purpose of this new guidance is to increase the transparency and comparability among organizations by recognizing lease assets and lease liabilities in the consolidated balance sheets as well as providing additional disclosure requirements related to leasing arrangements. The new guidance was effective for us beginning January 1, 2019, which we adopted using a modified retrospective method and the transition relief guidance provided by the FASB in ASU 2018-11. Under this adoption method, we have not restated comparative prior periods and have carried forward the assessment of whether our contracts are or contain leases, the classification of our leases and the remaining lease terms. Based on our portfolio of leases at January 1, 2019, $21.6 million of lease assets and liabilities were recognized in our consolidated balance sheets, which related to operating leases for real estate. Under the transition relief guidance, we have elected the lease vs. non-lease components practical expedient relating to the asset class of real estate, the short-term lease exemption practical expedient and the package of practical expedients. In connection with the adoption of this standard, we updated our control framework and implemented changes to existing controls to account for leases. See “Note 6. Leases” for additional information.

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Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. 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 of property and equipment and intangible assets, the life of our client relationships, the fair value of our stock-based awards and the fair value of our financial instruments, intangible assets and goodwill. These estimates are based on historical experience where applicable and other assumptions that management believes are reasonable under the circumstances. Actual results could materially differ from these estimates.

Seasonality

Our revenues are seasonal in nature. Recurring revenues include revenues relating to the annual processing of payroll forms, such as Form W-2, Form 1099, and Form 1095 and revenues from processing unscheduled payroll runs (such as bonuses) for our clients. As payroll forms are typically processed in the first quarter of the year, first quarter revenues and margins are generally higher than in subsequent quarters. These seasonal fluctuations in revenues can also have an impact on gross profits. Historical results impacted by these seasonal trends should not be considered a reliable indicator of our future results of operations.

Employee Stock Purchase Plan

An award issued under the Paycom Software, Inc. Employee Stock Purchase Plan (the “ESPP”) is classified as a share-based liability and recognized at the fair value of the award. Expense is recognized, net of estimated forfeitures, on a straight-line basis over the requisite service period.

Funds Held for Clients and Client Funds Obligation

As part of our payroll and tax filing application, we (i) collect client funds to satisfy their respective federal, state and local employment tax obligations, (ii) remit such funds to the appropriate taxing authorities and accounts designated by our clients, and (iii) manage client tax filings and any related correspondence with taxing authorities. Amounts collected by us from clients for their federal, state and local employment taxes are invested by us, and we earn interest on these funds during the interval between receipt and disbursement.

These investments are shown in our consolidated balance sheets as funds held for clients, and the offsetting liability for the tax filings is shown as client funds obligation. The liability is recognized in the accompanying consolidated balance sheets at the time we obtain the funds from clients. The client funds obligation represents liabilities that will be repaid within one year of the consolidated balance sheet date. As of March 31, 2019 and December 31, 2018, the funds held for clients were invested in money market funds, demand deposit accounts, commercial paper and certificates of deposit. Short-term investments in commercial paper and certificates of deposit with an original maturity duration greater than three months are classified as available-for-sale securities, and are also included within the funds held for clients line item in the consolidated balance sheets. These available-for-sale securities are recognized in the consolidated balance sheets at fair value, which approximates the amortized cost of the securities. Funds held for clients are classified as a current asset in the consolidated balance sheets because the funds are held solely to satisfy the client funds obligation.

Stock Repurchase Plan

In May 2016, our Board of Directors authorized a stock repurchase plan allowing for the repurchase of shares of our common stock 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. Since the initial authorization of the stock repurchase plan, our Board of Directors has amended and extended and authorized new stock repurchase plans from time to time. On February 13, 2018, we announced that our Board of Directors authorized the repurchase of up to an additional $100.0 million of common stock. Most recently, on November 20, 2018, we announced that our Board of Directors authorized the repurchase of up to an additional $150.0 million of our common stock. As of March 31, 2019, there was $142.3 million available for repurchases. Our stock 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, shares withheld for taxes associated with the vesting of restricted stock and other corporate considerations. The current stock repurchase plan will expire on November 19, 2020.

During the three months ended March 31, 2019, we repurchased an aggregate of 110,054 shares of our common stock at an average cost of $178.72 per share to satisfy tax withholding obligations for certain employees upon the vesting of restricted stock.

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Recently Issued Accounting Pronouncements

Management has reviewed all the recently issued, but not yet effective, accounting pronouncements, and does not believe any of these pronouncements will have a material impact to the Company.

**3.** REVENUE

Revenues are recognized when control of the promised goods or services is transferred to our clients in an amount that reflects the consideration we expect to be entitled to for those goods or services. Substantially all of our revenues are comprised of revenue from contracts with clients. Sales and other applicable taxes are excluded from revenues.

Recurring Revenues

Recurring revenues are derived primarily from 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. Talent acquisition includes our applicant tracking, candidate tracker, background check, on-boarding, e-verify and tax credit services applications. Time and labor management includes time and attendance, scheduling/schedule exchange, time-off requests, labor allocation, labor management reports/push reporting and geofencing/geotracking. Payroll includes our payroll and tax management, Paycom Pay, expense management, garnishment management and GL Concierge applications. Talent management includes our employee self-service, compensation budgeting, performance management, executive dashboard and Paycom learning and course content applications. HR management includes our document and task management, government and compliance, benefits administration, COBRA administration, personnel action forms, surveys and enhanced Affordable Care Act applications.

The performance obligations related to recurring revenues are satisfied during each client’s payroll period, with the agreed-upon fee being charged and collected as part of our processing of the client’s payroll. Recurring revenues are recognized at the conclusion of processing of each client’s payroll period, when each respective payroll client is billed. Collectability is reasonably assured as the fees are collected through an automated clearing house as part of the client’s payroll cycle or through direct wire transfer, which minimizes the default risk.

The contract period for substantially all contracts associated with these revenues is one month due to the fact that both we and the client have the unilateral right to terminate a wholly unperformed contract without compensating the other party by providing 30 days’ notice of termination. 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.  For clients who purchase multiple applications, due to the short-term nature of our contracts, we do not believe it is meaningful to separately assess and identify whether or not each application potentially represents its own, individual, performance obligation as the revenue generated from each application is recognized within the same month as the revenue from the core payroll application. Similarly, we do not believe it is meaningful to individually determine the standalone selling price for each application. We consider the total price charged to a client in a given period to be indicative of the standalone selling price, as the total amount charged is within a reasonable range of prices typically charged for our goods and services for comparable classes of client groups.

Implementation and Other Revenues

Implementation and other revenues consist of nonrefundable upfront conversion fees which are charged to new clients to offset the expense of new client set-up as well as revenues from the sale of time clocks as part of our employee time and attendance services. Although these revenues are related to our recurring revenues, they represent distinct performance obligations.

Implementation activities primarily represent administrative activities that allow us to fulfill future performance obligations for our clients and do not represent services transferred to the client. However, the nonrefundable upfront fee charged to our clients results in an implied performance obligation in the form of a material right to the client related to the client’s option to renew at the end of each 30-day contract period. Further, given that all other services within the contract are sold at a total price indicative of the standalone selling price, coupled with the fact that the upfront fees are consistent with upfront fees charged in similar contracts that we have with clients, the standalone selling price of the client’s option to renew the contract approximates the dollar amount of the nonrefundable upfront fee. The nonrefundable upfront fee is typically included on the client’s first invoice, and is deferred and recognized ratably over the estimated renewal period (i.e., ten-year estimated client life).

Revenues from the sale of time clocks are recognized when control is transferred to the client upon delivery of the product. We estimate the standalone selling price for the time clocks by maximizing the use of observable inputs such as our specific pricing practices for time clocks.

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***Contract Balances***

The timing of revenue recognition for recurring services is consistent with the invoicing of clients as they both occur during the respective client payroll period for which the services are provided. Therefore, we do not recognize a contract asset or liability resulting from the timing of revenue recognition and invoicing. We have elected to apply the practical expedient not to disclose the value of unsatisfied performance obligations for contracts that are less than one year in length. However, this expedient cannot be applied to initial 30-day contracts with a client that also contain an implied performance obligation in the form of a material right as the material right performance obligation is being recognized over the expected client life which exceeds one year. For these 30-day contracts, we determined that the core, non-material right, performance obligations are generally satisfied in full by the end of each reporting period as most of our contracts with clients start at the beginning of a calendar month. For the material right performance obligation, as discussed above, we defer the amounts allocated and recognize them ratably over the estimated client life of ten years.

Changes in deferred revenue related to material right performance obligations as of March 31, 2019 and 2018 were as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2019 | 2018 |
| Balance, beginning of period | $64,651 | $51,624 |
| Deferral of revenue | 5,561 | 3,943 |
| Recognition of unearned revenue | (2,701 ) | (1,790 ) |
| Balance, end of period | $67,511 | $53,777 |

We expect to recognize $7.3 million of deferred revenue related to material right performance obligations in the remainder of 2019, $9.5 million of such deferred revenue in 2020, and $50.7 million of such deferred revenue thereafter.

Assets Recognized from the Costs to Obtain and Costs to Fulfill Revenue Contracts

We recognize an asset for the incremental costs of obtaining a contract with a client if we expect the amortization period to be longer than one year. We also recognize an asset for the costs to fulfill a contract with a client if such costs are specifically identifiable, generate or enhance resources used to satisfy future performance obligations, and are expected to be recovered. We have determined that substantially all costs related to implementation activities are administrative in nature and also meet the capitalization criteria under Accounting Standards Codification ("ASC") 340-40. These capitalized costs to fulfill principally relate to upfront direct costs that are expected to be recovered through margin and that enhance our ability to satisfy future performance obligations.

The assets related to both costs to obtain, and costs to fulfill, contracts with clients are accounted for utilizing a portfolio approach, and are capitalized and amortized over the expected period of benefit, which we have determined to be the estimated client relationship of ten years. The expected period of benefit has been determined to be the estimated life of the client relationship primarily because we incur no new costs to obtain, or costs to fulfill, a contract upon renewal of such contract. Additional commission costs may be incurred when an existing client purchases additional applications; however, these commission costs relate solely to the additional applications purchased and are not related to contract renewal. Furthermore, additional fulfillment costs associated with existing clients purchasing additional applications are minimized by our seamless single-database platform. These assets are presented as deferred contract costs in the accompanying consolidated balance sheets. Amortization expense related to costs to obtain and costs to fulfill a contract are included in the "sales and marketing" and "general and administrative" line items in the accompanying consolidated statements of income.

The following tables present the asset balances and related amortization expense for these contract costs:

| | As of and for the Three Months Ended March 31, 2019 | | | |
|---|---|---|---|---|
| | Beginning Balance | Capitalization of Costs | Amortization | Ending Balance |
| Costs to obtain a contract | $158,989 | $ 19,387 | $ (5,721 ) | $172,655 |
| Costs to fulfill a contract | $101,756 | $ 15,005 | $ (3,470 ) | $113,291 |

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| | As of and for the Three Months Ended March 31, 2018 | | | |
|---|---|---|---|---|
| | Beginning Balance | Capitalization of Costs | Amortization | Ending Balance |
| Costs to obtain a contract | $126,207 | $ 15,122 | $ (4,418 ) | $136,911 |
| Costs to fulfill a contract | $72,061 | $ 11,043 | $ (2,515 ) | $80,589 |

**4.** PROPERTY AND EQUIPMENT

Property and equipment and accumulated depreciation and amortization were as follows:

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Property and equipment | | |
| Buildings | $101,541 | $101,421 |
| Software and capitalized software costs | 76,153 | 66,634 |
| Computer equipment | 45,362 | 39,492 |
| Rental clocks | 17,788 | 16,950 |
| Furniture, fixtures and equipment | 16,869 | 16,474 |
| Leasehold improvements | 1,344 | 1,274 |
| Vehicles | 74 | 74 |
| | 259,131 | 242,319 |
| Less: accumulated depreciation and amortization | (92,247 ) | (82,969 ) |
| | 166,884 | 159,350 |
| Construction in progress | 11,604 | 8,589 |
| Land | 9,023 | 9,023 |
| Property and equipment, net | $187,511 | $176,962 |

We capitalize computer software development costs related to software developed for internal use in accordance with ASC 350-40.  For the three months ended March 31, 2019 and 2018, we capitalized $8.9 million and $6.6 million, respectively, of computer software development costs related to software developed for internal use.

Rental clocks included in property and equipment, net represent time clocks issued to clients under month-to-month operating leases.  As such, these items are transferred from inventory to property and equipment and depreciated over their estimated useful lives.

Included in the construction in progress balance at March 31, 2019 and December 31, 2018 is $0.2 million and $0.1 million in retainage, respectively.

We capitalize interest incurred for indebtedness related to construction in progress.  For both the three months ended March 31, 2019 and 2018, we incurred interest costs of $0.4 million, of which we capitalized $0.1 million and $0.4 million, respectively.

Depreciation and amortization expense for property and equipment, was $9.3 million and $6.0 million, respectively, for the three months ended March 31, 2019 and 2018.

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**5.** GOODWILL AND INTANGIBLE ASSETS, NET

As of both March 31, 2019 and December 31, 2018, goodwill was $51.9 million. We have selected June 30 as our annual goodwill impairment testing date. We have elected to perform a qualitative analysis of the fair value of our goodwill and determined there was no impairment as of June 30, 2018. As of March 31, 2019 and December 31, 2018, there were no indicators of impairment.

All of our intangible assets other than goodwill are considered to have definite lives and, as such, are subject to amortization. The following tables provide the components of intangible assets, which are included in Other assets in our consolidated balance sheets:

| | March 31, 2019 | | | |
|---|---|---|---|---|
| | Weighted Average Remaining Useful Life (Years) | Gross | Accumulated Amortization | Net |
| Intangibles: | | | | |
| Trade name | 3.3 | $3,194 | $ (2,502 ) | $692 |
| Total | | $3,194 | $ (2,502 ) | $692 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Weighted Average Remaining Useful Life (Years) | Gross | Accumulated Amortization | Net |
| Intangibles: | | | | |
| Trade name | 3.5 | $3,194 | $ (2,449 ) | $745 |
| Total | | $3,194 | $ (2,449 ) | $745 |

The weighted average remaining useful life of our intangible assets was 3.3 years as of March 31, 2019. Amortization of intangible assets for both the three months ended March 31, 2019 and 2018 was $0.1 million.

**6.** LEASES

The Company's leases primarily consist of noncancellable operating leases for office space with contractual terms expiring from 2019 to 2024. All of our leases are operating leases and, as a lessee, we have not entered into any sublease agreements. The lease term is defined as the fixed noncancellable term of the lease plus all periods, if any, for which failure to renew the lease imposes a penalty on us in an amount that appears, at the inception of the lease, to be reasonably assured. While some of our leases include an option to extend the lease up to five years, it is not reasonably certain that any such options will be exercised due, in part, to the dynamic nature of our sales force and rate of growth. Some of our leases contain termination options that are not reasonably certain to be exercised. However, if a termination option is exercised, we remeasure the lease asset in the consolidated balance sheets using the updated lease period. None of our leases contain residual value guarantees, substantial restrictions or covenants.

Lease assets of $24.9 million as of March 31, 2019 were included in Other assets in our consolidated balance sheet. Short-term lease liabilities of $8.7 million as of March 31, 2019 were included in Accrued expenses and other current liabilities in our consolidated balance sheets. In addition, long-term lease liabilities of $16.2 million as of March 31, 2019 were recognized in Other long-term liabilities in our consolidated balance sheets. When a lease contains a predetermined fixed escalation of the minimum rent, we recognize the related lease expense on a straight-line basis and record the difference between the lease expense and the amount payable under the lease as an adjustment to the right-of-use asset. We recognized $1.6 million as of March 31, 2019 as a reduction to Other assets for deferred rent in our consolidated balance sheets.

Rent expense associated with operating leases for the three months ended March 31, 2019 and 2018 was $2.4 million and $1.8 million, respectively. Cash paid for amounts included in the measurement of our operating lease liabilities was $2.2 million for the three months ended March 31, 2019.

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Because no implicit discount rates for our leases could be readily determined, the Company elected to use an estimated incremental borrowing rate to determine the present value of our leases. The weighted average discount rate related to our portfolio of leases at March 31, 2019 was 4.2%. The weighted average remaining lease term for our leases was 2.6 years as of March 31, 2019.

The undiscounted cash flows for the future annual maturities of our operating lease liabilities and the reconciliation of those total undiscounted cash flows to our lease liabilities as of March 31, 2019 were as follows:

| | |
|---|---|
| 2019 | $6,877 |
| 2020 | 7,862 |
| 2021 | 4,974 |
| 2022 | 4,285 |
| 2023 | 2,543 |
| Thereafter | 335 |
| Total undiscounted cash flows | 26,876 |
| Present value discount | (2,025 ) |
| Lease liabilities | $24,851 |

The table above does not include any legally binding minimum lease payments for leases signed but not yet commenced. As of March 31, 2019, the present value of the operating lease liabilities that had not yet commenced was $4.0 million.

**7.** LONG-TERM DEBT, NET

Long-term debt consisted of the following:

| | March 31, 2019 | December 31, 2018 |
|---|---|---|
| Net term note to bank due September 7, 2025 | $33,954 | $ 34,389 |
| Total long-term debt, net (including current portion) | 33,954 | 34,389 |
| Less: Current portion | (1,775 ) | (1,775 ) |
| Total long-term debt, net | $32,179 | $ 32,614 |

On December 7, 2017, we entered into a senior secured term credit agreement (as amended from time to time, the "Term Credit Agreement"), pursuant to which JPMorgan Chase Bank, N.A., Bank of America, N.A. and Kirkpatrick Bank made certain term loans to us (the "Term Loans"). Our obligations under the Term Loans are secured by a mortgage and first priority security interest in our headquarters property. The Term Loans mature on September 7, 2025 and 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%. As of March 31, 2019, our indebtedness of $34.2 million consisted solely of Term Loans made under the Term Credit Agreement. Unamortized debt issuance costs of $0.2 million as of both March 31, 2019 and December 31, 2018 are presented as a direct deduction from the carrying amount of the debt liability.

Under the Term Credit Agreement, we are subject to two material financial covenants, which require us to maintain 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. As of March 31, 2019, we were in compliance with these covenants.

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 provided for a senior secured revolving credit facility (the "Facility") in the aggregate principal amount of $50.0 million (the "Revolving Commitment"), which could be increased to up to $100.0 million, subject to obtaining additional lender commitments and certain approvals and satisfying certain other conditions. The Facility includes a $5.0 million sublimit for swingline loans and a $2.5 million sublimit for letters of credit. The Facility was scheduled to mature on February 12, 2020. On April 15, 2019, we entered into the First Amendment to Revolving Credit Agreement (the "First Amendment"). Pursuant to the First Amendment, Wells Fargo Bank, N.A., was added as a lender and the Revolving Commitment was increased to $75.0 million, which may be further increased to $125.0 million subject to obtaining additional lender commitments and certain approvals and satisfying other conditions. The scheduled maturity date of the Facility was extended to April 15, 2022.

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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%. The proceeds of the loans and letters of credit under the Facility are to be used only for our general business purposes and working capital. Letters of credit are to be issued only to support our business operations. As of March 31, 2019, we did not have any borrowings outstanding under the Facility.

Under the Revolving Credit Agreement, we are required to maintain 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 Revolving 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 certain investments, dispose of assets, enter into certain transactions, including swap agreements and sale and leaseback transactions, pay dividends or distributions on our capital stock, and enter into transactions with affiliates, in each case subject to customary exceptions for a facility of the size and type of the Facility. As of March 31, 2019, we were in compliance with all covenants related to the Revolving Credit Agreement.

As of March 31, 2019 and December 31, 2018, the carrying value of our total long-term debt approximated its fair value as of such date. The fair value of our long-term debt is estimated based on the borrowing rates currently available to us for bank loans with similar terms and maturities.

**8.** DERIVATIVE INSTRUMENTS

In December 2017, we entered into a floating-to-fixed interest rate swap agreement to limit the exposure to floating interest rate risk related to the Term Loans. We do not hold derivative instruments for trading or speculative purposes. The interest rate swap agreement effectively converts a portion of the variable interest rate payments to fixed interest rate payments. We account for our derivatives under ASC Topic 815, "Derivatives and Hedging," and recognize all derivative instruments in the consolidated balance sheets at fair value as either short-term or long-term assets or liabilities based on their anticipated settlement date. See Note 9, "Fair Value of Financial Instruments". We have elected not to designate our interest rate swap as a hedge; therefore, changes in the fair value of the derivative instrument are recognized in our consolidated statements of income within Other income, net.

The objective of the interest rate swap is to reduce the variability in the forecasted interest payments of the Term Loans, which is based on a one-month LIBOR rate versus a fixed interest rate of 2.54% on a notional value of $35.5 million. Under the terms of the interest rate swap agreement, we will receive quarterly variable interest payments based on the LIBOR rate and will pay interest at a fixed rate. The interest rate swap agreement has a maturity date of September 7, 2025. For the three months ended March 31, 2019 and 2018, we recognized a loss of $0.5 million and a gain of $0.8 million, respectively, for the change in fair value of the interest rate swap.

**9.**FAIR VALUE OF FINANCIAL INSTRUMENTS

Our financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, funds held for clients, client funds obligation and long-term debt.  The carrying amount of cash and cash equivalents, accounts receivable, accounts payable, funds held for clients and client funds obligation approximates fair value due to the short-term nature of the instruments.  See Note 7 for discussion of the fair value of our debt.

As discussed in Note 2, we invest the funds held for clients in money market funds, demand deposit accounts, commercial paper with a maturity duration less than three months and certificates of deposit, and classify as cash and cash equivalents within the funds held for clients line item in the consolidated balance sheets.  Short-term investments in commercial paper and certificates of deposit with a maturity duration greater than three months are classified as available-for-sale securities, and are also included within the funds held for clients line item.  These available-for-sale securities are recognized in the consolidated balance sheets at fair value, which approximates the amortized cost of the securities.  As of March 31, 2019 and December 31, 2018, all available-for-sale securities and certificates of deposit were due in one year or less.

As discussed in Note 8, during the year ended December 31, 2017, we entered into an interest rate swap.  The interest rate swap is measured on a recurring basis based on quoted prices for similar financial instruments and other observable inputs recognized at fair value.

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The accounting standard for fair value measurements establishes a three-level fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs such as quoted prices in active markets
- Level 2 – Inputs other than quoted prices in active markets for identical assets or liabilities that are observable either directly or indirectly or quoted prices that are not active
- Level 3 – Unobservable inputs in which there is little or no market data

Included in the following table are the Company's major categories of assets and liabilities measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018:

| | March 31, 2019 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |
| Commercial paper | $— | $25,506 | $ — | $25,506 |
| Certificates of deposit | $— | $4,000 | $ — | $4,000 |
| Liabilities: | | | | |
| Interest rate swap | $— | $523 | $ — | $523 |

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | |