COWEN

EQUITY RESEARCH

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- Software
- Computer Services & IT Consulting: Business Services

Bryan C. Bergin, CFA
646 562 1369
bryan.bergin@cowen.com

Jared Levine, CFA
646 562 1431
jared.levine@cowen.com

QUICK TAKE: INDUSTRY UPDATE

DAILYPAY HCM CALL RECAP: ON-DEMAND PAY & US EMPLOYMENT INSIGHTS

THE COWEN INSIGHT

Our call with Jeanniey Mullen, Global Chief Innovation & Marketing Officer of leading private On-Demand Pay provider DailyPay centered on intricacies of earned wage access and broader financial wellness trends, including drivers and the developing comp landscape. DailyPay provided insight on the impact of COVID-19 to its operations and US employment dynamics from its proprietary Workforce Index.

Cowen Call with DailyPay

Audio Replay Link

What is On-Demand Pay? The Next Major Wave of HCM Disruption

As detailed in our Ahead of the Curve report: **On-Demand Pay: You've Already Earned It** (***LINK***), we believe this represents the next major wave of disruption in payroll & HCM. On-Demand Pay enables access to earned wages in advance of the traditional payday via tech platforms. It differs from payday and consumer loan products in several ways, but most critically, DailyPay's solution does not charge interest or penalties, and is based on accessing funds already earned rather than anticipated future wages. Versus other payroll solutions, DailyPay does not trigger a same-day payroll run for employers.

Big Opportunity Addresses Broad Need

The ultimate opportunity is the enablement of earned wage access to all employees. In an industry of relative infancy, DailyPay has experienced consistent y/y doubling of revenue. And, even as the On-Demand Pay opportunity itself is significant, it has natural extensions into broader financial wellness applications. DailyPay recently moved into this arena via its SAVE 3.0, offering a savings feature to support improved financial behavior. DailyPay sees broad usage regardless of income level, from those earning minimum wage to comfortable six-figure salaries, showing wide needs to access funds ahead of payday. Research points to a staggering amount of US workers living paycheck to paycheck (70%+) and many with bare savings (<$400) often using predatory alternative means of funding.

DailyPay Background

DailyPay was founded in 2015 and has grown to service a few hundred employers and 2+ million users. Its offering integrates into employers' payroll or time & attendance system, with APIs across most major players. It does not charge employers to offer its functionality, a key advantage as this is increasingly viewed as a cost-less employee benefit. DailyPay monetizes its offering through transaction fees paid by users upon access: $1.99 for next day transfer of funds (currently waived) and $2.99 for instant access. However, it allows users for free to track net wages earned and the number of days until the next payday within its app. Further, its new SAVE 3.0 feature, which allows users to earmark funds for saving in advance of payday and is offered free.

DailyPay vs. Competitor Offerings

DailyPay differs from competition across several factors. First, it is solely responsible for funding the access to On-Demand Pay to users, while some competitors require the employer to provide full or partial funding. DailyPay was also built to give users access to 100% of net pay, while other providers limit the amount of net pay accessible (e.g., up to 50%). Its pricing model is based on transaction fees while some competitors monetize through subscription fees, via interchange or ATM fees on prepaid debit cards, or direct debit of users accounts. Versus public HCM providers with native On-Demand Pay development, DailyPay's HCM vendor-agnostic approach accommodates across platforms and can port if employers switch payroll/T&A systems. It expects ~5 years before this offering becomes the norm.

Client Usage

DailyPay has found the greatest utilization of On-Demand Pay with users that make less than $80k annually. However, it does see interest in the functionality from users making over six-figures too, evidencing the broad appeal. Interestingly, it sees 4 primary user categories:

- 1) Advantageous users, users with no financial challenges, but utilize On-Demand Pay to purposely drive behavior toward and end goal such as improving credit scores by paying bills early or to invest in career trainings, etc. Approx. 20% of users.

- 2) Users with unexpected expenses that have real short-term financial needs, such as a broken water heater or those in between jobs that need to access funds from the first paycheck often on a delay. Approx. 15% of users.

- 3) Users that who only utilize DailyPay's savings feature. Approx 5-10% of users.

- 4) Regular users who utilize its On-Demand Pay functionality to manage their lifestyle, including people that like to pay their bills weekly. These users typically access their pay 1-2x per week. Interestingly, it has found the vast majority of users withdraw odd $ amounts (vs. ATM examples of even withdrawals like $100), supporting its view that usage is primarily for bill payment. Majority of users at 55-60%.

Barriers to Adoption and Misconceptions

- **Pre COVID-19:** Prior to COVID-19, potential employers' biggest pushback from offering On-Demand Pay to their employees was centered on compliance risks and a view of perceived unintended consequences for employees. Compliance concerns were primarily related to taxes, in that there was broad misconception of increased burden for employers from potential requirement to run payroll daily. However, since DailyPay is the sole party advancing the funds, employers are not required to run payroll daily. Employers have also been concerned about granting employees 100% of net pay prior to the normally scheduled payday due to a perception that employees may spend it all prior to payday on non-essential items and then receive a paycheck for $0 and be in worse financial shape. DailyPay, through various user surveys, real-time user feedback and other data points, has been able to largely allay these fears and misconceptions.

- **Post COVID-19:** DailyPay has seen ramping adoption and a notable decline in pushback from employers. In fact, employers have been better able to grasp the positive benefit of On-Demand Pay for employees as a result of the pandemic. This includes numerous client stories of employees who were now able to afford to purchase essential supplies to be able to keep working (and safely), which might not have been an available if these employees had to wait until payday to purchase. DailyPay has waived fees on next day access to On-Demand Pay funds as a result of the pandemic as well to support users in a challenging time for most workers.

DailyPay Workforce Index: New Insights on a Subset of US Employment

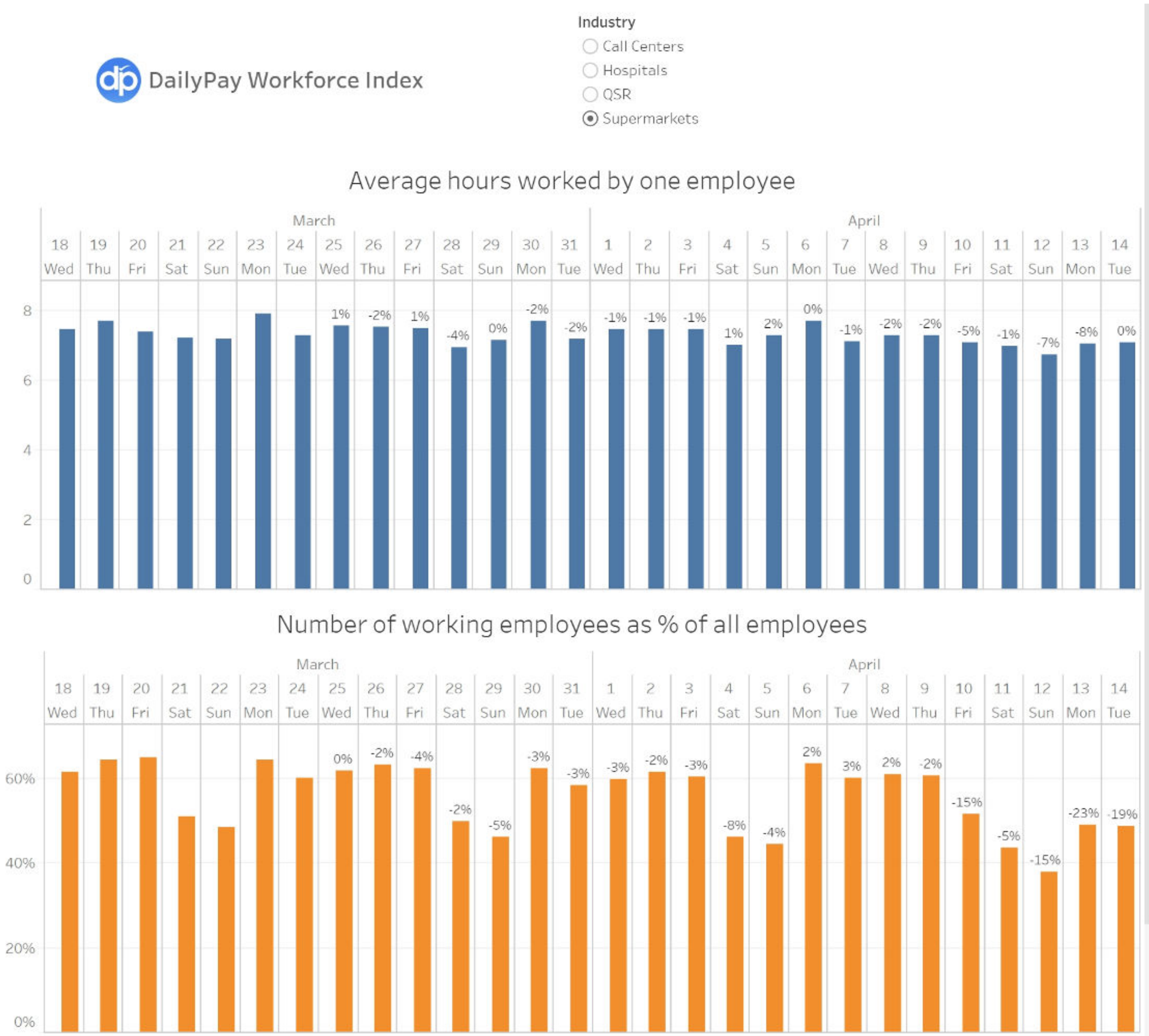
The company recently created the DailyPay Workforce Index, using its proprietary data (Link **HERE**). The index has two datasets, one that tracks average hours worked by employees and the other the number of active working employees as a % of all employees. Data is currently offered among employers that comprise a significant portion of hourly workers, across 4 major industry sub-verticals: Hospitals, Call Centers, Supermarkets and Quick Service Restaurants (QSR).

- During March 26th, it found that 16% of DailyPay usage was tied to specified reason related to COVID-19. Since then, it has tracked 13% of usage on each of April 3rd and April 15th.

- According to DailyPay, all 4 industries are showing declines in working employees, due to reasons likely to be caused by direct and indirect impact of coronavirus (layoffs, restructuring, quarantine, sickness and anxiety).

- Aside from these verticals, it has found that Retail clients have mostly been furloughing workers (a positive development for HCM vendors on a PEPM model), while Hospitality has been fairly mixed between furloughs and layoffs. It is also now starting to monitor the impacts of stimulus checks to its users.

Supermarkets



Source: DailyPay Workforce Index

QSR

Source: DailyPay Workforce Index

VALUATION METHODOLOGY AND RISKS

Valuation Methodology

Software:

Our valuation methodology is primarily based on Enterprise Value to Free Cash Flow (EV/FCF), followed by Price-to-Earnings (P/E). However, this varies by company; for instance, we will often use Enterprise Value to Revenue (EV/Revs) or a discounted cash flow (DCF) analysis for software companies that are primarily subscriptions-based, or for growth companies that have recently entered the public equity markets.

Business Services:

We use forward P/E and EV/EBITDA multiples to value the companies in the Business Services industry. We support our valuation with FCF yield and cash per share analysis.

Investment Risks

Software:

The global economy or specific end markets significantly worsen, contracting IT spending and impairing software growth. The rate of SaaS/Cloud adoption slows, resulting in prolonged sales cycles and higher-than-anticipated quarterly volatility across much of our coverage universe. Competition increases materially, driving deflationary pricing pressure and compressing margins. In particular, innovation by new entrants in the software sector often produces solutions with similar or better functionality at materially lower prices than incumbents' legacy offerings.

Business Services:

Risks

Global economic growth could impact consumers' and clients' discretionary spending

The Business Services industry is sensitive to global economic growth. During a downturn or a recession, both consumers and clients tend to reduce discretionary spending, which would have a direct negative impact on revenue growth at Business Services companies.

Regulation

Future regulation initiatives could have a negative impact on revenue growth prospects. Changing federal and government laws in the U.S. and internationally could have a negative impact on operations and financial results.

Foreign exchange risk

While the companies' consolidated financial statements are reported in U.S. dollars, portions of the revenues (varies by company) are generated in other currencies (euros, British pounds, Asian currencies, etc.). This creates currency and hedging risk.

ADDENDUM

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Cowen and Company, LLC. New York 646 562 1010 **Boston** 617 946 3700 **San Francisco** 415 646 7200 **Chicago** 312 577 2240 **Cleveland** 440 331 3531 **Atlanta** 866 544 7009 **Stamford** 646 616 3000 **Washington, D.C.** 202 868 5300 **London** (affiliate) 44 207 071 7500

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Assumption: The expected total return calculation includes anticipated dividend yield

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POINTS OF CONTACT

Reaching Cowen

Main U.S. Locations

New York
599 Lexington Avenue
New York, NY 10022
646 562 1010
800 221 5616

Boston
Two International Place
Boston, MA 02110
617 946 3700
800 343 7068

Cleveland
20006 Detroit Road
Suite 100
Rocky River, OH 44116
440 331 3531

San Francisco
One Maritime Plaza, 9th Floor
San Francisco, CA 94111
415 646 7200
800 858 9316

Atlanta
3424 Peachtree Road NE
Suite 2200
Atlanta, GA 30326
866 544 7009

Chicago
181 West Madison Street
Suite 3135
Chicago, IL 60602
312 577 2240

Stamford
262 Harbor Drive
Stamford, CT 06902
646 616 3000

Washington, D.C.
2900 K Street, NW
Suite 520
Washington, DC 20007
202 868 5300

International Location

Cowen International Limited

London
1 Snowden Street - 11th Floor
London EC2A 2DQ
United Kingdom
44 20 7071 7500