

SaaS/Application Software

Topic of Discussion:

HCM 2020 Part Deux: Demand Trends High; ULTI Sprints to new NetSuite Leverage

REPORT HIGHLIGHTS: We attended two different HR industry events last week -- the largest annual expo outside of the large HR Tech Conference and a HR user group in NYC -- and we came away confident that the recent overall strong spending trends in the HCM space are likely sustainable through at least some point in 2018. While overall demand remains quite healthy, we continued to hear that mid-market core HRMS and payroll remain the hottest demand areas while the enterprise segment remains soft compared to 2013 & 2014, which is likely good for both PCTY and ULTI and a mild negative for WDAY. However, we heard SAP struggled significantly in 1Q, which would be positive for both CSOD and WDAY. Overall, we came away most positive about CSOD, PCTY, and ULTI, especially ULTI where we picked up new NetSuite leverage through N's Accenture partnership.

- **Current HCM demand trends remain healthy; mid-market core HRMS/payroll remains much stronger than enterprise.** Vendors we spoke with were overall positive about current demand trends in the broader HCM end-market, with demand for Learning Management and Performance Management a bit higher than our expectations.
- **ULTI drives new leverage in NetSuite partnership with Accenture-led transaction.** The most interesting data point we heard was Accenture (ACN, N/R) bringing ULTI into a deal with a well-known national telecommunications company.
- **CSOD makes changes to mid-market sales leader.** We also heard that CSOD let go the leader of its mid-market sales team in January, right before the company's annual sales kick-off meeting.
- **SAP struggles with nine (9!) outages in a single month, new HCM investments coming.** We also heard multiple times that SAP had nine outages within its HCM Cloud platform in the month of January.
- **SmartRecruiters is the hot new ATS vendor, but iCIMS reaching dominant level.** We heard from several vendors and consultants that SmartRecruiters (private) is the hottest newer vendor in the Recruiting software/Applicant Tracking space and is gaining significant traction, including a new partnership with SilkRoad (private).
- **Artificial Intelligence could be the next frontier in Recruiting software.** We met with several vendors capitalizing on artificial intelligence (AI) and machine learning in HR, specifically targeting recruiting and applicant tracking systems.
- **Analytics hot, but customers continue to struggle with use and implementation.** We spoke with several vendors about analytics and heard presentations from IBM on the subject of Workforce analytics.

Companies Mentioned in Report:

- Cornerstone OnDemand, Inc. (CSOD: \$34.35, PT: \$45.00)
- Paylocity Holding Corp. (PCTY: \$38.27, PT: \$45.00)
- Workday, Inc. (WDAY: \$74.98, PT: \$80.00)
- NetSuite Inc. (N: \$81.04, PT: NA)
- Ultimate Software Group, Inc. (The) (ULTI: \$196.59, PT: \$220.00)

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Sector Chart

Nasdaq (NDA)

05/02/16

Current HCM demand trends remain healthy; mid-market core HRMS/payroll remains much stronger than enterprise. Vendors we spoke with were overall positive about current demand trends in the broader HCM end-market with demand for Learning Management and Performance Management a bit higher than our expectations. We came away most positive about mid-market HRMS and payroll demand which we believe continues to be the hottest end-market in all of enterprise software. We did hear several vendors highlight enterprise level core HRMS/payroll demand while good, has tapered off since early 2015 which remains consistent with industry commentary we published in the fall. Our discussions suggest this enterprise segment softness will likely last through CY16.

Much of the demand trends can be sourced to what seems to be the never ending digital transformation of HR. As highlighted by well-known industry analyst Jason Averbuch, this product evolution likely does not stop until the technology is built for a workforce and how the workforce works versus built for HR as most of the technology is today. HR technology today is very good at automating HR processes but few systems are truly designed to properly engage a workforce to maximize productivity which our prior research has shown results in workforce usage on HR systems that varies widely between companies. So companies continue to seek new tools and technologies to gain the proper insight and engagement to drive their workforces forward.

Ultimate drives new leverage in NetSuite partnership with Accenture led transaction. The most interesting data point we heard was Accenture (ACN not rated) bringing ULTI into a deal with a well-known national telecommunications company. We understand the deal started as ACN selling NetSuite (N Hold) to this customer but Ultimate was included because of its NetSuite partnership once the deal was expanded to include core HRMS and payroll. While we do not believe the transaction to be significantly large in value for ULTI, we understand the transaction cracked the door open for ACN to work with ULTI more going forward. However, we have not heard of any formalized ULTI practice started within ACN but view the relationship as another channel that can add deals to ULTI's sales funnel. But we believe any partnership with ACN could be meaningful over time because ACN is likely sourcing larger than average deals that ULTI's current customer base but also because ACN is a significantly large N partner and is involved with consistent N deal flow.

Cornerstone makes changes to mid-market sales leader. We also heard that Cornerstone let go the sales leader of its mid-market sales team in January right before the company's sales annual kick off meeting. We do not view this development as surprising given the company's mid-market segment seemed to underperform in 2015, but note our prior checks indicated mid-market sales nominally improved in 1Q which might reflect the leadership change in that team. We believe the risk of such move could disrupt current sales pipelines but we have yet to hear of such disruption.

SAP struggles with nine (9!) outages in a single month, new HCM investments coming. We also heard multiple times that SAP had nine (yes 9!) outages within its HCM Cloud platform in the month of January. While we understand the outages had a minimal time impact individually, nine outages in a single month would be among the most ever we have come across. More importantly, we heard this issue affected the company's HCM business in the March quarter which we would assume other competitive vendors were leveraging to their respective advantage. However, we did hear that SAP has announced internally a plan to significantly invest in its HCM platform over the next two years to make it more competitive. Major enhancements we heard include developing a multi-tenant payroll module, a significant Recruiting software upgrade, and an enhanced LMS platform. While we will take a wait and see approach to the platforms ultimate functionality, we believe CSOD, ULTI, and WDAY

can all benefit competitively in the near term until these products are properly upgraded.

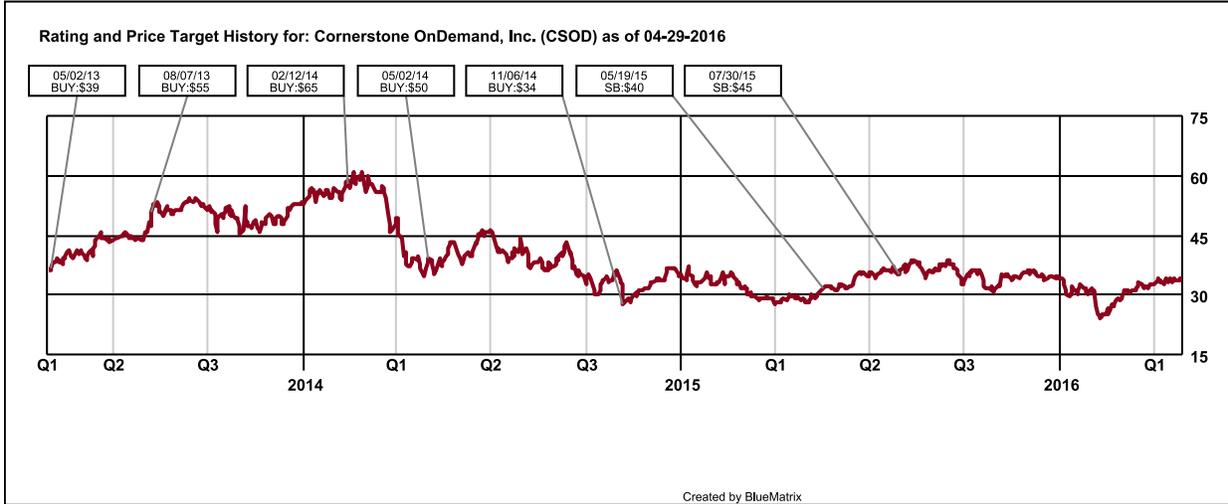
SmartRecruiters is the hot new ATS vendor, but iCIMS reaching dominant level.

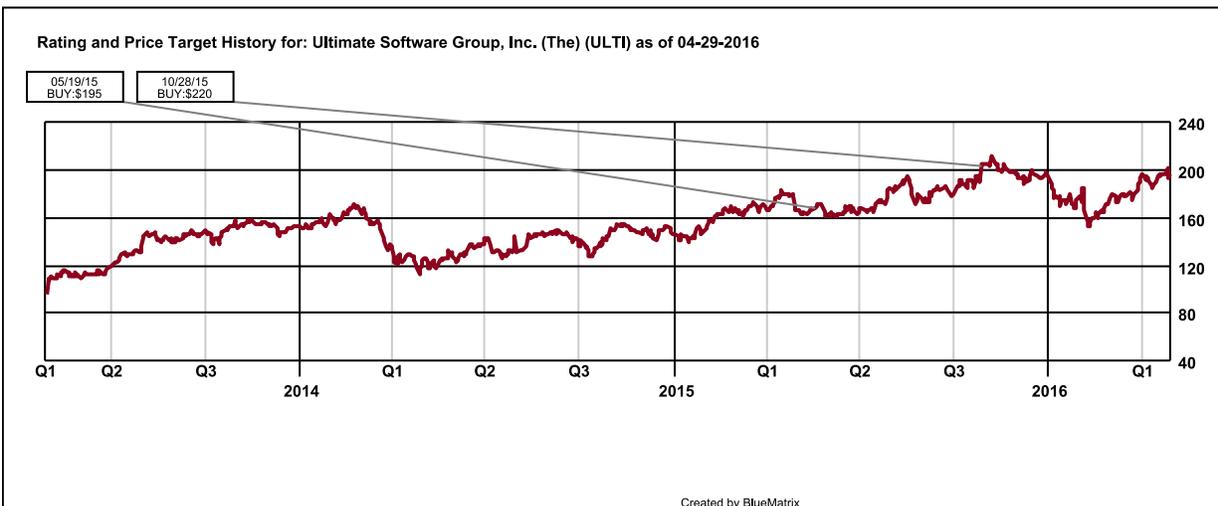
We heard from several vendors and consultants that SmartRecruiters (private) is the hottest newer vendor in the Recruiting software/Applicant Tracking space and is gaining significant traction, including a new partnership with SilkRoad (private). While clearly an interesting company to watch, our conversations all agreed iCIMS (private) has become the dominant vendor in the ATS segment with significantly high win rates. With the acquisitions of Taleo (Oracle) and Kenexa (IBM) over the last several years, the mid-market and low end of the enterprise ATS market has been up for grabs. We continue to see iCIMS (and heard significant positive iCIMS commentary at one of the events) as the most dominant vendor with Cornerstone and Jobvite (private) gaining traction but will now add SmartRecruiters to our vendors to watch list.

Artificial Intelligence could be the next frontier in Recruiting software. We met with several vendors capitalizing on artificial intelligence (AI) and machine learning in HR, specifically targeted towards recruiting and applicant tracking systems. Untapt (private) and Pymetrics (private) were two particular vendors we found most interesting and what we believe could be early disrupters in HR. Untapt uses machine intelligence and predictive analytics to analyze massive amounts of data to formulate outcomes that help match the right candidate with the right position. Pymetrics leverages neuroscience, big data, and machine learning for talent assessment. After speaking with a few companies we learned early adopters of AI and machine learning recruiting solutions are utilized by companies hiring entry and junior level positions which require less human touch. We learned most companies use of AI technologies ended once a potential candidate reaches a more senior level role and a human touch is required more a more complex hiring process such as to negotiate salary and benefit packages. Although early, we believe the introduction of AI and machine learning throughout the HCM suite could provide the longer term product innovation needed to keep product refresh cycles active.

Analytics hot, but customers continue to struggle with use and implementation.

We spoke with several vendors about analytics and heard presentations from IBM on the subject of Workforce analytics. Overall, interest in analytics remains a very hot area within HCM but customers continue to struggle with implementation of leverage the results properly. However, our conversations suggest the enterprise customer segment is beginning to better leverage these applications as the newer applications are more user friendly but penetration and use in the mid-market remains almost non-existent. Our biggest takeaway from our analytics conversations is that overall sales remain light in the next two years and could provide only nominal billings uplift to either Cornerstone or Workday.







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